Industry super at risk of hubris

How the Productivity Commission could go one better for comparison sake.

Industry super funds are taking their current position for granted. They risk performing like old-fashioned retail funds if they allow hubris to set in.

There is the risk of industry fund executives becoming self-congratulatory and complacent. That, in turn, runs the risk of letting the rot that infected some of their competitors to creep into their practices.

As the outflow of funds from banks to industry funds becomes a flood, we may also see a leaking of the same executives – those who earned their stripes at the Big Four banks – emerge in the industry fund world.

If this happens, it may not be long until the same old bad practices reoccur under a different guise.

And while the Hayne Royal Commission and the Productivity Commission appear to have anointed industry super as the most efficient way for saving for retirement, there is an efficiency limit.

For super balances of $400,000 and over, there are far more cost and efficiency benefits to be gained by using a retail investment platform.

I view the 'active' management styles employed by most industry funds as gambling with member funds. A statistically far smarter bet is to buy index funds. It's a much more cost-effective solution.

Where industry funds have an advantage (as the advertising campaign has made resoundingly clear) is they are cheaper in many cases (but not necessarily better) than most retail, bank-run funds.

I stress this may be better – but not in all cases – as there are several retail funds charging half the cost of the industry fund equivalent.

My greater concern is the inability to make proper comparisons.

Consumers are often confused by the description of 'good' and 'bad' funds, when both industry and retail funds invest in the same asset classes. The evaluation comes down to what exposure each fund has to specific asset classes, and how well diversified the underlying portfolios are within and between each other.

This lack of comparability between funds leads to misrepresentation. For example, many funds labelled 'balanced' (traditionally a fund which has a 70/30 ratio to growth versus defensive assets) have an 80-90 per cent, or even higher, growth assets exposure.

Funds with higher exposure to growth assets will obviously perform better in good times than funds which have, say, a 65 per cent exposure.

When the market corrects, however, as it always does, the fund with the highest growth assets exposure will be subject to the highest falls. This leaves investors in that fund to wonder why their 'balanced' portfolio has been so adversely affected.

Bear in mind, there is nothing wrong with a higher to exposure growth assets if your investment risk profile and life stage warrants it. In my 40s, my exposure to growth assets exposure was well into the 90 per cent range. Now that I am in my mid-50s, this exposure is well below 80 per cent.

Given that I have always advocated for cost-effective funds, we recently ran a comparison with what our clients pay with the five 'best' industry funds (as identified by rating agency Canstar in February 2019).

This is not as easy as it sounds, as there are no strict rules governing how funds describe asset allocations and/or (often the lack of) strategies for diversifying investment risk.

A comparison of the total costs and performance of 'balanced funds' over a seven-year period based on an investment of $500,000 is tabled below:

Fund	Accumulated Value 7 years ($)	Return on investment (%)	Investment Management cost pa (%)	Growth Assets exposure (%)
Catholic Super	$922,269	9.14%	1.17%	85%
Host Plus	$998,799	10.39%	1.40%	93%
CBUS	$979,952	10.09%	1.07%	85%
Australian Super	$982,447	10.13%	0.88%	78%
Sun Super	$956,518	9.71%	0.73%	81%
Non-industry fund balanced portfolio *	$969,408	9.92%	0.50%	65%
Non-industry fund growth portfolio *	$1,061,210	11.35%	0.50%	80%

Diversified portfolio constructed using MFG researched investment options, managed via an MFG approved investment platform.

It makes an interesting comparison – and highlights the difficulty of comparing apples with oranges!

The Productivity Commission's proposed beauty parade of the top 10 performing funds is sadly doomed to fail because of the lack of transparency. The impact could be enormous. If suddenly, 30 per cent of the population 'piles in' to the top fund and become overweight in growth assets, then when the inevitable occurs they will see their retirement savings hopes dashed.

I believe that a better focus for the Productivity Commission and government in the post-Hayne era would be to define the various asset classes, so we can compare apples with apples, and to focus more on the quality of advice provided.

Superannuation has become far too complex (and too opaque) for the average worker to navigate in order to find the best outcome possible. In a former life as a Centrelink FIS officer, I saw this every day.

The quality of the advice and the appropriateness of guidance tailored to the individual makes the biggest impact on the long-term wealth accumulation and the preservation of capital. It should not be limited just to the tools the adviser uses.

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