Chant West

Research Paper

Chilean Pension System

Updated comparison with Australia

December 2016

Comparing Apples with Apples.

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1. Executive Summary

The Financial Services Council (FSC) has asked Chant West to update its 2014 report comparing the Australian and Chilean pension systems. This request is in response to the continued interest from regulators in using the Chilean pension system as a model for a renewed Australian default superannuation system.

How do MySuper fees compare with the fees charged by Chilean pension funds?

The administration fees charged by MySuper products compare favourably with the fees charged by Chilean pension funds (called 'AFPs'). The average MySuper administration fee is 0.25% pa compared with the average Chilean AFP administration fee of 0.62% pa (determined using the OECD methodology that allows comparison of fees between different fee systems with different fee structures). While PlanVital, the Chilean default AFP, charges an administration fee of only 0.17% pa, it only has 10% of all AFP members. Other members pay much higher fees. In contrast, most Australian superannuation members are in MySuper products where fees are low (average 0.28% pa). The Australian MySuper system has been much more successful in ensuring that default members pay a reasonable level of fees.

Investment fees and costs in MySuper products are higher than Chilean AFPs for similar options, 0.59% pa compared with 0.50% pa. However, the lower Chilean investment fee is because Chilean AFPs invest almost solely in equities and bonds. There is no meaningful allocation to property or alternative assets that have performed well for Australian superannuation funds over the last 15-20 years, but do attract higher fees. Indeed, the investment fee differential is much smaller than is warranted by the major differences in asset allocation and suggests MySuper members are getting a much better deal on their investments than members of Chilean pension funds.

Is the Chilean tender system delivering on its objectives?

When Chile introduced its tender system in 2010, there were only five pension funds (referred to as Pension Fund Administrators or AFPs) – four very large funds and one small fund. Fees were generally considered to be high because of the lack of competition. The Government introduced the tender system with the objective of increasing competition and reducing administration fees.

The tender system has certainly reduced administration fees for default members. There are now four very large funds and two small funds. The average administration fee of the four large funds is about 1.45% of a person's salary, compared with 0.41% for the current default fund. However only one new AFP has entered the market since the tender system began. With only one default provider, the tender system makes it almost impossible for other providers to enter the market and it stifles new competition. Further, only 10% of Chilean pension memebrs are covered by these default arrangements.

PlanVital, the current Chilean default AFP, is not returning a profit to shareholders and has the worst performance of all the AFPs. The anticipated flood of new members has not eventuated. It remains to be seen whether PlanVital can generate a reasonable profit with its current strategy and, at the same time, provide strong investment performance and high quality services to its members.

Should the Australian default superannuation system adopt the Chilean tender system?

The Australian superannuation system does not lack competition and this report shows that our MySuper administration fees are comparable with those of the Chilean default fund. The Chilean system had an obvious problem of a small group of high fee-paying funds and the tender system successfully provided a low-cost default option for new entrants to the system. However, the Australian system already has low cost default MySuper options provided by a range of product providers. The problem encountered in Chile that led to the introduction of the tender model simply does not exist in Australia.

A tender system may have relevance for Chile, but it is difficult to see what relevance it has for Australia given our very different structure, more sophisticated investments and the depth of competition that already exists. The most likely result of such a tender system in Australia would be the rise of products that solely focus on cost at the expense of long-term outcomes for members. This is not in the interests of Australian super fund members or indeed of the Australian economy as a whole.

2. Overview of Chilean Pension System

2.1 Three pillars

In 1981, Chile's pension system was restructured to comprise three pillars: a poverty prevention (solidarity) pillar, a mandatory contribution pillar, and a voluntary savings pillar. The combination of these pillars seeks to guarantee that individuals maintain a similar standard of living during retirement as they enjoyed during their working lives, and to eliminate poverty among the elderly and disabled.

The goal of the solidarity pillar is to prevent poverty among the elderly and disabled and is available to the poorest 60% of the population.

Under the mandatory contribution pillar, employees are required to contribute 10% of their wage or salary to an individual account and choose a private sector Pension Fund Administrator (AFP) to manage the account. Currently, there are six AFPs operating in Chile. When members retire, they receive a pension based on the level of their individual account.

Assets in the mandatory system are currently about US$167 billion (June 2016). The number of members is about 10.1 million, of which about 5.2 million (51%) are making contributions. The four largest AFPs have combined assets of about US$158 billion (96%).

To complement mandatory savings made through AFPs, there are tax incentives to encourage people to make voluntary contributions through various financial instruments.

In 2008, the Government introduced a number of major reforms that were designed to increase participation in the pension system (particularly the self-employed and women), bolster the solidarity pillar and reduce high administration fees. However, due to political pressure, the requirement for the self-employed to make mandatory contributions has been delayed several times and still has not been introduced.

The Superintendency of Pensions (SP) is the principal regulator of Chile's pension system.

2.2 Mandatory pillar

(a) Contributions, administration fees and tax

The mandatory contribution rate of 10% of salary is subject to a ceiling on monthly earnings of about US$2,940 (indexed for inflation). Average monthly earnings are about US$1,050.

Employers are required to deduct an employee's contribution from their paycheck and forward it to the employee's chosen AFP. With the exception of new workers entering the workforce, employees may choose any AFP and may switch AFPs at any time.

In addition to the 10% mandatory contribution, employers deduct additional contributions to cover administration fees and death and disability insurance premiums, which are on average about 1.4% and 1.4% of salary, respectively.

AFPs are free to set the administration fees they charge members, but the fee must be the same percentage of salary for all their members. Note that only contributors pay this fee, and they represent about half the total number of members. These fees are intended to cover all of the AFP's costs, most of which relate to administration and distribution (a very small component relates to internal investment management).

Employee contributions are tax deferred in that contributions and earnings are tax exempt until withdrawal. Retirees pay regular income tax on their pension income.

(b) Default tender for new workers

In 2008, the Government introduced a public tender system designed to increase competition between AFPs and reduce administration fees. This involves a tender every two years where AFPs bid on the estimated 700,000 new workers who enter the workforce every 24 months.

The AFP with the lowest administration fee (which must be less than the fee in effect at the date of the bidding process) wins the tender and is designated as the default AFP provider. New workers entering the workforce are obliged to join the default AFP and remain with it until the end of the AFP's 24-month default term (the current period started in August 2016).

The winning AFP must offer its bid price to all of its members, regardless of whether they are existing members or new entrants.

Modelo, a new AFP, won the first tender in 2010 with a bid of 1.14% (of salary), and the second tender in 2012 with a bid of 0.77%. PlanVital won the third tender in 2014 with a bid of 0.47% and also won the fourth tender in 2016 with a bid of 0.41%, and will continue to receive default members for the next two years until August 2018.

