



# Reducing Retirement Income Costs

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# ● ● ● | Reducing Retirement Income Costs

*"When I was young I thought money was the most important thing in life; now that I'm old - I know it is!"*



*Oscar Wilde*



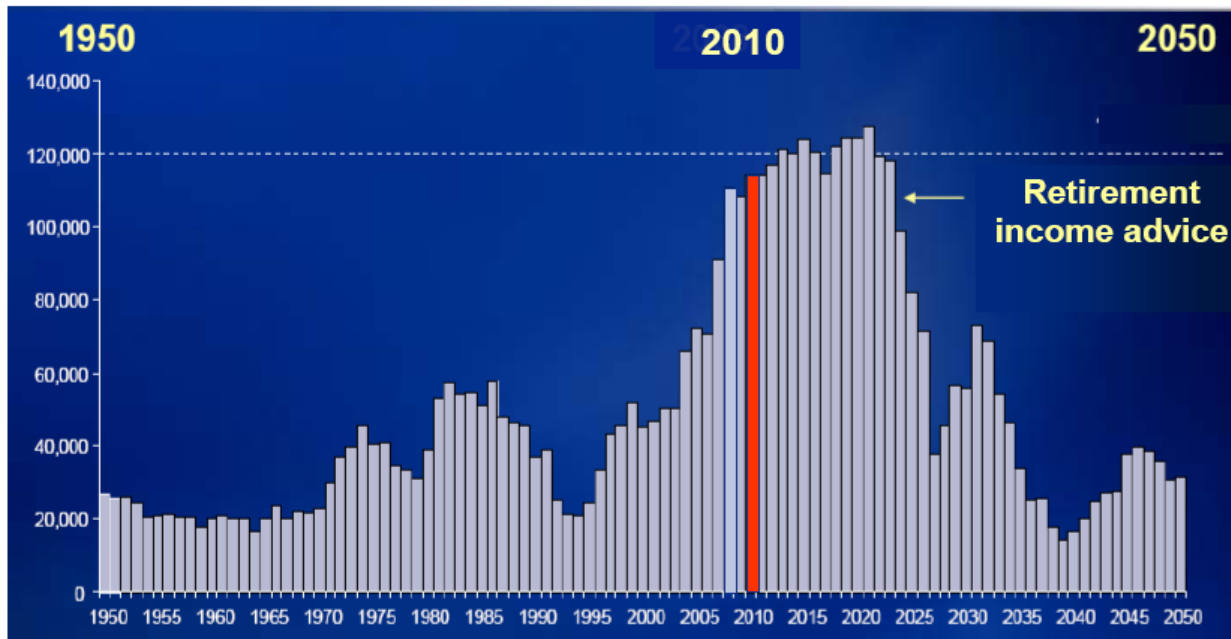
# We'll cover Retirement Income (RI)

- ▼ Set the post retirement scene
- ▼ Pressure to reduce costs
  - Government, Competition, Consumer expectations
- ▼ What are the costs? Where?
- ▼ Top 5 cost issues and drivers
- ▼ Cost reduction strategies
- ▼ Targeting a minimal cost framework
- ▼ Conclusions & recommendations

