

## Media Release

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## Super fund size matters Deloitte actuarial research

**4 June 2009:** Deloitte Actuaries & Consultants superannuation partner Wayne Walker confirmed the widely held view that larger superannuation funds have a definite cost advantage over smaller funds.

As part of Deloitte's ongoing research into the superannuation industry, the actuarial team analysed 60 industry funds looking at both their cost structures and the returns earned on their default options.

The study looked at the returns achieved by both small and large funds to see if there was any statistical evidence to suggest that smaller funds were able to generate higher returns to offset the generally higher costs they were incurring. The results showed that on average most of them are not.

"While there are small funds that buck the trend, the larger funds with lesser fees also generally delivered the better returns," said Walker.

"Clearly, a part of these higher returns (net of fees and taxes) comes from the lower investment costs of large funds. Nevertheless the gap in returns between large and small funds is more than simply lower fees. Large funds appear to be delivering genuinely better investment performance to the bulk of their members who use the default option.

"The difference in performance is statistically and financially significant.

"These results hold clear implications for individual Australians. The combined impact of lower operational/ investment costs together with the higher returns achieved by large funds is enough to increase the retirement benefit of Australians by almost 25% over a working lifetime," said Walker.

The results also hold implications for funds.

Walker explained: "Scale offers a clear potential for funds to deliver extra benefits to their memberships. This adds some logical impetus to the government's desire to rationalise funds into fewer and larger entities.

"However, it is far from a death sentence for smaller funds. We can find well performing smaller funds that seem to defy the trend. For many smaller funds it does mean that they need to work much harder to deliver extra benefits and services that are of real value to their members in ways that offset the scale advantages of their large competitors.

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“One of the ways for smaller funds to access scale benefits is through strategic partnerships with the better scaled services providers and/or other funds.

“Some funds talk about the virtues of being small and closer to their members by offering a more personal service to them. That is fine, but the challenge is to turn a general statement of intent into specific and tangible value,” Walker said.

### The research and results: costs

Deloitte examined both the annual reports and PDS documentation of 60 industry funds focussing on operational costs rather than fees. Walker explained that fees paid can be subsidised for short periods and are often difficult to quantify whereas actual costs are the best measure of what members will ultimately bear over the longer term.

The study looked at costs associated with administration/ operations and investment. Operational costs are described in accounts and annual reports and are largely related to the number of members. The study excluded defined benefit funds so as to better compare like with like.

Size of Fund (members)	Number of funds	Operational costs \$ per member per week
< 50,000	26	\$2.18
50,000 to 100,000	8	\$1.93
100,000 to 500,000	12	\$1.59
>500,000	6	\$1.08

Investment costs are harder to identify. Fund accounts and annual reports often simply report on investment income after deducting manager fees. The Deloitte study relied on the PDS which obliges the funds to tell members the fees deducted from their accounts. These vary from investment option to option and reflect many diverse factors – asset allocation, active or passive investment, etc. As the overwhelming majority of members in any fund invest in the default option nominated by the trustee, the study concentrated on the fees associated with default options.

Size of Fund (\$millions)	Number of funds	Investment fees (% of assets)
< \$1,000	29	0.75%
\$1,000 to \$2,500	12	0.76%
\$2,500 to \$10,000	12	0.59%
>\$10,000	7	0.57%

The results show clear economies of scale in both administration/operations and in investment management.

## The research and results: investment return

In the investment return table below the study looks at returns for small and large industry funds over the five years to 30 June 2008. Small funds are those with less than \$1billion in assets and large funds are those with more.

Investment returns (% pa)						
Net of taxes and investment fees						
	For the year ending June 30					5 year average
	2004	2005	2006	2007	2008	
<b>First quartile return</b>						
Small < \$1billion	11.78%	11.85%	13.98%	14.84%	-7.75%	8.47%
Large > \$1 billion	13.25%	13.38%	14.46%	15.39%	-6.65%	10.15%
<b>Median return</b>						
Small < \$1billion	12.90%	13.31%	14.60%	15.65%	-6.85%	9.53%
Large > \$1 billion	13.75%	14.00%	15.20%	16.36%	-5.85%	10.42%
<b>Third quartile return</b>						
Small < \$1billion	13.55%	14.50%	15.10%	16.95%	-5.80%	10.22%
Large > \$1 billion	14.60%	14.41%	16.73%	17.82%	-4.50%	11.01%

A comparison of investment return is much more complex than a simple comparison of default funds.

It may be that smaller funds invest more conservatively, are not able to access some of the more complex structures made available to larger funds, or are constrained by limited cash flow in adjusting asset allocation to respond to changing investment conditions.

Smaller funds may also have other investment options that have performed much better than their nominated default. This may be true, but the study asked whether the 90% or more of members who invest their entire super in default funds care about this. On the whole they are not sophisticated investors, they rely on the trustee to make decisions for them, and our research reveals a significantly lower return from smaller funds in the most important default options.

Indeed the shortfall in return continues beyond a fund size of \$1 billion – and the study concludes that funds less than \$2billion in size also suffer a return shortfall.

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### For further information:

Wayne Walker  
 Partner Actuaries and Consultants  
 Mobile: 0419 390 436  
 Tel: + 61 (0) 3 9671 6916  
[wawalker@deloitte.com.au](mailto:wawalker@deloitte.com.au)

Louise Denver  
 Corporate Affairs & Communications  
 Mobile: 0414 889 857  
 Tel: +61 (0) 2 9322 7615  
[ldenver@deloitte.com.au](mailto:ldenver@deloitte.com.au)



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