(c) Multiple investment funds

Since 2002, AFPs have been allowed to offer up to five investment funds, called Funds A to E, which have different proportions of their portfolios invested in equities. The assumption is that the greater the investment in equities, the greater the risk and expected return. All AFPs must offer Funds B to E, while offering Fund A is voluntary. All AFPs currently offer all five Funds. Members may invest in two Funds. Fund B is the default option for members up to age 35, Fund C is the default for males from age 36 to 55 and females from age 36 to 50, and Fund D is the default for males over age 55 and females over age 50.

Each Fund operates within regulated investment limits that cover investments in government instruments, equity instruments, foreign investments, unhedged foreign currency and instruments of greater risk (e.g. high-risk debt). Table 1 shows the equity allocation ranges for each Fund.

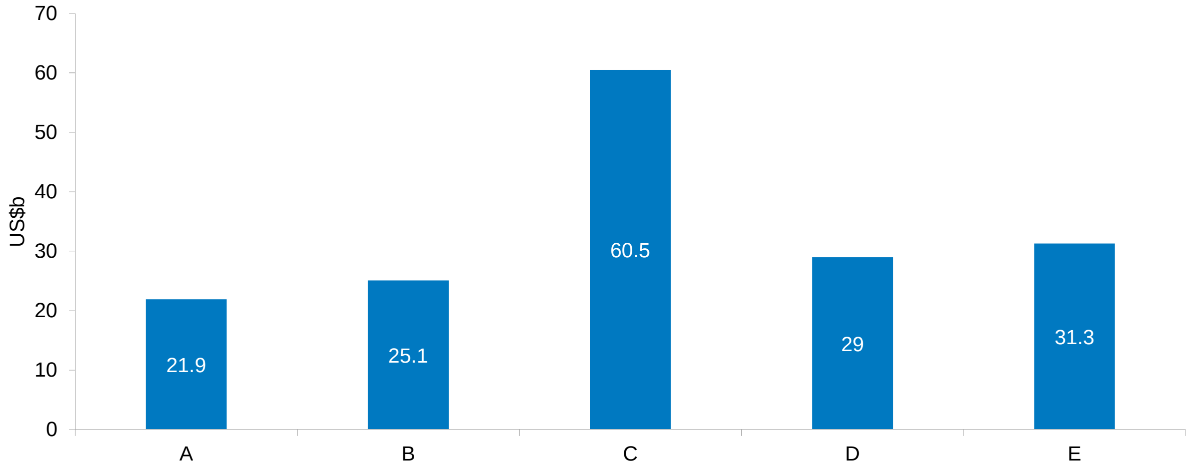
Table 1: Minimum and Maximum Limits on Equity

Fund	Type of Fund	Minimum Limit (%)	Maximum Limit (%)
A	Most risky	40	80
B	Risky	25	60
C	Intermediate	15	40
D	Conservative	5	20
E	Most conservative	0	5

Source: Superintendency of Pensions, The Chilean Pension System (2010)

Chart 1 shows the size of the Funds at June 2016. Fund C held the greatest level of assets with 36%. The other four Funds each held roughly the same level of assets.

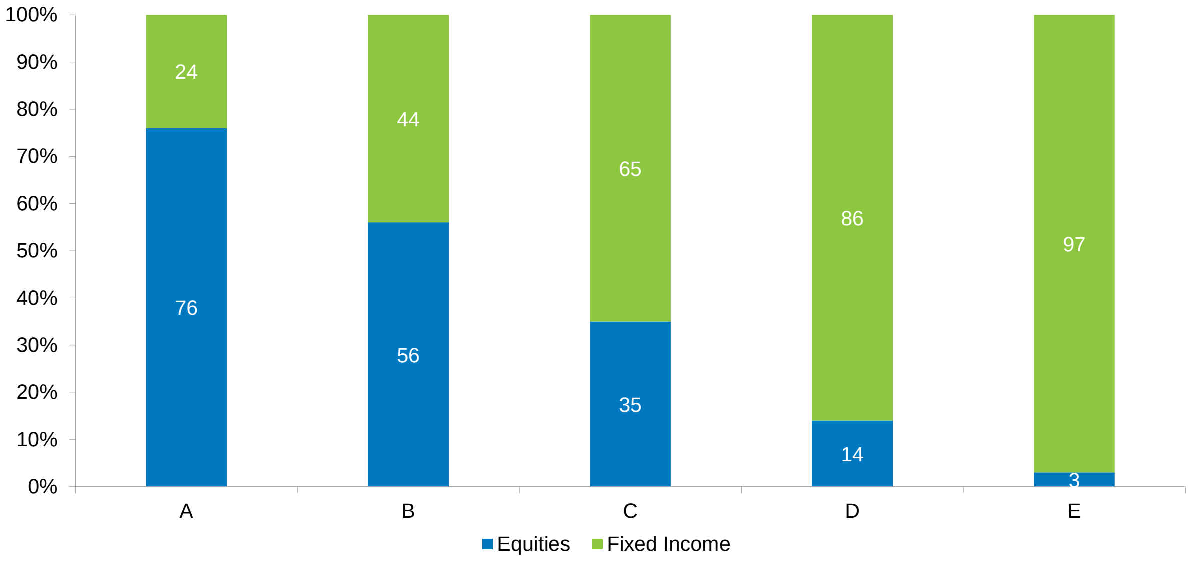
Chart 1: Assets Under Management (US$b)



Source: Superintendency of Pensions, 'Aggregate Portfolio of Pension Funds by Type of Funds' (June 2016)

Chart 2 shows the split between equity and fixed income securities at June 2016. The overall split across the five Funds between equity and fixed income was 34% / 66%. The later sections of this report will focus on Fund A as it is more comparable with the growth assets of Australian MySuper products.

