Chant West

Research Paper

Chilean Pension System

Relevance for Australia

August 2014

Comparing Apples with Apples.

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1. Executive Summary

This report has been commissioned by the Financial Services Council (FSC) to support its second round submission to the Financial System Inquiry (the Inquiry).

In its Interim Report (July 2014), the Inquiry makes considerable reference to the Grattan Institute's report on fees in the Australian superannuation system *(Super Sting: April 2014).* The Grattan report claims that Australians pay too much for superannuation when compared with other countries, and it recommends we hold a fee-based tender to select one or more funds to be the default fund for compulsory employer contributions for a period of time. This is similar to the approach used in the Chilean pension market.

The FSC has asked Chant West to analyse the Chilean pension system in detail and to comment on its fee structure and its relevance and suitability as a model for Australia.

Is it necessary for members to put pressure on funds to reduce fees?

The Grattan report claims that fees in Australia are too high because members are disengaged and do not put pressure on funds to reduce fees.

We disagree with this claim. While the majority of members may be disengaged, their funds are acting for them in putting downward pressure on fees because they have strong incentives to do so. Firstly, because there is vigorous competition between funds to attract and retain members and the fees that funds charge – especially under MySuper – represent an important point of difference. Secondly, funds are obliged to justify every year that their members are not being disadvantaged as a result of their scale.

There are over 100 MySuper products competing for default superannuation. Of these, ten have assets of over $20 billion, six have assets of between $10 and $20 billion, and 33 have assets of between $2 and $10 billion. Clearly, there are enough funds with sufficient scale to generate vigorous competition. Of course fees could always be lower, and one way we expect to see this occur is through further fund consolidation over time.

Segmentation within the industry also adds to the competitive environment. Broadly speaking, the industry can be divided into three groups of roughly equal size: for-profit retail funds, non-profit funds and self-managed funds. Each segment competes vigorously for members.

Against this background, the funds themselves put enormous pressure on the fees charged by their service providers – most importantly their administrators and investment managers. We see this in action constantly in the course of our consulting services, where we regularly conduct tenders on behalf of major funds and witness the competitive pressures first hand.

The end result is that it is not necessary for members to put pressure on fees – their funds already do this for them and will continue to do so.

Are Chile's default fees really less than one-third of MySuper fees?

The Grattan report claims that Chile's default fees are less than one-third of MySuper fees. This is not correct. The problem lies in which fees are included or excluded in the analysis. The Grattan report analysis of the Chilean system takes into account administration fees only. However the report then goes on to compare those fees with total MySuper fees which take into account both administration fees and investment fees.

In this report, we compare the two systems on a like-with-like basis. Our analysis shows that, while Chilean fees are lower overall, they are certainly not "less than one-third of MySuper fees". What differences there are can be attributed to two main factors.

The first is that Chilean funds are invested very differently to Australian MySuper funds. The second is the tender system that results in fee levels that, arguably, are not sustainable. We discuss this in greater depth later.

Using OECD methodology to calculate charges on a consistent basis, the average MySuper total fee is 0.85%, comprising 0.27% for administration and 0.58% for investment. The comparable figures for the Chilean default fund are 0.47% (total fee), comprising 0.20% for administration and 0.27% for investment. Overall, therefore, most of the difference in fees between the two systems is accounted for at the investment level, because the administration fees are broadly similar.

There are valid reasons for the difference in investment fees. Essentially, funds in Chile (including its default fund) manage 57% of assets in-house at very low cost. Most of these are domestic assets, predominantly in fixed income securities. Overall, 59% of Chilean assets are invested in fixed income, which is relatively cheap to manage. By comparison, we estimate that less than 5% of MySuper assets are managed in-house and only 20% are invested in fixed income securities. These structural differences explain why MySuper investment fees are higher than those in Chile.

Finally in this overview of fees, it is worth noting that, prior to August 2014, the Chilean default fee was 0.62% made up of 0.33% for administration and 0.26% for investment. So until very recently the average MySuper administration fee (0.27%) was actually lower than the Chilean default administration fee (0.33%). Again, we look at the implications of the most recent tender later in this report.

Should Australia hold a fee-based tender to select one or more funds to be the default fund for compulsory employer contributions?

When Chile introduced its tender system in 2010, there were only five pension funds (referred to as Pension Fund Administrators or AFPs) – four very large funds and one small fund. Fees were generally considered to be high because of the lack of competition. The Government introduced the tender system with the objective of increasing competition and reducing administration fees.

The tender system has certainly reduced administration fees but only one new AFP has entered the market. There are now four very large funds and two small funds. The average administration fee of the four large funds is about 1.45% of a person's salary, compared with 0.47% for the current default fund. Prior to August 2014, the default administration fee was 0.77% of a person's salary.

As we have explained above, the Australian superannuation system does not lack competition and our MySuper fees are comparable with those of the Chilean default fund. In the Chilean system, the default fund must offer the same fee to all members – existing members and new entrants. Using this system, it is difficult to see how non-profit funds in Australia could successfully compete in a tender system. Their fees simply reflect their costs. They cannot lower their fees just to be successful in a tender. They can only lower them if they reduce the level of services provided or change the way they invest, neither of which would be in members' best interests.

A tender system may have relevance for Chile, but it is difficult to see what relevance it has for Australia given our very different structure and investment objectives and the depth of competition that already exists.

2. Overview of Chilean Pension System

2.1 Three pillars

In 1981, Chile's pension system was restructured to comprise three pillars: a poverty prevention (solidarity) pillar, a mandatory contribution pillar, and a voluntary savings pillar. The combination of these pillars seeks to guarantee that individuals maintain a similar standard of living during retirement as they enjoyed during their working lives, and to eliminate poverty among the elderly and disabled.

