

The Ambachtsheer Letter

Research and Commentary on Pension Governance, Finance and Investments

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TURNING RETIREMENT SAVINGS INTO PENSIONS:

HOW MUCH SHOULD IT COST?

“Our biggest aim with ‘MySuper’ is lowering overall costs while maintaining a competitive, market-based, private sector infrastructure for super. We want to make super better value for money and we have designed the ‘MySuper’ concept with this in mind.”

Jeremy Cooper

Chair, Super System Review Panel

As reported in The Australian Financial Review

20 April, 2010

Lowering Pension Costs in Australia

The ‘Choice of Fund’ legislation passed by the John Howard Government in 2004 was supposed to produce a lower-cost, more effective pension system in Australia. This has not come to pass. Research has confirmed what theory had already predicted. Offering pension fund or investment choices to people who neither want them, nor know what to do with them, does not produce a lower-cost, more effective pension system. Instead, it leads to increased costs and reduces system effectiveness (see, “Australia’s ‘Choice of Fund’ Legislation: Success or Failure?” by Fear and Pace, *Rotman International Journal of Pension Management*, Fall 2009).

The current Kevin Rudd Government commissioned the Super System Review last year to discover a better, simpler path to a lower-cost, more effective pension system for Australians. To this end, the Review Panel released two new reports this past April 19 and 20:

1. *MySuper: A Super Option Designed Just for Members* describes the *MySuper* concept as a simple, cost-effective product that redefines what Australians should be able to expect from their super in the 21st Century. Its proposed features include a ban on trailing com-

missions and contribution fees, a new duty on trustees to manage solely in the interest of plan members (including overall costs), and a default post-retirement product.

2. *MySuper: Default Fund Costs* was prepared by Deloitte. It estimates a benchmark cost structure for the new *MySuper* product. It shows that some *MySuper* members could expect to pay less than half what they are paying now for their super.

These reports are not only timely contributions to the Australian pension reform debate, but also to the debates currently underway in countries such as Canada, Netherlands, United Kingdom, and United States. Why? Because costs are the elephant in the pension reform closet. No matter how elegant pension design, if the costs of turning retirement savings into pensions are too high, retirement income systems cannot deliver adequate pensions at reasonable costs.

Nudges Needed

The Australian Review Panel cites research indicating that over eighty percent of super plan members are ending up with their retirement savings invested in their fund’s default option. Average super balances range from \$18,400 in retail fund