SUBMISSION TO THE REVIEW INTO THE GOVERNANCE, EFFICIENCY, STRUCTURE AND OPERATION OF AUSTRALIA'S SUPERANNUATION SYSTEM (2009)

OVERVIEW:

This submission necessarily includes a discussion of the concept of 'efficiency' to respond to questions in the paper entitled **'Operation and Efficiency'** which was produced by the Review Panel of the Australian Superannuation system review chaired by Jeremy Cooper a former Deputy Chairman of the Australian Securities and Investments Commission. The review has been charged with examining and analysing 'the governance, efficiency, ***structure***, and operation of Australia's superannuation system'. It will make recommendations to Government by June 2010.

The review paper 'Operation and Efficiency' does not centrally discuss the term **'structure'**, let alone include it in its title, and one wonders why. After a flawed discussion of 'efficiency', the paper has a heading 'Design/Architecture' (p. 6) under which technology is addressed. The design of the technology of a superannuation scheme ideally depends on who the structure of the scheme is ideally designed to serve and how, so as to establish related data capture and accountabilities. However the review paper takes a market driven and ideological rather than a scientific approach, which is wrong. The Panel appear to be covert supporters of efficient market theory, who believe that all available information about a commodity (a share or other investment) is reflected in its price. The paper appears to be a confused and deliberately confusing product. These criticisms are justified later with a related discussion of competition.

The implications of ineffectively defining '*efficiency'* and not addressing '*structure'*, are also that the review has ignored the central requirements of its establishment by government, perhaps to maintain instead the self-seeking financial market ideology upon which such writers incomes, power and status normally rest. One often sees this kind of male product. Whenever one does so, one wonders whether the writers are acting consciously, which I regard as wily, or if they are merely frightened silent, confused and/or incoherent because of poor education and the related rapacious, secretive, feudal environment in which they have made a successful living they would rather not disturb. Are they mainly evil, good or scared or stupid? You be the judge. I answer the three key Panel questions below first and follow this up with more explanations and answers later.

4.2 What is efficiency? A. It is being comparatively capable or competent at producing the outcomes or effects desired by the superannuation scheme members.

4.3 Where can efficiencies come from?
A. Lasting efficiencies can only be gained by re-designing scheme structures to meet the members' aims more effectively through transparent competition.

4.1 Is superannuation just another industry or does it deserve different treatment because it is social infrastructure provided by the private sector?

A. Government service provision has been an aspect of all industry development since Karl Marx was a boy. Ask instead what the fund members want and try to obtain it through open competition.

To obtain what the fund members want there is a general need for Glastnost (transparency) and Perestroika (restructuring) in Australian superannuation, to rescue these savings and related investment and support systems from their pre-scientific financial origins. These depend on feudal ideals of commercial in confidence behaviour, in markets where all are conceived as traders, rather than as producers or consumers with collective and individual interests ideally pursued through scientific approaches, and who are also represented by their elected governments. See the attached submission to the Parliamentary Joint Committee Inquiry into Financial Products and Services and the submission on the Productivity Commission draft report of the Review of Australia's Consumer Policy Framework for further discussion of this problem.

The capacity for scientific investigation depends on reliable definitions, related classification systems and their consistent application or transformation for scientific reasons. The current and attached submissions thus call for clearer definitions and related operational descriptions of how business is done under the relevant categories of the Australian and New Zealand Standard Industry Classification (ANZSIC) system. In the light of the causes of the global financial crisis, this is particularly urgent in regard to Construction; Finance and insurance; and Property and business services, because these categories crucially underpin nearly all development and may often explain its failure.

Industry superannuation funds are called non-profit funds because they ideally represent and seek the interests of their members – rather than business shareholders or anybody else. The entire non-profit business sector requires consistent industry and community clarification to support the G20 London Summit Leaders Statement and Declaration on Strengthening the Financial Systems (2.4.09) fast, effectively and flexibly. Carbon pollution reduction and related offset developments require attention in this context. These issues are addressed in the attached submission on the Productivity Commission Issues Paper 'Contribution of the Not for Profit Sector'. In charitable operations the ideal beneficiaries are not usually fund members, unlike in the ideal superannuation fund.

