Getting to grips with superannuation

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Superannuation is not a topic most workers think of often. Job security, a pay rise or more flexible working hours are usually much more urgent priorities. But retirement income should be a big issue for everyone.

Since the former Labor Government introduced its Superannuation Guarantee Charge in 1992, almost all Australian workers have for the first time had automatic access to benefits. All but the most lowly paid casual workers now have employer payments of at least 9 per cent of annual salary paid into their superannuation accounts. Many make their own voluntary payments too, bringing average contributions to 16 per cent this year. At least $500 billion is now invested in super funds, on behalf of eight million Australian workers. This is serious money in anybody's language.

So it is surprising to find so little knowledge of superannuation and its complexities among employees. Most people seem to regard the subject as all too hard. And publicity about recent poor fund performance has only fed that perception. The tragedy is that people are seeing superannuation itself as a flawed product, when in fact the issue of how contributions are invested is the real issue. The superannuation system remains a highly effective, tax-advantaged method for building essential wealth for retirement. But employees need to take far more interest in how contributions are made and where their money is going.

There are various types of funds: corporate funds are run by large organisations in-house — the public service, large private firms, for example. Retail funds are offered to individuals at a fee by finance or insurance companies. Not-for-profit industry funds are run by trustees [both employer and employee representatives] and cover workers in a particular industry sector. Banks also offer retirement savings accounts [RSAs] that are similar to superannuation funds.

There is also a plethora of investment styles across the different fund types. Growth options typically invest almost exclusively in shares and property; balanced options choose diversification and spread funds across the various asset classes, with perhaps sixty per cent in shares and property and the remainder in cash, fixed interest and bonds; capital guaranteed options concentrate solely on the more conservative choices and are able to guarantee that there will never be a negative return. Which type suits best depends on individual circumstances, including age, retirement intentions and risk tolerance.

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During the past two years, there have been huge differences in the performance of individual funds. Those with heavy exposure to the share market have recorded consecutive negative results. This means that $100 000 invested in July 2001 is now typically worth around $94 000. High-fee funds would have seen even greater falls. By contrast, those focusing heavily on property have done extremely well. Their returns would have seen $100 000 grow to around $125 000. Conservative funds would have increased our $100 000 to around $110 000. Even within the main categories there has been marked contrast in results, even where two funds appear to have similar investment weightings.

The notion that superannuation is now a bad investment per se is clearly nonsense. It all depends on which — and which type of — superannuation fund you are talking about. And that is at the heart of the employee's dilemma. Some are fortunate to be in funds offering broad options for choosing how contributions are invested. Thus, workers nearing retirement, or nervous about the state of the economy, can switch all or part of their balance to a conservative, secure option and so maintain all the retirement wealth they have built up in preceding years. Alternatively, younger people can ride out short-term volatility by remaining in growth options, safe in the knowledge that in the long haul these achieve the best results.

But sadly, many people do not have this choice and are locked into a corporate fund that offers no investment choice. Others have taken out retail accounts and can only switch investment styles by switching between funds. This can be a costly exercise, with a doubling up of fees often compounding disappointing investment returns. The federal government is attempting to introduce this type of fund choice as its preferred vehicle for improving superannuation flexibility for employees. Arguably, however, choice within the existing fund is a better option, since it offers the only cost-free way of changing the investment mix to suit individual circumstances. It is highly doubtful that ordinary employees are ever going to be financially literate enough to be continually switching between one fund and another. Yet with just basic awareness they can quite easily switch between investment choices — and back again — within their funds without incurring any financial penalty, providing the fund offers this type of flexibility. Rather than choice of funds, it is actually choice of investment styles that is critically important for employees as their circumstances change over a full working life.

At present, the industry funds are especially attractive in this sense. Almost all offer multiple switching at no cost. They have also totally outclassed their competitors in investment performance terms. The recently-published InTech annual review of balanced super funds finds that the retail funds have recorded an average 2.4 per cent loss for the past year, following a ▸

4 per cent loss in the previous year. Balanced industry funds have done far better with their best performers recording gains of between three and four per cent last year, following slightly smaller gains the year before. Eight of the ten best-performing balanced super funds are not-for-profit industry funds. CARE, the industry fund for the clerical, administrative and retail sector [and, incidentally the fund chosen by ALIA for contributions for its staff] is Australia's best-performer over the past five years with an average annual return of almost five per cent. Industry funds also offer very attractive add-on services such as low cost life and disability insurance and home loans. And industry funds are massively cheaper too. On average a retail fund charges annual fees of $1200 on a $50 000 balance, according to *The Australian*. Industry funds average annual charges are $249 on the same amount.

Given all this, it is surprising to see some so-called 'superannuation experts', business spokesmen and politicians still criticising industry funds continually. Just this week, some of these people were at it again. Industry funds should spend more on marketing; should promote themselves more; and, if they wanted to encourage more employers to use them, should 'switch their focus away from employees'. This is a remarkable argument, rather like advising Woolworths to stop concentrating on shoppers. But the thinking behind it is quite clear: industry funds have to recognise, they were told, that 'if you don't pay commissions [to them] no financial planner will recommend you' to employers. And there we have it. Contributors need to understand that those commissions would come straight off the top of their account balances.

Since award superannuation began in 1988, the proportion of Australian workers with superannuation has risen from forty-seven per cent of full-time employees to the present ninety-eight per cent. Industry funds have played a major part in this very positive development. Throughout this time the finance sector has attempted to get its hands on as much of this guaranteed income source as possible. That is what lies behind its opposition to industry funds.

Australian employees need to take much closer interest in their superannuation. Choices they make about its management involve highly personal issues. There are many options available to them, and there will be more in the future. In making their decisions, they should carefully weigh their own needs. And they should be extremely sceptical about advisers whose first action is to direct them to high-fee, high-risk strategies. ■

Eight of the best performing balanced super funds are not-for-profit industry funds...

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