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6 October 2017

Alex Maevsky
Inquiry Manager
Productivity Commission

By email: Alex.Maevsky@pc.gov.au

Re: Superannuation Inquiry – Superannuation member switching

Dear Mr Maevsky,

I write to provide the Productivity Commission with a copy of a new report by Rice Warner Actuaries, which is relevant to the Commission's current inquiry into superannuation competitiveness and efficiency.

The Rice Warner report, which is the first study of its kind, analysed the outcomes for people who switched among a data set of 10 million accounts. Among other things, the report asked:

- Who switched?
- Where did they switch to?
- Did the product into which they switched charge higher or lower fees?
- Did the product into which they switched have higher or lower returns?

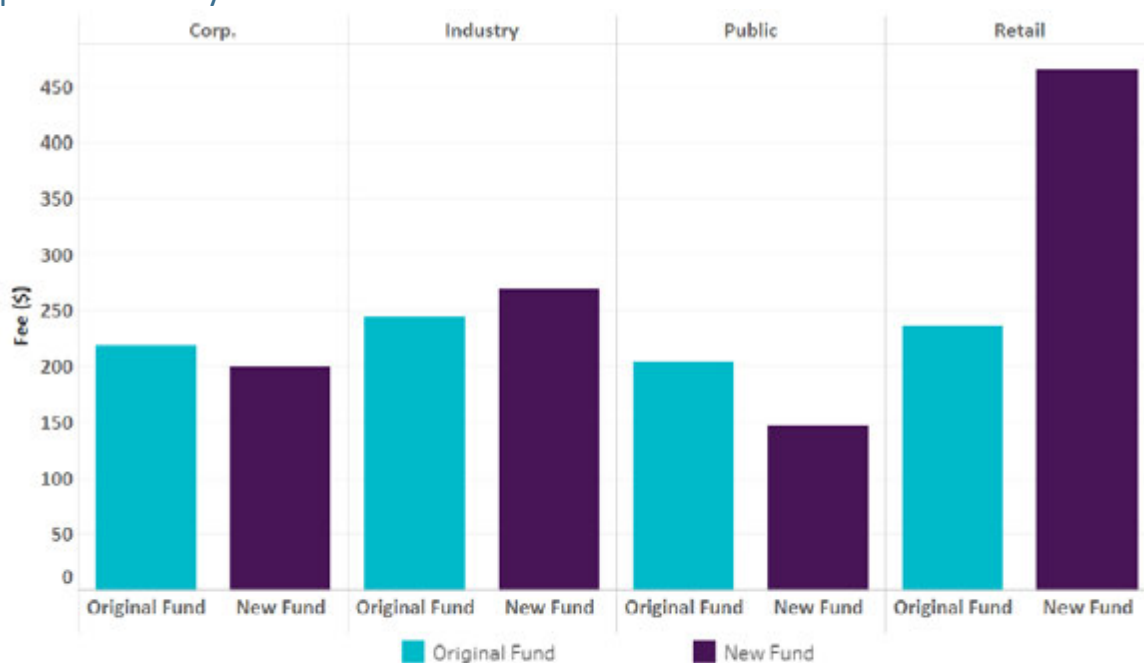
The analysis focused on the year to June 2015, though there is no reason to believe the events of that year were unusual.

Rice Warner found that the aggregate *net* impact (balancing out gains and losses) of changing funds undermines system efficiency, because it resulted in a *\$137 million increase in fees*; and a *\$284 million decrease in investment performance* per annum.

We stress these are per annum figures, and we would expect these reductions in efficiency would be cumulative with each successive year's switching cohort.

Figure 1 shows the effect of switching on fees by sector, and Figure 2 shows the aggregated increase and decrease in fees by sector.

Figure 1 –When members exercise “choice of fund” they pay higher fees, predominantly to retail funds



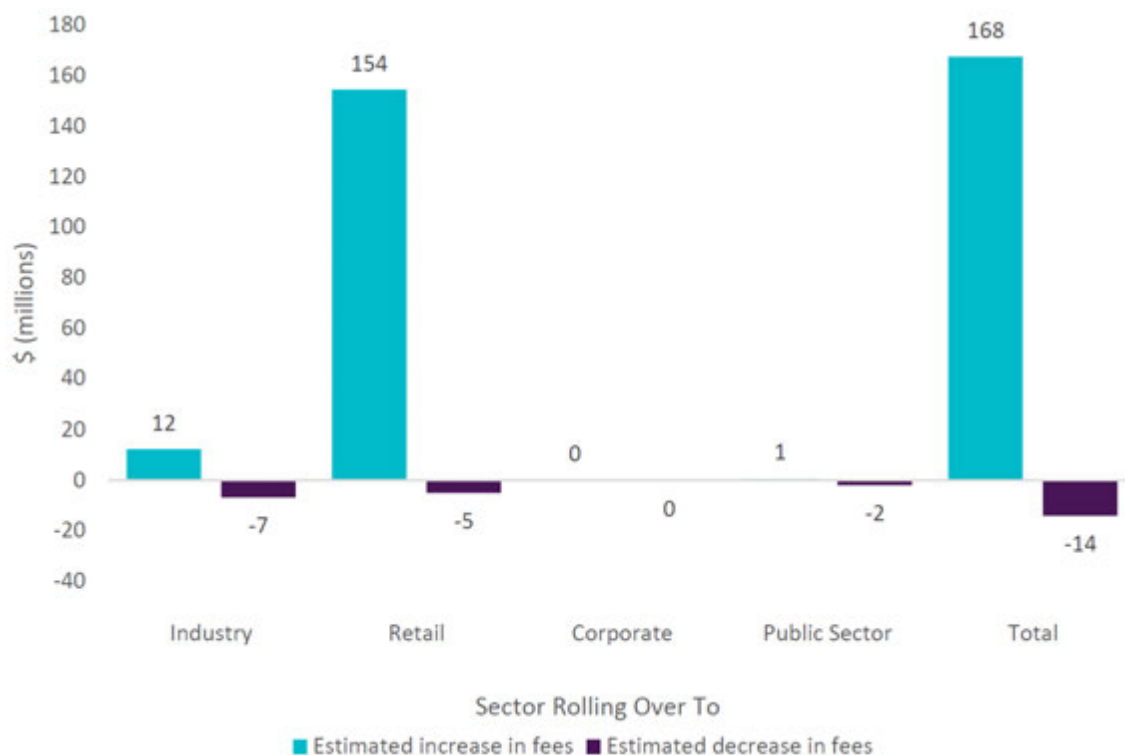
*Retail employer plans have been excluded from analysis as the level of discount provided is unknown. Hence the 'Retail' sector represents personal superannuation products only.

Source: Rice Warner

Note: For the year ending June 2015

More startling, however, is that, across the system (industry, public sector, retail funds) the estimated increase in super fees from switching was \$170 million, of which \$157 million or 92 per cent was in the retail sector (Figure 2).

Figure 2 – Aggregate increase and decrease in fees paid by sector

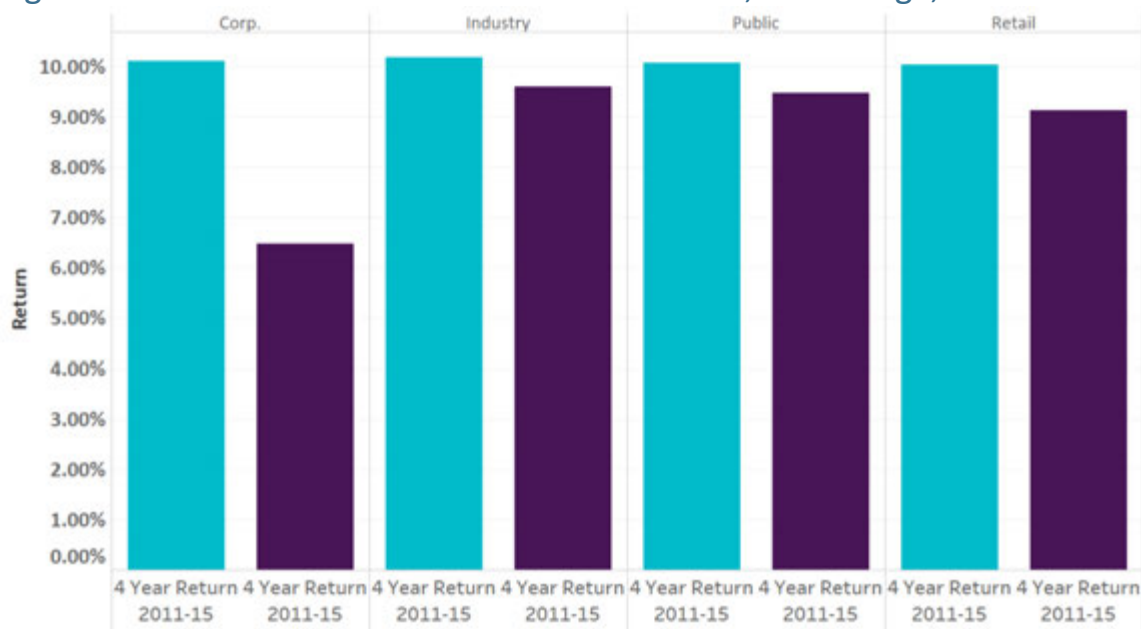


Source: Rice Warner

Note: For the year ending June 2015; Retail fee decreases do not include the decreases from rolling over into Retail Corporate Plans, due to the practice of providing discounts to PDS rates.

Members not only choose to switch into (or, more accurately, are *sold* into) funds with higher fees, they also switch into funds that generated lower net returns than they would have had if they had not switched funds (Figure 3).

Figure 3 – Members switched into funds that had, on average, lower net returns



*Light blue represents the members' original fund and dark blue represents the fund rolled over to.

Source: Rice Warner

Note: Difference in historical returns for those members moving to a fund with lower 4y returns

These differences in performance are significant in terms of system efficiency. Figure 4 shows the estimated annualised effect on member balances arising from the changes in returns (i.e., the increase in four year investment returns for members that rolled over to funds with higher returns, and the estimated decrease in four year investment returns for members that rolled over to funds with lower returns) for the year ending 30 June 2015.

Figure 4 – Aggregate annualised effect on member balances of differential returns by sector, year to June 2015



Overall, the key findings of the research were that:

- Just under 1 million Australians switched super funds in 2014-15 with more than half paying higher fees and switching to funds with lower returns
- Switchers paid an estimated additional \$170 million in fees after switching super funds
- Of those additional fees, 92% or \$157 million was in retail funds; \$12 million or 7% was in industry funds
- Retail super funds are the main switching destination accounting for 72% of all switches
- Retail super funds account for 92% of those members switching to a fund with higher fees
- Of members switching from industry to retail funds only 7% paid lower fees
- Members rolling into industry funds are generally twice as likely to pay lower fees than those rolling into retail funds (21% against 9%)
- Retail funds accounted for 87% of decreases in investment returns
- The net impact of changing super funds was a \$137 million increase in fees p.a.
- Net impact of changing funds is a \$284 million decrease in investment performance p.a.

These outcomes are not a surprise to us, nor should they surprise those who are familiar with the other literature regarding what happens to members in a sales-driven retirement income system (a sales-driven system is, intrinsically, what happens in a system based on “choice of fund”).¹ The attached report from Rice Warner clearly points to market failure and commercial exploitation of information asymmetries.

This research reinforces the need for the Commission to (i) place appropriate scrutiny on the Choice segment of the superannuation system, and (ii) take seriously the inextricable relationship between “choice of fund” and sales, and the risks to consumers of a sales-based superannuation system (especially a system that permits participation by providers driven by profit).

In its Inquiry so far, the Commission has placed scrutiny on the default segment of the superannuation system to a greater degree than the Choice segment of the system.² Similarly, the Government has excluded Choice products from the most critical aspects of its recent superannuation legislation.³

¹ Studies that look at the performance outcomes of members invariably show that members experience lower net returns when they switch. See, e.g., Gan, Su et al., Individual investor portfolio performance in retirement savings accounts, Australian Journal of Management, 2014 (analysing 10 years of data for over 15,000 members and finding that “Switching activity is invariably associated with lower risk adjusted returns (alphas) and this is also evident across the various analyses reported.”).

Studies regarding whether members could reasonably be expected to become rational and informed investors suggest they cannot: See, e.g., Delpachitra, Sarath and Rafizadeh, Schumann, The Switching Decision: Are Members of Superannuation Funds Rational and Informed Investors?, Australasian Accounting, Business and Finance Journal (2014).

We also note that research relating to switching typically is survey-based and asks member’s what factors influenced their choices. Survey-based analyses typically only include logical factors like returns, fees, or changes in employment as being drivers of switching; seldom are factors such as “advertising” or “sales” included. Moreover, it is not clear that individuals would honestly recognise or attribute their decisions to sales efforts.

² While this difference in scrutiny is evident in the Commission’s reports in Stage 1 and Stage 2, the most troubling indication that the Commission is embracing the Government’s policy intentions is the Commission’s Issues Paper for Stage 3.

In the Issues Paper, the Commission commits over ¼ of the substantive length of the document to matters relating solely to the default system and how to reform it. There is not a single question focused on the Choice segment. Where the Commission inquired about barriers to competition, it focused solely on *policy* impediments, rather than the behaviour of market participants, disclosure quality, or factors relating to member behaviour and financial literacy.