The national ideal appears to be many industry and community savings and investment pools and related payment systems, using consistent definitions and rules which are also consistently and openly applied, unless another course of action appears more appropriate for some good reason, such as the key differences between profit driven and non-profit driven aims and activities. One assumes superannuation is ideally discussed in this broader national industry and community context and driven by transparent competition to achieve the economic, social and environmental goals of triple bottom line accounting, which have been recommended by the United Nations (UN). The justification for this direction is discussed below, followed by more answers for the Review.

The Review Panel ask whether it is a good idea to identify an investment option that is comparable across all super funds. For many reasons, which I have previously entered into and now do so again, it seems good to identify housing as a foundation investment option that is comparable across all super funds. I therefore attach an early discussion of future development at Harold Park in Sydney, in the hope that it might be supported by government and relevant industry superannuation fund managers as a flexible planning model for regional aims and investments to bring about more sustainable development.

1. RECOGNIZE THAT EFFICIENCY IDEALLY RELATES TO THE NECESSITY FOR A CLEAR SCHEME STRUCTURE TO MEET ALL MEMBERS' GOALS.

2. RECOGNIZE THAT CUTTING COSTS ALSO REQUIRES A CLEAR SCHEME STRUCTURE AND THE POTENTIAL FOR EFFECTIVE COMPETITION TO ACHIEVE ALL THE MEMBERS' GOALS.

What is 'efficiency' and how does it ideally relate to scheme structure and operation? The term is not defined in the terms of reference given to the review. Neither the review terms of reference nor a definition of the term 'efficiency' are included in the paper 'Operation and Efficiency' produced by the Review Panel. However, the terms of reference state the following under the heading 'Scope':

> **1.2 Efficiency:** Ensuring the most efficient operation of the superannuation system for all members whether active or passive members and whether making compulsory or voluntary contributions, including removing unnecessary complexities from the system and ensuring, in light of its compulsory nature, that it operates in the most cost-effective manner and in the best interests of members.

The above repeats the word 'efficiency' rather than defining it. However, the statement appears to be an aim which clearly links the concept of 'efficiency' to serving all superannuation scheme members as effectively as possible. This aim also appears to span a range of different superannuation schemes, which may make up the national superannuation system. The above therefore seems a reasonable statement of the key superannuation aim, especially if married to a common English dictionary definition of 'efficient', which is: 'capable; competent; producing effect' *(for members, one assumes).*

Who are the ideal scheme members (and therefore the wider system members) and what do they want? I assume the members are all those who contribute to the pool of funds which underpin the scheme, and that the related collection, savings, investment and payment functions are the central pillars of the scheme structure. But, as Freud might have said, 'What do members want?' This requires clear and early definition to establish efficient market competition to achieve their goals through a related design of technology to gather data and define clear accountabilities. Do members currently in non-profit financial schemes, such as industry superannuation funds, appear to have different goals to contributors in more traditional market ventures? This question requires an answer.

One should not assume, for example, that all superannuation fund members normally only want more money from the investment of their savings. Some may also seek higher levels of security for their investments than the recent global financial crisis has demonstrated to them. Some members may seek the capacity to get low interest personal housing or related loans from the common savings pool. Some may seek to know much more clearly what they are investing in, so that their money can be directed to achieve greener environments, (rather than to support traditional war related production), without the high levels of risk which normally attends achievement of new environmental goals.

My experience, which was discussed in a recent submission on the ideal relationships between the Members Equity Bank, UniSuper, Perpetual Ltd. and government regulators, is that better structural design of a superannuation system to achieve the members' goals of affordable housing and low interest loans would also reduce many obnoxious costs. A new social challenge is to link community goals for carbon pollution reduction and sustainable development to other primary economic goals as effectively as possible.