# Retirement demographics

## The reality of post-retirement needs

Increase in population over age 60



Net change in population (60-79) over 100 years in Australia

Source: Jim DeCarlo AXA

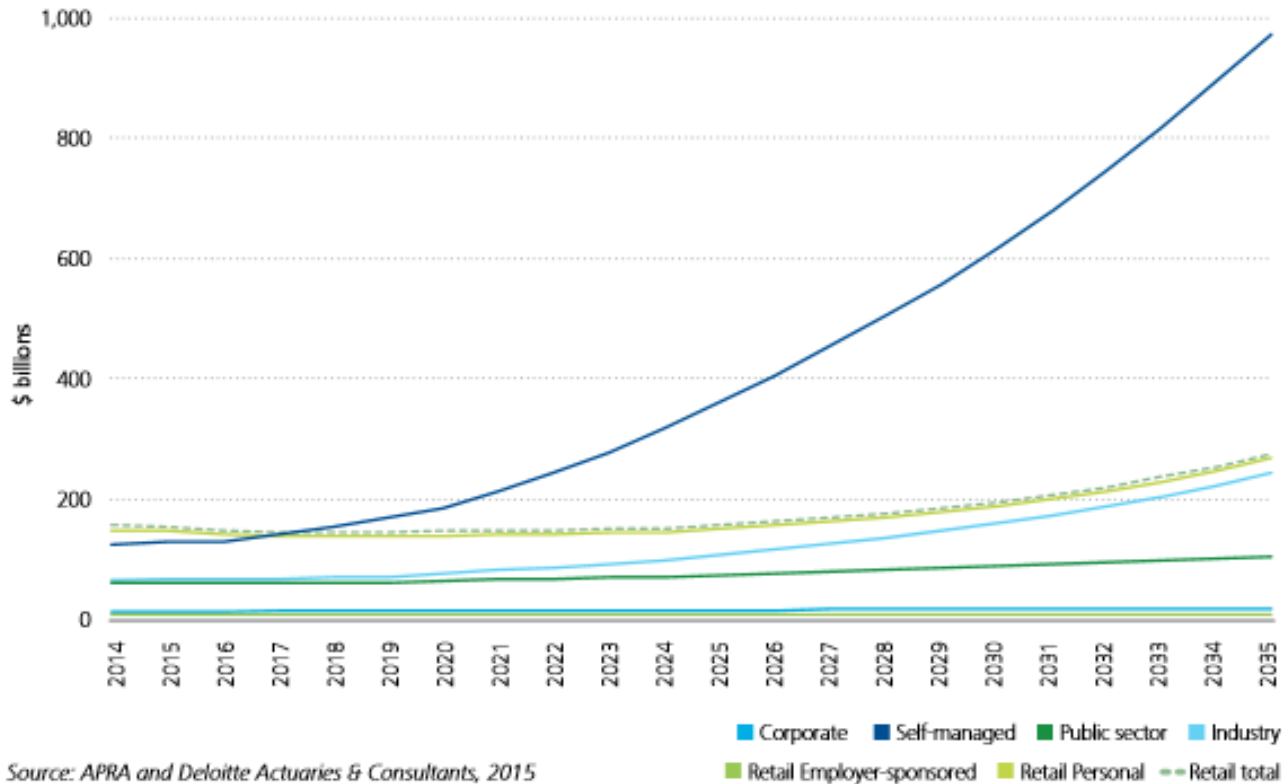


redefining / financial services

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# Retirement financials

Figure 10: Post-retirement assets by market segment

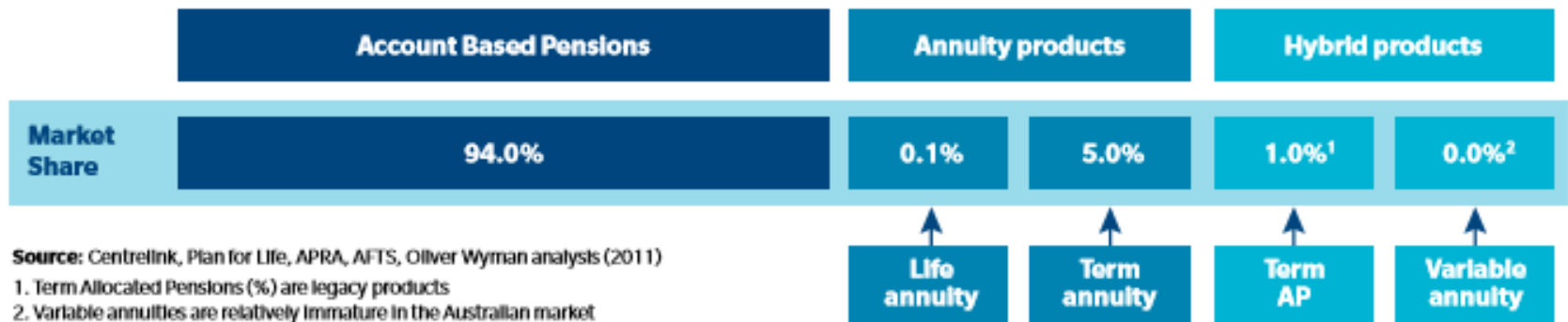


Source: APRA and Deloitte Actuaries & Consultants, 2015

Source: Deloitte – Dynamics of the Australian Superannuation System – The next 20 years: 2015 - 2035

