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Comparing super funds

Apples vs apples or fruit salad?

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Fifteen to 20 years ago superannuation funds largely invested in distinct and clearly defined asset classes; like shares, property, fixed interest and cash. The risk level was measured based on the percentage of growth assets which were defined as shares and property, and the rest was classified as defensive assets made up of fixed interest and cash.

Since then, superannuation funds have increasingly invested in 'alternative' assets, which are made up of a variety of types of assets often with very different risk profiles. These include asset classes like infrastructure, private equity, hedge funds, absolute return funds, and investments in non-investment grade fixed interest (or credit). These assets may be illiquid and/or highly leveraged. Moreover, as they are often unlisted they tend to be valued on an infrequent basis which reduces their perceived volatility.

The asset allocations of superannuation funds have therefore become more complicated, and the classification of funds according to their risk level more difficult. The traditional definitions of growth assets and defensive assets do not seem to work anymore. Some funds are classifying these new asset classes as 100% defensive, other funds are classifying them as 100% growth, and some choose to classify them as both growth and defensive. While the latter may best reflect the nature of the assets, the classification is subjectively determined by the fund.

The superannuation funds make representations to members, and are shown in surveys like SuperRatings, with a certain level of growth assets. However, funds are calculating this differently and it is very difficult to make comparisons of the actual investment risk. Over time, funds that have higher exposures to more risky assets would be expected to outperform, but members need to understand what they are buying and the underlying risks involved.

In 2010, APRA stated that investment risk should be measured as the likely number of negative annual returns over a 20 year period. APRA then asked the FSC and ASFA to develop industry guidance for the disclosure of investment risk, and subsequently a seven level classification system (the 'Standard Risk Measure') was developed. This measure has not been widely adopted, is not used to determine the main survey groupings, and is seen by many to have a number of flaws (including being overly sensitive to the underlying assumptions). APRA has also defined a reporting standard (SRS533) which defines asset class types, but it does not address how to aggregate assets into totals for 'growth' and 'defensive' assets.

Therefore, we believe that more work needs to be done on an industry-wide and generally accepted process for classifying the level of risky assets within a fund so that comparisons can be made on a like for like basis.

Typical asset allocations

Fifteen years ago and now

In Figure 1 we have shown a typical strategic asset allocation for a fund fifteen years ago. The property may have been split into direct and listed components, and the fixed income may have had an international and/or inflation-linked component, but in broad terms the typical strategic asset allocation was as shown. The average allocation to growth assets in a typical fund was around 65–70%.

A typical superannuation fund today would probably include allocations to infrastructure and private equity, and the total allocation to assets other than fixed interest and cash would be higher.

In Figure 2 we have shown the strategic asset allocation for two large funds today, taken from the funds' websites.

SuperRatings lists the growth assets for both funds at 76%, which falls at the top end of the 60–76% growth asset range defined for inclusion in the SuperRatings balanced survey.

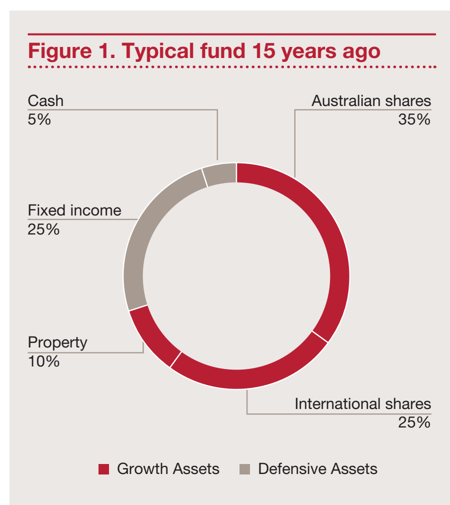

Figure 1. Typical fund 15 years ago

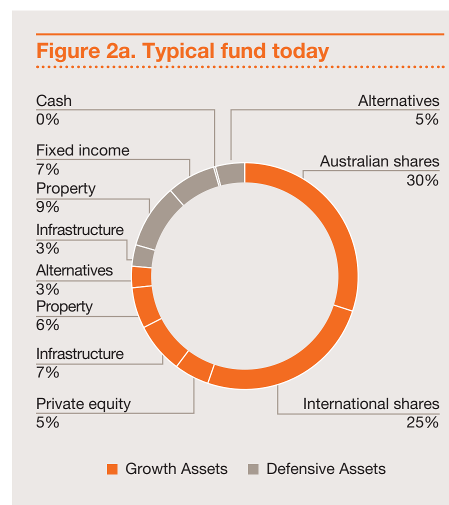

Figure 2a. Typical fund today

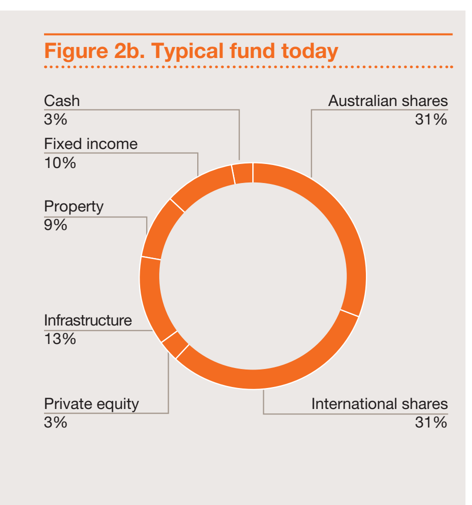

Figure 2b. Typical fund today

Both funds split the allocations to infrastructure, property and alternatives between growth and defensive. In the first case the split is explicit, and in the second it can be implied from the quoted 76% growth assets. In aggregate, the infrastructure, property and alternatives assets are split about 50/50 between growth and defensive for both funds.

