Submission to the Productivity Commission

Default Superannuation funds in modern awards

To what extent do workers covered by different awards have different investment needs? Should any such differences be taken into account in the selection of default superannuation funds for inclusion in awards? If so, how?

Should the investment strategy, investment return target and level of risk of the default investment option be factored into the selection of default superannuation funds for inclusion in awards? If so, how?

Should lifecycle investment strategies be considered? If so, how?

Dear Commissioners,

For me, the questions above lie at the heart of all that is wrong with superannuation in Australia. The fact they are only being asked now, show the dangers in constructing a mandatory and universal saving scheme. The companies involved in the 'mandated marketplace' do not have to innovate or appeal to customers, who are obliged to deal with them by law. Therefore, I dismiss the suggestion in the *Discussion Paper* that "many consumers do not have the interest, information or expertise to make informed decisions about their superannuation".[1] Rather than lacking interest, can I suggest many of us are resigned to the fact that some fund manager is going to help themselves to part of our income, regardless of what we do (or don't do) about it.

As someone who is a part time worker, with a disability, I know from my own experience that "investment needs" is a phrase of almost no meaning. One does not earn the amounts one would anticipate needing to be truly regarded as an investor. Yet, with very few exceptions[2] all workers have to be involved in the superannuation system. Further, if one was truly an investor, you would expect to be able to "profit-take"; i.e.: withdraw money when a market is high and, re-enter a market when it is low. This is what any rational investor would do, but given that you cannot take funds out of superannuation until retirement, it cannot really operate as a rational investment.[3]

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[1] Discussion paper, p.4

[2] See "Superannuation – The Basics", Sydney Morning Herald, http://www.smh.com.au/money/tools-and-guides/superannuation--the-basics-20100528-wj7p.html as at 18 April 2012. I note in particular, that the article says: '*The Superannuation Guarantee (Administration) Act says that employers do not have to pay the Superannuation Guarantee in certain circumstances. Some of the exceptions are:*

- *employees earning less than $450 per month;*
- *employees under the age of 18 who work 30 hours per week or less;*
- *employees over 70 years of age;*
- *anyone paid to do domestic or private work for 30 hours per week or less.*'

[3] And to make matters worse, the total in my own super fund fell or remained static (depending on investment strategy), according to recent information to members. While appreciating that this is a risk in long term investment, particularly in the context of worldwide financial uncertainty, it is not as if you can take your money out of superannuation to cut your losses. And this is confirmed when you read articles like: Lucy Battersby, *Market woes chip at superannuation nest eggs*, Sydney Morning Herald, January 19, 2012,

Given this, the Government should be prepared to put a sliding scale of deposits into superannuation funds on an annual basis. This should be in acknowledgement that a growing number of people work in casual, temporary, part-time and contracted positions. The superannuation system appears to rely, at least in part, on an increasingly dubious assumption of lifelong, continuous employment. And even when you are not employed and they are losing your money, the funds still take out their management fees. If the Government were serious about superannuation, it would insist fees were performance based; with penalties paid and members compensated when money was lost. Further, the Government itself might well share the liability with fund managers, it having mandated the superannuation system in the first place. Therefore, if it was good enough for Australian banks to extract financial guarantees from the Government during the Global Financial Crisis (GFC), I think Australians should expect a similar form of protection for the monies in superannuation accounts.

Additionally, an argument can be made that superannuation hits low paid workers harder than it does higher paid workers. The withholding of funds from a low paid worker (in the guise of 'saving for their retirement') will have an increased impact on their purchasing power and standard of living in the present; a corollary can be drawn with the Medicare Levy. In a speech before the National Press Club in 2006, the then head of Access Economics Geoff Carmody observed:

> For most of us, the Medicare Levy is a 1.5% 'flat tax' on all income: but not for all. You see, there are low income exemptions that are means tested and 'clawed back'. The basic 1.5% Medicare Levy applies to all taxable income when you earn more than $17,191. If you earn less than $15,903, there's no Levy. What about in between? Here, things turn nasty. Every extra dollar of income here means 20c in Medicare Levy. So the 1.5% Levy is really a 20% marginal tax for some poorer people. But there's more. The 20% Levy occurs where income tax is 15%. Here, the effective tax rate is really 35%.[4]

This demonstrates how flat taxes can be severely regressive in their impact on low income earners. The Government virtually concedes a similar effect in the case of superannuation, in its establishment of a co-contribution scheme for low income earners. However, this never compensates for the *actual* loss of earnings, as the co-contribution is deposited into a worker's superannuation account, not their take home pay. The Government should consider increasing its co-contribution and allowing an employee's co-contribution to fall,[5] so that the effective rate of contribution by lower income and part-time workers does not exceed the mandated legislative rate, in dollar for dollar terms.

