Media Report

Media	**Australian Financial Review**
Date	**29 June 2005**
Coverage	**National**
Circulation	**84,762**
Page	**36, Smart Investor**

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Calculating the cost of value

There is a call within the industry to standardise the pricing of units by superannuation funds.

Debate is raging over the best way to calculate the value of super fund units.

Photo-illustration: KARL HILZINGER

Lost amid the hullabaloo of the new choice of funds regime that begins on Friday, there is a row simmering over a complicated issue called unit pricing.

It all has to do with the way your super fund calculates the prices of your units in the fund and the earnings they generate. Different types of super fund do this in different ways, and there is a growing lobby calling for it all to be standardised.

Yesterday, actuaries Rice Walker produced a detailed study to stoke the debate, making a host of specific demands that would result in all public offer funds using the same unit pricing system.

First, some background. All new funds, and most commercial funds backed by financial services providers, use a method called forward unit pricing. In this system, the assets of a super fund are valued on a daily basis so that a unit value is determined at the end of each day. Applications to buy and sell units are processed using a price calculated after those applications have been received.

But many corporate and industry funds use a method called crediting rates. In this approach, a rate of interest is declared at specific intervals – annual rates used to be common, though they are now more commonly monthly or weekly – and then applied to the balance of each member.

People have two issues with the crediting rate approach. One is the argument that it is inequitable towards investors, because when you calculate values of assets over anything longer than a day, fluctuations in those assets (particularly shares) can lead to a misallocation of investment returns among members, particularly if they have been making contributions and withdrawals to the fund at different points during the year. Crediting rates are necessarily estimates.

The other issue has to do with the financial scandals that beset the US over a year ago, known as market timing and late trading. This is when people take advantage of changes in asset values that aren't yet represented in unit prices. For example, if a fund is priced weekly but you can buy into it today, and you know that markets have gone up, but that that performance won't be reflected in the fund's price until the end of the week, you can take advantage.

These scandals have had little purchase in Australia because of the forward pricing model, but it's a lot easier to manipulate a fund that uses an occasional crediting rate. And as industry funds and some corporate funds move into the choice of super regime, in which money will move in and out of funds much more frequently because people have much greater flexibility in their super, it becomes more and more of a pressing issue.

For these and other reasons, plenty of people want unit pricing to be the norm. As revealed in *The Australian Financial Review* yesterday, Deloitte responded to a recent unit pricing consultation paper from regulators the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority by recommending that "ASIC and APRA introduce regulatory policy that all new funds . . . calculate unit prices using only forward pricing".

(The regulators will make no formal comment before the results of the consultation are published in the third quarter, but the *AFR* believes the regulators won't force crediting rate funds to switch over: they will only publish guidelines.)

"There doesn't appear a great urgency to move to unit pricing."

Consultant Intech has been pushing for forward unit pricing for years. "The key is you should strike an accurate price as frequently as you allow investors to move in and out of the fund, and with the increased mobility with choice it demands more frequent pricing," says Brett Elvish, executive director. "That leads you to a full-blown unit pricing environment."

Another research group, Chant West, last week released a survey finding that half of all corporate funds use daily pricing and almost no industry funds.

Even industry funds that have already made the switch think things should be harmonised. "We strike a daily unit price – that's the most equitable method," says Brett Westbrook, chief executive of FuturePlus, which runs super schemes for local government employees and the energy industry. "Can you imagine going onto the share market and getting a price 12 months ago for a share? Daily is where best practice is at the moment."

And now comes the RiceWalker report. This calls for the establishment of industry standards to ensure good practice on unit pricing, and wants all organisations using the method to disclose whether they comply with it. It suggests all public offer super funds, and all default funds, should have to use unit pricing by July 2007. It wants all super funds to set out in detail the way investment earnings are allocated to accounts. It says all advisers providing advice on people moving benefits from one super fund to another should consider the impact of the pricing method the different funds use. And it suggests all organisations using daily unit pricing keep a minimum reserve aside in case of errors.

"If unit pricing is the optimium structure, then anyone taking money from the public should adhere to it," says director Michael Rice. "I can't imagine why they [the regulators] haven't made it compulsory."

But how much would it cost? The answer would depend on the fund but Rice reckons many corporate funds handling their finances in-house would have to spend upwards of $100,000 to reconfigure systems and make the change. And here's the first problem: over all industry and corporate funds using crediting rates, that probably equates to tens of millions of dollars.

Not everyone thinks that's sensible. "Given that most people aren't moving money around there doesn't appear a great urgency to move to [unit pricing]", says Mark Delaney, CEO of industry fund STA, which uses weekly crediting rates. He says people are more comfortable with the idea of an interest rate rather than a price anyway, and says when people request to come in or out of a fund it will be transacted at the end of the week on the price at that point, thus conferring no advantage to somebody who wants to arbitrage the price midweek.

And the Rice Walker proposal of putting aside a reserve, to handle errors from a system that is supposed to be less erroneous than the existing one, would certainly be controversial.

Howard Rosario, head of West Australian fund Westscheme, has a different objection. His fund is 40 per cent in unlisted assets that wouldn't be any more accurately valued on a daily basis than the weekly method he uses now, he says.

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