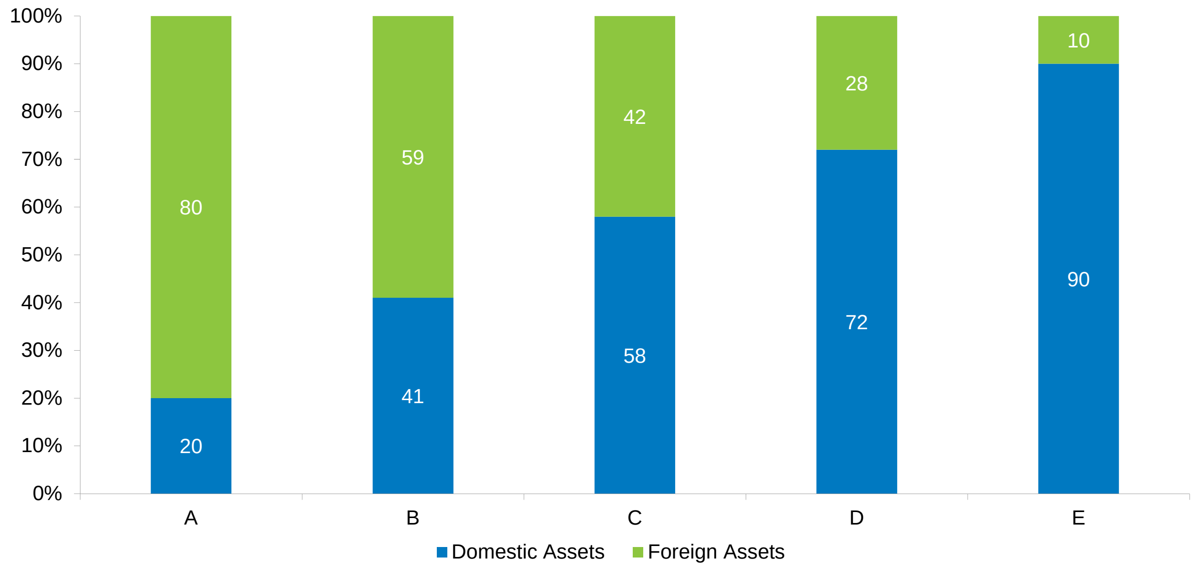
Chart 2: Equity and Fixed Income Investments (%)



Source: Superintendency of Pensions, 'Aggregate Portfolio of Pension Funds by Type of Fund' (June 2016)

Chart 3 shows how pension assets were invested across domestic and foreign investments at June 2016. The overall split between domestic and foreign was 59% / 41%.

Chart 3: Domestic and Foreign Investments (%)



Source: Superintendency of Pensions, 'Aggregate Portfolio of Pension Funds by Type of Fund' (June 2016)

(d) Minimum investment returns

AFPs must meet a minimum level of return for each Fund. For Funds C, D and E, the minimum level is the lesser of (a) the weighted average three-year return of all funds of that type less 2% per annum and (b) 50% of the weighted average return of all funds of that type. For Funds A and B, the minimum level is the same except that (a) is the weighted average three-year return less 4% per annum.

To meet the guarantee obligation, an AFP must hold a reserve equal to 1% of the value of each Fund. If a Fund's three-year return is below the minimum level, the AFP must transfer the difference from the reserve to that Fund within five days. The AFP must then top-up the reserve to 1% of the value of the Fund within 15 days.

Since underperformance of a Fund can have significant financial consequences for the AFP (given the return guarantee obligation), most AFPs invest in a very similar way, and with a short-term focus, to ensure they are not required to inject capital to top-up the reserve.

(e) The results thus far?

Despite all these reforms, there is growing dissatisfaction with the pension system within Chile, with recent public demonstrations. The problem is that the system provides insufficient income in retirement for most members. This is partly due to the immaturity of the mandatory system, as Chileans have not been contributing for long enough to make a significant difference to their retirement income, but also due to the large numbers of Chileans who are contractors or self-employed for whom there are long periods of no contributions.

Chileans are blaming the government and AFPs for these problems and while the system immaturity is the main issue, it is recognised that both the government and AFPs need to do much better in educating the community on what the pension system can achieve and what it and can't achieve.

3. Pension Fund Administrators

When the Government introduced major reforms in 2008 there were only five AFPs providing mandatory individual accounts. Competition was limited. The default tender system introduced in 2010 was designed to attract new providers into the system to increase competition and reduce administration fees. This objective was achieved with Modelo, a new AFP, winning the first tender in 2010. Table 2 shows the ownership details of the six AFPs.

Table 2: Ownership of AFPs

AFP	Ownership	Country of Owner
Capital	Grupo Sura ING	Colombia
Cuprum	Principal	United States
Habitat	Chilean Construction Chamber	Chile
Modelo	Atlantic Investment (individual shareholders)	Chile
PlanVital	BTG Pactual	Brazil
Provida	MetLife	United States

Source: Websites of each AFP

Table 3 shows the number of members and contributors of each AFP at June 2014 and June 2016. Clearly PlanVital is the only AFP to have grown since June 2014, as it receives all new entrants, but an increase of about 270,000 contributors over two years is lower than it would have anticipated. This lower increase was partly due to the continued deferral of requiring contributions for contract workers and the self-employed.

Table 3: Members and contributors by AFP (in thousands)

	30 June 2014		30 June 2016	
AFP	**Members**	**Contributors**	**Members**	**Contributors**
Capital	1,834	974	1,733	916
Cuprum	635	446	640	442
Habitat	2,097	1,152	2,040	1,137
Modelo	1,404	615	1,481	645
PlanVital	387	169	1,000	438
Provida	3,317	1,675	3,215	1,597
Total	**9,674**	**5,031**	**10,109**	**5,177**

Source: Superintendency of Pensions, ‘Statistical Bulletins No. 217 & 221’ (June 2014 & 2016)

Table 4 shows further information on the size of each AFP, including assets and the average balance (based on the number of contributors). The four large AFPs have significant assets and high average balances, and the other two AFPs are much smaller – Modelo that won the first and second tenders and PlanVital that won the third and fourth tenders.

Table 4: Size of AFPs at June 2016

AFP	Members ('000)	Contributors ('000)	Assets (US$b)	Average Balance (US$)
Capital	1,733	916	32.9	35,962
Cuprum	640	442	35.4	79,962
Habitat	2,040	1,137	44.2	38,898
Modelo	1,481	645	4.2	6,428
PlanVital	1,000	438	5.1	11,716
Provida	3,215	1,597	45.4	28,439
Total	**10,109**	**5,177**	**167.3**	**32,307**

Source: Superintendency of Pensions, 'Statistical Bulletin No. 221' (June 2016)

Note: The 30 June 2016 exchange rate of 663.75 Chilean pesos per $US has been used to convert Chilean pesos to $US

4. Administration Fees

4.1 Fee structure of each AFP

AFPs are free to set the administration fees they charge members, but the fee must be the same for all their members. This fee must be a fixed percentage of salary. It covers administration costs, distribution costs and the cost of the internal investment team. The latter is a very small component of total AFP costs. It does not include the investment fees charged by external fund managers (which are mostly used for foreign investment). These external investment fees amount to about 0.25% per annum when expressed as a percentage of total assets (see Section 5).

Employers deduct additional contributions to cover administration fees and death and disability insurance premiums. No fees are payable by members who do not contribute.

Table 5 shows the administration fees charged by each AFP in August 2016.

Table 5: Administration Fees Charged on Mandatory Contributions

AFP	Fee (% of Salary)	Average Monthly Salary (US$)	Average Annual Fee (US$)
Capital	1.44	1,077	186
Cuprum	1.48	1,959	348
Habitat	1.27	1,158	176
Modelo	0.77	832	77
PlanVital	0.41	756	37
Provida	1.54	866	160
Total	**1.45**	**1,047**	**n.a.**

Source: Superintendency of Pensions, 'Quotes and Contributors – Average taxable Income' (June 2016)

4.2 Total fees charged by AFPs

Table 6 shows the total fees charged by each AFP and the weighted-average fee of all AFPs expressed as a percentage of total assets.

