

Competitiveness and Efficiency of the Superannuation System

Personal Views of a Disgruntled Investor in Retail Funds and Suggestions on How to Improve the System

I am making this submission as (a) a 72 year old retiree (b) a self-funded pensioner and (c) a disengaged member of a superannuation/pension scheme.

Rather than make a submission addressing the issues relating to “How to Assess the Competitiveness and Efficiency of the Superannuation System”, I am detailing my own experience with the system and how disappointed I am with it as a whole. My objective in doing so is to demonstrate the gap between the thinking within the industry and regulators on one side and the feelings of an average member of superannuation schemes on the other. This gulf, a chasm of great magnitude, must be understood by not only the Productivity Commission, but also the regulatory bodies and the government.

First of all let me provide my background so that this submission is not considered as a vexatious exercise by a disgruntled “consumer” of the superannuation system.

I am a professional industrial engineer (with extensive experience in efficiency and productivity in a variety of productive systems) and I also have worked for a large Australian corporation as a business analyst and managed foreign direct investments (FDI). I hold professional qualifications from the UK and also a Graduate Diploma in Industrial Management and an MBA from a prestigious university in Australia. My final employment was with a government agency prior to retirement at the age of 70.

Until 2000, I made contributions to an employer’s superannuation scheme. It was a simple process where I contributed the maximum possible and the employer contributed according to the rules of the scheme. As an employee of a large corporation I did not find it necessary to take an active role, or any role, in keeping a check either how the scheme operated or performed. In part this was due to lack of time and in part the trust I had of the employer.

I left the company consequent to a restructure and its withdrawal from foreign investments. I was a decade short of the statutory retirement age. On the advice of my employer, my superannuation balance was transferred to a “Retail Fund”. My experience with the fund was unsatisfactory – but I had no knowledge, or wherewithal, to move to another fund. The subconscious thinking was that all retail funds have set up businesses to enrich themselves at the cost of “those who are unable or lack the initiative to make informed decisions and be assertive with over-powering financial planners accredited to the retail fund”.

One could argue that, as a consumer, I should be aware and should have taken an interest in my own financial future. This may be true in theory, may be true for some, but in the case of a majority of superannuation contributors, the disengagement with the system is due to its complexity, deliberate obfuscation by financial planners, lack of access to independent and qualified advisors outside of the retail fund, time constraints and other pressing domestic and personal issues.

To say that my financial planner/retail fund provided bad advice is to let them off too easily. A few years back I sold a rental property. I was advised by the financial planner to “invest” the money in “super” rather than buy another rental property. The financial planner strongly dissuaded me from putting that money into property saying the real estate market could crash and that I stand to lose as much as 40% in the short to medium term. With hindsight, I know it was all rubbish and that more astute investors put a significant part of their money in property and have come out far better than those who followed the advice of financial planners such as mine.

Obfuscation

The most common strategy of Financial Planners is to befuddle the client with heaps of worthless information with colourful charts and meaningless tables packed into glossy folders. The average client does not have the wherewithal to go through these annual reports and decide for himself/herself whether he or she has done well with the investments. I fall into this category.

One could argue that with a MBA I should be able to determine whether I am doing better than average. But it is a difficult task. One is that an aged retiree values the “remaining” time ahead of wealth. So, the likelihood is that he or she will leave the matter in the hands of the financial planner and hope for the best. At a guess, I’d say 90% of superannuation clients in the pension phase will be in this category. It would not be too different for those in the accumulation phase too, because of time constraints.

As a result many superannuation clients are at the mercy of their suppliers.

To rid this kind of obfuscation by the retail funds in the superannuation industry, there needs to be a simple, easy to understand, compulsory benchmarking system. But before I get to that let me give an example from the supermarket consumer area.

Many years ago, toothpaste was packaged for a particular brand, in tubes containing 110 grams, 140 grams, 170 grams etc. Each had a price. Sometimes some sizes were discounted. To work out whether the discounted 110 gram was a better value than the regular priced 170 gram tube, one has to be a wizard at mental arithmetic or carry a pocket calculator. It was only when the price per 100 grams became mandatory that the consumers were able to compare different packaging sizes and also different brands of the same products.

Likewise, the superannuation industry must come up with an easy to understand performance evaluation scheme. What would work for me, the average consumer, is given below.

Performance Assessment and Comparison

Retail funds offer a multitude of products – a “choice”. In a market based economy such as ours, this is called “freedom to choose what one wishes”. This, again, is a fallacy. Freedom to choose is good if one has all the relevant information, knowledge to evaluate and time to undertake the evaluation. But this is not the case as would be seen in industries such as insurance, energy, telephony, and other services. One can write volumes, for example, about the charade that goes in

the privatised electricity supply – where discounts are available only if one asks or threatens to change suppliers. And scores of electricity consumers are ripped off because they do not have the ability to negotiate a good deal.

But, given that the adherence to a market economy format unlikely to change, multitude of retail funds in the superannuation industry is also likely to continue.

However, the industry can be controlled in the interests of customers by introducing regulations to enable customers to make easy comparisons, such as in the toothpaste example above.

Firstly, all retail and industry superannuation suppliers should be asked to categorise what they are offering to one of several classes of risk – conservative, moderately conservative, balanced, etc. The risk category should be defined well so that the variation of the risk for a particular category falls within a defined bandwidth for all suppliers. This classification should be undertaken by an independent authority and binding upon all providers.