³ The Government’s proposed super reform legislation excludes most products offered by bank-owned super funds. Some examples include:

- Newly proposed requirements for super funds to assess the value-for-money of the MySuper products they offer do not apply to the category of products most used by bank-owned super funds (the vast majority (83 percent) of bank-owned and other retail superannuation assets are held outside MySuper and will be excluded from the requirement);
- Newly proposed portfolio holdings disclosure also would not apply to most bank-owned super fund products;

It is well known that the vast majority of bank-affiliated superannuation products and services are in the Choice segment.

The greatest area of inefficiency in superannuation is the Choice segment: it has more assets than the default sector, yet has delivered lower long term net returns to members, charged members more in fees and costs, and consumed more scarce labour and capital while doing so.

We would be very pleased to arrange a briefing on this research, accompanied by the responsible professionals from Rice Warner.

Thank you for your consideration of this letter and the appended research.

Kind regards,

Zachary May
Director of Policy
Industry Super Australia

Attachment

Member Switching, Rice Warner, 12 September 2017

Copy provided

Karen Chester, Deputy Chair, Productivity Commission
Angela MacRae, Commissioner, Productivity Commission
Matthew Linden, Director of Public Affairs, Industry Super Australia

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- Newly proposed APRA powers to issue directions to “connected entities” would typically exclude the bank-owned funds’ parent companies and related-party service providers; and
 - The “look through” reporting requirements for operating expenses have been modelled on the “look through” reporting requirements for investment, which have allowed two-thirds of the super funds owned by the big four banks, Macquarie and AMP to disclose absolutely zero investment expenses or member investment fees.

In addition, Choice Product Dashboards have been deferred a total of 5 years beyond their original commencement date on 1 July 2014. Many industry observers would expect a further deferral, or amendment to soften the requirement.

RICEWARNER

Insight like no other

Member Switching



Industry Super Australia

12 September 2017



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Table of Contents

1. Executive summary	2
1.1 Overview	2
1.2 The Data	2
1.3 Summary of findings	2
2. Background	5
2.1 Introduction	5
2.2 The dataset	5
3. Member rollovers	8
3.1 Summary of APRA statistics	8
3.2 Demographic trends in member flows	12
3.3 Are members' switches based on fund outcomes?	18
3.4 Cumulative rate of exit	28

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1. Executive summary

1.1 Overview

This report has been commissioned by Industry Super Australia (ISA) to assist it in responding to the Productivity Commission's (PC) three stage review into the efficiency of the Australian Superannuation system. The purpose of this report is to examine switching trends of superannuation members. We examine whether switching activity is consistent with members making informed decisions which will improve their retirement outcomes.

In this report, we examine trends in member rollover and switching behaviour both in relation to the number of members and the size of benefits (assets) transferred. Specifically, we address:

- Demographic trends in member rollover and switching behaviour.
- Whether member switches provide improved outcomes, namely:
 - lower fees following the change
 - improving the likelihood of improved investment returns based on historical investment performance (net returns).
- Switching rates from employer sub-plans to personal superannuation.
- Cumulative probability of member exit over three years.

1.2 The Data

In this report, we utilise data published by APRA supplemented by Rice Warner's own *Superannuation Insights* study, which involves the collection of annual statement data pertaining to over 10 million members per annum. Further information on the dataset can be found in Section 2.2 (The dataset).

1.3 Summary of findings

From this research, we have been able to make several observations for the sample based on data from 2013 to 2015.

1.3.1 Aggregate rollovers and switches

Based on both the Superannuation Insights sample and APRA statistics, retail funds have been the largest beneficiary of rollover activity, relative to switches to industry, corporate and public sector funds. APRA statistics show 72% of rollovers have a destination in the retail sector (at June 2015):

▪ Retail:	\$44.7b	72.1%
▪ Industry:	\$12.5b	20.2%
▪ Public Sector:	\$3.8b	6.1%
▪ Corporate:	\$1.0b	1.6%
▪ Total:	\$62.0b	100.0%

1.3.2 General findings about switching behaviour

We have observed the following demographic trends in member switching behaviour:

- A majority of this switching activity is concentrated around age 30, then tails off before peaking again just prior to retirement age. Retail funds are more likely to be the switching destination for members at all ages, in particular for members with balances in excess of \$50,000.
- Members with balances over \$100,000 are twice as likely to switch to a retail fund relative to an industry fund, though smaller balance accounts are more likely to be subject to a rollover to another fund, regardless of sector.
- Gender differences in rollover activity are generally small. However, it appears that women are less likely to switch funds between ages 30 and 50, which may be the result of taking time out of the workforce and being less engaged with super throughout this period.
- Members with longer tenure in the same fund remain loyal and are less likely to rollover.

1.3.3 Are decisions based on outcomes?

We have observed both fees and historical performance for incumbent and successor funds from member switches.

1.3.3.1 Fee outcomes and switching

When comparing the level of fees before and after a member switch, we observe that:

- Members are unlikely to have used fee levels as a primary reason for switching between funds, as many members are charged a higher fee after switching.
- 20% of members pay lower fees after switching funds, while 49% of members pay higher fees. 31% of members did not have a notable increase or decrease in fees paid (with a margin of \$10 either way).
- The aggregate fee outcomes from switching activity reveals a net increase of \$137 million in fees. The major component of this is a \$170 million increase in fees as a result of switching into funds with higher fees. Retail funds account for 92% of this increase in fees. This is modestly offset by a \$33 million saving in fees. For not for profit funds, the impact is not as stark, with an aggregate increase in fees of \$13 million, against a decrease of \$9 million.
- These outcomes for retail funds are driven by 59% of switching members paying increased fees, at an average increase of \$263 per person annually. Compared to industry funds, a similar proportion of members switching pay higher fees (50%), though the average increase for these members is only \$83.
- Members rolling into industry funds are generally going to be twice as likely to pay lower fees than those rolling into retail funds (21% against 9%). The average decrease on fees for those paying lower fees is also greater for those rolling into industry (\$110 p.a.) rather than retail (\$55 p.a.) funds.
- For members switching from industry to retail funds, only 7% paid lower fees at the new fund. Conversely, 78% of members switching from retail to industry funds paid lower fees.

1.3.3.2 Return outcomes and switching

When comparing performance of funds (using a 4 year period to 20 June 2015) before and after a member switch, we observe that:

- Members are unlikely to have used past performance as a proxy for their investment decision as the data shows on average that historical returns for the incumbent and successor fund tend to be similar.
- 36% of members would have received higher returns over the period, while 56% of members would have received lower returns. 8% of members did not see a notable increase or decrease in investment performance (with a margin of 0.05% either way).
- The aggregate estimated impact on investment returns reveals a net decrease of \$284 million annually. This is largely driven by a \$373 million decrease in returns annually for members rolling into funds with lower returns. Retail funds accounted for 87% of this decrease in returns. This is offset by an \$89 million increase in annual returns for those members switching into higher performing funds. 52% of this increase is accounted for by industry funds, while only 33% is by retail funds.
- These outcomes for retail funds are driven by 80% of members switching into retail funds achieving lower returns, at an average of 0.91%. Conversely, only 36% of members switching into industry funds achieved lower returns, at an average of 0.63%.
- For those rolling into higher performing funds, the average increase was 0.39% for retail funds vs. 0.72% for industry funds. For those rolling into lower performing funds, the average decrease in returns was 0.91% for retail funds vs. 0.63% for industry funds.
- Compared to industry funds, the outcomes for those rolling into retail funds are thus more likely to be negative. Further, the scale of this impact is also estimated to be larger for those rolling into retail funds.

1.3.4 Estimated impact of switching on member outcomes

At an aggregate level, and assuming that fees and performance remains constant, we have estimated that:

- The estimated aggregated net impact of switching funds is an **increase in \$137 million p.a.** being paid in fees by members.
- The estimated aggregated net impact of switching funds on investment performance is a **decrease in returns of 0.46%, or \$284 million p.a.**

This report was prepared and peer reviewed for Industry Super Australia by the following consultants.

Prepared by

Peer Reviewed by

Nathan Bonarius
Consultant

Alun Stevens
Senior Consultant

12 September 2017

2. Background

2.1 Introduction

The Productivity Commission (PC) is currently undertaking the third stage of its review into efficiency in the superannuation market. The second stage examined alternative models for the allocation of default business in the superannuation market. This report has been commissioned by Industry Super Australia (ISA) to assist it in responding to the PC review. In it, we examine trends in member rollover and switching behaviour based on activity reported to APRA and a sample of exits in Rice Warner's *Superannuation Insights* study.

The report focuses on member flows in the superannuation system between products (including both default and choice products) split by members and by asset flows. We provide detailed explanation of the most used channels and examine the changes in investment returns and fees that the members would have experienced resulting from their movement between products.

2.2 The dataset

2.2.1 APRA Data

In addition to the Superannuation Insights data we have also examined statistics published by APRA. The APRA data provides a market wide benchmark that complements the depth of the Superannuation Insights data. We have examined the following sources for this report:

- **Annual Fund Level Superannuation Statistics** - this contains detailed profile and structure, financial performance and financial position, conditions of release, fees and membership information for APRA-regulated superannuation funds.
- **Quarterly MySuper Statistics** – this contains data on MySuper products. The report contains information on the product profile, product dashboard measures, asset allocation targets and ranges, investment performance, fees disclosed for MySuper products, or where relevant, for the lifecycle stages underlying MySuper products with a lifecycle investment strategy, and MySuper URLs.
- **Annual Superannuation Bulletin** – this contains statistics that provide policymakers, regulators, trustees and the community with information to assess the overall performance of the superannuation system.
- **Annual MySuper Statistics** – this contains detailed data for all MySuper products, and allows users to analyse APRA-regulated MySuper products across a range of measures.

2.2.2 Superannuation Insights

Superannuation Insights is a yearly data analysis project undertaken by Rice Warner which involves the collection of anonymised details for more than 10 million member accounts per annum. The database is the only one of its kind for superannuation members and supplements our other research in forming the basis for many of our insights into the superannuation market.

The data used to carry out the study is de-identified member data at 30 June in 2015, 2014 and 2013, which includes relevant data for members who exited the fund during the financial year. The data requirements are substantially aligned with the data used for benefit statements at the end of each financial year.

The data used for Superannuation Insights covers the following aspects of the market:

- Demographics
- Investments
- Contributions
- Insurance
- Fees
- Employers
- Pensions
- Exits.

The sample is drawn from a variety of large and small funds that represent all market sectors (industry, retail and some public sector and corporate funds).

This data allows us to provide detailed analysis across several key areas:

- Analysis of membership profile by different segments and comparison with the peer group.
- Quantifying and comparing differences between members across gender, ages and geographic area.
- Understanding inflows of funds from contributions and roll-ins.
- Investment strategy – participation in default strategies versus choice investments, and how choice members differ from default members.
- Insurance analysis – take up of cover and average levels of cover along with analysis of insurance needs.
- Employer analysis – including average number of employers, average employer size, distribution of employers.
- Pensions – demographic and behavioural analysis of pension members including investment decisions, drawdown rates and balance analysis.
- Exits analysis – identification of key areas of member leakage from funds in absolute terms and the dynamics of the exiting membership.

2.2.3 Caveats and limitations

Although the Superannuation Insights data is extremely detailed and represents a significant sample of the superannuation industry, there are the following limitations. Overall, the quality of the sample is determined by the participant funds and despite the large overall participation in the study, there is still a bias in the data we have collected. For instance, the sample is skewed by the largest funds in the study – AustralianSuper has 2 million member accounts of the total 10 million in the sample. Also, members who may currently be in smaller, high cost funds are less likely to be a part of the sample. Lastly, not all funds have provided consistent exit data which can be mapped year on year; some funds have only participated in some of the given years.

Data on fees and investment performance have been drawn separately from Rice Warner's Superannuation Product database.

Limitations on certain data points

- Fees are not known for members exiting to an employer sub-plan superannuation product where they might have received a discount. We have identified these movements separately in the fees analysis and provided our own estimate based on MySuper statistics published by APRA.
- The data sample for corporate funds is relatively small.
- Members with missing investment information (in the incumbent fund) were assumed to be in the default option.
- Investment selection in the successor fund is unknown, we have assumed members select a similar option to the incumbent (based on default status or asset allocation) so that comparisons are on a like-for-like basis.
- When mapping fees on a product level, data limitations meant that a subset of members who rolled over had to be omitted from the analysis.

Not all data was provided by all funds

Although every effort is made to collect all the appropriate member data for Superannuation Insights, some funds were unable to provide complete data sets. Whilst the core areas of Superannuation Insights, such as demographics, insurance and investment, are substantially complete, some funds have not provided all details for exited members, and are omitted from demographic analysis.

Incomplete longitudinal results

Longitudinal analysis requires new participants to provide previous years' data. In some cases, this has been a large administrative burden and the funds have not complied. Funds which have participated in earlier years have had their data automatically analysed longitudinally.

Unable to examine SMSFs

We have not undertaken any analysis of differences in fees or investments for members moving to an SMSF as data is not available.