The above discussion suggests that the meaning of 'efficiency' and 'effectiveness' for members is the same – i.e. 'being comparatively more capable of producing a desired and stated outcome or effect'. This outcome may be social or environmental as well as economic, depending on the members' goals. The clear establishment of superannuation scheme goals to serve the clearly stated aims and interests of the members would also allow the establishment of the triple bottom line accounting ideally required by the UN. The concept of competition requires regional consideration in a holistic national context.

Those who wrote the review paper cannot provide a helpful discussion of the ideal operation of competition, which is addressed towards the end of their paper entitled' Operation and Efficiency' (p.31). This is because they have little understanding of the ideal way that the aims of members could be met. The Hilmer Report, which introduced national competition policy, defined competition as, '**striving or potential striving of two or more persons or organizations against one another for the same or related objects'** (1993, p.2). Hilmer saw competition as striving for goals which may be social or environmental as well as economic. This approach is consistent with the requirement for triple bottom line accounting, which is also necessary for sustainable development.

However, the Review Panel applies an outdated theoretical paradigm, which is discussed later, so they cannot give any account of why some people think 'offering extensive product choice is unnecessary and ineffective and only leads to higher cost' (p. 31). The paper does not define competition or address it adequately. It is never explained why increased fund manager trading may appear consistently related to increased member costs, rather than to better outcomes for members. A related major problem is that the review paper is not clear if the terms 'defaulting members' and 'default funds' apply to employees covered by an award, to employees whose employers choose the fund to which the employee will contribute, or to people, like myself, who assume the trustee/s of their superannuation fund are currently better equipped to make investment choices on the member's behalf, better than the member is herself. (Although God knows I wonder.) The above extremely different situations are confusingly lumped together in the analysis.

The most useful statement the paper makes about costs, in my opinion, is that according to a global pension fund analyst the following are 'the five key levers' that affect the administration costs of running a super fund (in order of impact) (p. 24):

1. Economies of scale (including the size of the average member account balance)
2. Transaction volumes
3. Cost environment (i.e. relative labour costs)
4. Complexity of the product; and
5. Service levels offered to members (*What some may define as a service others may see as a cost. As a past borrower from the Members Equity Bank which advertises itself as the Super Fund Bank, ask my views on the role of Perpetual.*)

One wonders why the term 'levers' is used regarding the above costs. Who pulls them?

3. TO CLARIFY MATTERS, EXPLAIN THE IDEAL OPERATIONS OF THE IDEAL TRUSTEE IN RELATION TO MEETING ALL MEMBERS AIMS

For fair treatment to occur, all members in any fund and in any industry are ideally treated consistently, in accordance with achievement of their aims, rather than with the wishes of their employers or others acting predominantly in their own interests, rather than in the interests of fund members.

The review terms of reference (under the related heading 'Scope') refer to Structure and Operation in the following ways:

> 1.3: Structure: promoting effective competition in the superannuation system that leads to downward pressure on system costs, examining current add-on features of the superannuation system; and, examining other structural legacy features of the system; and
>
> 1.4: Operation: maximising returns to members, including through minimising costs, covering both passive defaulting members, who should receive maximum returns and value for money through soundly regulated default products, and active selecting members, who should not be negatively impacted by conflicts of interest that may inhibit advice being given in the best interests of members.

Statement 1.3 is an aim related to the structure, rather than a definition, and the paper entitled 'Operation and Efficiency' provides neither a definition nor a description of the structure, as indicated earlier. One presumably cannot know or discuss the 'current add-on features of the superannuation system' or 'structural legacy features' of the scheme operation referred to in the terms of reference, until one knows what scheme structure is.

Statement 1.4 is also an aim of operation rather than a definition of operation. The concepts of 'defaulting members' and 'default products' requires early explanation because the terms have a confusingly negative connotation. Laws established the default related operations in industry superannuation schemes, which are also called non-profit.

These superficially appear to be by far the best way forward to many better schemes, because the trustees ideally represent the full range of members' interests on a production and related industry basis, which could be made ideal for transparent management and cost containment. Members come from government and private sector employers and workers. However, openly comparing the performance of all schemes may often be better action, rather than more legislation which challenges powerful vested interests and thus invites many lawyers to the public or other troughs. Educate members for choice.