Table 6: Total Administration Fees by AFP

AFP	Total Fees (US$m)	Total Fees (% of Assets)
Capital	171	0.52
Cuprum	154	0.44
Habitat	201	0.45
Modelo	50	1.20
PlanVital	16	0.32
Provida	256	0.56
Total	**847**	**0.51**

Source: Superintendency of Pensions, 'Quotes and Contributors – Average taxable Income' (June 2016)

4.3 Average fee using OECD methodology

Any comparison of fees (as a percentage of assets) can be very sensitive to the size of the average account balance at a particular point in time. To resolve this problem, the OECD uses a methodology (which it refers to as 'reduction in yield') to calculate the average fee paid by a member over their entire working life expressed as a percentage of their account balance. As we did in our 2014 report, we have assumed real wage growth of 1.8% per annum, gross returns of CPI + 5% per annum, and over a 40 year contribution period.

Table 7 shows the administration fee of each AFP and the weighted average fee across all AFPs. It is based on the OECD methodology and the assumptions shown above.

Table 7: Average Administration Fees Over a Lifetime

AFP	Description	Average Fee (% pa)
Capital	Non-default AFP	0.65
Cuprum	Non-default AFP	0.67
Habitat	Non-default AFP	0.57
Modelo	Default from August 2010 to July 2014	0.33
PlanVital	Default from August 2014	0.17
Provida	Non-default AFP	0.70
Weighted-Average		**0.66**

Source: Chant West

4.4 Profitability of AFPs

Table 8 shows the profitability of each AFP for the 12 months to 30 June 2015 and 30 June 2016.

Table 8: Profitability of AFPs – profit & return on equity (%)

	30 June 2015		30 June 2016	
AFP	**Net Profit (US$m)**	**RoE (%)**	**Net Profit (US$m)**	**RoE (%)**
Capital	50.1	8.2	40.9	6.7
Cuprum	167.1	15.8	46.7	4.0
Habitat	68.5	17.2	62.5	14.4
Modelo	13.9	54.7	13.1	48.5
PlanVital	0.2	0.3	0.2	0.4
Provida	74.7	15.8	78.2	4.2

Source: Superintendency of Pensions, 'Statistical Bulletin No. 221' (June 2016)

Note: The 30 June 2016 exchange rate of 663.75 Chilean pesos per $US has been used to convert Chilean pesos to $US

In 2014, PlanVital was the smallest and highest fee-charging AFP (both by some margin) and in the absence of new entrants its future was uncertain. So, in August 2014, it reduced its administration fee from 2.36% to 0.47% pa to secure all new entrants for the next 24 months. To account for this large fee reduction, it cut personnel costs by 60% and other operating expenses by 35%, even though its contributors have risen by 160% over the last two years. We understand it has done this by significantly reducing its salesforce (which is not required to gain default members) and has scaled back its branch network.

As discussed earlier, the increase of about 270,000 contributors over two years is lower than it would have anticipated, partly due to the continued deferral of requiring contributions for contract workers and the self-employed. It remains to be seen whether PlanVital can start to return a profit to BTG Pactual, its shareholder, as it has not done so in the last 2 years.

5. Investment Fees

The fees of external fund managers are not included in the administration fees of AFPs. While these fees are not directly deducted from a member's account, they are deducted from earnings before they are credited to members' accounts in the same way as they are in Australia.

The Superintendency of Pensions, Chile's pension regulator, has imposed controls on the level of the fees paid to external fund managers. Table 9 shows the maximum fees payable for mutual funds.

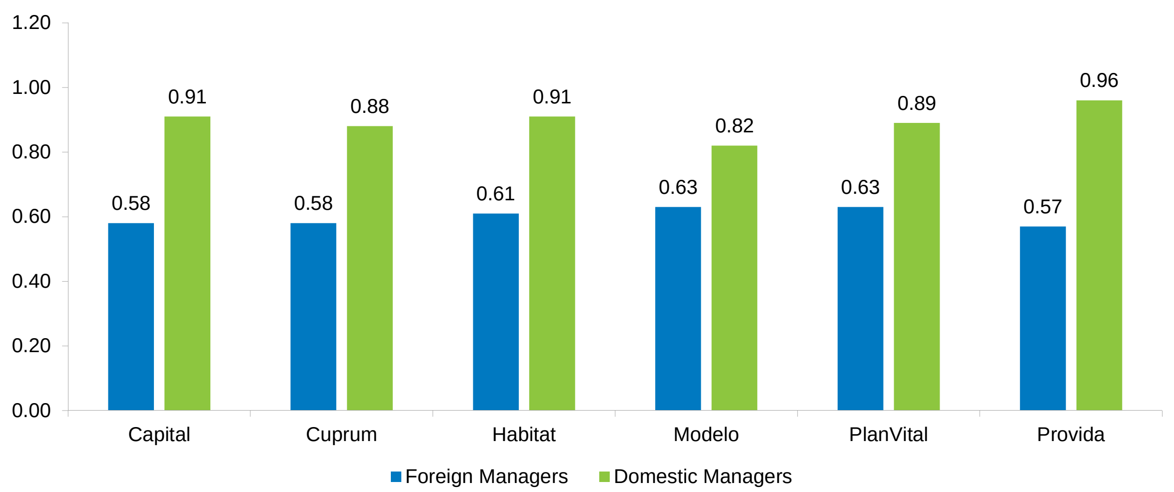
Table 9: Maximum Fees by Asset Class

Asset Class	Asset Sub-Class	Style	Maximum Fee (% pa)
Shares	Domestic, Global, EM	Index	0.50
	Domestic, Global	Active	1.25
	EM	Active	1.54
Bonds	Domestic	Index	0.25
		Active	0.76
		High Yield	1.01
	Global		1.05
	EM		1.08
Diversified Funds			1.16
Cash			0.53
Other			2.08

Source: Superintendency of Pensions, 'Pension Compendium General Rule No. 146' (June 2016)

AFPs must disclose their fees for each investment type to the pension regulator on a monthly basis and this data is then published on its website. Chart 4 shows the average fees charged by foreign and domestic fund managers for Fund A options, which are most comparable with Australian MySuper options in terms of growth assets. For every AFP, the investment fees for domestic managers are much higher than global managers, due to the small scale of Chilean fund managers when compared to large international fund managers.

