

Choice of Super Fund

March 2005

From 1st July 2005 employees will be able to choose a fund to which the employers have to pay the compulsory 9% super contributions (will not apply to voluntary, salary sacrifice or additional employer contributions). It is estimated about half of the Australian 10 Million working Australian will be offered a choice. If only 10% of these employees change their fund approximately 50 Billion dollars will move.

If you are working under a state industrial awards or under Australian workplace agreements and certified agreements or already in a defined fund, this choice may not be offered to you.

Employers would have to hand over a form to all employees before 28th July, where the employee can choose a fund including the employer's current fund as the default fund. If you decide to do nothing, your employer will pay your super into the default fund. You will be able to nominate any complying fund, which offers life insurance.

You can choose any public offer fund either in your industry or a retail fund. It can also be your self managed super fund provided it has death cover of at least \$50,000 for employees under 35 years of age. Further, employers can accept only one choice every 12-month period.

Choosing a good fund can be difficult, as many studies have proven that there is no correlation between return and fees charged. Well-known public offer super funds are beaten by many unknown names based on performance and flexibility. And past performance is no guarantee to what will happen in the future.

Also it is not very easy to compare two funds, as there are varieties of fees charged by public offer funds. Some of the examples are, entry fee, asset fee, financial advisor fee, management fee, administration fee, exit fee etc. Employers cannot offer advise on which fund you chose, using a financial advisor to assist can be helpful but their advise could be bias as they may have a vested interest (cut from entry fee) in recommending a particular fund.

To check if your fund is meeting the industry benchmark, ASIC has released some figures. An average growth fund has returned between 3.9 % to 5.5% (after all fees) in the past five years and balanced funds the return is even lower. Due to the recent climb in the share market, many funds have failed to recover the losses suffered in previous years.

Rolling over existing fund balance to the fund of choice should be considered carefully, you must first consider the exit fees beforehand and entry fees at the receiving end. Paying a set of fees to one fund makes more sense than paying to two funds.

A recent survey by selecting super found that average total expense ratio of fees is 2.3% of which average entry fees is 1.4% and the balance 0.9% in ongoing fees. Where funds do not have an entry fees the ongoing fees average about 1.8%. Industry funds have an average closer to 1%, for full results please visit www.selectingsuper.com.au

Earlier employers could choose and now the employees have a choice, so what is the fuss about. It is all about the returns and fees charged on the fund balances, over big balances, currently over 600 Billion and increasing at the rate of 12 Billion in new money entering in the form of compulsory super. At one end we have comfortable retirement and if super fund not invested properly, age pension (currently \$235 per week or \$393 for couples) after retirement.

After all, what can a 1% difference in return or fees make to the balance of fund is an interesting question. We did our calculations on the assumption a 40 year old person earning an average income of \$42,000 receiving compulsory 9 % super with current average super balance of \$24,000 will have at the time of retirement at the age of 65 years if salary increases each year by 3% and the return on the super fund is 5% and total fee charged by the fund is an average of 2.3% with 15% tax on contribution and income of the super fund . The following table gives the results

Balance a the age of 65			
Rate of Return	Rate of Fees Charged on Balance of Fund		
% Return After 2.3% fees	1.3%	2.3%	3.3%
-2.3%	94,549	85,366	77,380
0	121,413	108,623	97,567
2	204,694	180,184	159,177
5	306,086	266,841	233,333
6	352,096	306,086	266,841
7	406,077	352,096	306,086
10	631,350	543,887	469,450

The above figures demonstrate that a cheap fund with lower return should not be our target. The average return and fees our average person could end up with only \$266,841 which translates to \$257 per week @ 5 % return. In today dollars terms with 3% inflation, fancy retiring on \$123 per week! it's your choice....