

SUBMISSION: ISSUES PAPER ON SUPERANNUATION MATTERS

AUCTION BASED ALLOCATIONS OF ENTITLEMENTS TO DEFAULT ACCOUNTS

It is time to speak frankly.

-- a little scene setting

The major Australian banking conglomerates have long had an unassailable competitive advantage stemming from incorrect settings of critical regulatory parameters – a regulatory context that could be fairly called ‘institutionally corrupt’ is an inevitable result.

The Commission among others may like to reflect on the historical process over the past three decades. A diverse range of bank and non-bank deposit-taking institutions was steadily transformed to the 4-pillars industry structure that defines concentrated industrial ownership and dominant market power – dominating power extending well beyond banking business.

Just to recap, this transformation included the managed failure and absorption of all the state banks; the local failure and exit of all but one of the foreign retail banks newly licensed in the mid 1980s and subsequently the merging into a major bank of all the converted building society banks. Be not misled, any surviving non-bank deposit-taker exists at the discretion of the 4pillars.

..... and not one regulatory lament was heard about this destruction of the competitive environment for retail financial services – not least because the managed departure of a once loved ‘deposit taker’ is the only option when its failure is in prospect.

‘Akin to a cartel’ is a fair call regarding the outcome in the markets for retail financial services.

One glimmer of hope for a competitive force was the emergence of industry-funds in the superannuation arena -- that is now under threat as an apparent alliance of the cartel, its regulatory sponsors and their political allies rallies their forces to bring industry funds undone.

-- a bit of a set up?

I am concerned that this requested, and directed, inquiry, while nominally about ‘competition and efficiency’ in the provision of retail superannuation facilities, intends nothing of the sort.

Rather, as I see it, it is just another change of tack in a determined and seemingly endless quest of the Coalition political parties to disrupt and frustrate the role being played so well by the super funds known as industry funds.

The sustained sequence of these attacks on industry funds over the past 15 years is grist for a case-study in malign associations of political and commercial interests – all the more disturbing for the apparent motivation of denying union involvement that has been so beneficial.

The Commission should be open to two possibilities – one, that it may be being asked politically loaded questions and the other, its independent entitlement to explain why it may not answer them.

For starters, it is now beyond question that, in general, the best performing super funds are the so-called industry funds – consistently returning more to their members than bank-aligned retail funds do. One can, then, fairly put the question of how advisers, required to give advice in the best interests of their clients, can justify not recommending an industry fund as likely to deliver the best return.

-- conglomerated market power

This submission aims to encourage the Commission to reflect on the apparent ‘success’ and ‘prominence’ of the bank-aligned retail funds (BARF).

The conglomerate nature of the major banking businesses – banking, funds management and insurance et al – is open to package deals that embody cross-subsidization conducive to tilting rather than leveling the competitive playing field.

One such concern is about inducing borrowing customers to tie their employees to retail super funds associated with the bank. Another is about BARFs investing the funds under management in assets – deposits, property portfolios etc -- associated with the aligned bank and on unfavorable terms. In the longer run, employees leaving a captive employer may find that an apparently ‘low’ management fee is replaced by a higher fee – especially in the retirement phase when the fund is converted to a pension scheme.

-- what ‘institutional corruption’ of the regulatory environment?

The much heralded de-regulation of the retail financial system, commencing in the mid 1980s, was so badly mismanaged by the key regulatory agencies that, by 1990, Australia faced a major banking crisis – one that scared the tripe out of the government and the regulators. In the nature of these things the public response was to whistle a happy tune and pretend ‘nothing amiss’.

Subsequent regulatory paralysis and continuing incompetence served up the rest of the retail financial system to the 4pillars on a plate. [The industry funds should not be next].

Those wondering ‘how the hell this happened’ are still no better officially informed.

What happened, of course, was that the promised deregulation was one-sided – as the 4pillars were set free the wider regulatory noose tightened around the rest of the retail financial system.

The what-happened, in more detail, is that, in the late 1980s, prevailing 15% p.a. cash rates coupled with the ‘interest free’, transaction-account deposit base of the banks was delivering the major banks an enormous windfall flow of cash revenue for which they were unaccountable -- but which they used to devastating competitive effect.

New foreign banks and newly ambitious state banks chasing deposit and loan business became prey – the loan books they acquired were loans the 4pillars were happy to see go – and paying interest to get transaction-account deposits meant operating payments services at a loss.

The process had complexities that only a royal commission may uncover and expose – not least the way deep discounts were given to favored business borrowers rather than declare more profit and attract unwanted attention.

To appreciate the point being made, consider that, these days, the 4pillars are holding some \$ one-trillion – one thousand billions – in deposits on which no material interest is paid. Next ponder what would be happening if interest rates were anything like even 5% p.a. – let alone the 10% and 15%+ levels that were prevalent in the living memory of all.

..... and then convert that pondering to what really did happen in the 1980s and 1990s -- be in no doubt as to the destructive competitive power unleashed and misused.

-- so what's wrong here?

What's wrong here is that unaccounted bartering of free transaction services in exchange for interest free deposits, becomes a destructive force once banks earnings on the free deposits exceeds the unrecovered cost of payment services provided free of charge.

At a cash rates of 10% to 15%+ p.a. that excess was enormous and sustained for decades..... it financed destructively predatory competition.

There were, and remain, no restrictions on where the pillars deploy the 'excess' in the war games – it was used widely in building super funds-management businesses, in operating discount broking facilities; in operating and acquiring insurance businesses – all as well as driving competitor banks to the wall. Regulatory incompetence on a grand scale delivered an unassailable cartel.

-- don't let it happen again

A very credible concern is that once any semblance of normality is restored to interest rate settings these destructive competitive forces would be refreshed: if so, there would be nothing to stop the excess being deployed in a bidding war in auctions for retail super default business.

The 4pillars may well draw lots to order the wins in each four year sequence.

While the auction option is superficially appealing as a way of bringing competitive forces to bear on costs in the super-fund services arena, it has dangerous limitations while ever the regulatory context is so unfairly favorable to the 4pillars.

Whether or not industry fund costs and charges are now excessive may be a moot point – what is not moot is that, on performance criteria, industry funds are not the problem.

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26 September 2016