# Retirement products #1

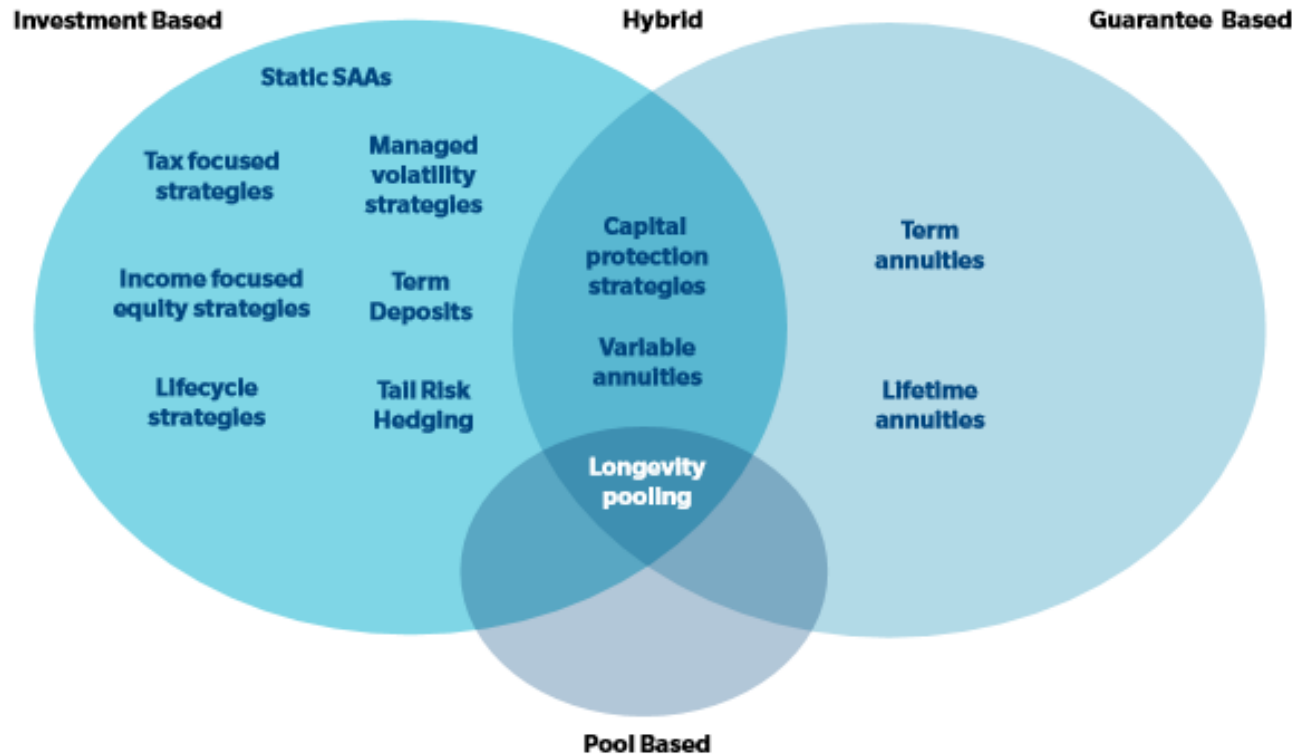
**Figure 1: Allocation of retirement savings in Australia**



Source: Mercer – Post-retirement Market Trends in Australian (June 2014)

# Retirement products #2

Figure 2: Post-retirement Innovation



Source: Mercer – *Post-retirement Market Trends in Australian* (June 2014)



# Definitions

- ▼ *Retirement Income* - the income after fees and other costs receivable by a pensioner from a superannuation provider.
- ▼ *Costs* – the total cost to a member in a superannuation fund across all elements contributing to the provision of retirement income from that fund.



