Superannuation for Dummies

Lack of investor engagement with superannuation is a widespread issue. The Institute Benefits Projection Working Group provides guidance on fee comparison for retail investors, and argues standardised measures would help both consumers and financial advisers.

A major finding from the Government's Cooper Review into the superannuation system was that it is too complicated, and as a result, people are not engaging with their superannuation.

Superannuation is a complex product. It packages insurance, investment and retirement funding – each of these can be a difficult technical topic in itself. Thus, it is not unusual that consumers' eyes glaze over when confronted by the jargon used in modern superannuation literature.

However, even granting the inherent complexity of superannuation, the current regulatory structure does very little to help interested consumers understand and compare superannuation products.

Investors would be better equipped to make decisions about super if the Government mandated standardised measures and terminology for more meaningful comparison of investment strategies and fees charged by superannuation funds.

Investment strategies – not just performance measures

When investors compare super funds, they should consider:

- the expected future return;
- the expected future volatility;
- their personal risk appetite; and
- other risk characteristics such as liquidity and risk of default.

One of the components of the Government's new 'Stronger Super' reform package is the introduction of a standardised 'MySuper' product as the basis for compulsory super contributions for employees who do not wish to choose their own investment strategy.

MySuper may go some way towards simplifying the investment component of superannuation, but employees will still need a method to compare MySuper strategies offered by different funds when they change jobs. The only tools currently at their disposal are the published past performance and the trustee's stated strategy and objectives. The major difficulties with these tools are a lack of standardisation in the calculation methods and the presentation of the results (if you can find them).

To help investors make informed comparisons and decisions about their super fund, the Government should mandate and provide free access to additional measures to facilitate more accurate comparisons of a fund's investment strategy:

- average performance, net of investment-related taxes, fees and costs, calculated on a consistent basis over one or more (agreed) timeframes;
- a measure of historical volatility, such as the 'standard risk measure';
- a liquidity measure such as the percentage of 'listed' versus 'unlisted' assets;
- a standardised investment expense ratio based on only investment-related fees and costs; and

- other standardised indicators of investment strategy differences such as 'growth' versus 'defensive' assets, overseas versus domestic assets, hedging ratio for overseas assets and use of 'active' versus 'passive' management.

Many fund members would need professional advice to understand and apply all of these measures, but they would be assisted greatly if advisers and commentators have access to a standardised set of regular performance measures.

Separating fees and costs

A major weakness of the current disclosure regime is a lack of clarity in how fees and costs are charged and disclosed. While fees are by no means the main driver of retirement outcomes, it should be possible for consumers to at least understand and compare the fees charged by different funds.

Some fees simply cover administration services such as the cost of collecting contributions, keeping records, and in some cases, additional services including web access and helplines. For most consumers, there's little point in paying extra fees for administration, unless they believe the additional services are worth the cost.

By contrast, many investors will be prepared to pay higher investment fees to gain access to asset classes that may earn better investment returns or achieve a better diversification.

The fees consumers are willing to pay should vary according to their life stage. For example:

- for younger employees starting their first job or changing employers for the first time, the focus will usually be on portability, simplicity and low fees;
- as employees move into the early stages of family life, when families are young and mortgages are high, a fund that provides optimum insurance may be the best solution; and
- later in their working life, when superannuation balances are larger, personal commitments are lower and retirement is much closer, employees may be more willing to pay a higher fee for professional advice regarding investment or retirement strategies.

To enable consumers to make informed super fund choices, fees and costs should be separated into three components:

1. **administration;**
2. **advice; and**
3. **investment.**

This may seem obvious, but many funds currently charge a single fee to cover all these components. Some funds charge a separate dollar fee for administration, but part of the "management fee" covers administration and advice, as well as investment management costs.

So what's the big deal? A young employee wanting to choose a low-cost fund to receive contributions from a part-time employer would have to understand the complexities of such a fund's investment strategy to be able to assess whether the package as a whole represents reasonable value for money – an unreasonable demand.

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Comparing fees and costs

The Cooper Review suggested that the regulatory body (APRA) should produce a 'league table' enabling fund members to compare fees on a consistent basis.

The difficulty with this proposal is that the impact of administration fees on a fund member's account balance depends on the combination of fixed dollar and asset-based fees, and the size of the member's account balance and annual contributions.

As such, every case is different. Moreover, the fixation on fees is unhealthy, unless it is placed in the context of retirement outcomes (which are, after all, the ultimate objective of retirement funding policy).

A better approach would be to focus on the impact of administration fees and costs on the eventual retirement benefit outcome over a working lifetime. APRA could provide projections for a hypothetical employee starting a career at age 25 and retiring at age 65, ignoring differences in investment strategy, but showing the impact of administration fees and costs alone.

An even better approach would be for APRA to provide a standardised framework for super funds to do the calculations themselves. ▲

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