The approach of splitting assets between growth and defensive has some merit. A property that is established and has long term leases has some characteristics of a bond, whereas a property that is still being built and has no tenants yet is more like an equity investment. Likewise, infrastructure that is established where pricing is regulated and the demand highly predictable also has some characteristics of a bond, whereas new infrastructure with development risks, pricing uncertainty, and reliant on usage predictions, is more like an equity investment. Where investment structures are illiquid and/or contain leverage, we believe that the assets should be classified more towards growth. The funds have much better information about the nature of the underlying investments, and although it has subjective elements, our understanding is that there is a methodology behind the approach they use.

Is this fair?

This would be a fair approach if it was consistently applied across all funds. The next question to address then is whether funds are being consistently classified according to the level of growth assets in their strategic asset allocation, and whether the groupings in the surveys are in fact a like for like comparison. Are some funds being disadvantaged in the surveys based on the way in which they are classifying growth and defensive assets?

We have analysed the strategic asset allocations for 30 funds in the SuperRatings Balanced (60–76) survey. We have compared the level of growth assets shown in the SuperRatings survey to a 'strict' calculation based on classifying everything other than cash and investment grade fixed interest as a growth asset. The underlying information was sourced from the websites of each fund.

We are not suggesting the strict approach as a solution, but it serves to highlight the range of approaches across the funds, and the extent to which some funds (but not all) are classifying assets other than cash and investment grade fixed interest as defensive assets.

We found that the range of growth asset exposures under this 'strict' definition is wide – from 62% to 97%.

We also found that the difference between the SuperRatings growth percentage and the strict definition ranges from zero up to 24%. This implies that up to 24% of some funds is classified as defensive, but they are not strictly defensive assets. Instead, they are assets like property, infrastructure, credit, and other alternatives that the fund is claiming have defensive qualities. There are also funds in the survey that are following the strict definition.

The conclusion that we draw from this is that funds are not consistently classifying growth and defensive assets, and that some funds are being disadvantaged in the survey as a result of this. The funds that classify property, infrastructure and alternatives as partly growth and partly defensive may be understating their level of risk relative to funds that take the strict approach.

Retail and corporate funds are impacted less by this issue, as they tend to hold less in unlisted and alternative assets, due to liquidity considerations. However, even within the industry funds group there are funds adopting the strict approach and some funds including property, infrastructure, credit, and other alternatives as defensive assets.

Are the groupings in the survey fair?

The other question here is that the range of 60–76% growth assets for the SuperRatings balanced survey is quite wide. Is a fund that has 76% growth assets comparable to one that has only 60% growth assets? Based on PwC's long term return assumptions, the difference in growth assets would account for a 0.6% pa difference in return at the overall fund level over the long term. However, in any one year the difference could be a lot higher.

The funds in the SuperRatings balanced survey cover three out of the seven Standard Risk Measure classifications – 'Medium', 'Medium to High' and 'High'. This seems to suggest that the survey range is too wide, that differences in assumptions are driving different outcomes for the Standard Risk Measure, or a bit of both.

The 30 funds that we analysed were also heavily skewed to the top end of the 60–76% growth assets range, with one-third of the funds reporting 75 or 76% growth assets. When considered with the subjective nature of the growth/defensive classification supplied by the funds, it is hard not to conclude that the growth/defensive split is being influenced by the survey grouping.

We believe that the range of 60-76% growth assets for the Balanced survey is too wide, and that something like 65%–75% would be more appropriate.

SuperRatings' position

SuperRatings has explained to us that they spent a number of years in the mid-2000s being actively involved in the growth/defensive definition debate. In their words, "The whole thing came down to the FSC and ASFA being unable to agree on definitions. Another piece of the discussion was that APRA and ASIC refused to clarify the situation, hence the status quo has remained for the last decade". SuperRatings' view is that legally this is what the funds tell members and hence this is a fund's position in the event of legal action occurring due to members believing they have been misled. SuperRatings believe it is not their position to override a fund's legal disclosure document. As a result, SuperRatings will continue to accept the funds' own growth/defensive definition until such time as there is more legislative clarity.

In terms of the band range (60–76%) for balanced options, SuperRatings said that this was a smaller range than other international surveys had traditionally adopted. SuperRatings' view is that since they introduced superannuation fund surveys to the industry in 2003, there had been no compelling argument to refine this or any other investment option range.

Conclusions

Our analysis indicates that there are a range of approaches used to classify superannuation fund assets in determining the level of 'growth' assets. The approach is determined by the fund, rather than any defined standard. The growth assets classification is used to determine comparative groups in surveys, and we believe that some funds are being disadvantaged by this process.

If you impose a strict definition of defensive assets as cash and investment grade fixed income, the weighting to growth assets can change by up to 24%.

The range of 60–76% growth assets for the SuperRatings balanced survey is quite wide. We believe that this range could lead to a significant difference in returns and is too wide. The fact that the funds are skewed to the top end of this range gives rise to the possibility that the growth/defensive split is being influenced by the survey grouping.

APRA has defined a reporting standard (SRS533) which defines asset class types, but it does not address how to aggregate assets into totals for 'growth' and 'defensive' assets. We believe that this would be a valuable addition to the reporting standard.

Members are choosing funds on the basis of the surveys, and often awards and remuneration are also based on the survey results. Trustees should be looking closely at the underlying investments in their funds to ensure that they are comfortable with the level of risk being taken, the classification of their fund in the survey and any variable remuneration based on survey results. We believe that industry-wide discussion needs to continue so that we can move towards a consistent framework to ensure that the comparison of superannuation funds is done on a like for like basis.

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