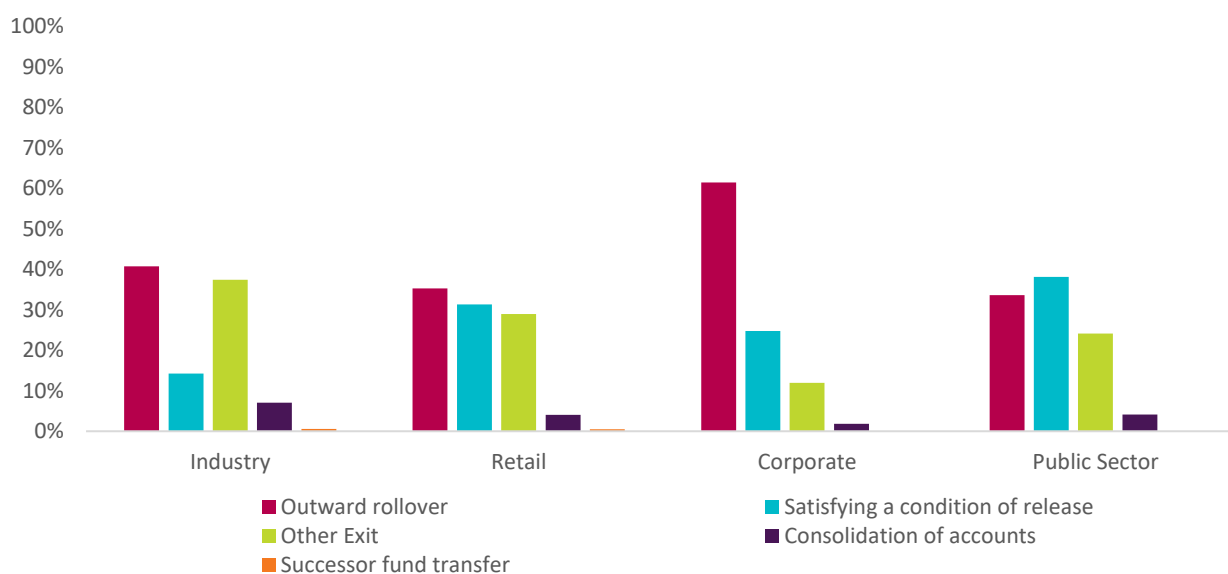
3. Member rollovers

3.1 Summary of APRA statistics

APRA statistics allow us to examine the overall composition of the market.

Graph 1 shows the percentage of member exits by type of exit. When examining the Superannuation Insights data, we focus on 'Outward rollovers' and other types of exit have been excluded.

Graph 1. Percentage of member exits by type - year to June 2016



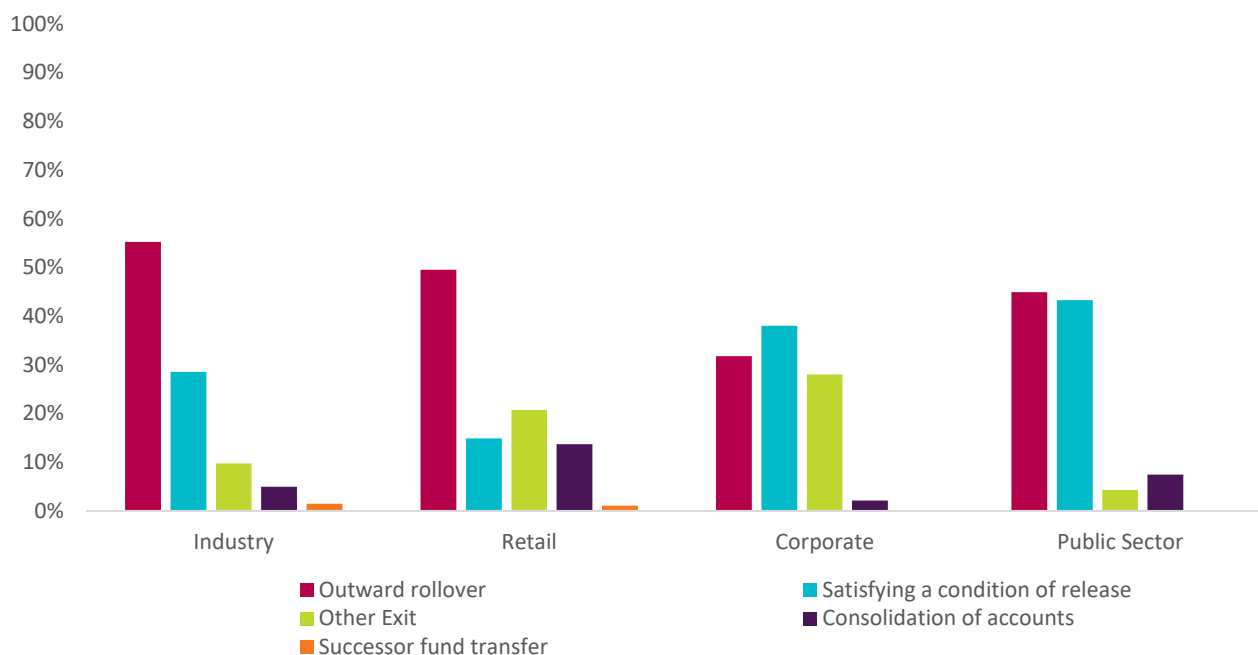
Source: APRA Fund Level Statistics.

Outward rollovers remain the biggest source of member exits across the industry, with the public sector as the exception, this is driven by demographics. Member growth in this segment is low and their population is aging, which explains why most member exits are as a result of satisfying a condition of release, which will primarily be retirement.

Other exits are not clearly defined by APRA in the reporting requirements, but likely include other forms of account closure such as zero balance closures and transfers to the ATO of lost superannuation.

Graph 2 shows the percentage of asset exits by type of exit.

Graph 2. Percentage of asset exits by type - year to June 2016



Source: APRA Fund Level Statistics.

Graph 3 shows the split of total industry assets between the four major APRA regulated sectors.

Graph 3. Total Assets – APRA Regulated Funds (\$,000)



Source: APRA Fund Level Statistics.

Industry and retail funds continue to dominate the landscape, albeit for different reasons. Corporate funds have continued to shrink and now represent less than 5% of assets. Market shares are useful to inform commentary on exits between sectors as larger sectors are likely to attract more rollovers simply due to the number of competitors and size of budgets for marketing and other activities.

Graph 4 shows the total number of member accounts for each sector between 30 June 2015 and 30 June 2016.

Graph 4. Total member accounts (excluding ERFs) 2015 - 2016



Source: APRA Fund Level Statistics.

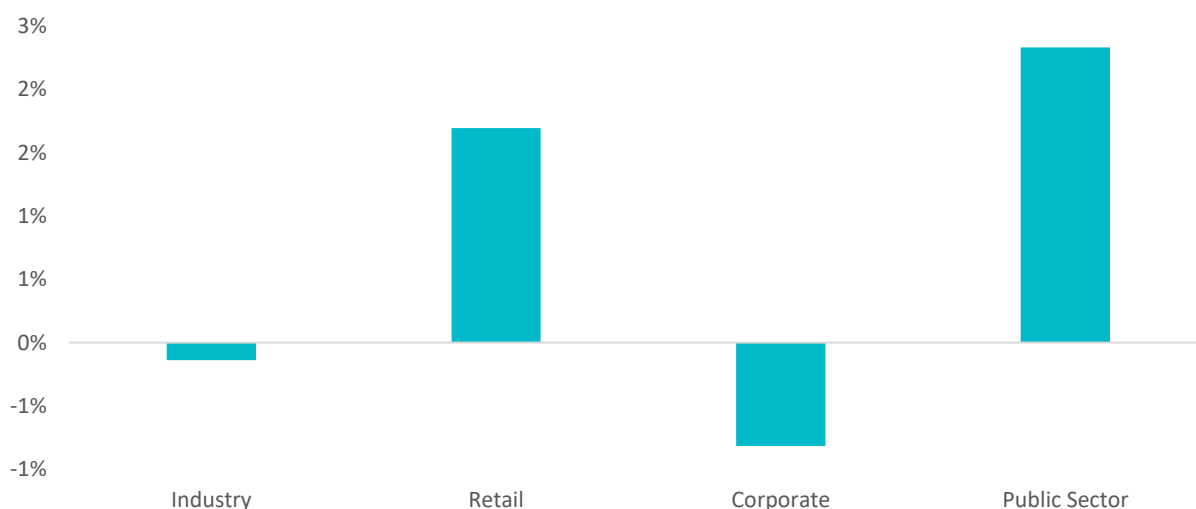
The number of superannuation accounts is falling for two reasons:

- Lost accounts with amounts below \$6,000 are now swept into the ATO, which attempts to find members so they can transfer the amounts into their active account.
- All superannuation funds run campaigns to encourage members to consolidate their accounts. Usually, members consolidate all inactive accounts into their current active account.

Over the year, only public sector funds experienced growth in the number of member accounts, but it was only 0.2%. The other three sectors all declined with retail experiencing the greatest reduction of 4.0%.

Graph 5 shows the net rollovers for each sector as a percentage of FUM in FY2016.

Graph 5. Net rollovers – APRA regulated Funds (\$'000)



Source: APRA Fund Level Statistics.

Unsurprisingly, corporate funds suffered the largest net rollouts for the year. As unengaged employees change jobs, they will often shift to the fund used by their new employer. As members develop an interest in their superannuation, they are more likely to maintain the same fund even when they change employer. This is less likely to occur if they leave a corporate fund.

Public sector funds had the highest inward net rollovers, with retail close behind. Industry funds experienced a small net outflow overall, largely due to the transfer of inactive accounts to the ATO.

Graph 6 shows the total outward rollovers by sector.

Graph 6. Total outward rollovers



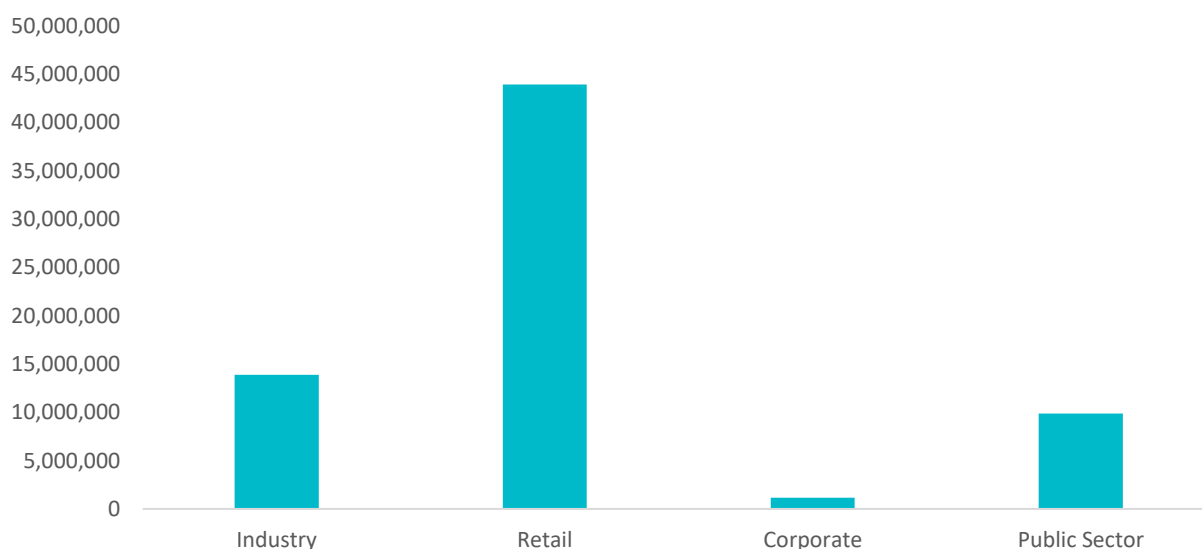
Source: APRA Fund Level Statistics.

Although the retail sector has positive net rollovers, it still has the largest outward rollover flows of the system, and greater than the combined outward rollovers of industry, corporate and public sector funds.

We note that retail funds have a more transactional relationship with their customer base which is driven by higher levels of choice and advice distribution channels. Not for profit funds seek to promote trustee management of investment and distribute products to a greater degree through wholesale channels and therefore may have a larger default membership base that may be less likely to change funds.

Graph 7 shows the total outward rollovers by sector.

Graph 7. Total inward rollovers by sector



Source: APRA Fund Level Statistics.

