The Australian Financial Review
Wednesday 23 November 2011 • www.afr.com

DUNSTAN

Member choice prompts exodus

Dissatisfied high net worth members of super funds are taking control of their own money, writes **Barrie Dunstan**.

Australia's more than 460,000 do-it-yourself superannuation funds, managing more than 34 per cent of the nation's super savings, loom as a major factor in the evolution of the entire $1.34 trillion superannuation industry, according to a new study.

This is one of several changes faced by super funds, on top of the global financial crisis and coming government reforms. But member choice which, ironically, many retail funds thought would favour them, is allowing dissatisfied high net worth members to take control of their own money.

"The extraordinary growth of the self-managed super fund segment and an ageing Australian population present a range of challenges for Australian superannuation institutions," says a major study by KPMG and the Australian Centre for Financial Studies.

The publication, which looks at super in the last decade, says many institutional super funds are facing increased rollovers to self managed super funds (SMSFs), and increased payments of benefits and pensions at the same time as a slowing in contribution flows.

"The long-term future for such funds is problematic. Our analysis also suggests many funds are struggling to reduce member costs," say the two main authors, ACFS director Deborah Ralston and KPMG national superannuation leader Sean Hill.

They say super funds that fail to adapt to the changing landscape "face the prospect of negative funds flow, diminishing assets and terminal decline". Hill says more rollovers to SMSFs, increased payouts and slowing contributions represent for many funds a "perfect storm [that] potentially threatens their future viability".

In addition, big funds are struggling to reduce member costs despite the phenomenal rise in the average size of funds in recent years. Ralston says costs per member declined only in 2009 before rising slightly in 2010.

Statistics show that in just six years, total contributions flowing into SMSFs have risen from 19.7 per cent of all flows in 2003-04 to 20.4 per cent in 2009-10. In dollar terms, contributions from members and employers to SMSFs are running at $22 billion a year against less than $12 billion in 2003-04.

The statistical analysis suggests treasurer Peter Costello's move to allow up to $1 million in contributions for the 2006-07 year provided the initial impetus for higher inflows, attracting $67.2 billion of contributions – or more than 41 per cent of total contributions in that year.

The study found that in the three years to June 2010, 26¢ in every dollar transferred out of institutional super funds went into a SMSF.

The percentage of total rollovers to DIY funds rose from 9 per cent in 2005-06 to a peak of 30 per cent in 2008-09 before settling back to 24 per cent in 2009-10.

Ageing membership has meant increases in pension payments.

The general view is that SMSF members usually want control. Hill says a survey by the Australian Taxation Office found 86 per cent of new trustees gave this as their most powerful motivation.

More than half of them believed they could out-perform their former fund and a third of them thought they could save fees.

The persistence of outflows into SMSFs, even after the worst fears of the global crisis eased, coincides with disappointing investment returns. Some suggest members close to retirement have been shifting out of super funds running a high level of equities into their own less volatile portfolios to lower the level of risk.

In an investment world of lower returns, big funds are under pressure to produce better returns for members by reducing costs. But the study finds that even with a big rise in the average size of funds – tripling from 2006 to 2012 to about $2.3 billion currently – the effect on costs has been variable.

The average size of super funds is likely to rise even further in the next four years: the study projects an average of $3.4 billion by June 2015. This will reflect continuing decline in the number of big funds from almost 390 now to only 310 in 2015. But the study projects a further 25 per cent jump in SMSFs to more than 579,000 in 2015.

While some recent experience suggests the performance of dollar assets improved with size (supporting the argument for fund mergers), analysis of data published by the Australian Prudential Regulation Authority suggest greater scale has not consistently meant reduced total costs per member, the study says.

In addition, there will be extra pressure on costs under the Stronger Super reforms. Some of the changes funds need to offer members to stem the flow to SMSFs (allowing greater control in the Choice funds) are likely to add to costs. Under the MySuper regime, disengaged members in the low cost default scheme cannot be used to cross subsidise the provision of features in the Choice regime.

This will leave funds with only a few options to reduce operating costs – increased focus on operating efficiency or merge with larger, more efficient super funds.

The study says part of the reason for funds' failure to reduce average expenses may be the enhancements they offer, plus the need to adapt to significant changes in regulation.

Hill says the proposed auto consolidation of multiple member accounts will reduce the number of members available to pay fees and there also will be pressure on funds to find the money to build the reserves that will be required under the new regime.

All funds are aware of these factors and are reviewing them, he says. There are still a lot of discussions between funds on whether mergers will solve these problems. And, the study adds, reaching agreement on mergers is a challenge.

As well, funds' ageing membership has meant increases in pension payments. Pensions have grown from about 20 per cent of benefit payments in 2000 to 50 per cent in 2011. The study warns that the ageing population will mean increasing numbers of pensioners for at least the next decade.

Super funds facing unfavourable demographics "that fail to adapt and respond face the prospect of negative funds flow, diminishing assets and terminal decline".