



Crediting Rates or Unit Prices Lessons from these volatile times

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Agenda

- Attribution methods and their evolution
- Are attribution methods meeting member expectations?
- Conclusions



The challenge

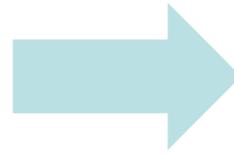
How to equitably attribute earnings to individual accounts in a collective investment

Principles

- Proper financial position
- Equitable for all members
- Best estimate at the time
- Balance individual versus the group
- Robust
- Transparent
- Able to be administered
- Can be understood by members

Framework

- Structure: unit prices or crediting rates
- Frequency of calculation
- Frequency of allocation
- Declared and interim rates
- Forward or historic pricing



Business rules
& Implementation

Crediting Rates or Unit Prices

- Debate has largely been around
 - Member understanding
 - Costs
 - Complexity
 - Risks

“APRA does not have a preference for unitisation or the use of crediting rates...APRA supervisors will look at the reasonableness of crediting rate and unitisation methodologies adopted by trustees and ***how well the policies work where investment choice, fund choice and portability of benefits give rise to ad hoc transactions, some involving large amounts of money.***”

APRA Insight Issue 1 2007 p 11 (our emphasis)

15 years ago

Sample crediting rate policy

- Declared rate
 - Annual
 - 3 year rolling average
- Interim rate
 - Updated quarterly
 - 3 year rolling average
 - Assumptions for current year

Now

Crediting rates & unit prices are being declared more frequently

Funds are moving from crediting rates to unit prices

Drivers for change

- Member investment choice
 - Fund choice
 - Market volatility
 - Higher account balances
- 
- Higher member engagement
 - Greater financial literacy
 - Higher member expectations

Have crediting rate structures kept up with these changes?

What the members are saying...

I don't understand my balance – I've tried to calculate it on a spread sheet

The call centre can't explain the amount of interest credited to my account

I've been checking my balance on the website. Why has it dropped by \$5,000 since yesterday?

Why do we have crediting rates? Unit prices are more tangible

Why does it take 10 days to process my switch? The industry standard is 24 hours

Why is the crediting rate negative when markets are rising?

What's happening to my money while I'm waiting for the fund to process my switch?

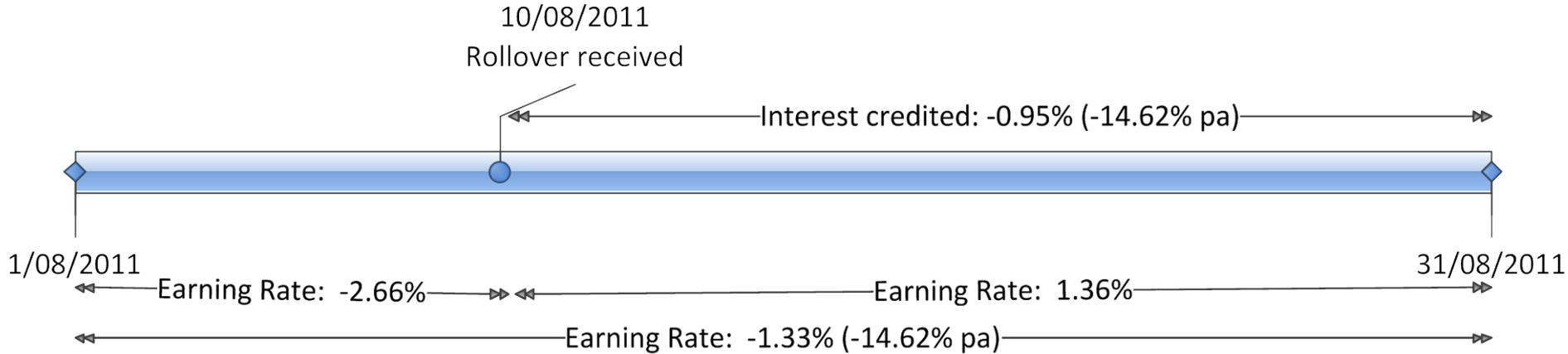
Key issues

- Frequency of calculation of crediting rates and unit prices
- Use of interim crediting rates
- Complexity of transactions
- Quality of disclosures and communication

Frequency

- Less frequent than daily
 - ⇒ For crediting rates - smoothing of returns
 - ⇒ For unit prices – stepped
 - ⇒ Reduces accuracy and equity for transactions within the period
- Frequency of calculation is typically aligned to frequency of switching