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http://www.smh.com.au/business/market-woes-chip-at-superannuation-nest-eggs-20120118-1q6ia.html as at 21 April 2012

[4] Carmody, Geoff, Tax Cuts or Tax Reform: Which? For Whom?, Address to the National Press Club, 5 April 2006, p. 2, http://accesseconomics.com.au/publicationsreports/getreport.php?report=70&id=79 (link no longer active as at 22 April 2012)

[5] Based on their level of income, much like progressive scales should work in relation to the assessment of income tax

As a fund member, I also took a very dim view of my fund automatically deducting money from my account and calling it "Life Insurance". One was never directly asked to consent to this deduction and, I only discovered it by accident when reading through a statement, baffled by the second amount that seemed to come out alongside the management fee. Needless to say, it was promptly cancelled, but this involved phone calls and letters; and naturally, none of the money already taken (in my view stolen) from my account was going to be remitted. Again, as a part time worker with a small "nest egg," which seems to be getting smaller under management, I am increasingly reticent about whether the whole concept of superannuation actually stands up to scrutiny. Will it really secure my future, or is it now in policy terms (to borrow a phrase from the GFC) "too big to fail?"[6]

It is certainly true that governments of all persuasions have been telling us since the late 1980s of the importance of superannuation, and there are now billions under management. How effective much of this management is however, can be highly questionable.[7] This is because it is easy for some in the media to say that 'markets are forcing retirees to work.' However, the decisions made by (and recommendations given by) financial advisors and fund managers seem to be explained away all too readily as legitimate business judgments of supposed corporate professionals. And for those of us who aren't financial experts (and that is most of us), we rely very heavily on advice – and some have done so to their peril.[8] Yet, in the context of the mandatory nature of the scheme that is superannuation, I wonder how fund manager behaviour is changed because of investor compulsion? In many ways, they can't lose business, even if they perform badly; besides, as with the example cited in footnote 8, many investors may not be alerted to problems until it's too late.

Yet, this is submission is not simply a call for more regulation. In many ways that would be unimaginative policy, costing employees, business and government more in terms of compliance. What it is can be described more as a question to the Commission – does the logic behind superannuation still hold true? Certainly you could, based on Australian Bureau of Statistics (or like measures), try to put "lifecycle calculations" into awards, but this would undoubtedly do more to complicate awards rather than simplify them.

Equally, we should not shy away from just how speculative superannuation is as an investment. Writing recently in the Brisbane Times, Chris Becker gave a disturbing analysis. In particular, he said:

> The average industry-wide ROR (rate of return) for the most recent five-year period was lower than the two preceding five-year periods and the volatility of quarterly industry-wide RORs was higher than the two preceding five-year periods. Increased volatility of superannuation RORs leads to greater uncertainty around members' final retirement outcomes.

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[6] See http://en.wikipedia.org/wiki/Too_Big_to_Fail as at 22 April 2012

[7] For example, see Max Newnham, *Taking sides in financial planning reform war*, Sydney Morning Herald, April 28, 2010, http://www.smh.com.au/small-business/finance/taking-sides-in-financial-planning-reform-war-20100427-tq6m.html#ixzz1slZVKMMo ; see also, Andrew Main (Wealth editor) *Markets forcing retirees to work after $75bn paper loss in superannuation*, The Australian, October 22, 201112:00AM, http://www.theaustralian.com.au/business/wealth/markets-forcing-retirees-to-work-after-75bn-paper-loss-in-superannuation/story-e6frgac6-1226173590785 as at 22 April 2012

[8] See for example, ABC 730 New South Wales, *Super collapse costs investors millions,* Broadcast: 18/04/2012 Reporter: Rebecca Baillie, http://www.abc.net.au/7.30/content/2012/s3480585.htm as at 25 April 2012

> There were also more frequent negative returns in the most recent five-year period compared with the two preceding five-year periods.[9]

Earlier in the article, Mr Becker had indicated that during the GFC, virtually all funds had suffered financial losses and the quantum amount under management had decreased.[10] While this is understandable from a purely financial perspective, can people who are relying on a pool of money to see them through retirement really afford to sustain loses? I think not, particularly if you also add in uncertainty of employment, variance in income and all the unintended events or misadventures that can happen in many people's lives.

