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Brent Sheather's
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RETIREMENT: HOW MUCH DO YOU NEED? (AGAIN) – Part 4: Comparing The Impact Of Lower Fees Versus Increased Contributions

In this, the last instalment of a four part series on saving for retirement, we go back to where we started: the RIIG report "Retirement Saving: A Framework For Adequacy". In their comprehensive review of the topic the actuaries modelled 16 different scenarios including investing via a growth fund, a conservative fund, withdrawing from KiwiSaver to buy a house at age 30 and retirement at ages 60 and 70. But one glaring omission in their work was the impact of fees on returns and thus how fees influence "the adequacy of retirement saving". Instead the authors simply assumed a return of 4.5% pa for a balanced portfolio after tax and fees. This assumption ignores the wide variation in fees levied by KS providers. For balanced funds these range, according to the Sorted website, from a low of 0.25% pa to a high of 3.4% pa, with an average of 0.92% pa. Inexplicably Sorted's total fees calculation doesn't include estimated transaction costs, including bid/offer spread so I have estimated these at 20 basis points pa. Fees can hugely impact retirement outcomes – even at the 1.12% pa estimated average fee, for someone starting off with KiwiSaver at age 20 and earning the income assumed by the RIIG, total fees in real terms are estimated at $59,000. For comparison their terminal sum is estimated at $400,000. Actuarially significant.

The mistake the Australian and NZ governments have made with compulsory Superannuation and KS respectively was the assumption that competition would ensure competitive and fair pricing and that investors were rational. The reality is that neither of these assumptions are valid: investment managers know that with employers matching contributions KS is no-brainer for most non-self-employed New Zealanders irrespective of the level of fees. The high level of fees relative to what institutional investors pay and the predominance of active funds over passive demonstrates the point that the finance sector appropriates some of the tax and employer subsidies for itself. Two academics from AUT made the comment a few years back that "annual fees on KS are far above international standards and not justifiable". The investment sector has a long history of obfuscating the fee issue and advocating higher contributions as the sole strategy available for maximizing retirement outcomes. At a recent conference on KiwiSaver organized by Asset Magazine: The manager of a major Kiwisaver scheme was quoted as saying, that contribution rates were key "it doesn't matter how well we provide a service or what fees we charge if we are not regularly contributing: Kiwis retirement nest eggs won't be sufficient for an enjoyable retirement. That has to be improved".

Unlike the RIIG, the Retirement Income Review, authored by the Australian Treasury, did consider fees and their impact on retirement outcomes. It made the important point that there are a number of different

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strategies which can be employed to maximise the terminal sum available for retirement and it talks about efficiency and in particular ensuring fees are low. "The focus of superannuation has often been on building larger balances through increased contributions. But lower fees will increase superannuation balances. Using superannuation assets more efficiently and accessing equity in the home can significantly boost retirement incomes without the need for additional contributions." Australian Liberal Senator, Andrew Bragg, has been campaigning for a default super savings scheme, similar to the Australian Future Fund (like our NZ Super Fund), which would have ultra-low fees by outsourcing fund management to wholesale fund managers making a 10 basis point fee or lower easily achievable. An investor with $1,000 can buy a Vanguard global equity fund with a fee structure of just 6 basis points so, given KiwiSaver has total assets of around $150 billion, it would be very easy for the New Zealand Treasury to organise an ultra-low cost default KiwiSaver scheme for New Zealanders with management fees, excluding transaction costs, of 6 basis points or less.

Understandably given most of the discussions of KS and retirement outcomes generally is orchestrated by fund managers and financial advisors there is rarely, if ever, any analysis of how low fees can improve retirement outcomes. The ultra low fee option for KS will obviously be opposed by KS providers and financial advisors that give KS advice. The margins of providers would be seriously diminished under this option and financial advisors interest in the business would likely evaporate given that their trailing commission would end. The cost of this "advice" can be substantial. I looked at 3 funds that pay trailing commission – one didn't disclose how much they pay to the advisor, one had trailing fees of 0.25% and the other paid trailing fees of 0.5%. In most cases the advice component of KS can easily be replaced by a glide-path approach – a growth portfolio to maybe age 50 then balanced from that point onwards with questions answered by AI. The obvious question is therefore: why did the RIIG study not consider whether its replacement rate definition of adequacy could, at least in part, be achieved by lowering fees rather than increasing contributions?

Given that "lower fees will increase superannuation balances" I used the KiwiSaver model to investigate the impact on the terminal sum for an individual entering a growth KiwiSaver scheme at age 21 and retiring at age 65 with the base case being 3% contributions from each of employee and employer, a growth portfolio, and fees at 1.05% per annum which is the average for growth portfolios plus estimated transaction costs including bid/offer spread of 30bps. I then looked at two scenarios: firstly increasing employee contributions from 3% to 5% with the current average growth KiwiSaver fee structure at 1.35% pa and secondly, holding employee contributions at 3% but reducing annual fees to 10 basis points plus an estimated 10 bps on transaction costs. Assuming investment via a growth KiwiSaver fund paying the average management fee for growth funds, an individual with the same

	Estimated Terminal Sum, Growth Portfolio, real terms
Contributions: 3% from employer and employee, fees at 1.35% per annum	$430,000
Contributions: 5% from employer and employee, fees at 1.35% per annum	$700,000
Contributions: 3% from employer and employee, fees at 0.2% per annum	$570,000

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earnings profile as detailed by the RIIG and saving 3% of his/her salary, matched by the employer, is forecast to have around $430,000 at retirement, in real terms. If the individual increases their contributions to 5% the estimated terminal sum rises to $700,000. Conversely, holding the contribution level at 3% but paying the same low level of management fee that the NZ Super Fund does, 10 basis points, the terminal sum rises to around $570,000. The sensitivity analysis above suggests that an ultra-low fee fund would allow KiwiSavers to achieve more than half of the gains in terms of enhanced terminal sum that would be achieved from a 67% increase in contributions. For most NZ'ers lowering fees is a more realistic option than doubling their contributions to KiwiSaver.

By email I asked the Retirement Income Interest Group of the NZ Society of Actuaries three questions: Firstly why did you not model the impact of varying levels of fees on retirement outcomes? Do any members of the RIIG work for firms who consult to KS providers? If that is the case is that the obvious reason as to why the RIIG didn't consider the potential of lower fees to replace, at least in part, higher contributions? The RIIG replied as follows: "RIIG has reviewed the article and included the response to your questions in the bullet points below.

For completeness, you may wish to direct readers to the full RIIG research you are referencing here Retirement-savings-adequacy-RIIG-2025.pdf which is focused on the level of KiwiSaver contributions likely to be adequate under a range of life events such as contribution gaps, first home withdrawals, and early retirement.

- The investment returns in the paper are stated after fees, and the paper includes sensitivities to returns which can also be used to understand the impact of lower fees.
- The paper represents the views of the authors, not their employers or other NZSA members. RIIG comprises members from a range of backgrounds, of which only one is involved in consulting to a KiwiSaver provider(s). The paper was reviewed by other NZSA members, helping to guard against single-issue dominance or potential conflicts of interest, supported by the NZSA Code of Conduct and any relevant employer policies."