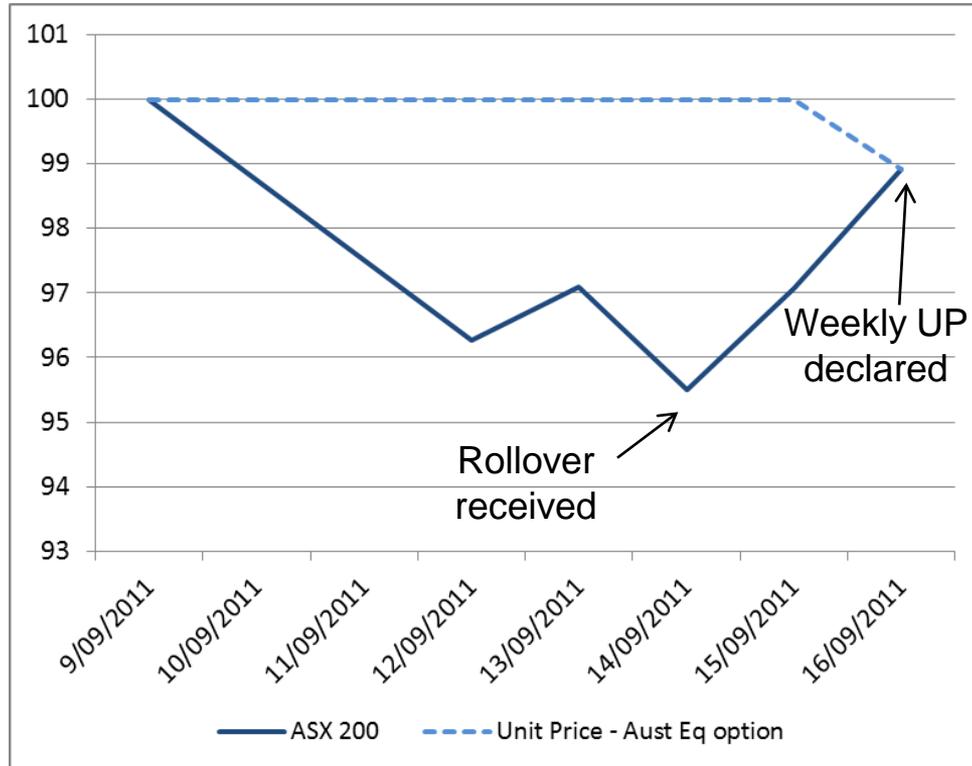
Case study 1: Monthly rates in a volatile market



Interest is credited to the rollover for the period 10 August to 31 August based on the fund's declared rate for the month, -14.62% pa

- Interest credited to member: -0.95%
- Actual earning rate for the period: 1.36%

Case study 2: Weekly prices in a volatile market

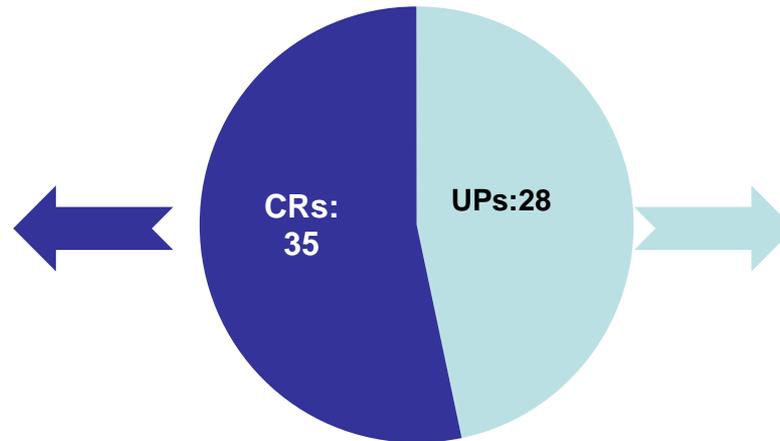


- \$100k rollover received effective 14 /09/2011
- Processed using 09/09/2011 unit price
- At 16/9/2011 Value = \$99k
 - A fall of 1.1%
 - ASX200 rose 3.6%

Industry practice

For industry and public sector superannuation funds

Frequency	Number
Daily	2
Weekly	4
6 Monthly	2
Monthly	15
Quarterly	1
Annual(*)	9
Unknown	2



Frequency	Number
Daily	9
Weekly	17
Monthly	1
Other	1

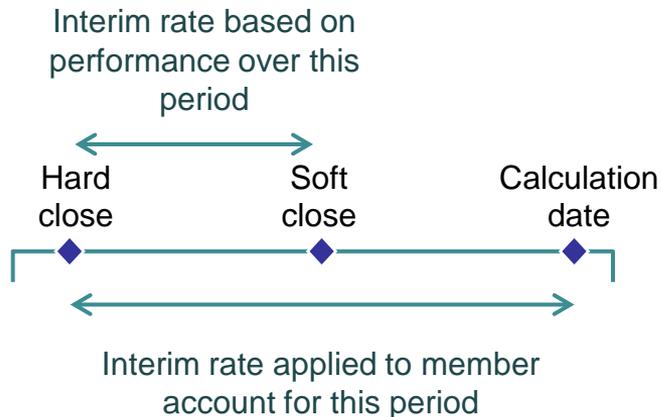
Note(*): Classification based on our interpretation of publically available disclosures

Frequency

- Effects exacerbated by volatile markets and significant cash flows within the unit pricing / crediting rate period
- Large cash flows increasing due to
 - Portability
 - Switching
 - Transition to retirement