The goal of the solidarity pillar is to prevent poverty among the elderly and disabled.

Under the mandatory contribution pillar, employees are required to contribute 10% of their wage or salary to an individual account and choose a private sector Pension Fund Administrator (AFP) to manage the account. Currently, there are six AFPs operating in Chile. When members retire, they receive a pension based on the level of their individual account.

Assets in the mandatory system are currently (June 2014) about US$170 billion. The number of members is about 9.7 million, of which about 5 million (52%) are making contributions. The four largest AFPs have combined assets of about US$163 billion (96%).

To complement mandatory savings made through AFPs, there are tax incentives to encourage people to make voluntary contributions through various financial instruments.

In 2008, the Government introduced a number of major reforms that were designed to increase participation in the pension system (particularly the self-employed and women), bolster the solidarity pillar and reduce high administration fees.

The Superintendency of Pensions (SP) is the principal regulator of Chile's pension system.

2.2 Mandatory pillar

(a) Contributions, administration fees and tax

The mandatory contribution rate of 10% is subject to a ceiling on monthly earnings of about US$3,000 (indexed for inflation). Average monthly earnings are about US$1,100.

Employers are required to deduct an employee's contribution from their paycheck and forward it to the employee's chosen AFP. With the exception of new workers entering the workforce, employees may choose any AFP and may switch AFPs at any time.

In addition to the 10% mandatory contribution, employers deduct additional contributions to cover administration fees and death and disability insurance premiums, which are about 1.5% and 1.3% of salary, respectively.

AFPs are free to set the administration fees they charge members, but the fee must be the same percentage of salary for all their members. Note that only contributors pay this fee, and they represent about half the total number of members. These fees are intended to cover all of the AFP's costs, most of which relate to administration and distribution (a very small component relates to internal investment management).

Employee contributions are tax deferred in that contributions and earnings are tax exempt until withdrawal. Retirees pay regular income tax on their pension income.

(b) Default tender for new workers

In 2008, the Government introduced a public tender system designed to increase competition between AFPs and reduce administration fees. This involves a tender every two years where AFPs bid on the estimated 700,000 new workers who enter the workforce every 24 months.

The AFP with the lowest administration fee (which must be less than the fee in effect at the date of the bidding process) wins the tender and is designated as the default AFP provider. New workers entering the workforce are obliged to join the default AFP and remain with it until the end of the AFP's 24-month default term (the current period started in August 2014).

The winning AFP must offer its bid price to all of its members, regardless of whether they are existing members or new entrants.

Modelo, a new AFP, won the first tender in 2010 with a bid of 1.14% (of salary), and the second tender in 2012 with a bid of 0.77%. PlanVital won the third tender in 2014 with a bid of 0.47%.

(c) Multiple investment funds

Since 2002, AFPs have been allowed to offer up to five investment funds, called Funds A to E, which have different proportions of their portfolios invested in equities. The assumption is that the greater the investment in equities, the greater the risk and expected return. All AFPs must offer Funds B to E, while offering Fund A is voluntary. All AFPs currently offer all five Funds. Members may invest in two Funds.

Each Fund operates within regulated investment limits that cover investments in government instruments, equity instruments, foreign investments, unhedged foreign currency and instruments of greater risk (e.g. high-risk debt). Table 1 shows the equity allocation ranges for each Fund.

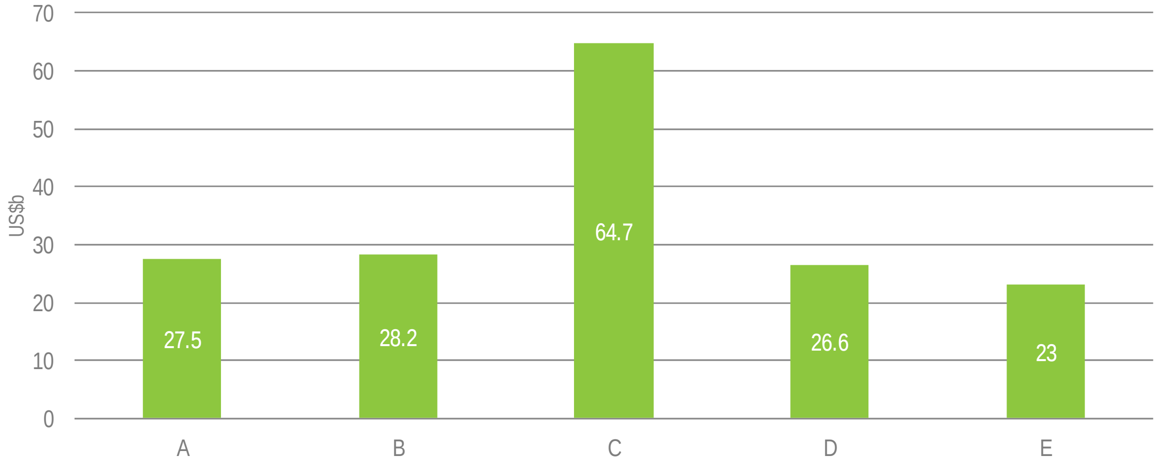
Table 1: Minimum and Maximum Limits on Equity

Fund	Type of Fund	Minimum Limit (%)	Maximum Limit (%)
A	Most risky	40	80
B	Risky	25	60
C	Intermediate	15	40
D	Conservative	5	20
E	Most conservative	0	5

Source: Superintendency of Pensions, The Chilean Pension System (2010)

Chart 1 shows the size of the Funds at June 2014. Fund C held the greatest level of assets with 38%. The other four Funds each held roughly the same level of assets.