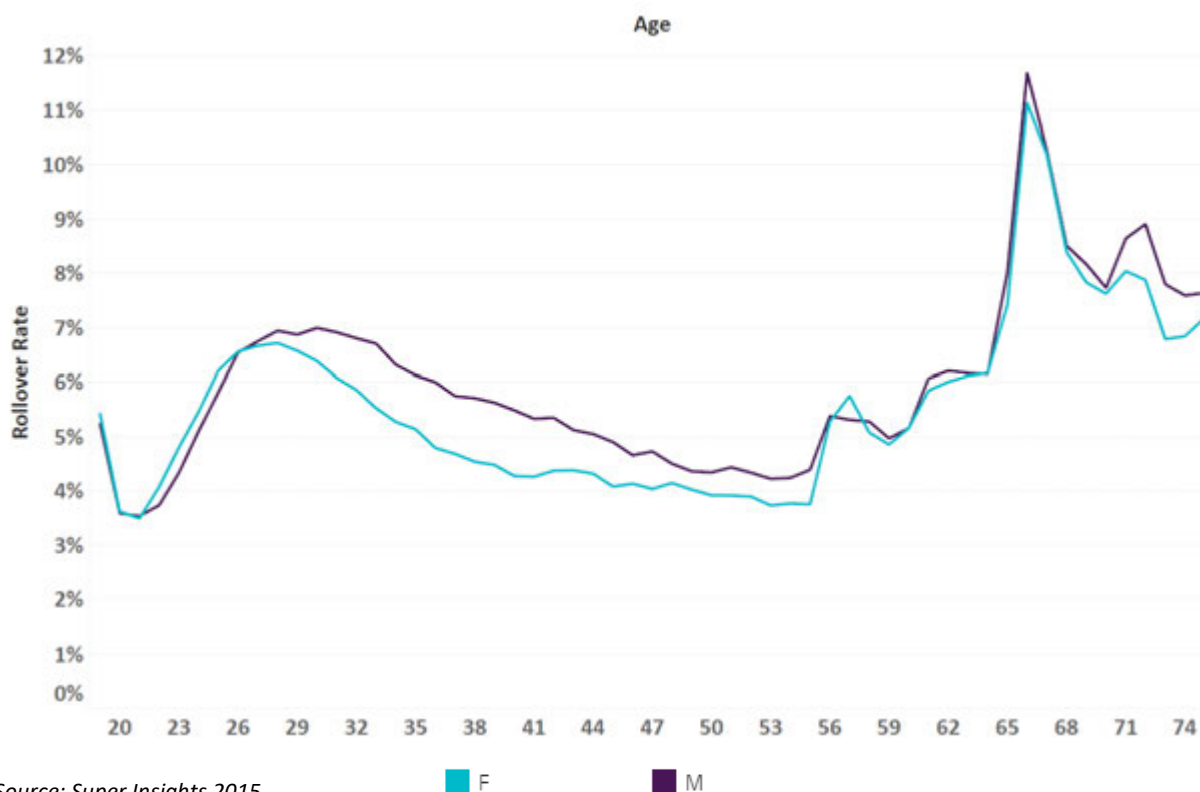
The retail sector has the largest inward rollovers of all the sectors. These are greater than the outflows for the retail sector. There is likely a lot of movement between funds within the retail sector. Corporate funds remain a relatively small part of inward rollovers, unsurprising due to the small size of this sector and the declining number of corporate funds. Public sector funds have much larger inward rollovers than outward, and industry funds have slightly lower inward rollovers than outward.

3.2 Demographic trends in member flows

The APRA data presented above provides context for the remainder of this report which is based on Rice Warner's *Superannuation Insights* exit data.

Graph 8 shows the proportion of members in each age group rolling over by gender.

Graph 8. Proportion of members rolling over by age and gender



Source: Super Insights 2015.

Superannuation members change their superannuation fund more frequently than they would change bank accounts. More than 5% of accounts are changed annually.

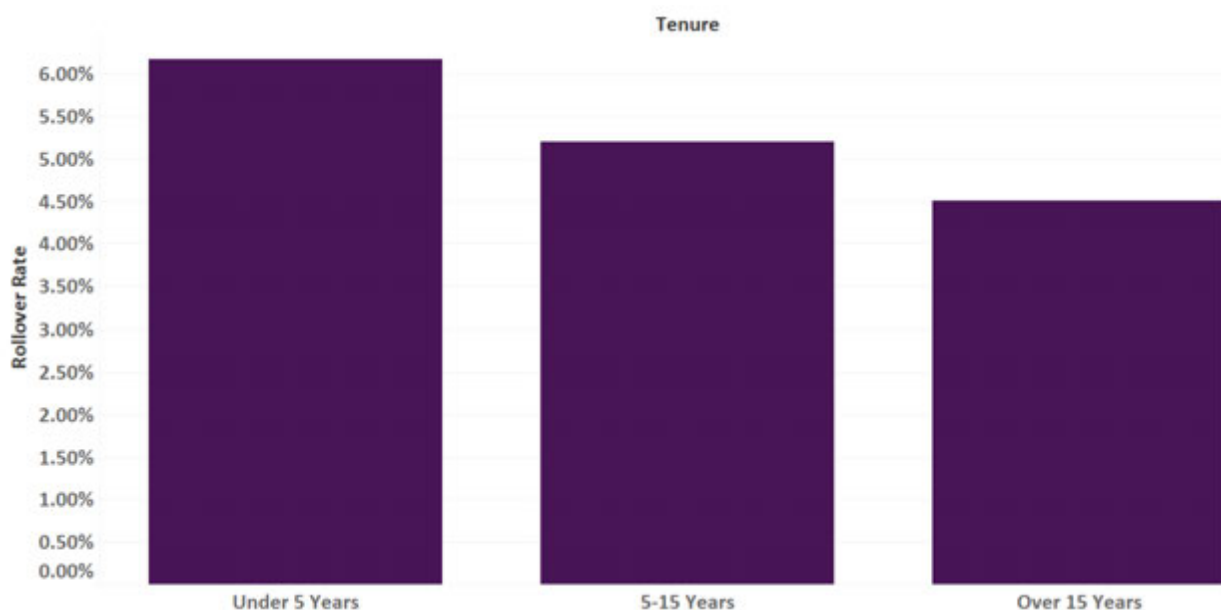
We note that males are more likely to rollover than females and this is consistent across the life-cycle. This is possibly a result of gender differences in workforce participation, rather than a gendered attitude to superannuation. The difference is most pronounced during the 30s where women are more likely to take time out of the workforce to raise children with some mothers never returning to work or waiting until their last children have finished school.

Rollover activity quickly ramps up between the ages of 20 and 30 as members begin to start their careers and move on from earlier jobs. We expect that this is at least partially driven by the movement of members into more stable, long term employment and other factors such as cross selling of products for example, at the point of taking out a mortgage. Male rollover activity continues to increase, peaking around age 30 before trending downwards. Females begin to trend down after approximately age 28. We expect that this is driven largely by lifestyle factors, such as starting a family.

Greater engagement with superannuation from age fifty-five is likely a result of members preparing for retirement (and accumulating larger balances). There is a spike for both females and males at age sixty-five, almost certainly the result of the consolidation of accounts and transfer into retirement products.

Graph 9 shows the proportion of members rolling over segmented by the amount of time they have spent at a fund.

Graph 9. Proportion of members rolling over by tenure at fund

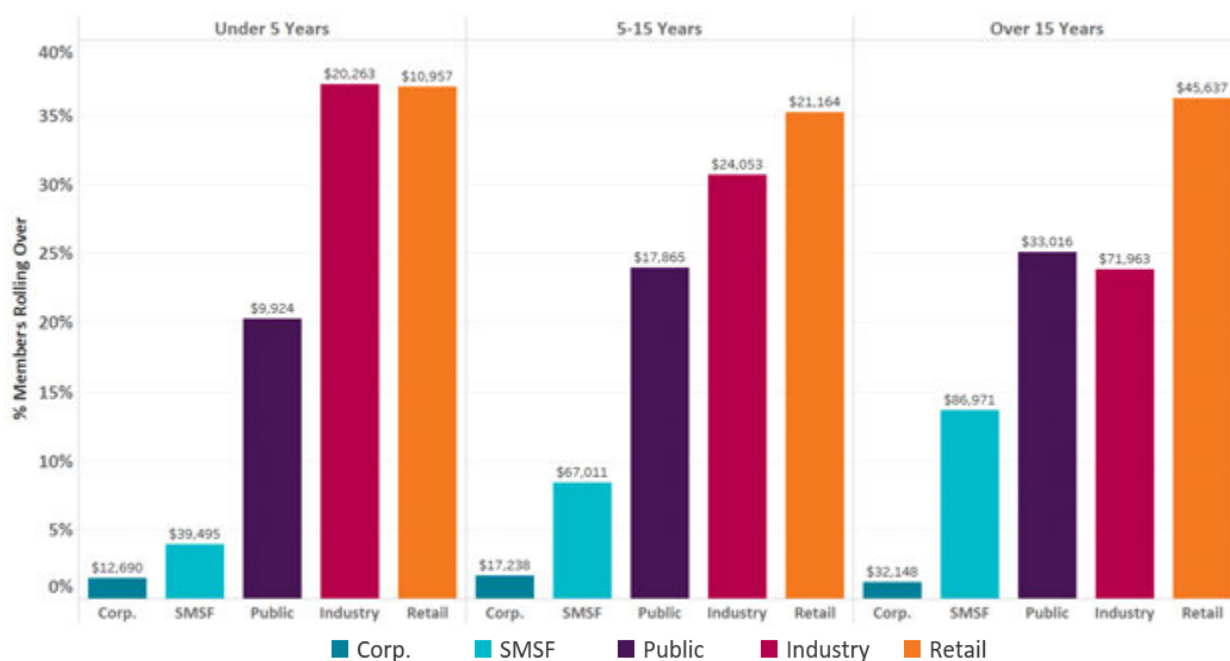


Source: Superannuation Insights 2015.

The rate of exit is negatively correlated with tenure, this is likely the result of survivorship bias. Many members who are comfortable with their fund will stay in it throughout their working life. Those who are unengaged are less likely to transition out of the fund.

Graph 10 shows the destination fund type for members by tenure.

Graph 10. Destination fund of members rolling out and average balance rolled over by tenure



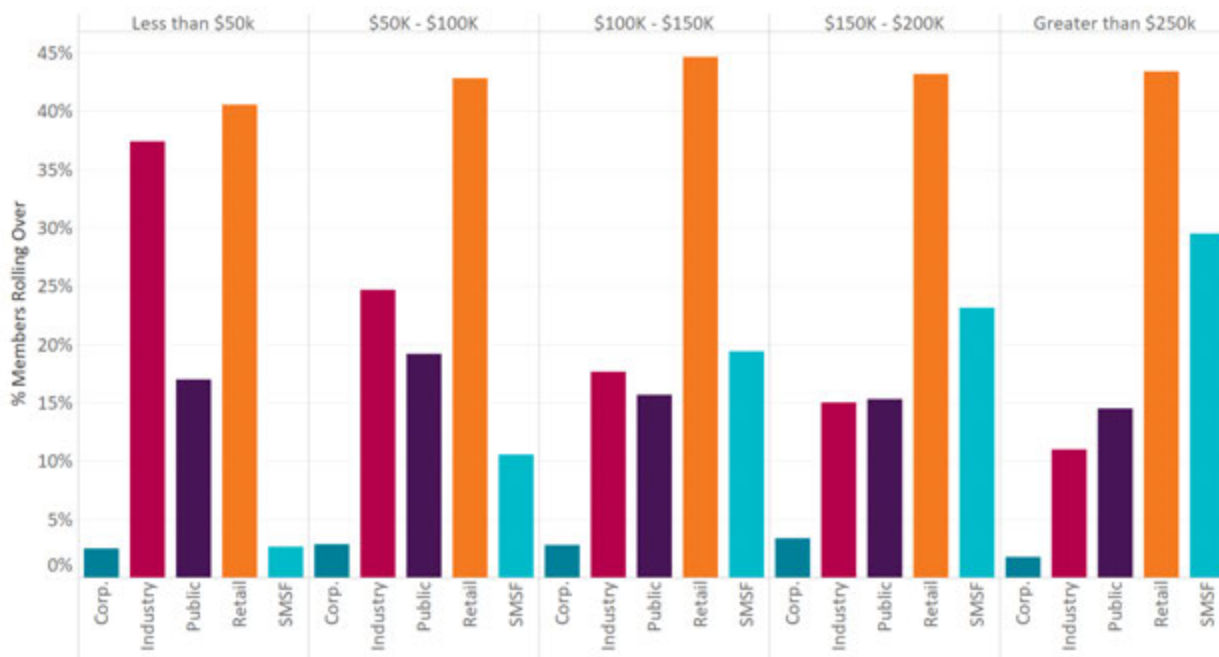
Value labels indicate average balanced rolled over, column height indicates the distribution of accounts by sector.

Source: Superannuation Insights 2015.

The largest balances at all durations go to SMSFs. However, more members go to retail funds. Retail funds maintain their share of member switches at higher tenures c. 35% of all exits, whereas industry funds have a lower share at higher tenures c. 25%. SMSFs and public sector funds have a greater share of rollovers at higher tenures.

Graph 11 shows the destination fund type for members by balance amount.

Graph 11. Destination fund of members rolling out by balance



Source: Superannuation Insights 2015.

