

28 July 2016

Highton, 3216

Attn: Ms Karen Chester

Deputy Chair

Productivity Commission

Locked Bag 2, Collins St East  
Melbourne VIC 8003,

Dear Deputy Chair

## **Re: Efficiency and Competiveness of the Superannuation System**

I note that the Productivity Commission is calling for submissions for the next stage of this inquiry.

The High Court of Australian in *Finch v Telstra Super Pty Ltd* [2010] HCA 36; (2010) 242 CLR 254 ruled at [35]:

“The government considers that the taxation advantages of superannuation should not be enjoyed unless superannuation funds are operating efficiently and lawfully. For that reason it has, by procuring the enactment of the *Superannuation Industry (Supervision) Act 1993* (Cth) (“the Supervision Act”) and regulations made under it, imposed quite rigorous regulatory standards.”

I will be lodging a submission to this inquiry which will focus on any “*efficiency*” aspect that the Deputy Chair and Commissioner MacRae may have not considered.

This aspect will be highlight by a case study where widows have been waiting for two decades to receive death benefits from a regulated superannuation fund.

One aspect of “*efficiency*” is the quantum of the final benefit compared to the contributions made by either the fund member or employer or both.

However another aspect of efficiency is how long does the member or beneficiary need to wait until they receive their benefit entitlement after it has fallen due?

If a superannuation fund is being operated efficiently then there should be a minimum delay in paying a death benefit after a death certificate has been lodged with the fund for example.

If there is a delay that stretches into months, years and even decades then this is not indicative of an efficiently operated superannuation fund and that operational efficiency needs to be greatly improved.

This also raises the issue of “*dynamic efficiency*”, including services to members, which includes responses to complaints concerning a delay in benefit payments when they fall due or the failure to make any benefit payments at all.

Many fund members are “*locked*” into a given fund and are unable to utilise “*Choice of Fund*” legislation, especially older members who have retired or are soon to retire.

This limitation is not just due to “*some modern awards and enterprise bargaining agreements*” (Page 37 of the interim report).

All members of *Defined Benefit* funds are “*locked*” into a given fund and cannot move to another fund.

## Scope of the Study

The Productivity Commission should develop criteria to assess whether and the extent to which the superannuation system is efficient and competitive and delivers the best outcomes, including optimising risk-adjusted after fee returns.

Under the “*best outcomes*” criteria must be a timing factor, since even if a benefit entitlement can be classed as “*efficient*” given the size of the benefit relative to the member or employer contributions, this is of little use to a member if they do not receive the benefit for several decades after it falls due.

In many cases the member or beneficiary will have died before a benefit is received.

The “*Best Interests*” criteria must include the timely payment of benefits when they fall due.

The “*Credibility and Transparency*” criteria must include actually allowing fund members access to the Trust Deed of the fund and other prescribed “*Fund Documents*”, not just having legislation that says they have a legal right of access.

As the interim report noted, the Australian Government recently announced that the objective of superannuation is:

“to provide income in retirement to substitute or supplement the Age Pension”.

This objective is not met when there is an extended delay in the payment of benefits after they fall due.

The interim report notes that the number of institutions funds has fallen from 4,712 in 1997 to 261 funds in 2015 {**Appendix A**} due to extensive consolidation of funds with the administration of many “*corporate*” funds being outsourced to either “*Industry Funds*” or “*Retail Funds*”.

The interim report notes:

The large reduction in the number of institutional funds (figure 1.2) reflects the consolidation that has occurred, as well as the demise of non-public offer, defined benefit corporate funds that characterised the earlier era of superannuation (chapter 2). In an accompanying trend, the growth in the number of small funds<sup>1</sup> has been driven by the increasing popularity of SMSFs. In 2001, there were about 210 000 SMSFs, but this had more than doubled to over 550 000 by June 2015.

Whilst such consolidation may lead to efficiency gains in “*back office costs*” there can also be diseconomies of scale that need to be considered.

Whilst most Defined Benefit funds have been closed to new members, many older Australians have an entitlement under a defined benefit pension scheme or defined benefit lump sum scheme.