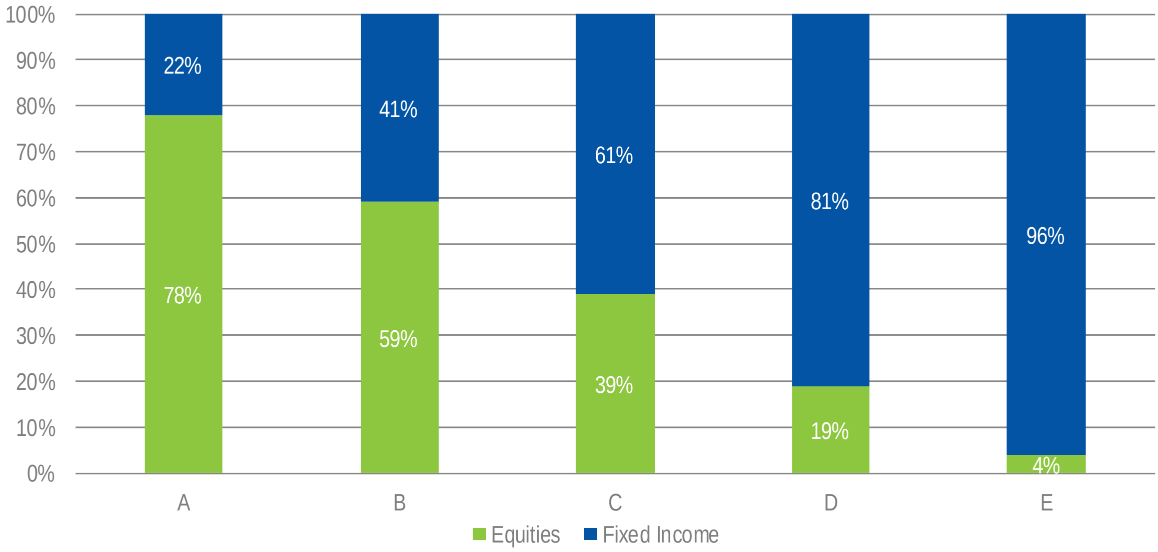
Chart 1: Assets under Management (US$b)



Source: Superintendency of Pensions, 'Portfolio Aggregate of Pension Funds by Type of Funds' (June 2014)

Chart 2 shows the split between equity and fixed income securities at June 2014. The overall split across the five Funds between equity and fixed income was 41% / 59%.

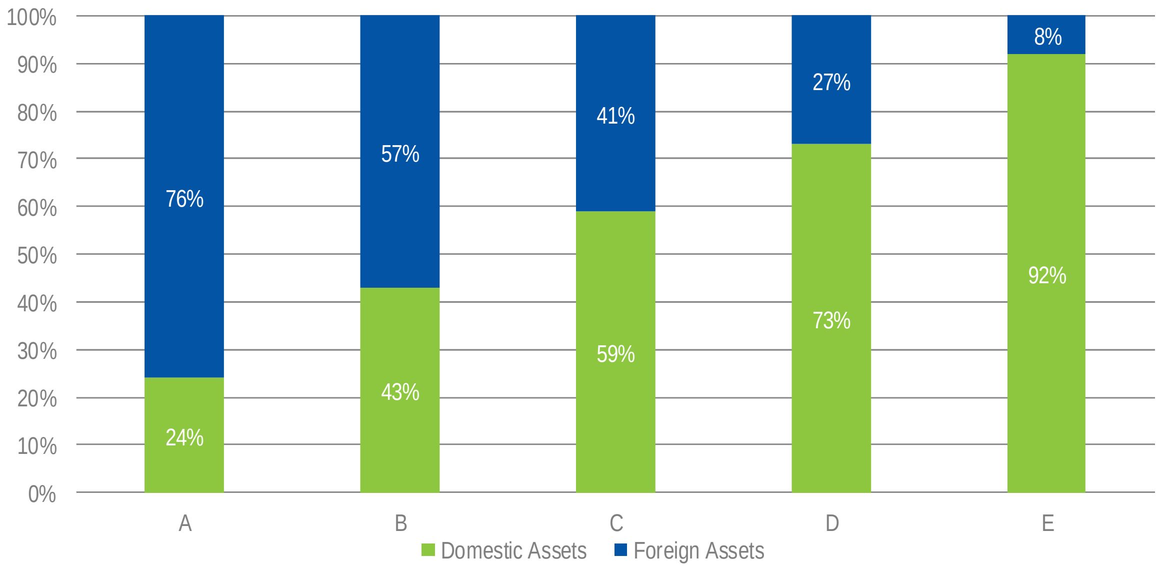
Chart 2: Equity & Fixed Income Investments (%)



Source: Superintendency of Pensions, 'Portfolio Aggregate of Pension Funds by Type of Fund' (June 2014)

Chart 3 shows how pension assets were invested across domestic and foreign investments at June 2014. The overall split between domestic and foreign was 57% / 43%.

Chart 3: Domestic & Foreign Investments (%)



Source: Superintendency of Pensions, 'Portfolio Aggregate of Pension Funds by Type of Fund' (June 2014)

(d) Minimum investment returns

AFPs must meet a minimum level of return for each Fund. For Funds C, D and E, the minimum level is the lesser of (a) the weighted average three-year return of all funds of that type less 2% per annum and (b) 50% of the weighted average return of all funds of that type. For Funds A and B, the minimum level is the same except that (a) is the weighted average three-year return less 4% per annum.

To meet the guarantee obligation, an AFP must hold a reserve equal to 1% of the value of each Fund. If a Fund's three-year return is below the minimum level, the AFP must transfer the difference from the reserve to that Fund within five days. The AFP must then top-up the reserve to 1% of the value of the Fund within 15 days.