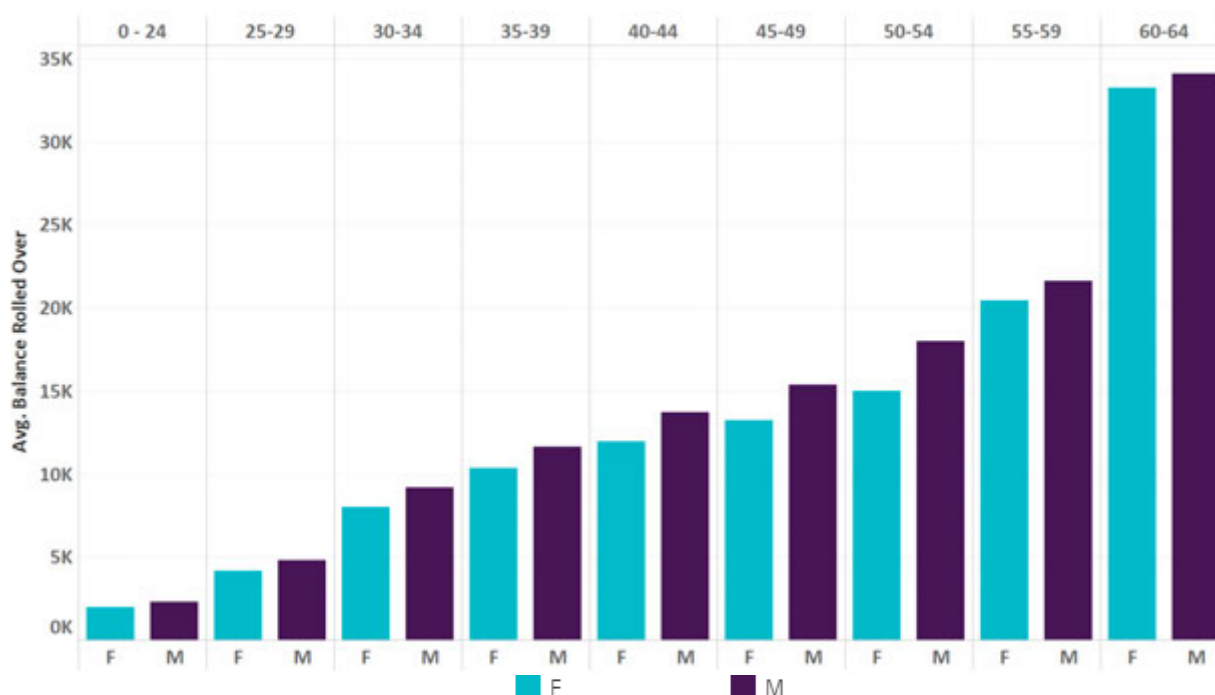
The retail sector has the greatest share of exits at all balances considered in Graph 11. As balance increases the retail sector's share of exits increases initially from 40% (at balances under \$50,000) to 45% (for balances over \$100,000). The proportion of members rolling into industry funds is highest for balances under \$50,000 at around 37% and falls to about 10% for balances of \$250,000. The probability of a switch being to a retail fund is roughly double that of industry funds for balances over \$100,000.

SMSFs are much more likely to be the source of rollovers for balances over \$250,000 where they represent 30% of exits. This makes sense given the large balance required to make an SMSF cost effective.

The rate of rollover to corporate and public sector funds remains relatively constant across balance bands.

Those members with tenure in a single fund above 15 years are also more likely to rollover to SMSFs or retail products (perhaps because of targeted financial advice programs) and are less likely to rollover to industry superannuation funds. Tenure has a clear positive correlation with age and balance, and the longest serving fund members are likely to be much older, partially explaining the bias towards SMSF arrangements.

Graph 12. Average rollover amount by age and gender



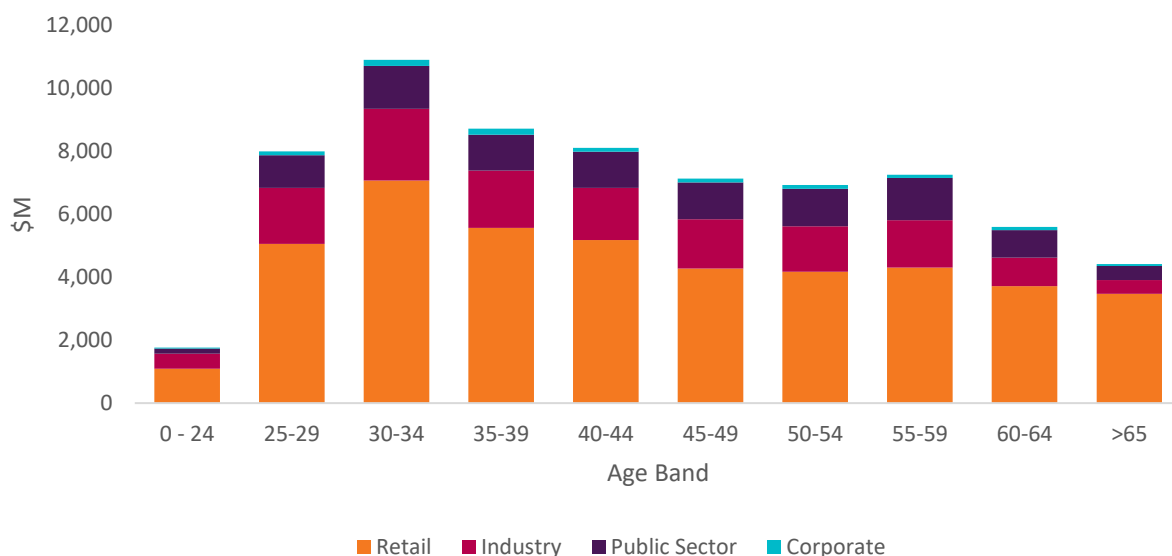
Source: Superannuation Insights 2015.

Overall the amount of money which is rolled out by members increases with age which is unsurprising. What is of interest is that the average rollover amounts are much lower than average account balances, implying that smaller accounts are being consolidated into larger accounts. Of further interest is that the gap between male and female rollover balances is smaller than the general gender gap in account balances. This is most likely a function of small lost inactive accounts being rolled over into the primary accounts and it is these that reflect the gender gap.

Graph 13 shows an estimate of total rollovers into each sector broken down by age, based on a combination of APRA and our own Superannuation Insights statistics. The totals by sector for Graph 13 are:

- Retail: \$44.7b
- Industry: \$12.5b
- Public Sector: \$3.8b
- Corporate: \$1.0b
- **Total: \$62.0b**

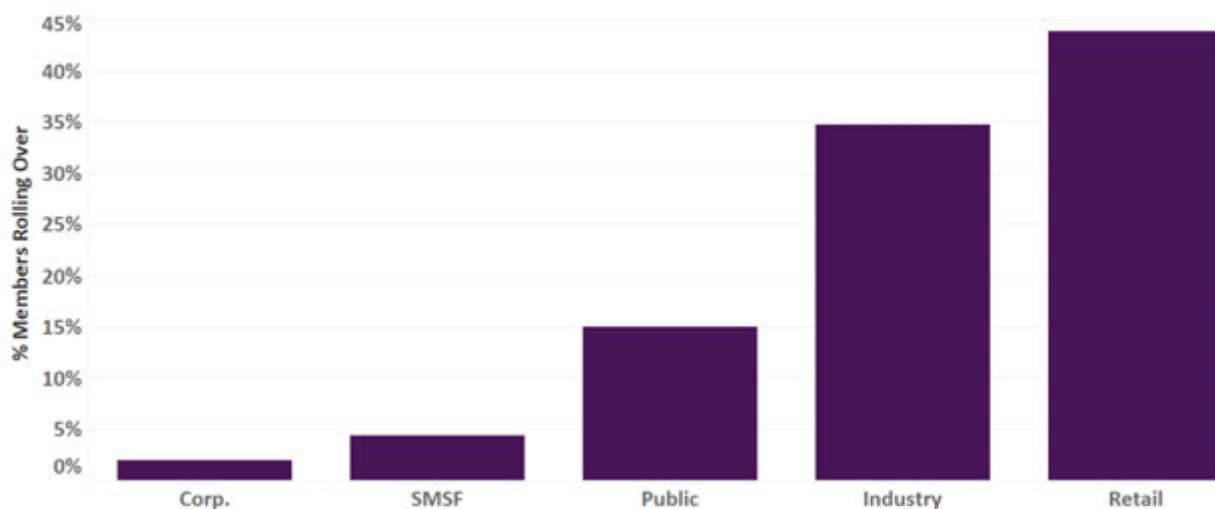
Graph 13. Estimated aggregate rollovers to sector by age by sector (excluding SMSFs) – year to June 2015



Source: Rice Warner estimate using APRA Fund Level Statistics and Superannuation Insights 2015.

The dollar value of rollovers to retail funds dominate at all ages. While the size of rollovers to industry funds remains relatively constant between ages 25 and 60, retail funds take a relatively larger proportion of rollovers above age 60.

Graph 14. Proportion of exits by rollover destination

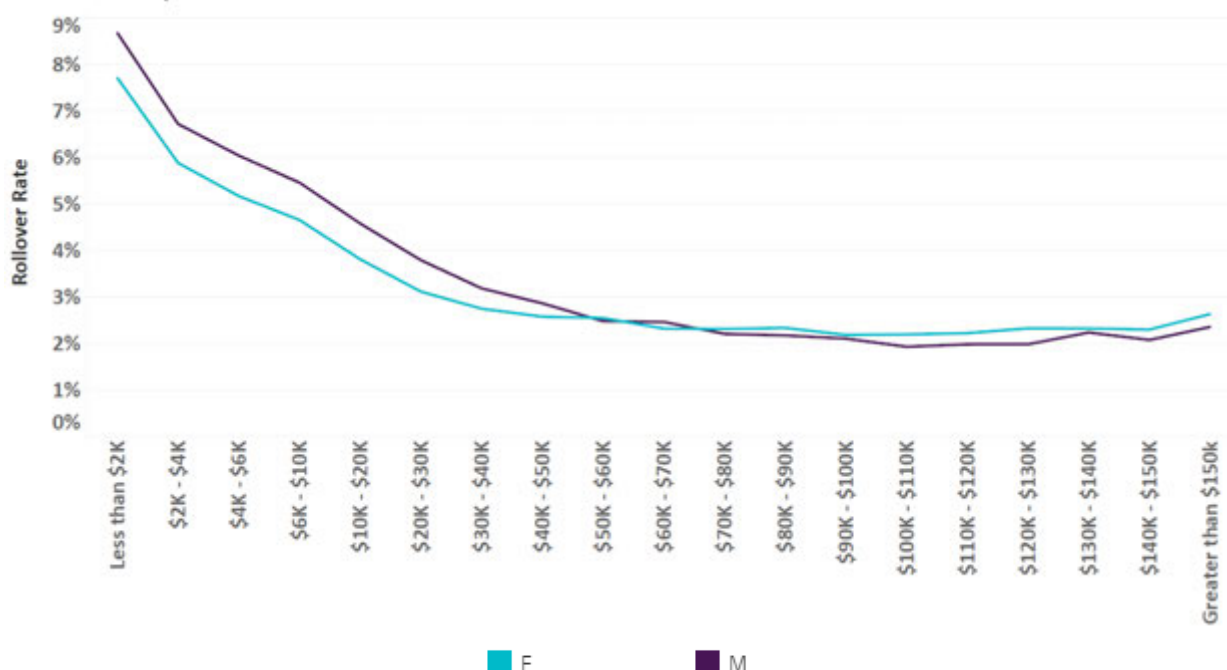


Source: Super Insights 2015.

Our destinations for exited members are consistent with APRA statistics. Retail funds are the primary destination for rollovers. The success of retail funds can be partially attributed to adviser distribution channels, the direct cross selling of superannuation products to customers of everyday banking and mortgage products under *share of wallet* initiatives and participation in the corporate outsourcing (wholesale) market.

Graph 15 shows the percentage of rollovers occurring in each balance band.

Graph 15. Percentage of rollovers by balance band



Source: Superannuation Insights 2015.

Smaller balance accounts generally form the bulk of rollovers. This is a function of consolidation activities of unneeded accounts or transfer of existing balances on a change of occupation.

3.3 Are members' switches based on fund outcomes?

The Productivity Commission is interested in whether members are being appropriately served by the superannuation industry in current default market structures. Member outcomes form the basis of the Commission's analysis into whether the superannuation market is efficient and competitive.

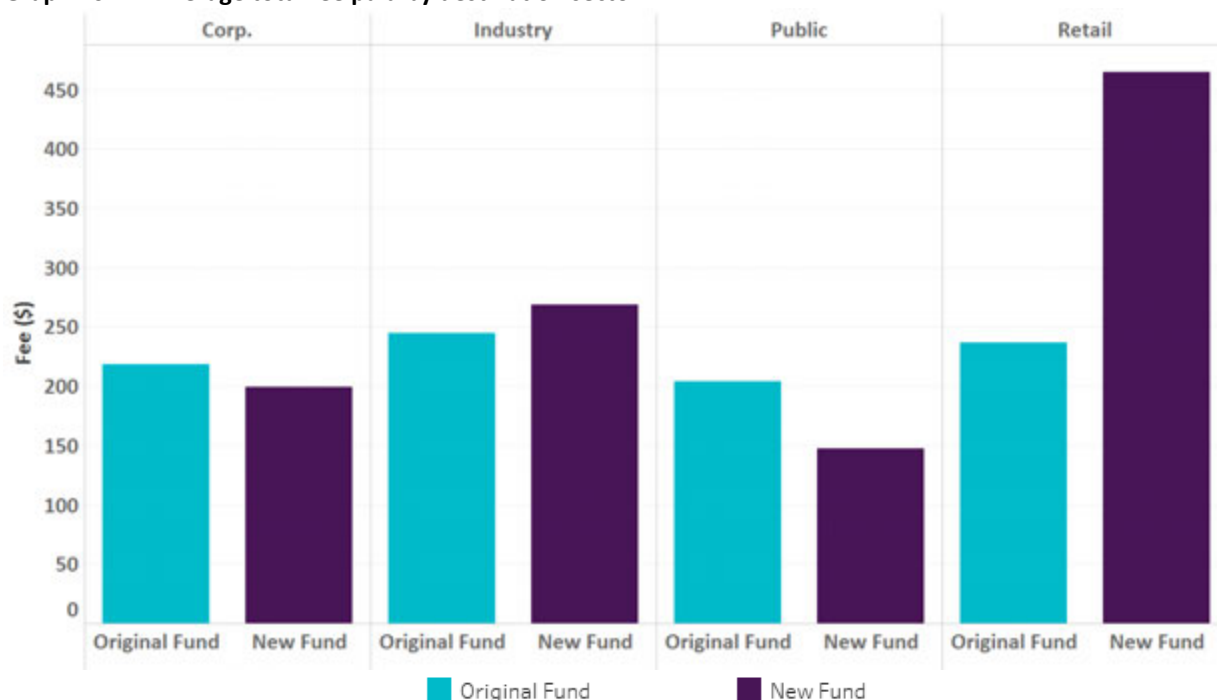
In an efficient market, it would be reasonable to expect that members would be motivated to seek out lower cost superannuation products or those that are likely to deliver higher returns based on their track record. In the context of member switches, we have compared fees and investment returns before and after member rollovers, to examine whether members make informed decisions to rollover to another fund based on these outcomes. We have not considered insurance, access to investment options or member services as part of this analysis, but given the primary purpose of the superannuation system to maximise people's retirement savings, this is a valid focus.