On page 17 the review panel paper explains that:

> Super contributions for employees who have not actively chosen a fund are made to a 'default fund' where the fund trustee (sic) sets the available investment options.

The above statement suggests a fund has only one trustee. One assumes the writers were not thinking of industry superannuation fund trustees when the above was written. Industry funds have a number of trustees who ideally represent the interests of the members as a whole, as well as those of specified member groups and individuals.

The paper must clearly explain the ideal role of the ideal trustee and how it ideally relates to all fund underwriting, other cost or 'leakage' (?) containment, to achieve the specified aims of the scheme members. The role of the single fund 'trustee' may be most clearly related to opportunities to milk superannuation fund members by generating costs as fast as possible in the 'trustee's' self interest and/or in the interests of his bigger, more powerful and attractive 'clients'. The latter may seem more like his bosses. What is 'leakage', which is often referred to and how does it relate to costs? (I am at sea on this.)

The writers explain that at present there are two main ways in which default funds (which appear to apply to industry superannuation funds and many others) are selected (p. 17):

> For employees covered by an award, employer and employee groups negotiate to select the funds that are included as the default fund in an award. Sometimes, several funds are nominated in an award and employers then chose.
>
> For employees not covered by an award, employers choose the default fund.

The above situation seems one in which many employees not covered by awards may be treated comparatively unfairly, with their funds also being exposed to higher levels of risk, in their employer's interest. However, the differences between employees who are not covered by awards and others are legion. Some not covered by awards may be very powerfully capable of determining their own financial fate while others have no power.

The common dictionary defines default as: 'failure, neglect to act, appear or pay'. It gives the examples of persons who do not pay debts and soldiers guilty of military offences. The fact that 'default' normally implies an undesirable thing is a particularly confusing term in superannuation policy, since 'default' in superannuation now seems to be driven by law. I am not regarded as ‘defaulting’ if I seek a doctor’s care, rather than treating my body myself. I should not be thought of as defaulting if I make the assumption that UniSuper trustees know how to manage my funds more effectively that I do, as they are supposed to be the experts and I am not. As a woman I am not normally regarded as ‘defaulting’ if I marry and hand over all my financial affairs to my husband so as not to have to worry. This language often seems purposely wrong and confusing.

But let us return to page 17 which states:

> Given that the vast majority of employees do not actively choose their fund or their investment option, it is important that default funds have default investment options that appropriately accommodate a variety of members and that members’ best financial interests are served.

For fair treatment, all members in any fund and in any industry are ideally treated consistently, in accordance with their aims, rather than with the wishes of their employers or any others acting predominantly in their own, rather than fund members interests.

The review paper is confused about whether the terms ‘defaulting members’ and ‘default funds’ apply to employees covered by an award, to employees whose employers choose the fund to which the employee will contribute, or to people, like myself, who assume that the trustees of their superannuation fund are ideally better equipped to make choices on the member’s behalf, better than the member is herself. Because of this confusion the writers do not appear to have an effective way of going forward or cutting costs.

I assume the definition of members ideally relates consistently to their geographic locations, their occupations or related voluntary service affiliations and to related ANZSIC definitions, as recommended by the Productivity Commission. The issue is important for clear and correct data entry and all related transparency. This is necessary for efficient or effective competition, accountability, analysis, fair and consistent treatment of members, and policy advice designed to improve each superannuation scheme and the broader national system of schemes further, in the interests of members.

THE MAJOR PROBLEM OF THE REVIEW PANEL IS THAT IT APPEARS UNWILLING TO DECLARE OR EXAMINE ITS BASIC ASSUMPTIONS

The review appears to take a different tack to that suggested above. Under the heading entitled ‘What is efficiency’ which occurs on page 4 of the paper entitled ‘Operation and Efficiency’ it is stated (without any overt reference to the review terms of reference) that:

> Efficiency operates on different levels. For example, from a government perspective, an efficient superannuation system is one that imposes the least demand on its fiscal position via the aged pension and its regulatory and taxation systems, while still achieving the Government’s policy objectives. For most members, efficiency means the highest end benefit for a given level of contributions during the accumulation phase.