Since underperformance of a Fund can have significant financial consequences for the AFP (given the return guarantee obligation), most AFPs invest in a very similar way, and with a short-term focus, to ensure they are not required to inject capital to top-up the reserve.

3. Pension Fund Administrators

When the Government introduced major reforms in 2008 there were only five AFPs providing mandatory individual accounts. Competition was limited. The default tender system introduced in 2010 was designed to attract new providers into the system to increase competition and reduce administration fees. This objective was achieved with Modelo, a new AFP, winning the first tender. Table 2 shows the ownership details of the six AFPs.

Table 2: Ownership of AFPs

AFP	Ownership	Country of Owner
Capital	Grupo Sura ING	Colombia
Cuprum	Principal	United States
Habitat	Chilean Construction Chamber	Chile
Modelo	Atlantic Investment (individual shareholders)	Chile
PlanVital	AFG Pactual	Brazil
Provida	MetLife	United States

Source: Websites of each AFP

Table 3 shows the size of each AFP. Note that the average balance is based on the number of contributors.

Table 3: Size of AFPs

AFP	Members (‘000)	Contributors (‘000)	Assets (US$b)	Average Balance (US$)
Capital	1,834	974	35.5	36,505
Cuprum	635	446	35.7	80,089
Habitat	2,097	1,152	44.4	38,550
Modelo	1,404	615	2.4	3,869
PlanVital	387	169	4.6	27,125
Provida	3,317	1,675	47.5	28,331
Total	9,674	5,031	170.1	33,807

Source: Superintendency of Pensions, ‘Statistical Record Pension’ (June 2014)

4. Administration Fees

4.1 Fee structure of each AFP

AFPs are free to set the administration fees they charge members, but the fee must be the same for all their members. This fee must be a fixed percentage of salary. It covers administration costs, distribution costs and the cost of the internal investment team. The latter is a very small component of total AFP costs (e.g. for Provida it relates to about 60 out of 2,000 staff). It does not include the investment fees charged by external fund managers (which are mostly used for foreign investment). These fees amount to about 0.26% per annum when expressed as a percentage of total assets.

Employers deduct additional contributions to cover administration fees and death and disability insurance premiums. No fees are payable by members who do not contribute.

Table 4 shows the administration fees charged by each AFP in July 2014. Note that, in winning the 2014 tender, PlanVital reduced its fee from 2.36% to 0.47%, effective August 2014. We discuss this later.

Table 4: Administration Fees Charged on Mandatory Contributions

AFP	Fee (% of Salary)	Average Monthly Salary (US$)	Average Annual Fee (US$)
Capital	1.44	1,167	202
Cuprum	1.48	2,080	369
Habitat	1.27	1,216	185
Modelo	0.77	794	73
PlanVital	2.36	761	216
Provida	1.54	920	170
Total	1.45	1,117	n.a.

Source: Superintendency of Pensions, 'Statistical Record Pension' (June 2014)

4.2 Total fees charged by AFPs

Table 5 shows the total fees charged by each AFP and the weighted-average fee of all AFPs expressed as a percentage of total assets.

Table 5: Total Administration Fees by AFP

AFP	Total Fees (US$m)	Total Fees (% of Assets)
Capital	196	0.55
Cuprum	165	0.46
Habitat	213	0.48
Modelo	45	1.90
PlanVital	36	0.79
Provida	285	0.60
Total	941	0.55

Source: Superintendency of Pensions, 'Statistical Record Pension' (June 2014)

As noted above, after it won the default tender PlanVital's administration fees fell from 2.36% to 0.47%, i.e. by about 80%. The new fee equates to about 0.16% of assets using the current average balance. However, as new members join over the next two years, the average balance will fall significantly which will have the effect of increasing the administration fee as a percentage of assets. We estimate that PlanVital's administration fee will be about 0.60% of assets at the end of the two year default period (assuming 700,000 new contributors in the next two years).

4.3 Average fee using OECD methodology

PlanVital's situation demonstrates that a comparison of fees (as a percentage of assets) can be very sensitive to the size of the average account balance at a particular point in time. To resolve this problem, the OECD uses a methodology (which it refers to as 'reduction in yield') to calculate the average fee paid by a member over their entire working life expressed as a percentage of their account balance.

The Grattan Institute used this methodology to calculate the fees charged in the Chilean pension system, assuming real wage growth of 1.8% per annum, gross returns of CPI + 5% per annum, and over a 40 year contribution period. Its report quotes the total fee for PlanVital as being 0.20% per annum of account balance. As noted above, this fee is essentially the administration fee only, and it excludes the fees charged by external investment managers.

Table 6 shows the administration fee of each AFP and the weighted average fee across all AFPs. It is based on the OECD methodology and its assumptions, as used in the Grattan report.

Table 6: Average Administration Fees Over a Lifetime

AFP	Description	Average Fee (% pa)
Capital	Non-default AFP	0.65
Cuprum	Non-default AFP	0.67
Habitat	Non-default AFP	0.57
Modelo	Default from August 2010 to July 2014	0.33
PlanVital	Default from August 2014	0.20
Provida	Non-default AFP	0.70
Weighted-Average		0.66

Source: Chant West

4.4 Sustainability of PlanVital's administration fee

There are questions about the sustainability of PlanVital's new administration fee. It represents an 80% fee reduction which means its revenue in August 2014 will be only 20% of its revenue in July. In order to return to its previous level of revenue (on which it made only a small profit last year), it needs to grow its membership by a factor of five (i.e. from about 170,000 to 850,000 contributors).

PlanVital expects to gain these new members during its 24-month default term. The experience of the previous default AFP, Modelo, however, was that after two years only about 60% of new members were contributing and, after four years, only about 40% were contributing. PlanVital is likely to have a similar experience and, if it does, it will take at least four years to return to the current level of revenue. Unless it can reduce its costs by a large amount, it is likely to make significant losses over that time.