3.3.1 Fees

Fee levels across the industry have remained a focal point for consolidation and rollover campaigns for a long time. Members need to keep overall fee levels in mind and try to balance fees against the performance and services provided by a fund, due to their significant impact on retirement balances over time.

Graph 16 shows the average total fees paid by a member split by destination sector. The fees are shown both before and after the switch. Average total fees are comprised of a set dollar fee, an asset based administration fee and an asset based investment management fee.

Graph 16. Average total fee paid by destination sector



*Retail employer plans have been excluded from analysis as the level of discount provided is unknown. Hence the 'Retail' sector represents personal superannuation products only.

Source: *Superannuation Insights 2015*.

Based on the Insights data, the experience of members who rollover varies by destination sector. Overall new fund fees are lower in the public and corporate sectors driven mainly by their non-public offer status and employer fee subsidies. Fees are marginally higher in the industry fund sector, which are mostly public offer, and they are significantly higher in the retail.

Most notably, the increase in fees when switching to a retail fund is much higher than other destination sectors. On average, total annual fees double, increasing by approximately \$200 when switching to a retail (personal superannuation) fund. This is primarily due to the switches to retail in our sample which come mainly from not-for-profit funds.

Graph 17 shows the estimated aggregate increase in total fees for members who rolled over to funds with higher fees, and the estimated decrease in total fees for members who rolled over to funds with lower fees, based on APRA statistics and the Superannuation Insights sample, for the year ending 30 June 2015.

Graph 17. Aggregate increase and decrease in fees paid by sector \$M – 30 June 2015



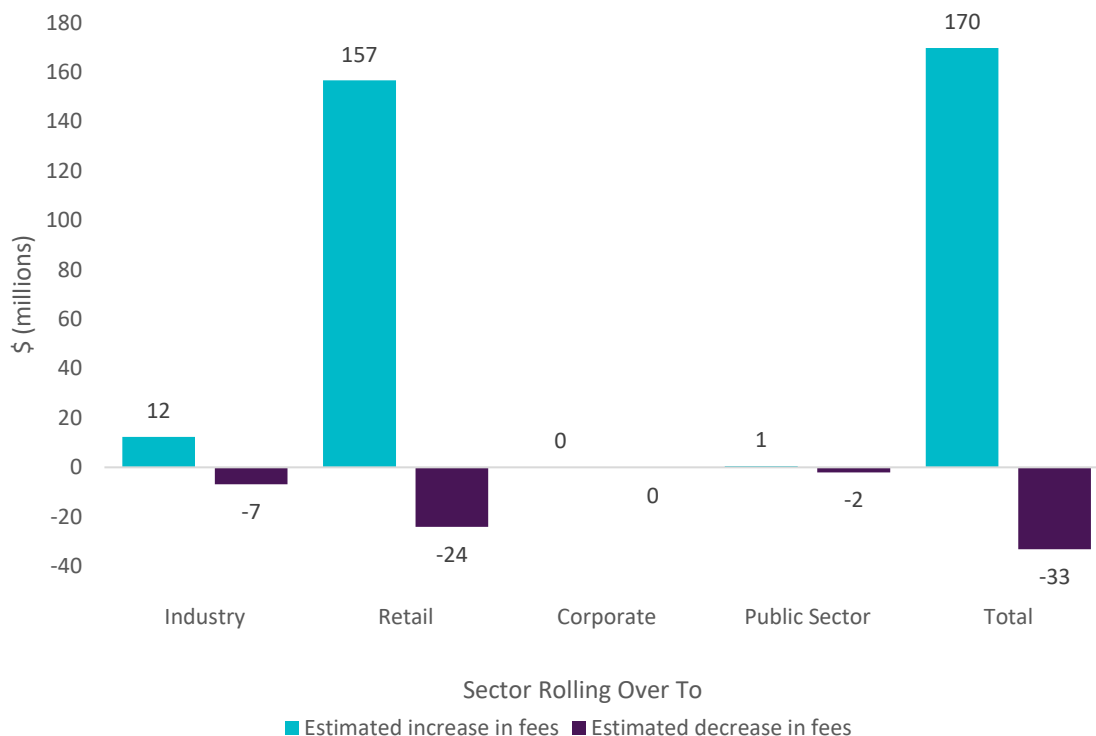
**Retail fee decreases do not include the decreases from rolling over into Retail Corporate Plans, due to the practice of providing discounts to PDS rates.*

Source: Rice Warner estimate using APRA Fund Level Statistics and Superannuation Insights 2015.

Members rolling into industry funds paid an estimated \$12 million more in fees with savings of approximately \$7 million for those who moved into funds charging lower fees. The higher fees for those switching to industry funds may be explained by the Superannuation Insights sample being dominated by larger (lower cost) industry funds reporting their exits to smaller (slightly higher cost) industry funds. Members rolling into retail funds paid an estimated \$154 million more in fees with savings of approximately \$5 million for those who moved into funds charging lower fees, though this estimate excludes potential cost savings that members may have experienced when moving into a corporate superannuation plan with a retail provider.

Graph 18 shows the aggregate increases and decreases in fees including employer sub-plan discount estimates (methodology detailed on the next page). We can see a slight adjustment in the retail numbers, with an estimated \$157 million more in fees, and savings of approximately \$24 million for those moving into funds charging lower fees. This is a net increase in fees of \$133 million for those members rolling over into retail funds.

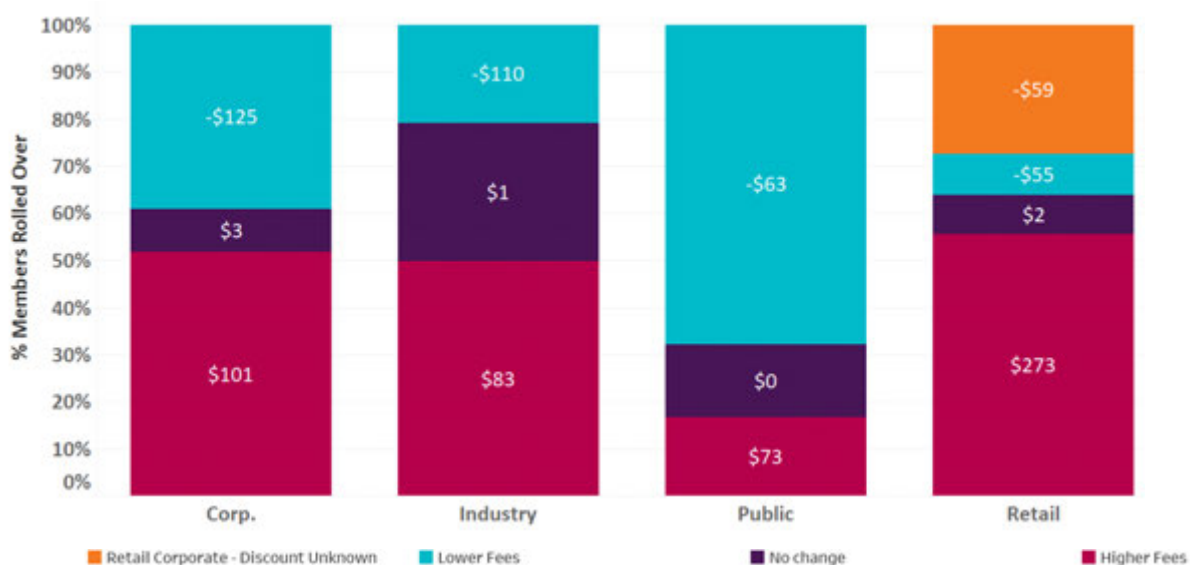
Graph 18. Aggregate increase and decrease in fees paid by sector \$M (including employer sub-plan discount estimates) – 30 June 2015



Source: Rice Warner estimate using APRA Fund Level Statistics and Superannuation Insights 2015.

Graph 19 shows the member outcomes of rolling over to different sectors in terms of the percentage of members who received an increase, decrease or no significant change in fees.

Graph 19. Member outcome of rollover



Note: the dollar labels indicate the average change in fees for each group of members.

Source: Superannuation Insights 2015.

When rolling over to an industry fund, approximately half of members either experienced a drop in fees or no effective change in fees (\$10 either way). For those rolling over to industry funds and realising a saving in fees, the average saving was \$110. In contrast, the average saving for those rolling over into retail funds (not including corporate plans) was \$55. The equivalent figure for corporate sub plans is estimated as \$59. Conversely, for those rolling over to industry funds with higher fees, the average increase was \$83, compared to an average increase of \$273 for those rolling into retail funds.

Of rollovers to retail funds 27% of the rollovers were to corporate plans where the fees are unknown due to the practice of providing discounts to PDS rates. For those rollovers where fees are known, members did not fare as well with just 9% of total members who rolled over to retail funds experiencing lower fees.

Table 1 shows the proportion of members who paid lower fees, split by the sector rolled over from and to, while Table 2 shows the proportion of members who paid higher fees.

Table 1. % of members paying lower fees by sector

From	Industry	Retail	Grand Total
To	(%)		
Corporate	39	57	39
Industry	18	78	21
Public Sector	67	94	68
Retail	7	22	9
Grand Total	19	51	20

Source: Superannuation Insights 2015.

Table 2. % of members paying higher fees by sector

From	Industry	Retail	Grand Total
To	(%)		
Corporate	53	26	52
Industry	52	6	50
Public Sector	17	3	17
Retail	57	23	54
Grand Total	51	14	49

Source: Superannuation Insights 2015.

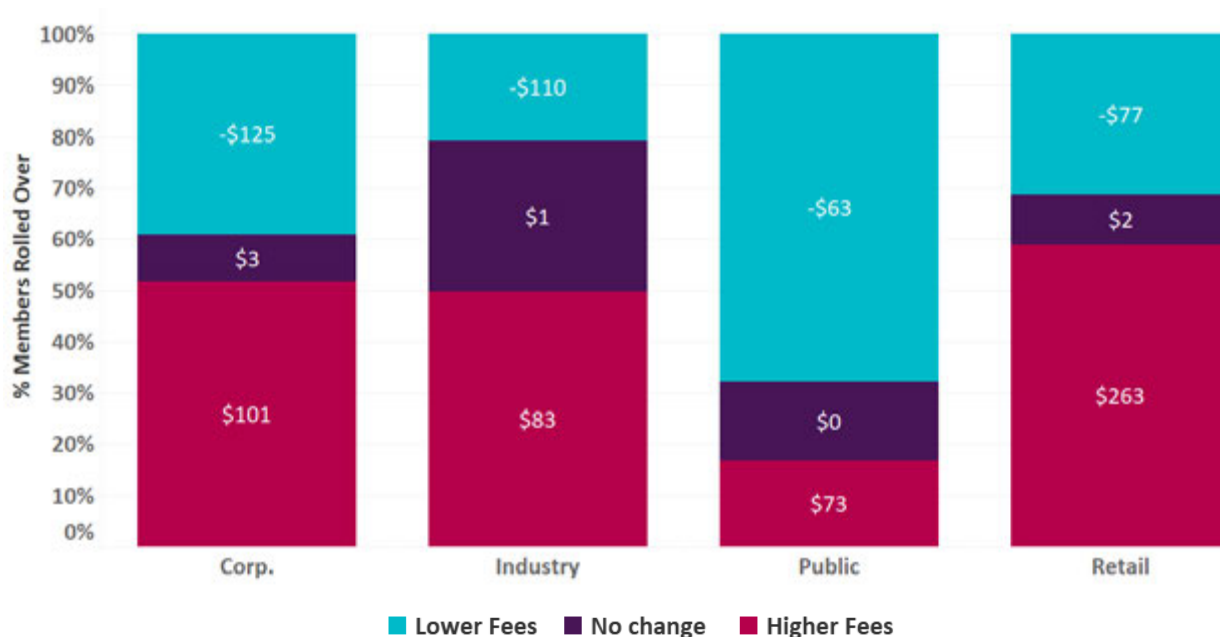
From Tables 1 and 2, we can see that 19% of members rolling out of industry funds move into funds that charge lower fees, while 51% move into funds that charge higher fees. Conversely, 51% of members rolling out of retail funds move into funds that charge lower fees, while 14% move into funds that charge higher fees.