Chart 4: External Investment Fees (% pa)



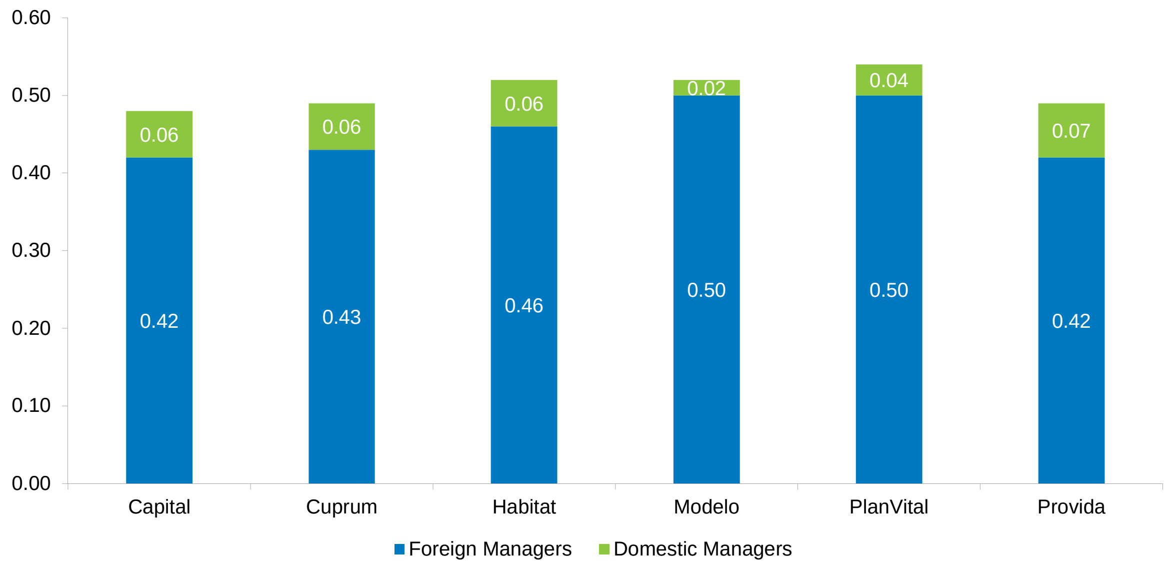
Source: Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2016 to 31 March 2016'

Note: The Chilean pension regulator does not report investment fees by type of investment (ie equities vs fixed interest), only by international/domestic investments.

The level of fees that members pay depends on the amount invested with external investment managers. We know that the average allocation to foreign investments is 41% (Chart 3), almost all of which is invested with external managers. On the other hand, most domestic assets are internally managed so it contributes very little to overall external manager fees.

Chart 5 shows the external manager fees (as a percentage of total assets) that are deducted from members' earnings for Fund A options where the average allocation to foreign investments is 80%. The average investment fee for Fund A options across all AFPs is 0.50% per annum.

Chart 5: External Investment Fees (% of total assets)



Source: Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2016 to 31 March 2016'

6. Investment Returns

Any product comparison should never simply focus on fees. What really matters to members is the return they receive after paying those fees.

Table 10 shows the 3 year real returns, net of investment fees, for each of the 5 Funds offered by each AFP, along with the ranking of each AFP in brackets. It shows that all PlanVital's Funds are ranked last over the last 3 years. On average, PlanVital's returns are 0.6% pa below the average return of all AFPs. We understand that PlanVital has less resources devoted to investments than the other providers as part of its low cost structure.

Table 10: Real returns for the 3 years to June 2016 (% pa)

AFP	A	B	C	D	E
Capital	4.2 (4)	3.8 (5)	4.2 (3)	4.0 (5)	3.7 (3)
Cuprum	4.6 (1)	4.2 (1)	4.8 (1)	4.6 (1)	3.9 (1)
Habitat	4.5 (2)	4.1 (2)	4.7 (2)	4.5 (2)	3.9 (1)
Modelo	4.5 (3)	3.9 (3)	4.1 (5)	4.2 (3)	3.5 (5)
PlanVital	3.8 (6)	3.3 (6)	3.7 (6)	3.9 (6)	3.3 (6)
Provida	4.2 (4)	3.9 (3)	4.2 (3)	4.1 (4)	3.6 (4)
Weighted Average	**4.4**	**4.0**	**4.4**	**4.3**	**3.8**

Source: Superintendency of Pensions, 'Statistical Record No. 44' (July 2016)

In Section 4.3, we showed that PlanVital's administration fees are about 0.5% below the median, using the OECD methodology. Since investment returns over the last 3 years have been about 0.6% pa lower than the AFP median, PlanVital members have given up more in investment returns than they have saved in lower administration fees.

7. MySuper Products

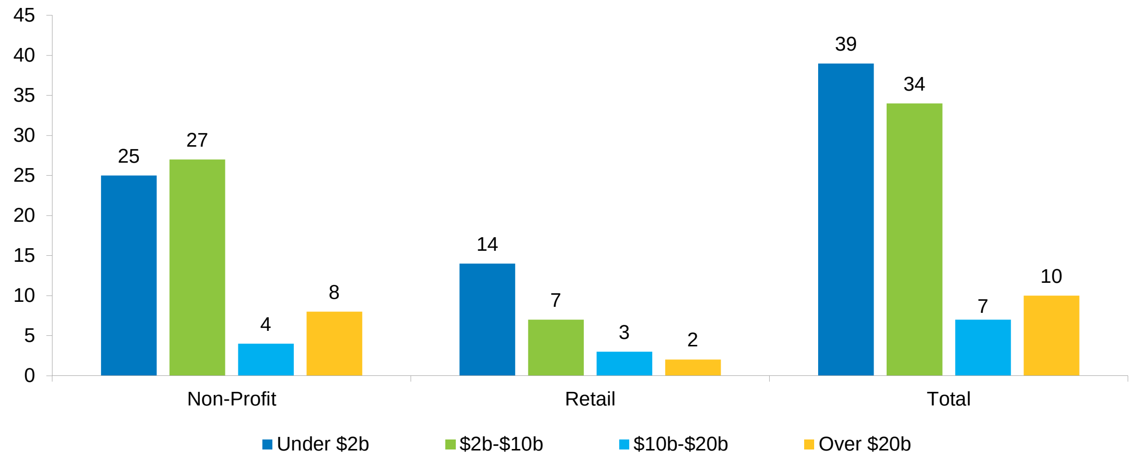
Since January 2014, it has been mandatory for employers to pay default SG contributions into a MySuper product. APRA has authorised over 100 MySuper products to receive default contributions. MySuper assets at June 2016 totalled about $689 billion (this includes account balances that must be transferred to a MySuper product by July 2017) representing about 17.6 million member accounts.

MySuper product providers compete vigorously for members on the bases of fees and services offered (including insurance). The structure of the industry promotes this competition. First, there are a large number of competing products. Second, the industry is segmented into three fiercely competitive groups of roughly equal size: for-profit retail funds, non-profit funds and self-managed funds.