This would enable customers, in a particular class of risk, to make comparisons easily with other providers. If my investments are in a “moderately conservative” portfolio, I should be able to compare readily the performance of other “moderately conservative” portfolios of other suppliers. It should be simple and straightforward and without loopholes for the supplier to engage in gimmickry.

To be sure, a customer may gradually move from an aggressive portfolio to more conservative portfolios as they get nearer to retirement. But if such movement is limited to well-defined risk categories, the customer can still evaluate the performance of his or her investment in a particular year, if all changes are limited to take place at the end of a financial year. The core aim, in this regard, is to enable the customer to make comparisons with other suppliers and make informed decisions regarding switching to another provider. The market structure should be made very simple – unlike, for example, that of industries such as insurance, electricity or telephony.

The example I would use here is the sale of potatoes at a farmers’ market. A potato is a potato. The variations are minor and presentation is unimportant. The price to the consumer is about the same irrespective of where in the market potatoes are bought. Unless all the farmers collude, the price would, generally, reflect the supply and demand. Likewise, superannuation/pension products offered by retail (and industry) funds must be like the potato: easy to identify, uncomplicated to compare, and relatively certain that one is not paying over the top.

Secondly, the reporting period should be the same as the financial year. Where a customer’s investment commenced or changed during the financial year, the reporting should nevertheless provide an accurate assessment as to how a customer’s investment performed adjusted to reflect the whole of the financial year. By leaving room for retail funds to shift the reporting year around, customers could be denied the opportunity to make relevant comparisons.

Thirdly, the suppliers should be compelled to show the average performance of a particular risk category across the industry. The average could be weighted according to volume. The idea is that the benchmark should be a rock solid indicator that does not leave room for a financial planner representing the retail fund to draw wool across the hapless customer’s eyes. The industry average

should be the percentage increase (or decrease) of value of all the investments made for a particular risk category.

Revenue of funds have two components – income and capital growth. Therefore, fourthly, these two components should be shown separately, both for the customer’s investment and in the industry average.

Transferability between Suppliers

One of the ruses employed by retail funds to retain their customers is to make it as difficult as possible for a customer to move to other suppliers. This process needs to be made simple, minimal costly, less traumatic to the customer and fast.

The ability of customers to move to other suppliers easily will make the suppliers do their utmost to provide the best outcome to their customers. But to prevent them making a mockery of “choice”, as it is now done by energy and telephony suppliers, the industry must be structured for easy comparison between retail funds.

Independent Evaluators

The industry regulators must establish an independent body that can advise customers on the performance of their particular retail fund in comparison to the industry average, risks and other salient matters. Often, customers are at the mercy of their financial planners and, given that the structure of the industry is such that no realistic comparison could be made, the customers are stuck with retail funds which may not be in their best interest.

The independent body should also produce an annual report making comparisons of all retail funds for each category of risk along with other details such as the amounts invested in the fund and the number of clients, etc.

Such information put out in the simplest form possible, from an independent body, is what is lacking now.

Also, importantly, individual clients should be able to request the independent body (for a small fee) to make an assessment of one’s portfolio and the performance in comparison to other providers. Such reports would be a check on the suppliers and to keep the suppliers on check.

In the Ideal World

In an ideal world, an average pensioner would want:

- (a) a secure income until death
- (b) not have to worry about his or her investment or deal with (retail) fund managers

A retiree is Time poor. The remainder of his or her life is precious, especially, that part of life when the pensioner is still able to enjoy life. Therefore, not having to be concerned about security of one's investments is paramount.

In an ideal world, again, each individual should be responsible to save for his or her upkeep in the retirement phase in life. Ideally too, the Aged Pension should only be available to those who, due to unemployment or disability, were unable to subscribe, or subscribe adequately, to a national pension scheme.

The single national pension scheme should be structured like the PSS Defined Benefit Scheme (Public Service Superannuation Scheme). All member and employer contributions, compulsorily, should go to this fund. The amount contributed should, at a minimum, be sufficient to deliver an amount equivalent to the current (Centre-Link) Aged Pension. And the fund will, at retirement, give a lifetime indexed pension, guaranteed by government. Responsibility for one's own income in retirement should be compulsorily ensured by legislating for the minimum amount that will suffice to provide a pension equivalent to the current Aged Pension. Option should be there, for those who wish, to contribute more and receive a higher pension. The scheme should be fair by ensuring that, where a pensioner dies early, for the remainder of his or her contribution (or part of the remainder, assuming there is an insurance component embedded in the scheme) to go to the estate of the deceased.

In the 15 years I worked in the public service, I was lucky enough to have been able to contribute the maximum amount to the PSS. I now get a pension that is sufficient to keep me out of going to Centre-Link begging for an Aged Pension.

Centre-Link Aged Pension should not be seen as an entitlement. Individuals must save for their retirement. What happens now is that probably half or more of those getting an Age Pension are those not deserving – those who cheat the system – like most of my neighbours. They live better than us because they have stashed their wealth away from the sources that they have to declare to the Centre-Link to be entitled to the Aged Pension – in whole or in part.

Of course the argument is that they paid taxes while they were in employment and therefore now they have an entitlement. This is not a fair system.

What we need in this country a contributory pension scheme as (I think) operated in the UK. One make a compulsory contribution through one's working life and, depending on what was contributed, one should receive a pension amount as long as one lives. Actuaries would be able to calculate what should be contributed to ensure to receive a liveable pension. The government funded Aged Pension should be only be provided to those who, for one reason or another, were unable to contribute sufficiently during their working life.

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