Interim crediting rates

- Necessary where benefits are calculated effective any date other than a declared rate hard close date
- Typically used for
 - Benefit quotes
 - Benefit payments
 - Processing switches
- A common structure:
 - Calculated based on performance to valuation date
 - Applied for period to benefit calculation date (may be some time after valuation date)



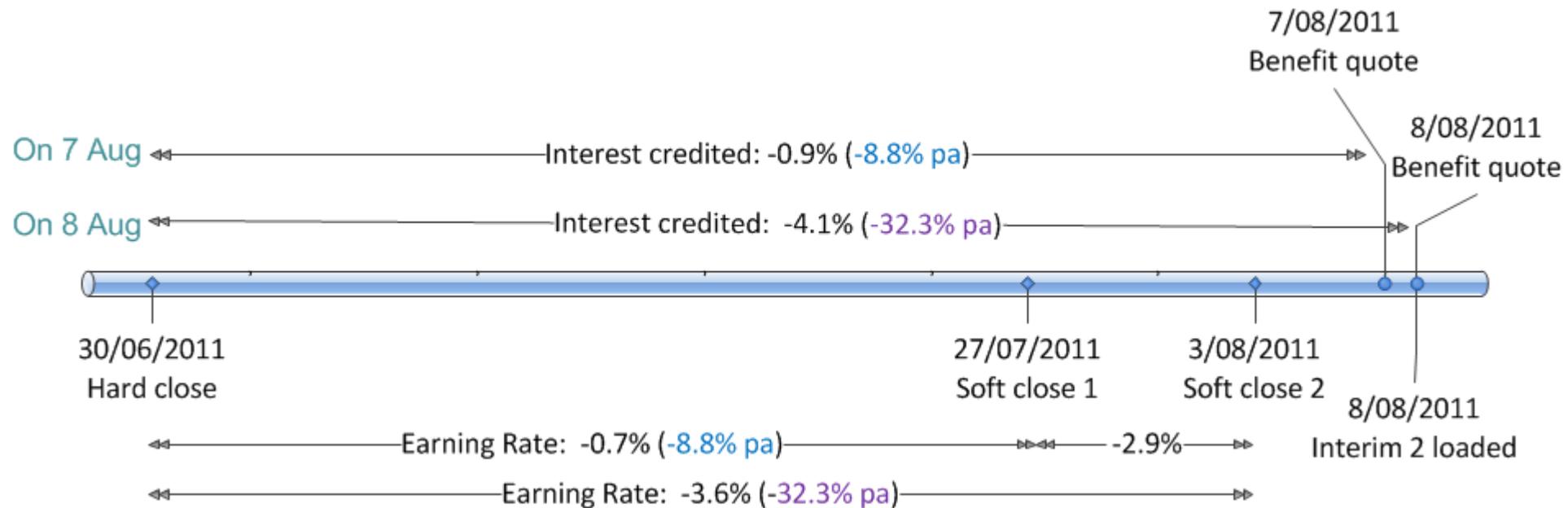
Interim crediting rates (cont.)

Issues:

- In volatile markets members' account balances can move significantly on the day that a new interim rate is loaded
- Members confusion and frustration
 - Benefit quotes are always an estimate based on the interim rate that applies on the date of the calculation
 - There is no fixed point
 - Difficult to reconcile quotes from one date to another

Case study 3: Interim crediting rates in a volatile market

- A member checks her balance on 7 August 2011 and again on 8 August 2011.
- Over the day the member's balance drops by 3%.
- Why?
 - Because a new interim crediting rate was been loaded



Complexity of transactions

- Funds that use a mixture of declared & interim rates typically have complicated:
- business rules
- processes
- calculation algorithms
- for switches and partial withdrawals.

Case study 4: Partial switch

- A member fully invested in option A requested a switch of 10% of his account to option B
- The switch was processed on 15 August 2011 in accordance with the fund's policies
 - Total account balance was crystallized
 - Calculation based on the interim crediting rate
 - Total account balance reallocated
 - 10% of the balance was allocated to option B
 - 90% was reallocated to option A

Case study 4: Partial switch (cont.)

Impact

- The 90% balance that was invested in option A throughout August 2011 was credited with interest based on
 - Interim crediting rate for 1 August 2011 to 15 August 2011
 - Declared crediting rate for 16 August 2011 to 31 August 2011
- Performance for option A was volatile during August 2011
 - Significantly better in the second half of the month
- Interest credited to the 90% balance for August 2011 was approximately 3% lower than the declared rate for that month

Quality of disclosure & communication

- Complexity means that funds struggle to respond to member queries
 - ⇒ Queries become complaints
 - ⇒ Members lose confidence
- Inconsistent disclosure of crediting rates

Conclusions

- Attribution methods have evolved, and must continue to evolve
- For many funds, crediting rate structures are struggling with
 - Volatile markets
 - Larger member cash flows
 - More financially sophisticated and demanding members

Conclusions (cont.)

- Issues raised relate to
 - Equity
 - Member expectations, perceptions and experience
- Some of these issues also apply to unit pricing where frequency less than daily

Unit pricing is the most appropriate way to allocate investment earnings and appears to be the best way to ensure equity for members who move between funds.

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