Chart 6 shows the number of MySuper products in various bands of assets under management at June 2016. Of the authorised MySuper products, ten have assets over $20 billion, seven have assets of between $10 and $20 billion, and 34 have assets of between $2 and $10 billion. The remainder have assets of less than $2 billion.

Clearly, there are already enough products with sufficient scale to generate healthy competition. Some of the smaller funds may not have the scale to continue to deliver quality services and competitive net returns to members at low cost, but this situation would likely be resolved by fund consolidation, as we have experienced in the recent past. This would result in more large funds competing for members, which again would put downward pressure on fees.

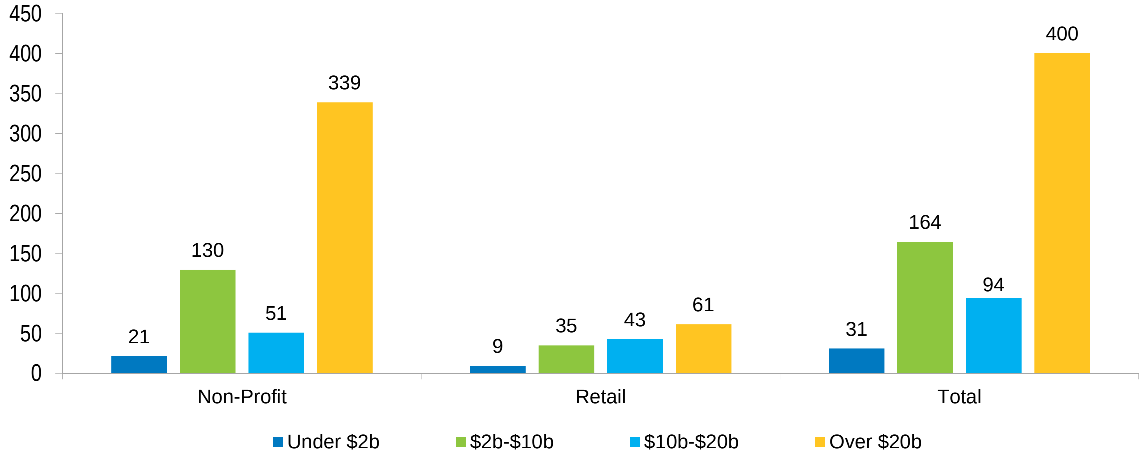
Chart 6: Number of MySuper Products



Source: Chant West

Chart 7 shows the total assets of MySuper products at June 2016. The ten largest products account for about 58% of total assets. The next 40 largest 40 account a further 37% of total assets. This means the 50 largest products (about half the total number of products) account for about 95% of total assets.

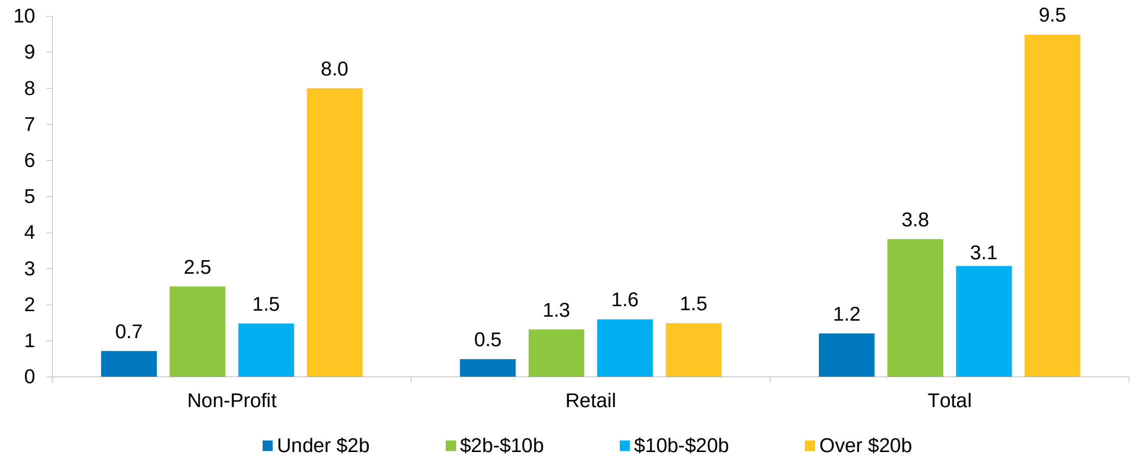
Chart 7: Total Assets of MySuper Products ($b)



Source: Chant West

Chart 8 shows the total number of member accounts of MySuper products at June 2016. The ten largest products account for about 54% of total members. The next largest 40 products account for about 39% of total members. This means the 50 largest products (about half the total number of products) account for about 95% of total members.

Chart 8: Total Member Accounts of MySuper Products (million)



Source: Chant West

8. Comparison of MySuper products with Chilean Pension Products

There has been much written about the Chilean pension system and the low fees delivered by its tender system. Some have claimed that it delivers much lower fees than the Australian system and therefore should be emulated in Australia. This section compares fees in the Australian system with the Chilean system on a like-with-like basis.

8.1 Average MySuper fees

Table 11 shows the weighted-average fees (using assets under management, including the account balances that must be transferred to a MySuper product by July 2017) charged by MySuper products in each industry segment. Note that we define retail passive funds as those that have 65% or more in passive management.

The fees shown in the table are based on June 2016 data. Typically, members pay administration charges directly by way of a dollar-based fee (often referred to as a 'member fee') plus a percentage-based administration fee. Investment fees are percentage-based, and are deducted from investment earnings before they are credited to the members' accounts.

The published MySuper administration fees are the maximum fees that members pay. With retail active funds, many medium to large employers, however, because of their scale, are able to negotiate lower administration fees for their employees. To assess the impact of these negotiations, we have sourced information from the five largest corporate master trust providers on the average administration fees paid in their MySuper products. Based on this information, we have reduced the percentage-based administration fee for retail active products by 0.17% – from 0.53% to 0.36% – to be more representative of the real-world situation.