# Reducing Retirement Income Costs

- ▼ Government policy, consumer & retiree pressures
  - Financial System Inquiry – CIPR but reduce costs
  - Productivity Commission – reduce costs
  - Budget intentions – remove product barriers, limit \$
  - APRA – reduce costs - fund mergers for scale
- ▼ Costs versus value
  - \$, %
  - also utility, security/risk, service, benefit



# Retirement Income Costs

## What? Where?

“The best way to keep loyalty in a man’s heart is to keep money in his purse.”

– *Irish proverb*

# Industry costs & fees data (1)

Table 50. Retail retirement income product fee rate (%) – Year to 30 June 2014

Retail retirement income product fee rate <sup>1</sup> (%) – Year to 30 June 2014				
Account balance	Operating	Investment management	Adviser	Total
>\$1 million	0.44	0.43	0.31	1.18
\$500,000 - \$1 million	0.51	0.42	0.34	1.27
\$250,000 - \$500,000	0.60	0.40	0.38	1.39
\$100,000 - \$250,000	0.71	0.39	0.43	1.53
\$50,000 - \$100,000	0.84	0.38	0.48	1.69
\$25,000 - \$50,000	0.99	0.36	0.54	1.89
<\$25,000	1.19	0.35	0.62	2.16
<b>Total Account based Pensions</b>	<b>0.75</b>	<b>0.39</b>	<b>0.44</b>	<b>1.58</b>
<b>Total Guaranteed Annuities</b>	<b>1.25</b>	<b>0.50</b>	<b>0.25</b>	<b>2.00</b>
<b>Total Retail Retirement Income</b>	<b>0.78</b>	<b>0.40</b>	<b>0.43</b>	<b>1.61</b>

<sup>1</sup> Expressed as a percentage (%) of average account based pension assets over the year to 30 June 2014.

Source: Rice Warner – Superannuation Fees Report 2014 - Financial Services Council (October 2015)

# Industry costs & fees data (2)

**Table 51. Comparison of retirement income products fee rates – Year to 30 June 2014**

Segment	Operating	Investment management	Adviser	Total
Corporate	0.16	0.46	0.02	0.64
Industry	0.14	0.71	0.04	0.88
Public Sector	0.17	0.59	0.04	0.80
Retail	0.75	0.39	0.44	1.58
Small Funds	0.12	0.52	0.15	0.80

*Source: Rice Warner – Superannuation Fees Report 2014 - Financial Services Council (October 2015)*

# Administration, Investment, Advice costs

<i>Administration</i>	<i>Administration</i>	<i>Administration</i>	<i>Investments</i>	<i>Advice</i>
<i>Back office</i>	<i>Middle office</i>	<i>Front office</i>		
Member records	Financial oversight incl. uding Treasury	Distribution	Asset consulting (Asset allocation)	Education
Contributions processing	Strategic and operational management	Sales	Investment management (Asset selection and monitoring)	Intra-fund (basic/minimal) advice
Benefits processing	Risk management	Member service	Investment Operations	Financial planning
IT&T incl admin & other systems	Product development		Transaction Costs	
Fund accounting				
Investments Custody				

# ● ● ● | Top 5 Retirement Income Cost Issues

1. Costs are too high generally across super system inc RI
2. High development costs for product innovation
3. Cost and value of provision of advice
4. Lack of transparency around costs
5. Retention challenge vs SMSFs