From the above, should one assume the concept of the 'highest end benefit' is the same as 'the highest benefit on retirement'? Clarity in language is vital as it will determine how the superannuation funds are ideally designed and treated for fund collection, investment and for cost containment, so as to maximise all the related member incomes. The ideal scheme structure can only be established by plain English. Many professionals, academics and bureaucrats appear either unwilling or incapable of using it. This is scary.

The Review Panel paper goes on to state (p. 4):

> The Review Panel takes the view that wholesale investment markets are fairly efficient, and so there are only marginal potential gains in efficiency that can be made through increased gross investment returns. There seems, however, to be much greater scope to improve system efficiency overall by refining and streamlining operational processes and reducing costs and leakages (including agency costs). Therefore, the determinant of efficiency should, in the first instance, be the ability to reduce the aggregate of those costs and leakages, rather than looking for ways to increase gross investment returns.

One wonders on what evidence the Review Panel decided the wholesale investment markets are fairly efficient. To do this one must demonstrate both the current and the ideal superannuation scheme structures. This is necessary to monitor their operations and outcomes effectively, so as to understand and reduce their costs, and to identify their comparative successes and failures in their competition to produce the desired results for members. These results may be social and environmental, as well as economic. As a superannuation fund member I do not want my money invested to enrich people whose economic interests lie in perpetuating arms, even if it enriches me in the process. Neither should Australian governments, because this is contrary to the direction of many UN Conventions and national directions to which they claim to be committed. Those embracing opaque commercial in confidence investments are naturally the first to tell us we cannot afford to protect any other species besides man. How convenient for them.

In general, it seems a giant leap of faith to deem the wholesale investment markets 'fairly efficient'. Why does the Review Panel do it? Compulsory superannuation fund acquisition commenced in Australia only in the early 1990s and the world has recently experienced the greatest financial crisis since the Great Depression, in which most if not all superannuation scheme members lost money. As a contributor to the UniSuper fund I don't call it fairly efficient, I call it a big target for a million extremely nasty leaches.

Many centrally important questions arise in relation to the definitions of 'costs' 'leakages' and 'agency costs' and their ideal and actual relationships to 'trustees', however the latter are defined and held accountable. In regard to the apparently equally fuzzy concept of 'wholesale' investment markets, Edna Carew helpfully distinguishes between wholesale and retail banking in her book 'The Language of Money'. She states:

> Wholesale banking: borrowing and lending in big licks. Individuals are small fry, relying on 'piggy banks' at the retail end of the business. Major corporations, banks, merchant banks and money market operators are the wholesalers of the financial world (1996, p. 345).
>
> Retail banking: banking services catering for ordinary individuals and small businesses as distinct from large corporations. Retail banking operations offer deposit facilities, lend money, transfer funds and are prepared to deal in relatively small amounts. (p. 284)

It appears difficult to differentiate clearly between wholesale and retail banking – for example, what is a 'big lick'? The ideal seems to be national industry and community savings and investment funding pools and related systems, using consistent definitions and rules which are consistently applied, unless another course of action appears to be more appropriate for some good reason, such as the key differences between profit driven and non-profit driven aims and activities. One assumes superannuation is ideally discussed consistently in this light. The Panel states:

> the determinant of efficiency should, in the first instance, be the ability to reduce the aggregate of those costs and leakages, rather than looking for ways to increase gross investment returns.

This is the wrong approach because the Panel appears fundamentally uninterested in understanding the complex and varying structures of current superannuation funds in order to achieve apparently ideal schemes or related competition.

Finally, in its discussion entitled 'What is efficiency' the Panel states:

> Having said that, less tangible efficiencies for members could also be brought about by overall simplification, fewer conflicts, better design of default funds and default investment strategies, fewer investment choices and better disclosure (independent of any reduction of costs and leakages). Admittedly, these sorts of efficiencies might be difficult to measure. The means to achieve some of these qualitative efficiencies are also canvassed in this paper. There is certainly also the possibility that better investment returns could arise from some of those qualitative efficiencies by themselves (ie without any reduction in costs and leakages) (p. 4-5).