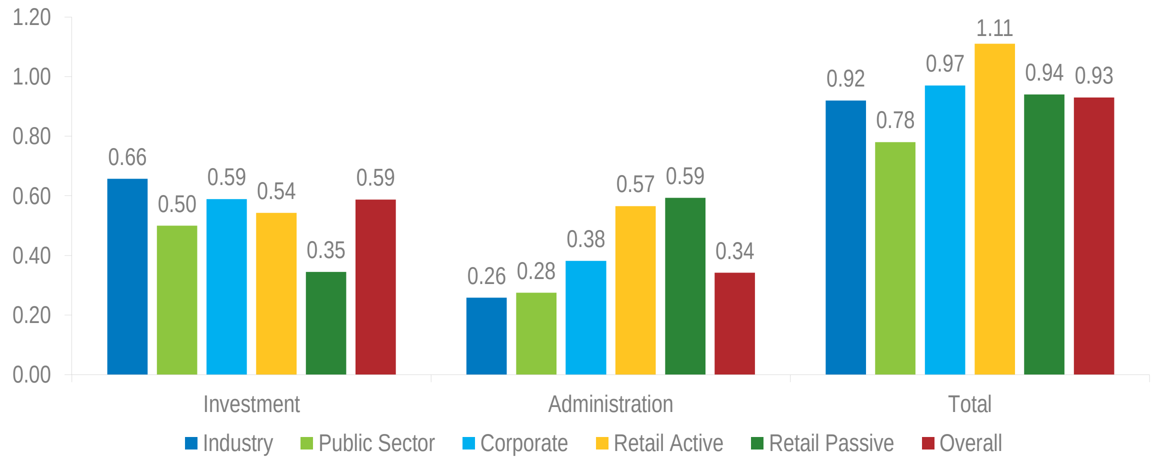
Table 11: Fee Structure of MySuper Products

Industry Segment	Administration Fee ($ pa)	Administration Fee (% pa)	Investment Fee (% pa)
Industry	83	0.09	0.66
Public Sector	41	0.19	0.50
Corporate In-House	90	0.19	0.59
Average Non-Profit	73	0.13	0.63
Retail Active	83	0.36	0.54
Retail Passive	83	0.41	0.35
Average MySuper	**75**	**0.20**	**0.59**

Source: Chant West, Super Fund Fee Survey, June 2016.

Chart 9 shows the weighted-average MySuper fees for different industry segments using an account balance of $50,000, which is the amount used for the representative member in MySuper dashboards and Product Disclosure Statements. The chart is based on the data in Table 11. The overall weighted-average MySuper fee is 0.93% per annum, comprising an administration fee of 0.34% and an investment fee of 0.59%.

Chart 9: Weighted-Average MySuper Fees by Industry Segments (% pa)



Source: Chant West, Super Fund Fee Survey, June 2016.

But how have fees changed with the introduction of MySuper? Has MySuper been successful in reducing the fees paid by members, particularly in higher-fee funds? Table 12 compares the current MySuper fees with the fees from July 2012, i.e. before any MySuper products had been introduced. It shows that the administration costs of public sector and corporate in-house funds have increased as they now provide a wider range of services to members.

The major change is for corporate master trusts where total fees have reduced, partly due to lower investment fees but mainly due to the removal of trail commission from these products which used to average about 0.40% pa. The fees shown below for these products include an average administration fee discount of 0.17% pa both pre and post MySuper. MySuper has been successful in reducing the fees charged by these higher fee-paying products. Members of smaller employer plans wouldn't receive a discount and would be paying an average total fee 1.28% pa, down from 1.82% before MySuper.

Table 12: Weighted average Pre-MySuper Fees vs. Current MySuper Fees (% of assets)[1]

Industry Segment	July 2012			June 2016		
	Investment	Admin.	Total	Investment	Admin.	Total
Industry	0.67	0.27	0.94	0.66	0.26	0.92
Public Sector	0.51	0.20	0.71	0.50	0.28	0.78
Corporate In-House	0.53	0.27	0.80	0.59	0.38	0.97
Corp. Master Trusts[2,3]	0.68	0.97	1.65	0.54	0.57	1.11
Average MySuper	**0.61**	**0.34**	**0.95**	**0.59**	**0.34**	**0.93**

Source: Chant West, Super Fund Fee Surveys, July 2012 and June 2016.

Notes:
1. The fees shown above are based on a $50,000 balance.
2. The corporate master trust fees in 2016 are based on retail active MySuper products to ensure we are comparing investment strategies with similar investment costs. The corporate master trust discount is based on data provided to Chant West by the major corporate master trusts.
3. The average administration fee shown for corporate master trusts in 2012 includes average trail commission of 0.40% pa.

8.2 Administration fees using OECD methodology

In Section 4.3, we showed average administration fees in Chile using the OECD's methodology. We now apply this methodology to Australian MySuper products using the fee structure in Section 7.1.

Table 13 shows the average administration fees of MySuper products and Chilean AFPs.

Table 13: Average Administration Fees Over a Lifetime

Product	Average Fee (% pa)
MySuper	
Industry	0.16
Public Sector	0.22
Corporate In-House	0.28
Average Non-Profit	0.19
Retail Active	0.46
Retail Passive	0.49
Average MySuper	**0.28**
AFP	
Capital	0.65
Cuprum	0.67
Habitat	0.57
Modelo	0.33
PlanVital	0.17
Provida	0.70
Average AFP	**0.62**

Source: Chant West

How do the MySuper and Chilean AFP administration fees compare?

- Broadly, MySuper administration fees compare favourably with those of Chilean AFPs. Most Chilean AFP members (80%) are in the four large AFPs that charge high fees (average fees of 0.65% pa) whereas most Australian superannuation members are in MySuper products where fees are much lower (average 0.28% pa). The Australian MySuper system has been successful in ensuring that all default members pay a reasonable level of fees, or at least they will after all Accrued Default Amounts are transferred by 1 July 2017.
- The average MySuper administration fee of 0.28% is higher than PlanVital's default fee of 0.17% effective August 2016.
- However the average non-profit MySuper administration fee of 0.19% is very similar to the Chilean default fee of 0.17%.
- The average retail active MySuper administration fee of 0.46% is higher than PlanVital's default fee of 0.17%.

8.3 Investment Fees

Table 14 shows the investment fees of MySuper products and Chilean AFPs. Since these fees are a simple percentage of assets in all cases, the average lifetime fees will be the same as in the table. We have used the investment fees for Chilean AFP 'Fund A' options as they have a similar level of growth assets to Australian MySuper options. The investment fees of Chilean AFPs for these options are lower than for MySuper products, but only by about 0.10% pa.

Table 14: Average Investment Fees

Product	Average Fee (% pa)
MySuper	
Industry	0.66
Public Sector	0.50
Corporate In-House	0.59
Average Non-Profit	0.63
Retail Active	0.54
Retail Passive	0.35
Average MySuper	**0.59**
AFP	
Capital	0.48
Cuprum	0.49
Habitat	0.52
Modelo	0.52
PlanVital	0.54
Provida	0.49
Average AFP	**0.50**

Source: Chant West and Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2016 to 31 March 2016'

Another way to compare investment fees is to look at the investment fees paid to external fund managers. Table 15 compares the investment fees paid to international and domestic fund managers for MySuper options and Chilean AFPs, using 'Fund A' options. The estimated MySuper fees are based on our experience with large MySuper funds and a 70/30 split of equities and fixed interest. Clearly, Australian MySuper products are paying much lower investment fees to fund managers than Chilean AFPs for similar types of investments.