# RI cost issues – Drivers

- ▼ Business model – wholesale / industry / retail, strategy, markets, distribution channel(s) and advice model
- ▼ Scale and volume
- ▼ Operational model – extent of efficiency
- ▼ Operational model – extent of complexity: RI Products, DC vs DB
- ▼ Investing - active versus passive
- ▼ Investing - asset allocation and access

# ● ● ● | RI cost issues – Assessments

- ▼ 1 *Costs are too high* - **Scale & Volume**
- ▼ 2 *Costs are too high* – **Passive vs Active Investment**
- ▼ 3 *Product diversity* – **Complexity & development cost**
- ▼ 4 *Cost & value of advice* – **Advice payment models**



# RI issues affecting costs – Assessment (1)

## ▼ *Costs are too high* - **Scale & Volume**

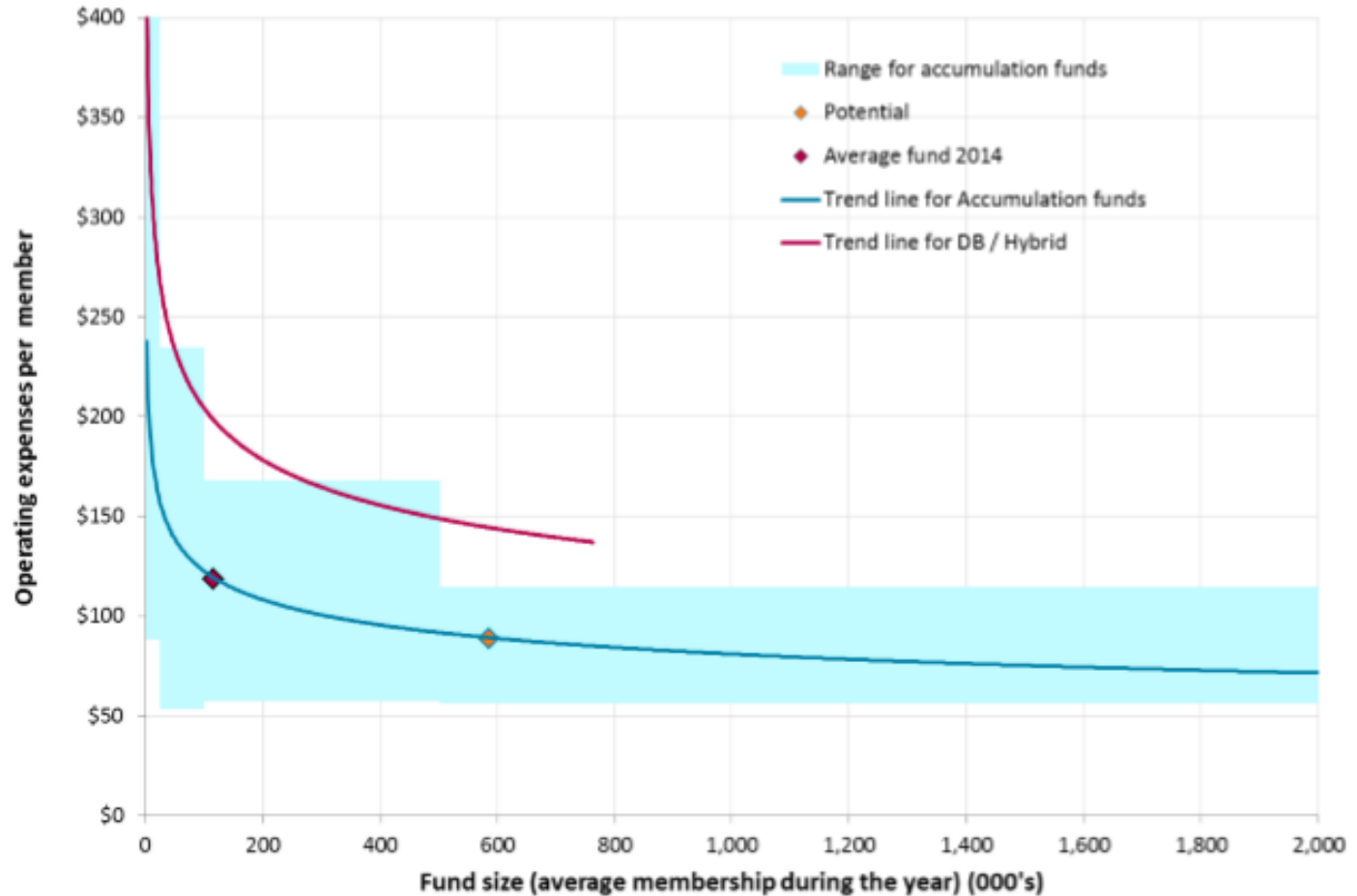
- FSI, Rice Warner, PC – Scale makes a difference
- Admin, Investing, Advice – different scale effect