For example the Defined Benefit Parliamentary scheme was closed to new members in 2004. However the former Treasurer, the Hon Joe Hockey MP, resigned from Parliament in 2015 he was entitled to an immediate pension of \$180,000 from the age of 50.

One of the assumptions made in the interim report is that Trustees in the compulsory superannuation system have been lawfully appointed to the office of trustee or where a fund has been transferred to the control of a new trustee that transfer process has been lawfully undertaken.

That assumption should be clearly articulated since under the current regulatory framework it is almost impossible for fund members to be certain of the legal status of the trustee of their fund and if they have been transferred to another fund without their consent, whether that transfer was conducted lawfully.

Trustees who have not been lawfully appointed to the office of trustee, are known as *trustees de son tort* and this has serious legal and efficiency implications for the fund members and beneficiaries.

Also the interim report takes the “*twin peaks*” regulatory model as a given.

However this model is seriously flawed as it is currently implemented.

Also the role and statutory powers of the *Superannuation Complaints Tribunal* (SCT) are glossed over.

The interim report notes:

“The Superannuation Complaints Tribunal (SCT) is an independent dispute resolution body. It deals with complaints relating to decisions and conduct of trustees, insurers and other decisions makers within the superannuation system.”

However the interim report fails to mention that due to the **Separation of Powers** doctrine derived from the **Commonwealth of Australia Constitution Act** the statutory powers of the Tribunal are very limited.

The Tribunal is unable to deal with a complaint that alleges the contravention of “**any law or governing rule**” which prevents the tribunal with dealing with misconduct by superannuation trustees.

The Tribunal can only deal with complaints where a trustee has acted lawfully but has made a decision that might be impugned on the grounds that the decision was “**unfair or unreasonable**”.

A typical example is the payment of a claim based on alleged total and permanent disability of a fund member.

This raises important “**access to the law**” issues for the members of superannuation funds and imposes additional costs on members when they are forced to seek legal advice in relation to their fund and their entitlements. The Productivity Commission conducted a recent inquiry into “**Access to Justice Arrangements**” {5 September 2014}.

In a compulsory superannuation system fund members should not be forced to incur additional financial costs and risks to ensure that they receive their lawful superannuation entitlements.

These costs can negate a large part if not all of their superannuation entitlement and so are a part of the “**efficiency**” equation.

Superannuation funds are a type of trust and the Courts have an inherent jurisdiction in the administration of all trusts, including superannuation trusts.

The Regulators **APRA** and **ASIC** have been established under **Chapter II** of the **Australian Constitution** and not under **Chapter III** as are the Courts.

This places an important limit on the scope of regulation of superannuation funds by these agencies. For example neither **APRA** or **ASIC** can construe the meaning of a superannuation fund Trust Deed.

The interim report makes the following representation:

## Risk management falls to members

The superannuation system is primarily made up of defined contribution schemes, giving members greater responsibility for managing risks, including investment, longevity, sequencing, inflation and interest rate risk.

Now this is quite true for people who have entered the workforce over the last two decades.

Most **Defined Benefit** schemes were closed to new members in the 1990s and 2000s.

However many older Australians now in retirement or soon to retire are members of **Defined Benefit** schemes.

The “**Risk Management**” of **Defined Benefit** schemes is quite different to the “**Risk Management**” of **Defined Contribution** Schemes.

Risk management in a **Defined Contribution** relates to the after “**costs and fees**” investments returns on member and employer contributions.

Risk management in a **Defined Benefit** relates to compliance with the provisions of the original Trust Deed as lawfully amended and with the solvency of the sponsoring employer.

Members of **Defined Contribution** schemes have to make decisions on how to best allocate their account balance across different asset classes whilst members of **Defined Benefit** Funds do not, since the employer bears the investment risk.

Knowledge of financial markets is more important to members of **Defined Contribution** Funds whilst knowledge of the laws of trusts is more important to members of **Defined Benefit** funds since their benefit is determined by the provisions of the Trust Deed that established the fund and any amending Deeds executed since then.

The Government has a role to play in providing this knowledge to fund members as has been noted in previous Parliamentary inquiries.

As to the five system-level objectives proposed (**Appendix B**), I would propose a sixth:

**“The superannuation system should provide the timely payment of lawful benefits when these benefits fall due for payment.”**

Current “**safeguards**” (**Appendix C**) are clearly inadequate when widows have to wait for two decades to receive their death benefits after the death of their husbands.