Further, the recent purchase of PlanVital by BTG Pactual (a large Brazilian investment bank), as part of its purchase of BSI (Swiss private bank), has raised questions about its future. At this stage, BTG Pactual has not committed to retaining PlanVital.

5. Investment Fees

The fees of external fund managers are not included in the administration fees of AFPs. While these fees are not directly deducted from a member's account, they are deducted from earnings before they are credited to members' accounts in the same way as they are in Australia.

The Superintendency of Pensions has imposed controls on the level of the fees paid to external fund managers. Table 7 shows the maximum fees payable for mutual funds.

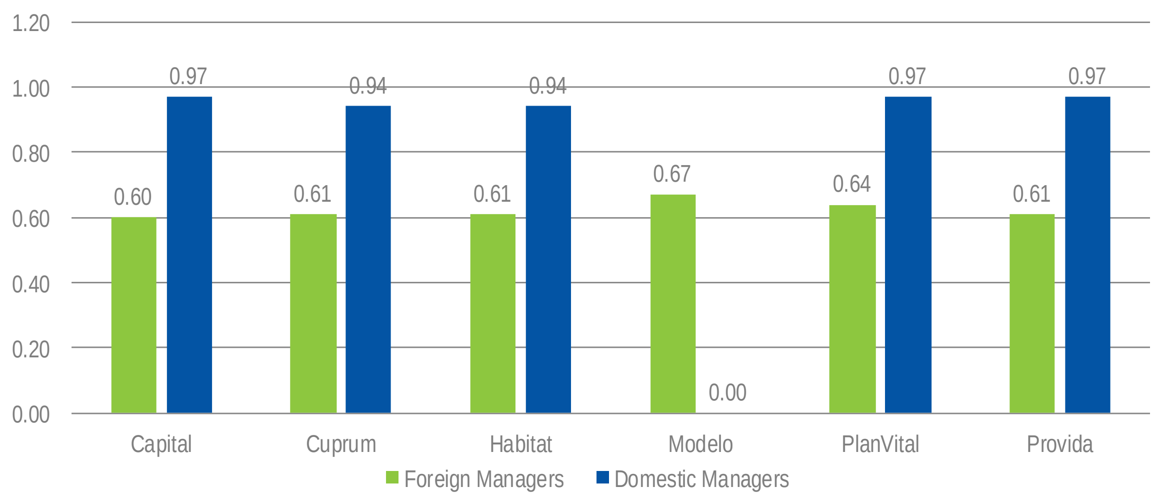
Table 7: Maximum Fees by Asset Class

Asset Class	Asset Sub-Class	Style	Maximum Fee (% pa)
Shares	Domestic, Global, EM	Index	0.60
	Domestic, Global	Active	1.29
	EM	Active	1.59
Bonds	Domestic	Index	0.26
		Active	0.75
		High Yield	1.01
	Global		1.02
	EM		1.07
Diversified			1.11
Cash			0.61
Other			1.97

Source: Superintendency of Pensions, 'Joint Resolution No. 41' (June 2014)

AFPs must disclose their fees for each investment type to the SP on a monthly basis. The SP publishes this data on its website. Chart 4 shows the average fees charged by foreign and domestic fund managers.

Chart 4: External Investment Fees (% pa)

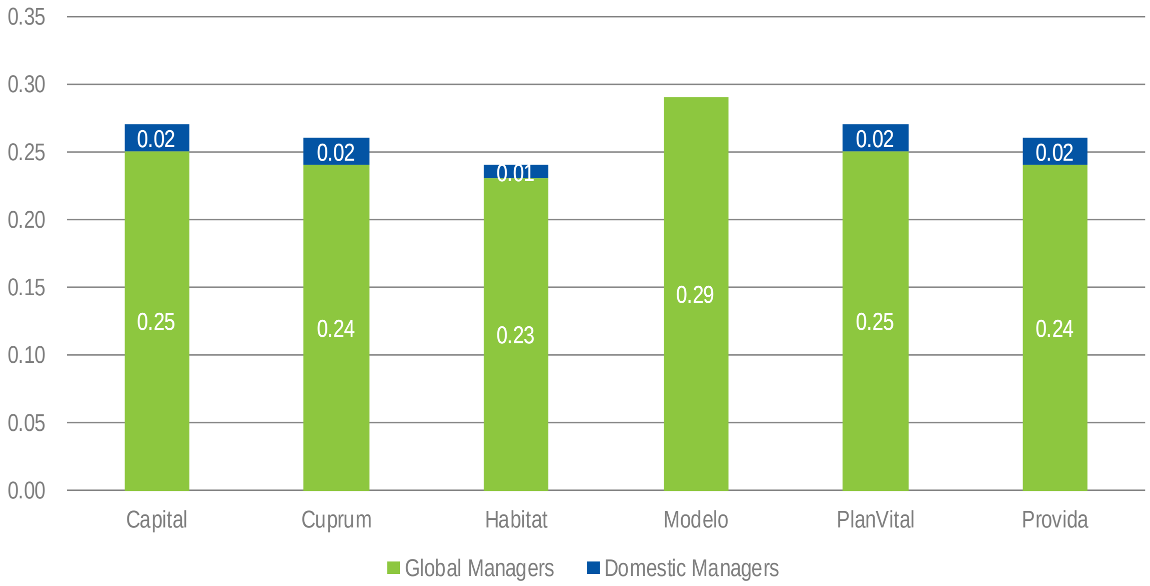


Source: Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2014 to 31 March 2014'

The level of fees that members pay depends on the amount invested with external investment managers. We know that the average allocation to foreign investments is 43% (Chart 4), almost all of which is invested with external managers.