## ▼ Cost reduction actions

- Merge & acquisition
- Member retention strategy
- Outsource, co-develop systems and products

# Scale & Volume – Operational Expenses

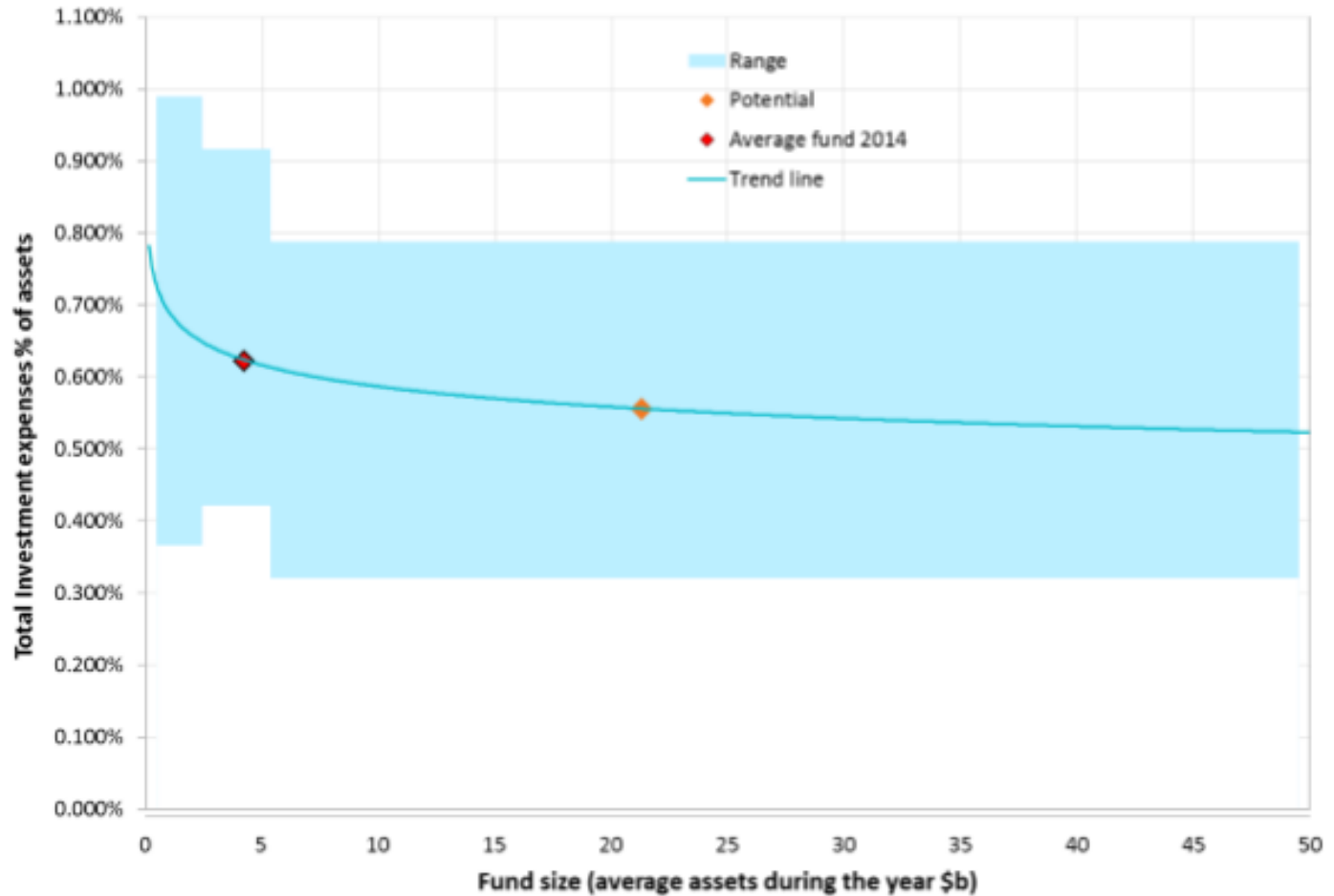
Graph 2. Impact of an increase in average fund size on operating expenses