If the above direction and related 'less tangible' or 'qualitative' efficiencies seem bizarre, it may be because the Panel neglects to mention its covertly underpinning assumption of 'efficient market theory' which appears to drive a great many of its confused and confusing statements besides the above. According to Carew:

> Efficient market theory is the assumption, which underlies modern finance theory, that all available information about a commodity (a share or other investment) is reflected in its price. Therefore, the current price becomes the best possible

> forecast of value. As soon as any new information becomes available, the price moves automatically to assimilate it (p. 119).

Enron, Fannie Mae, Freddie Mac, Bernie Madoff, and many others were shown to have lied about or manipulated prices to try to serve their managers' and other economic interests while also generating lies about the underlying value of many related 'assets'. This has recently led to a global financial crisis. Why does the Panel appear to believe the drivel about efficient market theory? (Nobody ever wants to write anything unwise?)

SOME RELATED QUESTIONS AND ANSWERS:

6.6.2: Should Australia have something similar to the national fund being introduced into the UK in 2012 through the Personal Account Delivery Authority?

A. God knows. However, their experience during the recent global financial crisis and beyond suggests the British people are more likely to be victims of high risk, highly exploitative financial regulation and related commercial in confidence behaviour than Australians are. We are not all descended from convicts, aborigines, victims of war and tuberculosis, and immigrants who started off working in small business just for nothing. Perhaps the British government would like to consider schemes more similar to ours.

6.2.5: What are the lessons arising from the global financial crisis on the availability and design of investment options in super?

A. That many assumptions underpinning much financial, economic and related legal and professional discourse are more evil and/or stupid than we ever dreamed and that those which ruled us in the past should rule us no more, especially in regard to superannuation.

7.3 Do trustees concentrate too heavily on strategies that rely on active trading of investments or would more passive management be better?

A. The terms 'active' and 'passive' management are very misleading in the current financial context where 'active' may just mean the capacity to constantly generate costs for scheme members while supporting many who may mainly live like leaches on more productive members of society. (Their assumptions and associations are still feudal.)

8.1.3: Should APRA persist in trying to identify an investment option that is comparable across all super funds?

A. No, because people at APRA superficially appear unlikely to have the will or capacity to do it properly. Let somebody else have a go because the task is important, especially in regard to the construction of a variety of kinds of housing and their related financial supports in various locations. I recommend the Productivity Commission tackle it because they take a more realistic institutional approach to economics that most do.

Australian housing construction is one of the most logical and necessary areas of Australian superannuation fund investment, as I have repeatedly argued in earlier submissions. When Peter Urban, a former chief economist at the Dept. of Foreign Affairs and Trade wrote the following he put his finger on a problem I then realized that I and many others shared. He said:

> 'If you want to fix a problem, you have to understand what the problem is. If you don't, you could make it worse. 'While everyone agrees there is a housing affordability problem the fact is, there are actually two problems – a mortgage affordability problem for many home owners and a housing cost problem for many people wanting to buy their first home' ('A super cure for mortgage defaults', Australian Financial Review, (AFR 14.8.07, p.63).

Urban does not refer to the related additional costs of the land and other regulation. I assume the role of government in regard to housing is ideally to make it easier for all Australians to find a suitable place to live. However, Milligan noted that housing has become increasingly expensive since 1960, and rising household income has not kept pace with rising housing price, especially in the past two decades. It has been argued that housing policy which seeks to increase affordable housing should mainly be targeted to making housing more competitively priced for those living in the lowest 40% of the total population of Australian household incomes. For many reasons which I have entered into in previous submissions, it seems good to identify housing as an investment option that is comparable across all super funds. I attach a related discussion of future development at Harold Park in Sydney, in the hope that it might be supported by government and relevant industry superannuation fund managers as a planning model for many related regional aims and investments to bring about more sustainable development.

Thank you for the opportunity to make this submission.
Yours truly
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