Further, 21% of members rolling into industry funds pay lower fees, against 50% of members paying higher fees. For members rolling into Retail funds, only 9% of members pay lower fees, while 54% of members rolling into retail funds pay higher fees.

By making use of APRA MySuper Statistics, an estimate for those in employer sub-plans can be obtained. We have compared these estimates against our own experience in running tenders for corporate superannuation business. The level of discount varies by provider, but our estimated discount on average was 33% of total fees.

We have applied the average level for sub-plans for which data was not included in the MySuper statistics. Using this methodology, we have estimated that approximately 80% of members rolling over into an employer sub-plan experience a reduction in fees.

Graph 20. Member outcome of rollover (with estimated corporate plan fee discount)



Source: Superannuation Insights 2015.

3.3.2 Investment Returns

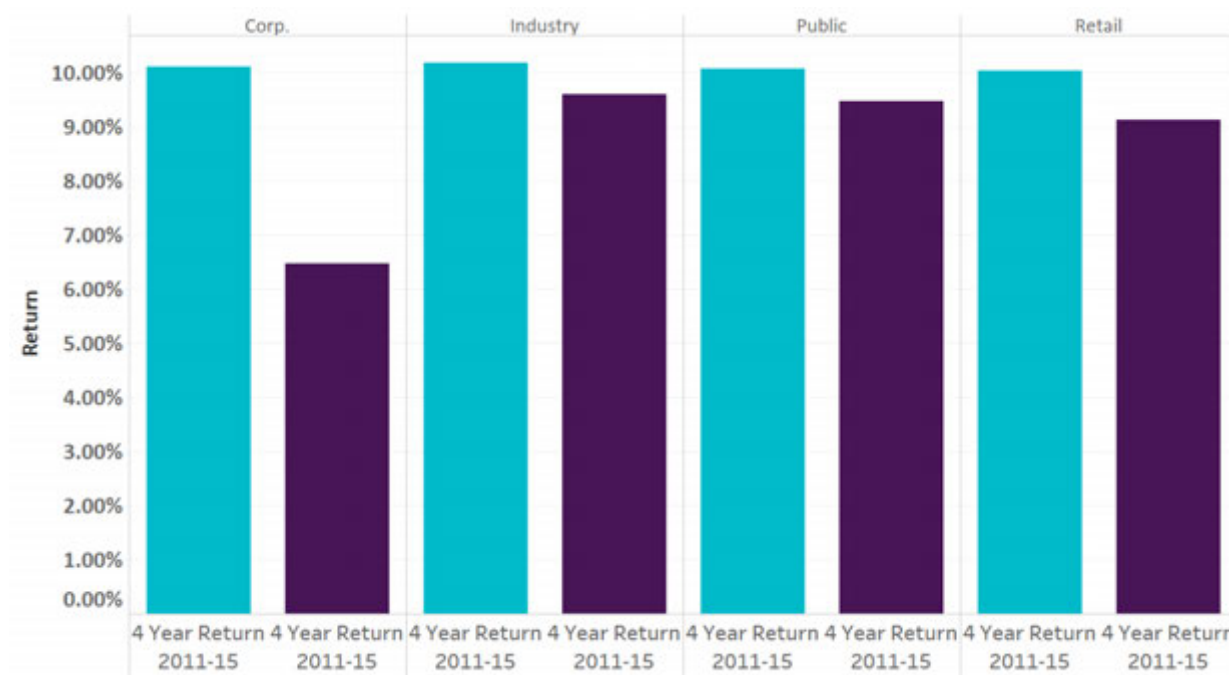
Fund investment performance is another major factor which dictates member outcomes. There have been suggestions that members should switch to high performing funds to maximise their outcomes. While we note that past performance is not a guide to future performance, we do know that funds which perform consistently well over the long-term tend to have robust governance and strong asset allocation. In these cases, they are more likely to perform well in the future relative to their peers.

We expect that many members would use past performance as a proxy to guide their switching decisions.

Although we are unable to predict the investment returns of funds in the future, we can compare how members would have fared based on historical returns.

Graph 21 illustrates the average investment returns for both the incumbent and successor funds where the performance was lower for the successor fund, split by destination sector.

Graph 21. Difference in historical returns for those members moving to a fund with lower 4y returns



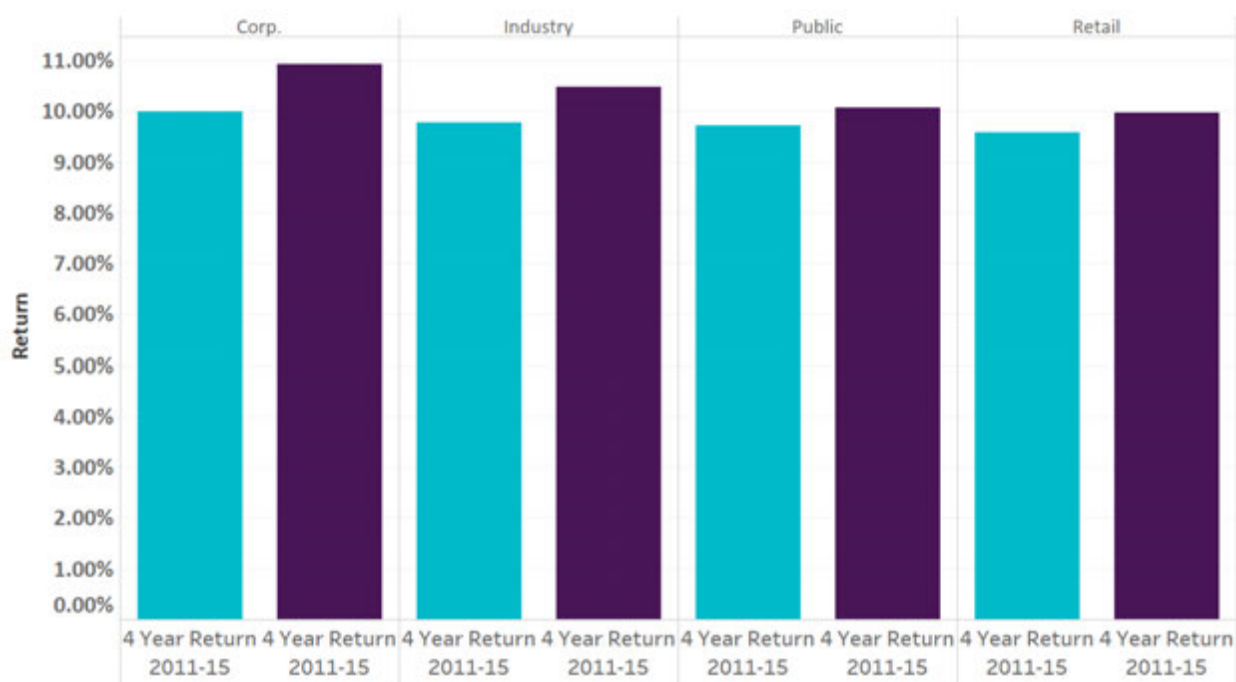
**Light blue represents the members' original fund and dark blue represents the fund rolled over to.*

Source: Superannuation Insights 2015.

This analysis is based on four-year annualised returns to 30 June 2015. The average historical performance for those rolling over to industry and public sector funds was approximately 0.5% p.a. lower than in the incumbent fund, whilst the equivalent figure for those rolling into retail funds was approximately 1% p.a. lower. Although this period is too short to conclude that these differences in results would continue, it does show that many members who switched have not done well in the period following the switch.

Graph 22 illustrates the average investment returns for both the incumbent and successor funds where the performance was higher with the successor fund, split by destination sector.

Graph 22. Difference in historical returns for those members moving to a fund with higher 4y returns



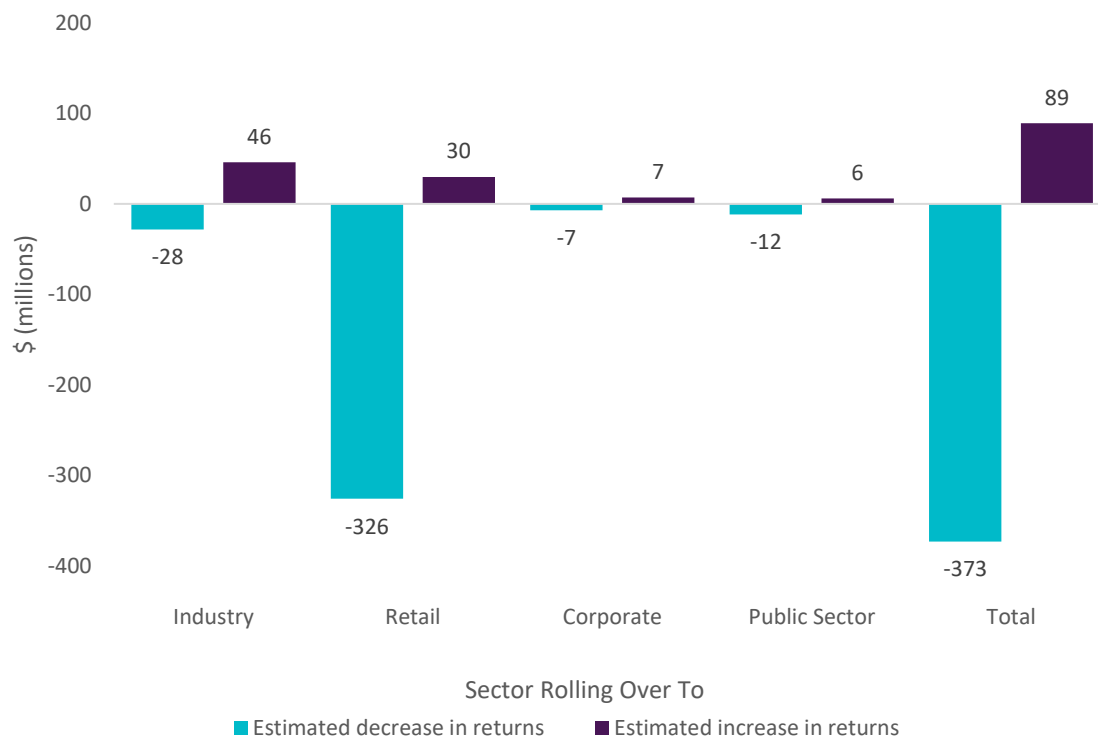
**Light blue represents the members' original fund and purple represents the fund rolled over to.*

Source: Superannuation Insights 2015.

The average historical performance for those rolling over to industry funds was approximately 0.7% p.a. higher than in the incumbent fund, whilst the equivalent figure for those rolling into retail funds was approximately 0.4% p.a. higher.

Graph 23 shows the estimated aggregate increase in four year investment returns for members that rolled over to funds with higher returns, and the estimated decrease in four year investment returns for members that rolled over to funds with lower returns, based on APRA statistics and the Superannuation Insights sample, for the year ending 30 June 2015.

**Graph 23. Aggregate annualised impact on member balances of differential returns by sector (\$M)
June 2015**



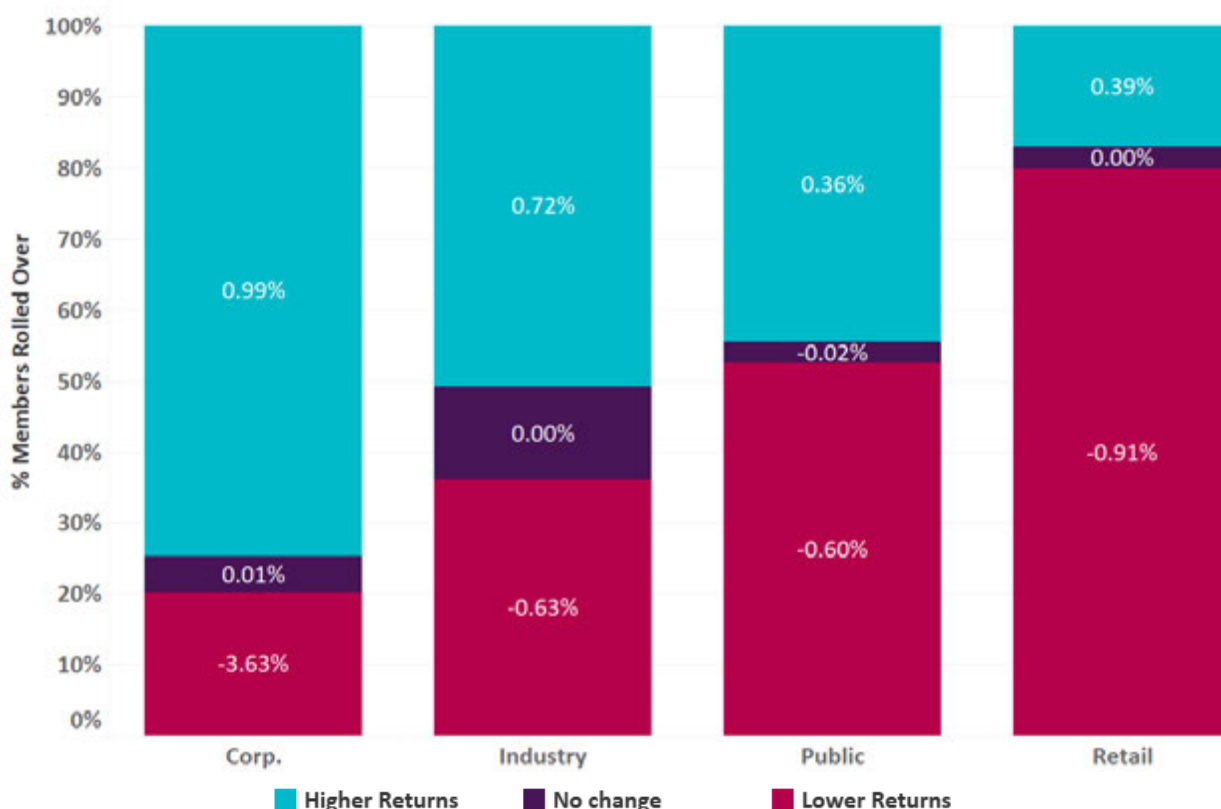
Source: Rice Warner estimate using APRA Fund Level Statistics and Superannuation Insights 2015.