Source: Rice Warner – Superannuation Fees Report 2014 - Financial Services Council (October 2015)

# Scale & Volume – Investment Expenses

Graph 3. Impact of an increase in average fund size on investment expenses



Source: Rice Warner – Superannuation Fees Report 2014 - Financial Services Council (October 2015)



# RI issues affecting costs – Assessment (2)

## ▼ *Costs are too high* – **Passive vs Active Investment**

- FSI, Rice Warner, PC - Passive is much lower cost
- S&P Indices Vs Active Funds Scorecard – Aust, US
- Asset management industry - vested interest in active

## ▼ Cost reduction actions


- More passive - core holdings – use indexed funds
- Follow Australian Super lead (50% passive in Aust equities) and International trend to passive
- Passive approach lower volume reduces transaction costs

# Passive vs Active Investment

Table 17. Average investment management fees (bps) of Active and Passive funds

	Active	Passive	Fee difference
Cash	15	0	15
Fixed Interest	58	27	31
Australian Shares	93	30	63
International Shares	99	42	57
Listed Property	79	46	33

Source: Rice Warner – Superannuation Fees - Financial System Inquiry (June 2014)




# RI issues affecting costs – Assessment (3)

## ▼ *RI product diversity* – **Complexity**

- FSI – *Comprehensive* Income Product for Retirement (CIPR)
- Early mover product innovation – risky, hard / expensive to sell
- Need more retirement products addressing longevity, sequencing, investment and, in the longer term, inflation risks

## ▼ Cost reduction actions

- Govt. implement budget promises – tax free deferred annuities etc
  - increases value to retiree relative to cost
  - removes major barriers to innovation
- Funds share costs by doing or outsourcing a joint development
- Continuously focus on member needs
- Keep products as simple as possible – avoid multiple features
- Embrace technology, improve loyalty and retention with good communication



# RI issues affecting costs – Assessment (4)

## ▼ *Cost & value of provision of advice* – **Advice payment models**

- Basic intra fund advice encouraged; Other fee for service
- Growing need in market for low cost advice - retiring & income
- Low balances to increase - aiding viability of both

## ▼ Cost reduction actions

- Stick to flat \$ fees – not % of assets – avoids fee “creep”, sharpens focus
- Robo advice to maximise value – clever software, needs analysis, unbiased and not conflicted, less risk to member and fund
- Transparency helps competitive tension as well as honesty to member
- Consider joint development of supporting systems



