The Australian

The brave new world of superannuation

- **Geoffrey Newman**

- From: **The Australian**
- January 13, 2011 12:00AM

Recommend Be the first of your friends to recommend this.

Share 2

10 retweet

LAST year was tumultuous for the superannuation industry, but 2011 promises to make the past 12 months look like a holiday.

The industry is being reshaped and remodelled and no super-annuation fund or individual with a super account will be unaffected by the changes.

The federal government may have committed to implementing most of the Cooper review reforms and the Future of Financial Advice changes, but some of the most difficult issues on the path to reform will be nutted out this year in consultations between super funds, Treasury officials and other key stakeholders.

The first pieces of draft legislation are expected to appear this year, but the fine detail of many changes is still to be resolved.

Super funds will be retooling their business models to operate in the new, more competitive super landscape, and that means working out how to contain costs, attract members, and retain existing ones. It means also considering opportunities to merge with other super funds, an imperative the reforms are helping to drive.

Despite the apparently overflowing dance card for the super industry, one target of its affection is cherished above all others: the proposed increase in the superannuation guarantee from 9 per cent to 12 per cent.

Increasing the super guarantee is estimated to add an extra $500 billion to the retirement savings pool by 2035 and add an average $150,000 to the retirement savings of the nation's youngest workers.

The extra money in the pot will also increase fees that can be earned by funds and their investment managers.

Actuaries Rice Warner estimate that although fees as a percentage of super assets will halve over the next 15 years, the dollar amount of those fees will double.

Superannuation Minister and Assistant Treasurer Bill Shorten laid it on the line at the industry's annual conference in Adelaide in November. He said the industry had a small window in which to push through the super guarantee increase and would have to lobby hard for it to be accepted by parliament and the community.

The Coalition is opposed to it because of the impost on small businesses and the fragile minority Labor government may not be around to have a second try.

Shorten said the industry must co-operate on the Cooper reforms to super, chiefly MySuper and SuperStream, if they wanted to win public acceptance of the increase, which would be phased in over six years from 2013.

Making super work better and at lower cost to consumers was a prerequisite to pouring billions of extra dollars into the system.

Shorten said the government was not going to keep "spreading your toast" for nothing in return.

Boosting retirement savings is undoubtedly essential, despite some disagreement on the best way to achieve it.

Rice Warner estimates the gap between what Australians are saving in total and what they need for a comfortable retirement has blown out to $900 billion.

Most experts believe that garnisheeing 9 per cent of wages and salaries over a working life is insufficient to meet the income expectations of retirees.

But increasing the super guarantee will prove harder than it should, mainly because the federal government has insisted on tying its fate to the passage of the mineral resources rent tax.

The government argues the tax is needed to offset foregone income tax thanks to the increase in the super guarantee.

Australian Institute of Superannuation Trustees chief executive Fiona Reynolds says there is a mistaken belief that because the super guarantee increase was announced early last year, it is a foregone conclusion.

She says the industry will have to better explain its case to build support for the increase.

But there may also be a risk that the more people hear about it, the less they like the idea.

A recent Axa survey found only 46 per cent were in favour of the increase, much lower than previous surveys had found.

However, some believe the increase is not as critical as the industry claims.

Rice Warner director Michael Rice says if the super guarantee increase fails "the world won't end", at least for super fund members. He says the average contribution rate from employers is actually about 14 per cent because many industry and public-sector funds contribute much more of their employees' income in super than the minimum 9 per cent.

He says 12 per cent won't close the retirement gap: a 15 per cent to 20 per cent super guarantee would be required for that to happen.

A larger pool of super will make it easier for the industry to absorb the costs of reform and increasing competition.

Bigger, more efficient (and fewer) funds are the goal of the government and the Cooper review.

Bigger funds can leverage the advantages of scale, providing more services to members at lower cost.

They also have more and better investment choices and can negotiate lower fees with investment managers and insurers.

Super funds are spending tens of millions of dollars gearing up for competition, streamlining systems and improving communication with members in the hope of strengthening brand loyalty.

MySuper, with its focus on lower fees and increased transparency of fees and investment performance, is expected to accelerate this trend but funds are not waiting for its introduction.

There is increasing competition in the low-cost space with retail funds such as AMP and BT, and industry fund Hostplus launching super cheap and popular, passive investment products.

Mergers are another way to meet the demands of increasing competition and more are expected this year.

"We hear a lot of funds are looking at the possibility of mergers," industry consultant Warren Chant says.

The biggest fund merger announcement so far was made last year with the planned $28 billion merger of First State Super and CareSuper.

Sunsuper chief executive Tony Lally says the barriers to mergers can be formidable because funds tend to be closely aligned with the values and culture of a single sponsor such as a profession or a trade union and it can be difficult to overcome cultural differences.

Cooper would like to see some of those rigidities disappear through improving the sector's corporate governance standards.

The government may not have granted him his wish for an end to the equal-representation rule on trustee boards and more independents, but the need for increased professionalism from trustees in a bigger, more competitive industry seems axiomatic.

Each sector points to alleged failings of governance in the other: industry funds point to conflicts of interest on retail-fund boards where trustees can be employees, and retail funds see the equal representation requirement of employers and employees on boards as anachronistic.

Funds will have to compete also for a declining number of superannuation accounts.

The industry has thrived in the past on the broken system, whereby new accounts are opened every time a person changes his job, leading to his super being spread over multiple accounts and inactive accounts being transferred into high-cost eligible rollover funds.

With each new account comes an additional administration fee.