Members rolling into industry funds would have received an estimated annualised increase in returns of \$46 million, against an estimated decrease in returns of \$28 million when moving into funds with weaker performance. Members rolling into retail funds would have received an estimated annualised increase in returns of \$30 million, against an estimated decrease in returns of \$326 million when moving into funds with weaker performance. This is a net decrease in annual investment returns of \$296 million for those members rolling over into retail funds.

Note these estimates are based on historical performance applied to switching assets from APRA at 30 June 2015.

Graph 24 illustrates the proportion of member rollovers that are had better past performance split by sector. The comparisons are based on four- year investment performance to 30 June 2015.

Graph 24. Historical investment returns for exited members by destination sector



Source: Superannuation Insights 2015.

A change in investment performance of less than 5bps was included in the 'no change' category for this graph. Note that we have assumed the member invested in a similar option on switching to the new fund though it is likely that many members did choose a different investment strategy.

We note that 51% of members switching to an industry fund had a historically higher four-year investment return outcome, whilst 17% of members switching to a retail fund had historically higher investment returns.

Table 3 shows the proportion of members who moved to a fund with higher four year returns after rolling over, split by the sector rolled over from and to.

Table 3. % of members achieving higher returns by sector

From	Industry	Retail	Grand Total
To	(%)		
Corporate	74	80	75
Industry	52	23	51
Public Sector	46	*	45
Retail	17	13	17
Grand Total	37	17	36

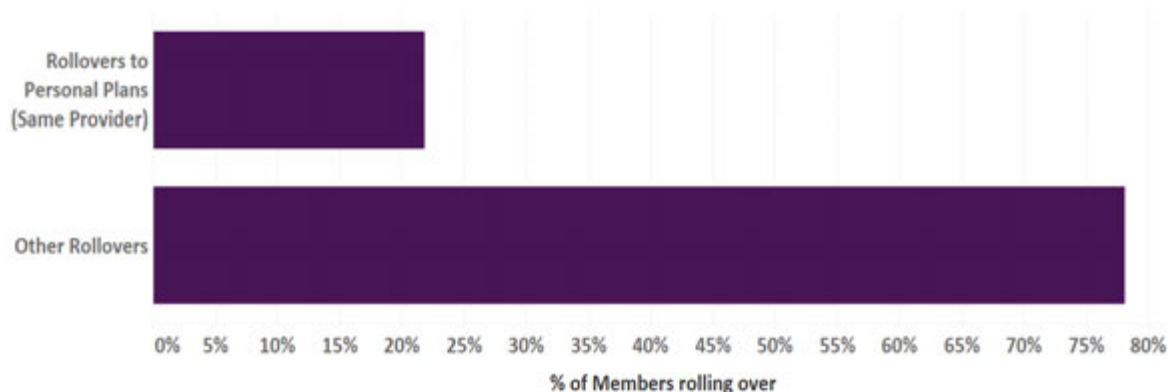
*Data is unavailable.

Source: Superannuation Insights 2015.

3.3.3 Transfers from Corporate to Personal Superannuation

Of exits from retail funds, we observed a 22% rate of flips from retail employer plans to personal plans. This rate is an indicator of the level of default business that converts to Choice each year relative to total rollovers.

Graph 25. Retail flipping rate – Superannuation Insights sample

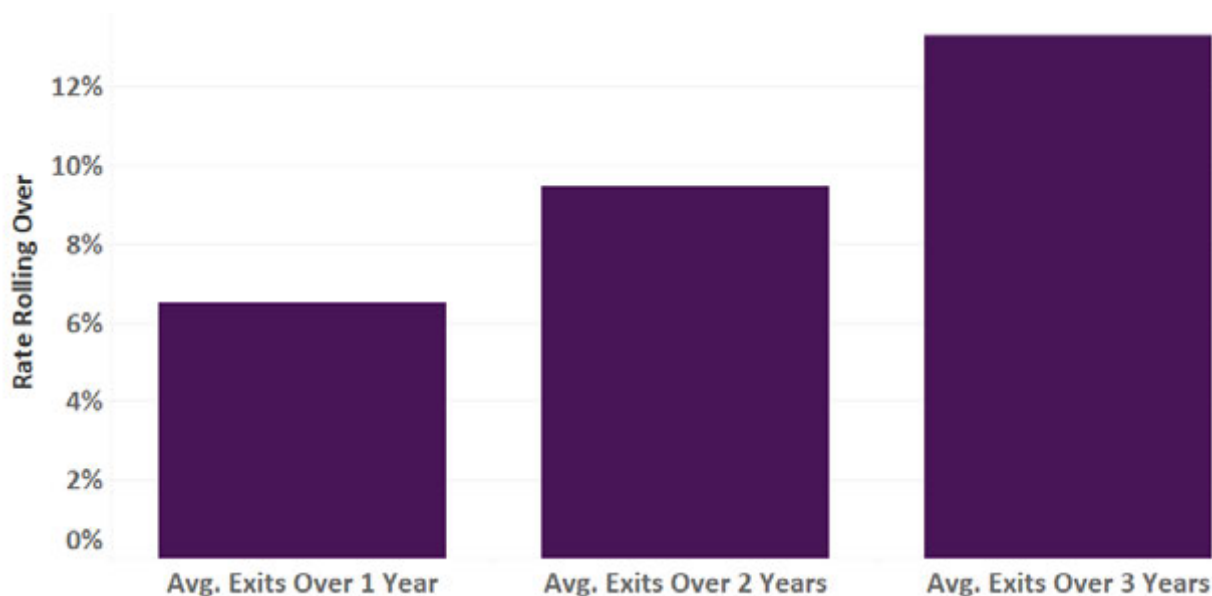


Source: Superannuation Insights 2015.

3.4 Cumulative rate of exit

We have further analysed what the cumulative rate of exit is for members over a period of three years by controlling the population at the start of 2013 and observing those members who left over a three year period (where data is available). From this analysis, we find that the probability of a member leaving a fund over a three year period is approximately 13%.

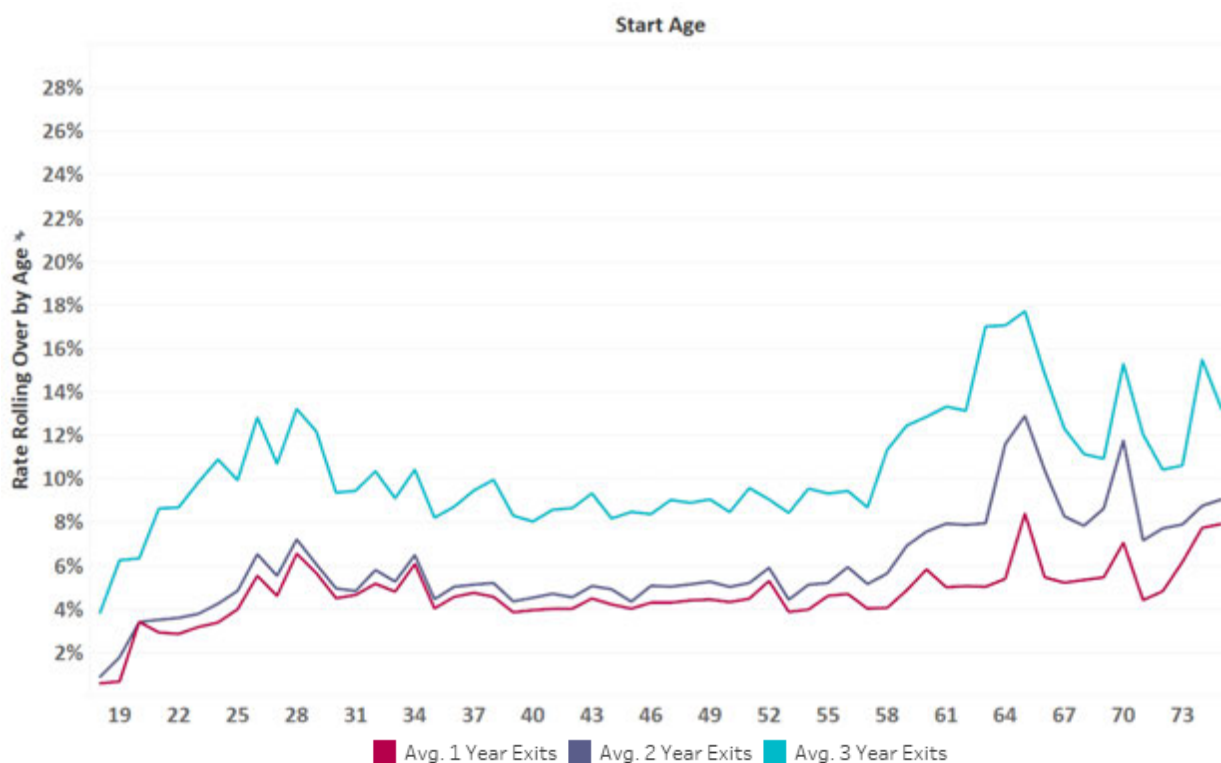
Graph 26. Cumulative rate of exit – 3 years



Source: Superannuation Insights 2015.

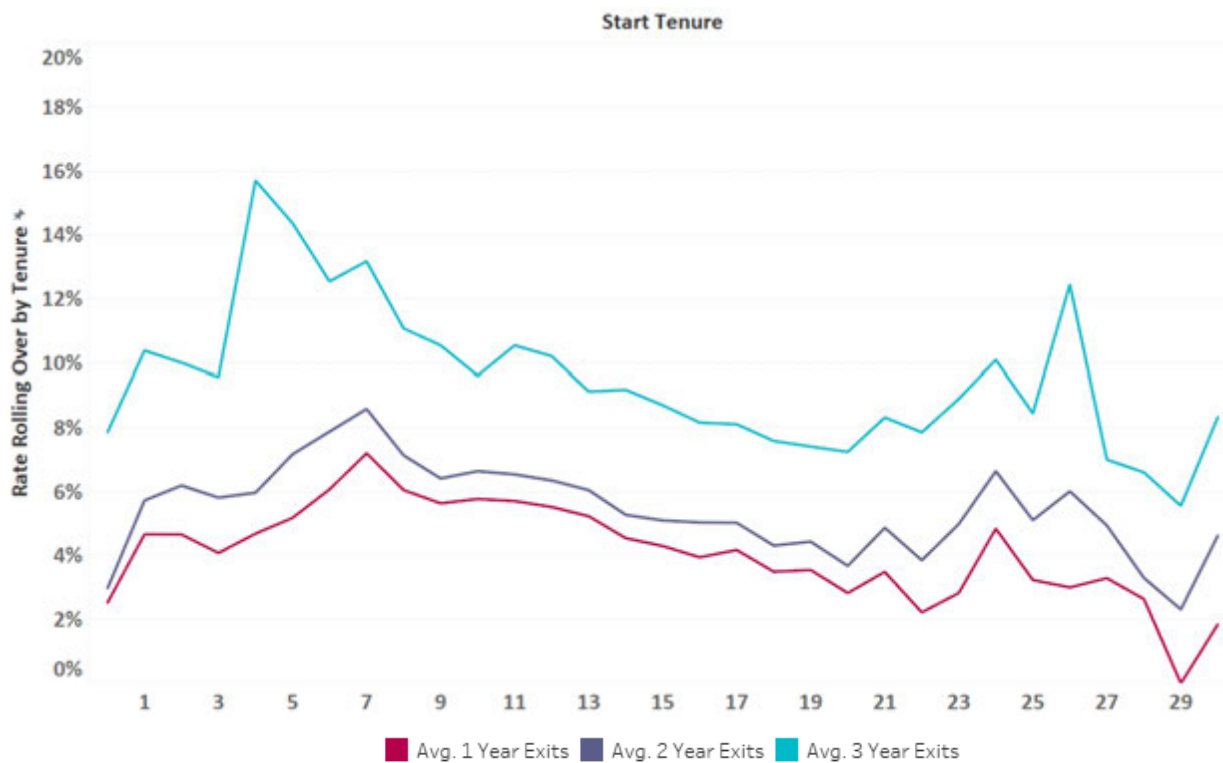
Graph 27 and Graph 28 show the cumulative rate of exit by age and tenure respectively.

Graph 27. Cumulative Exit probability by age over 1, 2 and 3 years



Source: Super Insights 2015

Graph 28. Cumulative Exit probability by tenure over 1, 2 and 3 years



Source: Super Insights 2015