# Principles for a best practice minimal cost framework

1. Underlying super (accumulation) industry must be best practice in Administration, Investment Operations Management, Advice
2. A relentless primary focus on reducing \$ costs
3. Focus on value for money as well as reducing costs
4. Embrace technology and innovate with its tools / enablers
5. Must recognise the specific specialist needs and wishes of retirees and within that the different needs and goals of retiree segments
6. The post-retirement sub-industry must be: competitive, transparent & product diverse, with stable and supportive Government policy and regulation
7. In product design, recognise members' cognitive constraints and behavioural biases
8. A need to attack multiple cost issues in parallel
9. Disrupt yourself before you are disrupted



# Target minimal cost framework - Administration

<i>Cost functional area</i>	<i>Minimisation action</i>	<i>Reasons &amp; effects</i>
<b>Administration – Back office</b> – Processing, IT&T	Mirror Stronger Super Superstream recommendations into RI – e-commerce, TFN.	Efficiency from automation and no exceptions thus avoiding manual processing/intervention.
	Charge admin fees as \$.	Keeps sharper focus on costs for provider and member.
	Share cost of building support systems including for new products & advice.	Lower development cost per member.
	Have a strong member retentions program.	Build / retain scale – lower cost per member
<b>Administration – Middle office -</b> Product Develop't. Mgt Strategy	Keep products as simple as possible, but: Badge or share development of gntd and longevity products. Pursue mergers & acquisitions	Increased complexity increases development, sales, administration and servicing costs. Product diversity critical to meet needs & member retention Build scale & volume – lower costs per member & spread product diversity costs
<b>Administration – Front office</b> Distribution - Platforms	If platforms a key part of business model, aim for a single all embracing platform. If not, avoid them. Replicate only core elements re investment on choice in own fund.	Just one system to maintain. Get scale benefits – lower cost per member covered. Provide core benefits without cost and complication of platform delivery.
Member service	Open direct channels to people with higher net worth/balances eg SMSFs	Build and retain scale enabling lower costs per member.

# Target minimal cost framework – Investment, Advice

<i>Cost functional area</i>	<i>Minimisation action</i>	<i>Reasons &amp; effects</i>
<b>Investment -</b> Investment management	Use passive / indexed investments as core	Market returns at low cost
	Use investment manager(s) that charge base \$ fees - not as a % of FUM.	Truer fee for service. Avoids escalation of fees with member account and investment markets growth. Enforces fee reductions as % of FUM over time.
<b>Investment -</b> Asset allocation & Investment Mgt	Greater use of own portfolio construction focussing on longer term recurrent income streams.	Provides retirees with what they ultimately need – income at low cost.
	When available use Govt investments that match assets and liabilities and reduce risk in inflation, long term duration and longevity.	Lower provider costs as risk reduction is very expensive given long term nature of market, inflation and longevity risks. Security of income important to retirees.
<b>Advice</b>	Provide access for own members to basic advice based on segment advice templates at clearly set out fixed \$ costs.	Member knows cost so can make value decision on use. No surprises. Reduces chance of misselling.

# ● ● ● | Conclusions & Recommendations

*"It is better to have a permanent income than to be fascinating."*




*Oscar Wilde*



# Conclusions – general

1. There is significant scope for cost reductions in admin, investment and advice
2. Best to attack costs on all fronts
3. Focussed, efficient, effective execution of cost reduction ideas and projects is critical
4. Self disrupt before being disrupted
5. The war on costs is never over



# Conclusions & Recommendations

## – Retirement Income costs specific

1. Providers should pursue scale via mergers & acquisitions
2. Funds should passively invest a greater portion of their portfolios
3. Govt and consumer groups need to keep the pressure on the industry on costs
4. Govt needs to follow through on amending regulations to support product diversity including longevity risk management to enable competitive, relevant products at higher volumes, less cost

# Conclusions & Recommendations cont.

5. Investment costs could be reduced by setting base contracts in \$ not % of FUM
6. The size and continued growth of SMSFs will support the competitive friction on RI provision, constraining RI costs
7. Low cost flat \$ fee effective robo advice options for pre and post retirees will emerge as advice models are road tested and refined

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