Difference between accumulation and defined benefit super funds

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Most Australian workers have a superannuation fund into which monthly or quarterly deposits are made by their employer as well as the option for contributions to be made by the worker themselves. There are two primary types of funds; defined benefit funds and accumulation funds. This article looks at the differences between these types of funds.

What's the purpose of superannuation?

The main purpose of a superannuation fund is to build a pool of savings for retirement.

Employers need to make super guarantee payments (a legislated percentage of the employee's wages) and some employers will also offer higher contributions as part of a salary package, employment contract or enterprise agreement. You should seek legal advice if your employer is not meeting its statutory requirements in relation to super guarantee payments. You can learn more about this in our blog, "My employer hasn't been paying my superannuation guarantee".

As well as the super guarantee and any top-up payments made by your employer, fund members are also able to add their own contributions (capped in a financial year). Such "personal contributions" have significant tax saving opportunities. If your spouse is not working or is a low-income earner, you can also contribute to their superannuation account with additional tax saving opportunities.

The type of fund the worker has will determine how their benefit is paid when they retire.

Defined benefit funds

Defined benefit funds are a dying breed. Most that are still in existence relate to public sector or large corporate funds. Some examples of current corporate defined benefit funds include TelstraSuper, QANTAS Super, QSuper and Australia Post Super. Unfortunately, they don't accept new members.

How much your benefit is worth on retirement is "defined" by the rules of the fund itself and depends on the following:

- How much money your employer has to contribute based on your earnings;
- How much extra you contribute yourself;
- How long you have worked for your employer; and
- Your salary level when you retire.

For example, after 30 years' holding a defined benefit fund, your retirement benefit might be worth:

- Five times your final salary (as a lump sum); or
- 80% of your final salary (as a monthly payment), until you die.

For many defined benefit fund members, the payments upon retirement can be significantly better than an accumulation fund. If you're considering changing from a defined benefit fund to an accumulation fund, it's crucial that you seek professional advice before you take that step.

Once you get out of a defined benefit fund, you can't get back in. If you are unsure whether you will be better off by moving, we suggest you don't, at least not before receiving advice. Defined benefit funds are extremely generous when considering the benefit available on retirement.

Accumulation funds

Most Australians have an 'accumulation' fund. The idea is that your money grows or 'accumulates' over time, similar to a savings account with a bank.

The value of your super in an accumulation fund depends on the following:

- How much money your employer has to contribute based on your earnings;
- How much extra you contribute yourself;
- How much your fund earns from investing your money;
- How high any fees are that you are being charged by your fund; and
- The type of investment option you choose for your fund.

If a profit or return is made on the funds invested on your behalf, then these returns are added to your account balance. Unfortunately, any investment losses are also taken out of your account balance. Accumulation funds perform optimally when contributed to over a long period of time. Profits and losses can be somewhat volatile over short periods of time but are often evened out when the fund's performance is considered over a longer period.

Most funds allow for members to choose the way their money is invested.

When you're young, you may choose a more aggressive investment portfolio as you have the time to weather the ups and downs of the market. As you age and approach retirement, you may choose to have a more balanced, or even conservative, investment portfolio. There are also options to choose, for example, a 'green' investment fund or to expressly forbid your super fund to invest your money in certain ventures.

In an accumulation fund, **you** bear the risk of profits and losses. The timing of such profits and losses can significantly affect your super payout upon retirement.

For example, if you're retiring at a time that funds have performed well over the last few years, the balance of your fund paid out to you will be comparatively good. On the flip side, if the fund has performed poorly over the 2-3 years prior to your retirement (for example, as funds did during the global financial crisis and in the early days of the Covid pandemic), your balance may be eroded, delivering you less retirement income.

Get help from a superannuation and insurance lawyer

It is always recommended that you take an active role in managing how your money is invested by your superannuation fund. Remember, most funds allow for members to choose the way their money is invested. If you're unsure about your options or what type of portfolio would best suit your needs, you should contact your super fund or financial advisor for advice.

Contacting Hall Payne Lawyers

You can contact us by phone or email to arrange your consultation; either face-to-face at one of our offices, by telephone or by videoconference consultation.

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