Chart 5 shows the external manager fees (as a percentage of total assets) that are deducted from members' earnings. The average investment fee across all AFPs is 0.26% per annum.

Chart 5: External Investment Fees (% of total assets)



Source: Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2014 to 31 March 2014'

6. MySuper Products

Since January 2014, it has been mandatory for employers to pay default SG contributions into a MySuper product. To date, APRA has authorised over 100 MySuper products. MySuper assets at June 2014 totalled about $585 billion (this includes account balances that must be transferred to a MySuper product by July 2017) representing about 18.5 million member accounts.

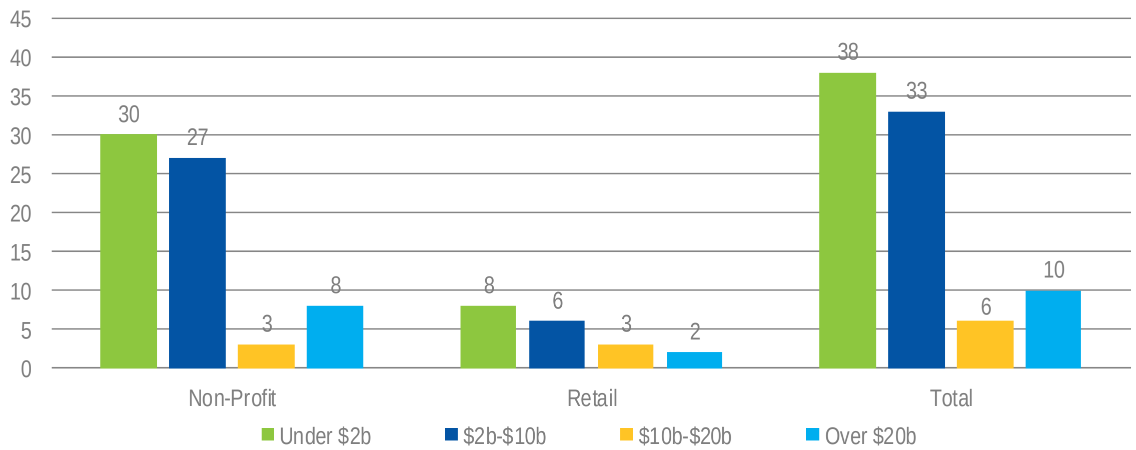
MySuper product providers compete vigorously for members on the bases of fees and services offered (including insurance). The structure of the industry promotes this competition. First, there are a large number of competing products. Second, the industry is segmented into three fiercely competitive groups of roughly equal size: for-profit retail funds, non-profit funds and self-managed funds.

The Grattan report argues that fees in Australia are too high because members are disengaged and do not put pressure on funds to reduce fees. We believe it is not necessary for members to put pressure on fees, as the funds do this for them through their vigorous competition.

Chart 6 shows the number of MySuper products in various bands of assets under management at June 2014. Of the authorised MySuper products, ten have assets over $20 billion, six have assets of between $10 and $20 billion, and 33 have assets of between $2 and $10 billion. The remainder have assets of less than $2 billion.

Clearly, there are already enough products with sufficient scale to generate healthy competition. Some of the smaller funds may not have the scale to continue to deliver quality services and competitive net returns to members at low cost, but this situation would likely be resolved by fund consolidation, as we have experienced in the recent past. This would result in more large funds competing for members, which again would put downward pressure on fees.

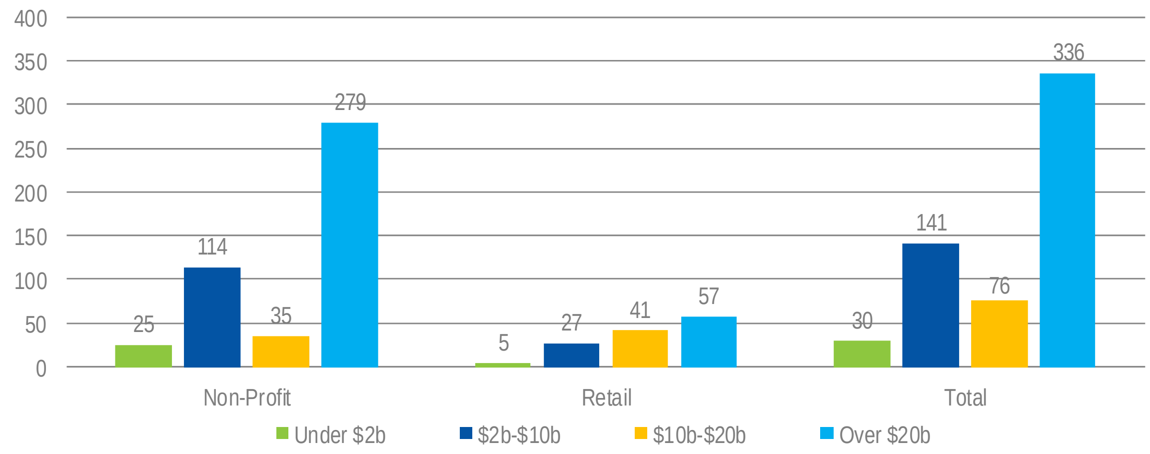
Chart 6: Number of MySuper Products



Source: Chant West

Chart 7 shows the total assets of MySuper products at June 2014. The ten largest products account for about 58% of total assets. The next 40 largest 40 account a further 37% of total assets. This means the 50 largest products (about half the total number of products) account for about 95% of total assets.

