Saving super: counting the cost of fees

A strategy to put $38,116 extra in your pocket.

Summary: Fees are generally an invisible force within superannuation, and they can make a significant difference to your account balance over time. Most of us don't take them into account.

Key take-out: Those in managed super funds need to ask what fees they are paying on their super, insurance cover, and for external financial advice.

The highly effective industry super "compare the pair" campaign has rightly focused attention on the difference the cost of funds management makes to retirement.

According to my calculations, by the age of 60 an Australian super fund member (who at age 50 held an account balance of $500,000) could be around $38,000 better off – simply by shopping around for a more cost-effective super fund. While a half percentage saving in fund fees doesn't sound like much, over a decade this can mean an additional $38,116 in your fund!

That number is based on the difference between fees of 1 per cent pa versus 0.50 per cent per annum on a super balance of $500,000, accumulated for 10 years, plus Superannuation Guarantee contributions at 9.5 per cent per annum on an annual salary of $60,000. The calculations assume salary indexation of 2.5 per cent per annum and average gross earnings of 7.44 per cent per annum.

Just don't make the mistake of thinking industry super funds are free. The average cost to the member in an industry super fund is around 1 per cent to 1.3 per cent per annum, and this is significantly higher than it should be.

Depending on respective investment risk profiles, most super fund clients with competent financial advisers are paying between 0.45 per cent and 0.65 per cent per annum on their managed fund super investments. This leaves the many industry and retail super fund members (paying 1.0 per cent per annum and over for the same service) at a distinct disadvantage.

Fees are also an issue for the trustee / members of self-managed super funds who have not factored in their investment costs, on the assumption that since they are doing everything themselves it is also free.

In addition to the cost of their own time, they also are paying for accountants, lawyers (and in the case of some SMSF clients) financial advisers. These costs quickly add up, as does the opportunity cost of all the responsibilities and time that go hand in hand with running a DIY fund.

According to the Financial Services Council/Deloitte Access Economics, Australians will collectively save almost $300 million per annum in fees per year across 14 million MySuper accounts. MySuper is an Australian Government superannuation initiative to provide low-cost and simple super products for employers to choose as their default super fund.

When viewed collectively, the MySuper savings represent big dollars, and are an ostensible 'punch on the nose' to the vested interests of the managed super fund industry. When you do the sums however, $292 million divided by 14 million equates to just $20.86 per account. Even as savings over a decade, this only amounts to around $200 – 300 in fee savings to the individual, which certainly won't make much of a difference to the quality of a retirement.

So, what should we as super fund members do?

Firstly, if you are in a managed super fund, simply ask your super fund how much you are paying in fees as a percentage. If the number is 1 per cent or over, you are almost certainly paying too much.

Based on the scenario outlined above, this is the equivalent of giving your fund a new car on your retirement, a seriously good holiday in Europe, or about 10 trips for you and your spouse to Phuket ... when any of them could, and should, have been yours!

But the questions (and changes) should not end there.

Don't overlook the cost savings on personal insurance in super

Make sure that any life and total and permanent disability (TPD) insurance is arranged 'commission free' with premiums paid directly from your super.

On average, I estimate that an Australian super fund member aged 50 with $1 million in life and TPD cover can achieve further premium savings of $990 per year by paying 'nil commission' premiums directly from their super fund (as opposed to meeting these costs from personal cash flow).

The savings reflect the difference between insurance premiums 'with commission' versus 'nil commission' for a male aged 50 (occupation office worker) for life and TPD insurance of $1 million held within super. As a general rule, the premium savings on "commission free" life insurance cover is approximately 30 per cent.

There are several factors at play: the first is that premiums for insurance inside super can be paid from fund earnings, so the tax treatment is therefore more generous than paying these with personal after-tax dollars. Secondly, insurance premiums are also usually tax deductible within the fund, producing a further reduction in the net cost of cover.

Furthermore, in the event of a claim, a life insurance benefit can be paid tax free to a spouse or dependent children. In the event of a TPD claim, the benefit is able to be retained in the tax-effective super environment.

Hire a financial adviser and have the hard discussion

Now, a lot of people have 'drunk the Kool Aid' and subscribe to the view that a financial planner will add costs and /or consume these and any other savings. My advice: do the numbers.

Have the hard discussion with your adviser, don't just slink away. You may find they offer different tiers of service, so a less expensive approach may be appropriate at your stage in life and may well be to your advantage.

A financial adviser should be held to account. If they are not returning you benefits/savings of at least double what you pay them – every year – leave them and find one who will. Just don't forget to factor in the value of their advice on Centrelink and taxation strategies as well.

Rice Warner, a highly-respected firm of actuaries, reported recently that it expected the industry to arrive at super fees of around 0.5 per cent per annum in a decade. But, in my view, that is 10 years (or $38,116 extra in fees) too late.

Competition is the force which will drive down super fees, but consumers need to be better armed to understand the battle they are in. I agree with FSC chief executive Sally Loane when she says, "if competition reforms are introduced to allow all funds compete in an open and transparent market, fees in superannuation will fall dramatically."

I look forward to that scenario. As a society, we need to expend considerably more effort to raise the standard of financial literacy in order to equip ourselves better to drive down the costs of funding our retirement.

The vested interests of the super fund industry will come slowly and reluctantly to the table on lowering fees. It is in their interests to delay the inevitable reduction in fees for as long as they can – regardless of the benefit that such a change would bring to their members.

The big funds (all of them) want to hang on to that $38,116 of yours for as long as possible.

Theo Marinis