But Australians are becoming more savvy, taking their accounts with them and they are also more willing to consolidate accounts.

Private companies that assist members in pooling their super are making that task easier and the government is set to make it easier still by making tax file numbers the primary identifier for super accounts.

SuperRatings reported recently that major super funds had their new member growth rates fall to an all-time low of 1.7 per cent in 2009-10, five years after most Australians were given choice about where to place their super.

"The flow-on effect . . . is that many funds' costs will come under increasing pressure as the two decade long new customer spree has hit a brick wall," SuperRatings chief Jeff Bresnahan says.

"Many are now unsure of just what the future holds."

Lally says the number of accounts could shrink by 20 per cent in the next five years because of these trends, resulting in a large fall in revenue for some funds.

For this reason some like Rice Warner, are sceptical that superannuation fees will fall at all.

"Fees won't fall, costs savings will be redeployed into other areas," Rice says.

Large funds will continue to be threatened also by the growth of self-managed super as an increasing number of Australians believe they can do a better job of investing their savings.

But funds are fighting back by offering increased flexibility, such as the ability for a person to trade directly a

certain proportion of his shareholding.

Reynolds says not-for-profit funds need to look at developing their own version of a self-managed fund.

"We are in real danger that as soon as people get a decent retirement balance they go and start up an SMSF," she says.

The fees deducted from a superannuation account, although important, are not the biggest determinant of how much money a person retires with.

Investment performance remains the biggest swing factor.

The industry generally believes it is performing well and delivering on its promise to give stable, solid investment returns, but many admit another bad year for the sharemarket will not be a welcome development in trying to encourage people to save via super.

"Markets are a critical piece of the puzzle in 2011," BT's head of super Melanie Evans says.

The most recent superannuation statements members would have received from their super funds show that the median balanced fund returned 9.79 per cent in the year to June 30 as sharemarkets bounced back.

But median returns are still down 3.52 per cent a year over three years in the wake of the global financial crisis.

Longer term returns are higher if not spectacular, with the average balanced fund returning about 5 per cent a year over the past 10 years, after fees and taxes.

But that is still barely above the return on cash in the bank over the same period.

Reynolds acknowledges funds have to get those returns higher to show people that investing in super and the sharemarket is worth the added risk.

"It's not good for us seeing stories that you would have been better off putting your money in cash," she says.

But she says the stability of returns is important also.

"It's more about stability than shooting the lights out returns," Reynolds says.

Mediocre investment returns, along with the halving the annual caps on concessional contributions to super, have combined to slash voluntary contributions.

Chant says another poor year for sharemarket returns will put pressure on retail super funds in particular because their cashflows are more dependent on voluntary contributions.

He says although only 10 per cent of net cashflows for industry funds come from net voluntary contributions, that figure is 50 per cent for retail funds and they will be hit harder if those contributions do not recover.

Another related battleground will measuring performance.

The Cooper reforms require that funds report investment returns in a consistent fashion, yet there is wide disagreement on how returns should be measured.

"The areas that will really create some heat are the measurement of (fund) performance and measuring the volatility of performance," Cooper says.

Chant West says the only fair way to measure performance is to deduct all fees and taxes from gross investment returns to get the amount that is actually credited to a member's account, but at present not-for-profit funds don't deduct administration fees because they can be different for each member.

The Australian Prudential Regulation Authority produces league tables that try to capture an average

performance across a fund's many investment options, but they are unlikely to meet the higher standards required by Cooper.

Median returns tell only part of the story, however, and how well that money is invested and spent still depends on decisions made by members.

As investment balances grow, people are increasingly hungry for financial advice but Australians have shown a reluctance to pay for such advice.

A recent survey by Investment Trends shows people think $300 to $400 is a reasonable price to pay for a full financial plan, a price advisers say does not even cover their costs.

Cooper says a form of low-cost advice that all members of MySuper funds can access easily is an important part of a revamped default super fund.

The federal government has not yet insisted that MySuper funds offer integrated advice from July 2013, but it does want the industry to come up with a solution that would give everyone access to advice.

Perhaps the most difficult puzzle is educating and motivating those who take too passive an approach to superannuation.

Being passive has financial consequences.

The global financial crisis highlighted the disturbing fact that many people were not aware how exposed their savings were to movements in the sharemarket.

Many approaching retirement found, in hindsight, that their super should have been in a more conservative investment option.

Some super funds are working on clever ways to get people more involved in their super with some working on iPhone apps, for example.

But is that sort of day-by-day engagement going too far?

Cooper says people should choose the best fund for them but they shouldn't be trying to chase last year's investment returns.

"You don't want a culture where people switch super funds a couple of times a year," he warns.

Recommend Be the first of your friends to recommend this.

Share 2

10 retweet

Copyright 2011 News Limited. All times AEDT (GMT +11).

All times are EST. © MarketWatch, Inc. 2008. All rights reserved. Subject to the **Terms of Use**. Designed and powered by **Dow Jones Client Solutions**. MarketWatch, the MarketWatch logo, BigCharts and the BigCharts logo are registered trademarks of MarketWatch, Inc. Dow Jones is the registered trademark of Dow Jones &

Company, Inc. Intraday data delayed at least 15 minutes. "Intraday data is provided by **Interactive Data Real Time Services** and subject to the **Term of Use**." FXQuoteTM provided by GTIS, an Interactive Data Company "Historical and current end-of-day data provided by **Interactive Data Pricing and Reference Data**". FTSE (Footsie) is a trade mark of the London Stock Exchange and the Financial Times and is used by FTSE International under license.