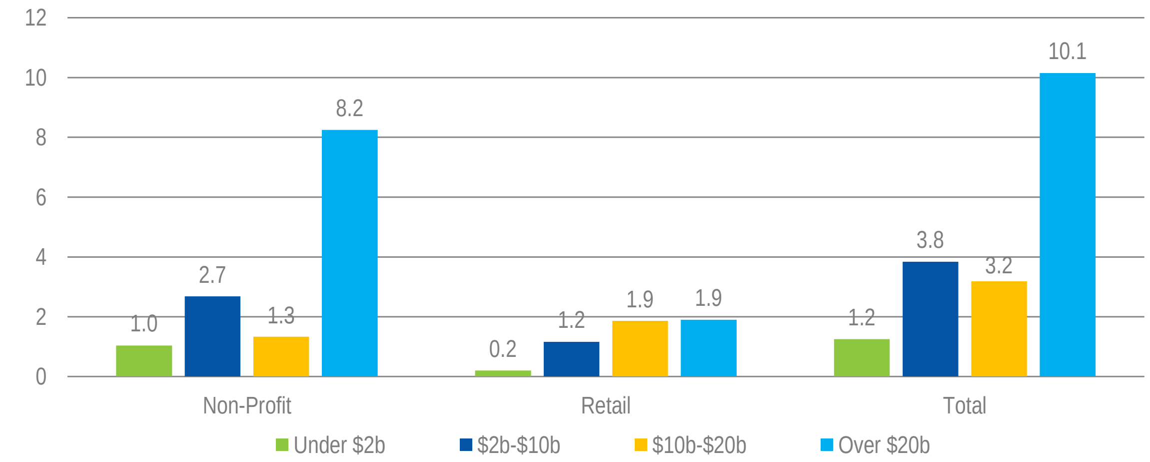
Chart 7: Total Assets of MySuper Products ($b)



Source: Chant West

Chart 8 shows the total number of member accounts of MySuper products at June 2014. The ten largest products account for about 55% of total members. The next largest 40 products account for about 38% of total members. This means the 50 largest products (about half the total number of products) account for about 95% of total members.

Chart 8: Total Member Accounts of MySuper Products (million)



Source: Chant West

7. MySuper Fees

The Grattan Institute claims in its report that Australian funds charge fees that are, on average, three times the median OECD rate. The report compares the total fees charged by MySuper products with the published OECD fees, many of which include administration fees only (as is the case with Chile). This means those fee comparisons are not comparing like with like. This section addresses that issue.

7.1 Average MySuper fees

Table 8 shows the weighted-average fees (using assets under management, including the account balances that must be transferred to a MySuper product by July 2017) charged by MySuper products in each industry segment. Note that we define retail passive funds as those that have 65% or more in passive management.

The fees shown in the table are based on March 2014 data. Typically, members pay administration charges directly by way of a dollar-based fee (often referred to as a 'member fee') plus a percentage-based administration fee. Investment fees are percentage-based, and are deducted from investment earnings before they are credited to the members' accounts.

The published MySuper administration fees are the maximum fees that members pay. With retail active funds, many medium to large employers, however, because of their scale, are able to negotiate lower administration fees for their employees. To assess the impact of these negotiations, we have sourced information from the five largest corporate master trust providers on the average administration fees paid in their MySuper products. Based on this information, we have reduced the percentage-based administration fee for retail active products by 0.17% – from 0.58% to 0.41% – to be more representative of the real-world situation.

Table 8: Fee Structure of MySuper Products

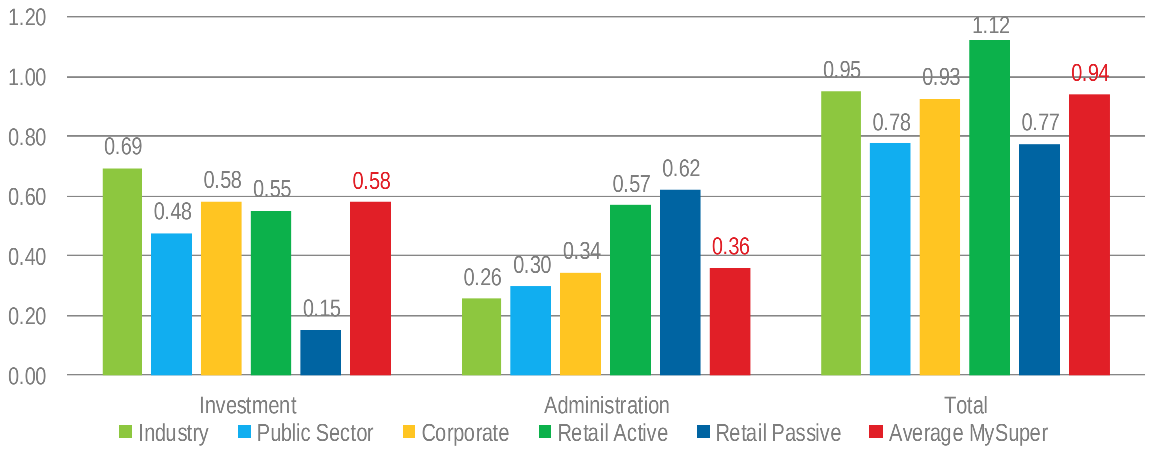
Industry Segment	Member Fee ($ pa)	Administration Fee (% pa)	Investment Fee (% pa)
Industry	81	0.09	0.69
Public Sector	39	0.22	0.48
Corporate In-House	87	0.17	0.58
Average Non-Profit	72	0.13	0.63
Retail Active	79	0.41	0.55
Retail Passive	60	0.50	0.15
Average MySuper	73	0.21	0.58

Source: Chant West

Chart 9 shows the weighted-average MySuper fees for different industry segments using an account balance of $50,000, which is the amount used for the representative member in MySuper dashboards and product disclosure statements. The chart is based on the data in Table 8. The overall weighted-average MySuper fee is 0.94% per annum, comprising an administration fee of 0.36% and an investment fee of 0.58%.