Beyond this, there are the economic distortions inherent in superannuation. Becker observes two critical issues. These relate to the skewed nature of who holds fund accounts, combined with how the paradox of thrift may come to hurt the economy (and put people out of work). He explains that:

> (while) 25 per cent of superannuation accounts are held by those about to retire (over 50 years of age), this cohort comprises some 60 per cent of account balances.
>
> If this cohort (and the similar sized Gen X that follows) sees even a modest correction in their super, the actual amount of spending (aggregate demand) they can do while in retirement will affect the entire economy. In addition, if they have to save more in the later years of their working life to make up this loss, this also has an immediate and instant impact due to the delayed consumption.[11]

It is at this point that one really begins to think that as a worker and citizen, you may have been sold something of a policy lemon when it comes to superannuation. Admittedly, less generous characterisations like "Ponzi scheme" also come to mind. Ultimately, the more I read and hear about superannuation, the less confidence I have in it, and the claims of its proponents. Many of the concerns one expressed to the Treasury's Review of the Superannuation System remain the same now as they were then.[12]

Little seems to have changed. While noting Mr Becker's advice to aim for absolute returns, I am not entirely sure that reducing growth will necessarily provide a level of increased protection against loss. In saying this, I interpret Becker's model as still presuming people have a fairly consistent period of employment throughout their working life, as he claims investment based on absolute returns will:

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[9] Chris Becker, *Is super for saving or speculation?,* Brisbane Times, April 17, 2012, http://www.brisbanetimes.com.au/business/is-super-for-saving-or-speculation-20120417-1x4l7.html#ixzz1tKcIDBid as at 28 April 2012

[10] See ibid, where the author writes: *To put this in context using the APRA (Australian Prudential Regulation Authority) results for an average fund, since the GFC, a $100,000 portfolio (assuming no further contributions) would still have been reduced to $95,400 even after two solid years of performance (the previous year was 8.9 per cent for all funds).*

Therefore, even after a period of relatively good performance, the quantum in many people's accounts had not been restored.

[11] Ibid

[12] See generally, my submission at http://www.supersystemreview.gov.au/content/submissions/downloads/Adam_Johnston_091224.pdf as at 29 April 2012

> (work) for both the near-retiree, who needs to both protect his large amount of savings (from loss and declining purchasing power) and the young accumulator, where although a large loss can be recouped due to the vagaries of time, the opportunity cost of this permanent loss can be massive.[13]

What of those who at both ends of the age spectrum may find they have not accumulated much? As someone with a disability, I openly acknowledge an increased risk of ending up in that position. And you need not be disabled to end up in this position. As I told the prior *Superannuation Review:*

> Ultimately, I doubt the Government will ever be able to avoid administering some sort of aged pension scheme. Some people (often through no fault of their own, due to illness, seasonal employment and the like) will never have enough superannuation. Additionally, it is noteworthy that the *Issues Paper** itself acknowledges the superannuation earned in someone's working life is only likely to cover a small proportion of their needs.[14]

In coming to this conclusion, I then feel in a position to ask: are there groups of people, workers and families who should be formally excused from involvement in the superannuation system. In my view, low paid, casual, seasonal workers and contract workers should at least have the option of exiting the superannuation system. The Minister for Superannuation, the Hon. Bill Shorten MP told a conference of Superannuation Funds in 2010 that:

> I thought the Australian Financial Review's highly regarded commentator Brian Toohey made an interesting point on the ABC Insiders couch last Sunday morning.
>
> The nub of Brian's point was that it's a bit of a tough ask of Government to tell hard working Australians that they have to forgo some of their wages now and put it away for later.
>
> Especially when cost of living pressures are substantial and the need to balance the family budget this month, not in 30 years time, is fore of mind and kitchen table discussion. I'm glad Brian made the point, because it's a frequently cited objection. But here's my answer.
>
> If you are negotiating your next pay rise, do you want to in effect hand over the extra money to the Reserve Bank (or indeed to a cynical CBA) in higher mortgage interest repayments? Do you want to give it to Coles or Woolies or Caltex in higher grocery or petrol prices? Or to Qantas or Virgin in inflating holiday prices?
>
> Or instead, do you want to stick it away in a superannuation nest egg – and benefit as you do from concessional tax treatment.[15]

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[13] Becker, op. cit.
* See *Review Into The Governance, Efficiency, Structure And Operation Of Australia's Superannuation System*, Phase Three: Structure, Issues Paper, 14 December 2009 (www.SuperSystemReview.gov.au), p.11
[14] Refer to footnote 12, above, p. 6 of 7
[15] The Hon Bill Shorten MP, Address to ASFA 2010 National Conference, Adelaide Convention Centre, 10 November 2010,

But does Mr Shorten's argument stand up to scrutiny? Surely, there are more inflationary pressures at work in a modern market economy, which can determine the inflation rate, and it will not come down singularly to a pay rise? Other things like floods, fuel costs and the like will raise prices at Woolworths and Qantas. And, as argued by Becker, reserving more money in the superannuation system will potentially put a dampener on consumption and economic growth.

In conclusion, for many people it is doubtful whether superannuation can be called an "investment". It is a story of lost money and complex (sometimes questionable) financial instruments. The mandatory nature of the scheme also, in my view, has a critical effect on how funds behave. And as explained earlier, the Government should be held more directly to account for the failings of the superannuation system it has created.

Yours faithfully,

Adam Johnston

1 May 2012

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http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2010/005.htm&pageID=005&min=brs&Year=&DocType= as at 29 April 2012