I trust these comments will be of assistance and that you will find my submission to be lodged before 9 September 2016 to be of interest.

Yours Sincerely

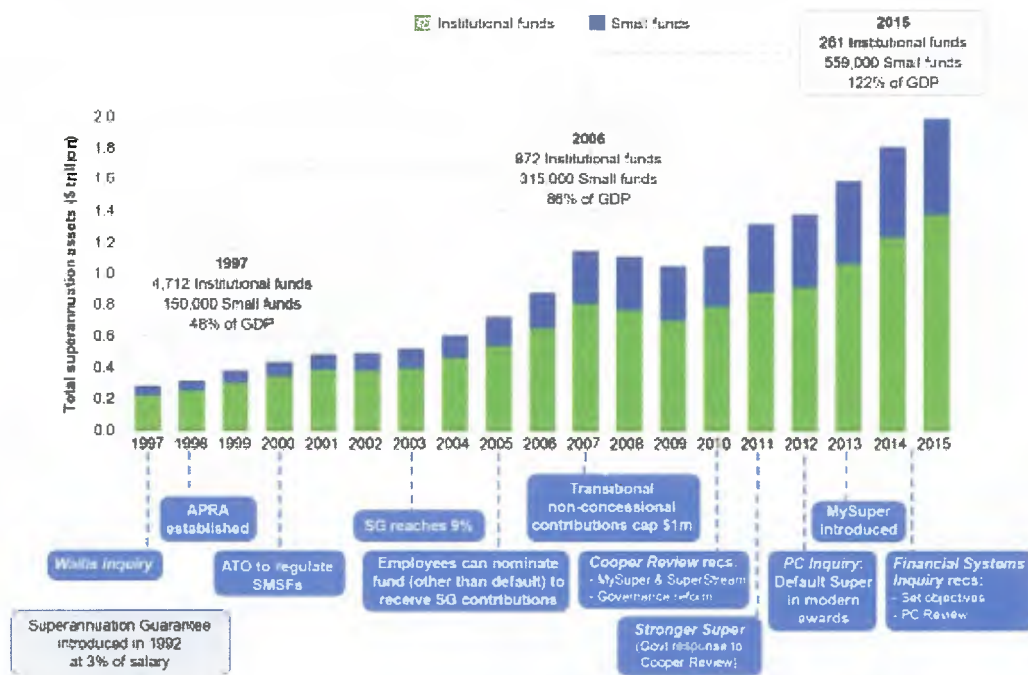
Phillip Sweeney

cc

- Commissioner – Angela MacRae

## Appendix A

Figure 1.2 Key developments in the modern superannuation system<sup>a</sup>



<sup>a</sup> 'Institutional funds' comprise corporate, industry, public sector and retail funds. 'Small funds' comprise small APRA funds, single-member approved deposit funds and SMSFs

Data sources: ABS (Australian National Accounts: National Income, Expenditure and Product, Australia, March 2016, Cat. no. 5206.0) APRA (2007, 2014a, 2016c).

## Appendix B

- Five system-level objectives have been proposed, against which the assessment criteria are designed, to ultimately guide the final assessment.
  - The superannuation system maximises net returns on member contributions and balances over the long term.
  - The superannuation system meets member preferences and needs, in relation to information, products and risk management, over the member's lifetime.
  - The superannuation system provides insurance that meets members' needs at least cost.
  - The superannuation system complements a stable financial system and does not impede long-term improvements in efficiency.
  - Competition in the superannuation system that drives efficient outcomes for members.

## Appendix C

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### Box 4.1 Financial System Inquiry subsidiary objectives

In addition to the overarching objective that has been accepted by Government, the Financial System Inquiry formulated six subsidiary objectives. They were for superannuation to:

- facilitate consumption smoothing over the course of an individual's life
- help people manage financial risks in retirement
- be fully funded from savings
- be invested in the best interests of superannuation fund members
- alleviate fiscal pressures on Government from the retirement income system
- be simple and efficient, and provide safeguards.

Source: Murray et al. (2014a, p. 95).

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