Note that we have adjusted the published administration and investment fees for retail passive funds to more accurately reflect the cost of passive investment. (We have reduced investment fees by 0.20% and increased administration fees by the same amount).

Chart 9: Weighted-Average MySuper Fees by Industry Segments (% pa)



Source: Chant West

7.2 Administration fees using OECD methodology

In Section 4.3, we showed average administration fees in Chile using the OECD's methodology. We now apply this methodology to Australian MySuper products using the fee structure in Section 7.1.

Table 9 shows the average administration fees of MySuper products and Chilean AFPs.

Table 9: Average Administration Fees Over a Lifetime

Product	Average Fee (% pa)
MySuper	
Industry	0.16
Public Sector	0.25
Corporate In-House	0.25
Average Non-Profit	0.19
Retail Active	0.48
Retail Passive	0.55
Average MySuper	0.27
AFP	
Capital	0.65
Cuprum	0.67
Habitat	0.57
Modelo	0.33 (default until July 2014)
PlanVital	0.20 (new default from August 2014)
Provida	0.70
Average AFP	0.66

Source: Chant West

A comparison of MySuper and Chilean AFP administration fees may be summarised as follows:

- Broadly, MySuper administration fees compare favourably with those of Chilean AFPs.
- The average MySuper administration fee of 0.27% is less than the Chilean default fee charged in the two years to August 2014, which was 0.33%, but higher than the new default fee of 0.20% effective August 2014.
- The average non-profit MySuper administration fee of 0.19% is less than the new Chilean default fee of 0.20%.
- The average retail active administration fee of 0.48% is higher than the new Chilean default fee of 0.20%.

7.3 Investment Fees

Table 10 shows the investment fees of MySuper products and Chilean AFPs. Since these fees are a simple percentage of assets in all cases, the average lifetime fees will be the same as in the table.

Table 10: Average Investment Fees

Product	Average Fee (% pa)
MySuper	
Industry	0.69
Public Sector	0.48
Corporate In-House	0.58
Average Non-Profit	0.63
Retail Active	0.55
Retail Passive	0.15
Average MySuper	0.58
AFP	
Capital	0.27
Cuprum	0.26
Habitat	0.24
Modelo	0.29 (default until July 2014)
PlanVital	0.27 (new default from August 2014)
Provida	0.26
Average AFP	0.26

Source: Chant West and Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2014 to 31 March 2014'

Clearly, Chilean investment fees are lower than MySuper investment fees. As mentioned earlier, this is because Chilean AFPs and MySuper products are invested very differently. Table 11 looks at these differences in more depth. It provides a high level comparison of Chilean AFP and MySuper investments, based on the information in Section 2.2(c).

Table 11: Investments – Chile AFPs versus MySuper

Investments	Chile	MySuper
Management by internal team	57%	< 5%
Asset Sector		
Equities	40%	56%
Bonds	60%	20%
Unlisted assets	Nil	24%

Source: Superintendency of Pensions, 'Portfolio Aggregate of Pension Funds by Type of Fund' (June 2014) and Chant West

The main differences in investment approach between Chilean AFPs and MySuper products may be summarised as follows:

- More than half the assets in the Chilean system are managed by an internal investment team. The cost of managing these assets is negligible as the size of the team is only a small fraction of the total number of employees of each AFP. In contrast, we estimate that internal management represents less than 5% of assets under management for MySuper products.
- Chilean AFPs have a much lower allocation to growth assets than MySuper products. Since growth assets are more expensive to manage than defensive assets, MySuper investment fees would be expected to be higher those of Chilean AFPs.
- About 46% of the total assets of Chilean AFPs are invested in internally managed Chilean bonds. These assets are cheap to manage, but this concentration carries potential risks.
- Many MySuper products have, in recent years, reallocated some of their defensive asset exposure from bonds to unlisted assets. These unlisted assets are more expensive to manage than bonds, but they provide important return and diversification benefits.

7.4 Total fees using OECD methodology

Finally, Table 12 shows the total fees of MySuper products and Chilean AFPs.

The average MySuper total fee is 0.85%, which is higher than PlanVital's fee (Chile's new default fund) of 0.47%. It is also higher than Modelo's fee (Chile's default fund between 2010 and 2014) of 0.62%.

Clearly, the component parts of the total fee tell the story. The average MySuper administration fee of 0.27% compares favourably with PlanVital and Modelo – 0.20% and 0.33%, respectively. The average MySuper investment fee of 0.58%, however, is much higher than PlanVital and Modelo – 0.27% and 0.29%, respectively. This, as explained, reflects the very different nature of investments in each country.

Overall, we believe MySuper fees compare favourably with default fees in Chile when the clear differences in the approach to investment management are taken into account.

Table 12: Average Total Fees Over a Lifetime

Product	Administration (% pa)	Investment (% pa)	Total (% pa)
MySuper			
Industry	0.16	0.69	0.85
Public Sector	0.25	0.48	0.73
Corporate In-House	0.25	0.58	0.83
Average Non-Profit	0.19	0.63	0.82
Retail Active	0.48	0.55	1.03
Retail Passive	0.55	0.15	0.70
Average MySuper	0.27	0.58	0.85
AFP			
Capital	0.65	0.27	0.92
Cuprum	0.67	0.26	0.93
Habitat	0.57	0.24	0.81
Modelo (old default)	0.33	0.29	0.62
PlanVital (new default)	0.20	0.27	0.47
Provida	0.70	0.26	0.96
Average AFP	0.66	0.26	0.92

Source: Chant West and Superintendency of Pensions, 'Fees Paid by Pension Funds from 1 January 2014 to 31 March 2014'