Table 15: Investment Fees by Type of Manager

Fund	International	Domestic
Average MySuper (estimate)	0.45	0.35
Capital	0.58	0.91
Cuprum	0.58	0.88
Habitat	0.61	0.91
Modelo	0.63	0.82
PlanVital	0.63	0.89
Provida	0.57	0.96

Note: The Chilean pension regulator does not report investment fees by type of investment (ie equities vs fixed interest), only by international/domestic investments.

Source: Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2016 to 31 March 2016'

8.4 Asset Allocations

Tables 14 and 15 showed that the investment fees for Chilean AFPs are lower than MySuper investment fees but, on the other hand, Chilean AFPs pay much higher fees to fund managers than MySuper products. How can this be? It is because Chilean AFPs and MySuper products invest very differently.

Table 16 compares the strategic asset allocations of the average Chilean AFP 'Fund A' option with that of the average Australian MySuper option. It shows that while Chilean AFPs are invested in shares and fixed interest, Australian MySuper products are invested in a much wider range of assets. These assets such as property, infrastructure, private equity and hedge funds, provide much greater diversification to the portfolio but are also higher cost investments.

Table 16: Average returns to 30 June 2016 – MySuper vs Chilean AFPs

Investment Option	MySuper	Chilean AFP Fund A
Internally managed investments	<5%	20%
Growth	72	76
Domestic Shares	25.9	15.8
International Shares	26.3	59.9
Domestic Property - Listed	1.1	-
Domestic Property - Unlisted	4.4	-
Global Property - Listed	2.0	-
Global Property - Unlisted	0.3	-
Private Equity	2.3	-
Infrastructure – Growth	4.1	-
Hedge funds/Other – Growth	6.0	0.2
Defensive	28	24
Domestic Bonds	7.2	4.2
Int'l Bonds	6.5	19.9
Diversified Fixed Interest	2.4	-
Cash	4.3	-
Property – Defensive	1.7	-
Infrastructure – Defensive	1.5	-
Private Debt	0.8	-
Hedge funds/Other – Defensive	3.2	-

Source: Chant West Strategic Asset Allocation Survey, June 2016 and 'Portfolio Aggregate of Pension Funds by Type of Fund' (June 2016)

Further, in Chilean AFPs, almost all domestic assets are internally managed. While for Fund A, domestic assets is only about 20% of the portfolio, for Fund C (the largest option) it is 57% and for Fund E (the most conservative option), 90% is internally managed. The cost of managing these assets is negligible as the size of the team is only a small fraction of the total number of employees of each AFP. About 50% of the total assets of Chilean AFPs are invested in internally managed Chilean bonds. These assets are cheap to manage, but this concentration carries potential risks.

In contrast, we estimate that internal management represents less than 5% of assets under management for MySuper products. While some larger industry funds are moving to more internal management to reduce investment costs, it is critical that appropriate governance processes are put in place to ensure that long-term returns are not sacrificed. These funds are typically introducing good governance processes for the internal investment function that apply a similar rigorous assessment to that used for external fund managers.

8.5 Investment Returns

The preceding discussion noted that the investments of Australian superannuation funds are more sophisticated than those of Chilean AFPs, as Australian funds invest in a wider range of asset classes and tend to invest more with fund managers rather than managing most assets internally. This leads to higher investment costs but does it translate to superior performance?

Table 17 compares average real returns to 30 June 2016 for Australian multi-manager superannuation options with the Funds offered by Chilean AFPs that have similar growth assets. It shows that over 1 and 3 years, the performance of Australian superannuation funds is higher, especially for the more aggressive options. Since September 2002, when AFPs were first required to offer 5 Funds to members, the Chilean Funds have performed slightly better. However the comparisons suggest that the greater diversification of investments in the Australian superannuation market (not just equities and bonds) has led to much less volatile returns, especially for the more aggressive options.

It must be noted that any performance comparison between various pension systems around the world must be treated with some caution as the risks associated with the different investment markets vary greatly.

Table 17: Average real returns to 30 June 2016 – Australian Super Products vs Chilean AFPs

Investment Option	Growth assets	1 Year	3 Years	From 1 Sep. 2002
Australia – Growth	72	2.2	7.4	5.0
Chilean AFP Fund A	76	-5.1	4.4	6.1
Australia – Balanced	52	2.4	5.8	4.2
Chilean AFP Fund B	56	-2.9	4.0	5.2
Australia – Conservative	32	3.1	4.8	4.2
Chilean AFP Fund C	35	-0.9	4.4	4.9

Note: The real returns shown above are gross of tax and net of investment fees. The Australian superannuation returns have used nominal net of tax returns and have deducted CPI for each period and added back tax at the rates used in ASIC's MoneySmart Superannuation calculator (ie 7% for Growth, 8% for Balanced and 11.7% for Conservative).

Source: Superintendency of Pensions, 'Statistical Record No. 44' (July 2016), Chant West Multi-Manager Survey June 2016.

8.7 Total fees using OECD methodology

Finally, Table 18 shows the total fees of MySuper products and Chilean AFPs.

The average MySuper total fee is 0.87%, which is much lower than the average Chilean AFP but higher than PlanVital's fee (Chile's default fund) of 0.71%.

The average MySuper administration fee of 0.28% is much lower than the average Chilean AFP but is higher PlanVital's administration fee of 0.17% pa, although the average not-for-profit administration fee is about the same as PlanVital.

And while the average MySuper investment fee of 0.59% pa is a little higher than PlanVital's investment fee of 0.54% pa, the level of sophistication and diversification of MySuper portfolios is much greater than PlanVital's vanilla portfolio of equities and fixed interest, with significant amounts of internally managed Chilean bonds. We would expect a much higher fee differential given this greater diversification of assets.

Overall, MySuper fees compare favourably with PlanVital's default fees in Chile, especially when the clear differences in the approach to investment management are taken into account.

Table 18: Average Total Fees Over a Lifetime

Product	Administration (% pa)	Investment (% pa)	Total (% pa)
MySuper			
Industry	0.16	0.66	0.82
Public Sector	0.22	0.50	0.72
Corporate In-House	0.28	0.59	0.87
Average Non-Profit	0.19	0.63	0.82
Retail Active	0.46	0.54	1.00
Retail Passive	0.49	0.35	0.84
Average MySuper	**0.28**	**0.59**	**0.87**
AFP			
Capital	0.65	0.48	1.13
Cuprum	0.67	0.49	1.16
Habitat	0.57	0.52	1.09
Modelo (old default)	0.33	0.52	0.85
PlanVital (new default)	0.17	0.54	0.71
Provida	0.70	0.49	1.19
Average AFP	**0.62**	**0.50**	**1.12**

Source: Chant West and Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2016 to 31 March 2016'