SUPERANNUATION COMPETITIVENESS AND EFFICIENCY

Submission to the Productivity Commission ("PC") review into Superannuation Competitiveness and Efficiency ("Review")

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INTRODUCTION

The PC will receive a multitude of detailed, complex submissions. This submission will be short and to the point, partly to allow the PC to spend more time on the detailed submissions, but also to try to demonstrate to the PC that we are not dealing with rocket science.

It will argue that because of the imperfect nature of information about superannuation and investing that is available to consumers it is naïve to think that giving consumers more choice of product will lead to a better outcome than is currently the case. In fact it will argue that less competition, in other words fewer providers would benefit consumers.

Evidence will be cited to support these views, but anyone who has worked in or been close to the industry just knows it to be so.

IMPERFECT INFORMATION

"They [free market policies] were never based on solid empirical and theoretical foundations, and even as many of these policies were being pushed, academic economists were explaining the limitations of markets — for instance, whenever information is imperfect, which is to say always." Joseph E Stiglitz in "Bleakonomics"

To the interested observer, this makes complete sense. The literature supporting this view is expansive and convincing. With superannuation and investing the imperfections are extreme. The simple fact is that even the experts have difficulty determining in advance who can out-perform the market. John Bogle has made his, very successful, career by arguing for the superiority of index funds over funds that are actively managed. Others have shown that random selections will do as well as the experts. The debate rages on, which just proves the point; knowledge of the superannuation market and how it works is imperfect, extremely so.

The situation with superannuation is made worse by the fact that consumers are investing over a time horizon of more than forty years which complicates matters further and raises the level of uncertainty to a level that most individuals cannot deal with.

So, if even the experts can't pick the best funds or investors what chance has the average consumer?

COSTS AND FEES

The Grattan Institute (2014) , among others, has shown that not only are fees and therefore costs the best predictor of future returns, but that those funds with the lowest fees, on average, produce the highest returns. This supports the John Bogle view of the benefits of indexed funds, because they have low fees.

The Australian superannuation industry is characterised by a plethora of different providers whose product is generally indistinguishable one form another. The way the public offer funds compete with each other is through the meaningless, but somehow compelling, use of historical return rates and inane marketing and advertising to the superannuation contributor (glossy documents all showing the same happy families) and through trying to coerce employers, at great cost to existing members of the fund, to switch the default fund for their employees, at least for those funds that are contestable.

At the risk of digressing, the Australian superannuation industry is beginning to remind me of a trip to the toothpaste aisle in a supermarket – all I want is toothpaste that works and all I get is confused and irritated by the pointless choice and irrelevant differentiation.

In addition funds do not generally have sufficient scale to be truly effective.

The result of all this inefficiency has been the depriving of the Australian superannuant of a significant part of his or her potential retirement benefit. (Grattan Institute 2014)

The number of funds needs to be reduced dramatically and the wasteful marketing and advertising, not to mention the bureaucracies, reduced almost to zero. A large, self-serving and counter-productive industry has grown up around the Australian Superannuation Guarantee. It has a vested interest in maintaining the status quo and expanding itself. It will be hard to dislodge and will lobby aggressively, and probably with the use if its members' superannuation money, to resist change.

FUND GOVERNANCE

Kevin Yi Liu in his June 2013 doctoral thesis entitled, Australian Superannuation, Operational Structure, Investment Performance and Trustee Governance found that *" retail funds significantly under-performed their not-for-profit counterparts using the new risk-adjusted performance measure (the RAVA method) at the total fund level. Furthermore, I found that the under-performance of the retail funds was not driven by asset allocation differences or investment manager skill differences but due to the cost differences between the two types of funds.*" (Liu, 2013. Page 286)

This conclusion supports the Grattan findings about the impact of cost on superannuation outcomes. It also suggests that funds operated for profit and the best outcomes for superannuation consumers are not compatible. A superannuation fund trustee board cannot act in the best interests of its members whilst maximising profits for the owners of the trustee. This is just common sense.

One solution to this particular source of inefficiency is simple, only permit superfunds whose trustees are a not-for-profit entities with no ownership ties to a for-profit entity to operate an Australian superannuation fund. This suggestion is supported by findings from research by Keith Ambachtscheer..

CONCLUSION

In conclusion, and to save the PC time, I recommend reading the Grattan report and implementing a contestable default process with annual “nudges” to the consumer via the tax return system to consider changing to one of the selected default funds. In other words a system based on that advocated by the Grattan Institute. Obviously there will be many devils in the detail.

A worthwhile enhancement to the Grattan model would be to ensure that all operators are not-for-profit. However, the possibility of that happening while the Australian banks and FIRE industry has the influence it currently has is zero, so we should focus on what is, even if only remotely so, possible. So it might be better to wait and see if the for-profit funds can change the way they do business. If the benefits to consumers and the community as a whole are anything like those estimated by the Grattan report, it would be very hard for anyone to argue against it, with integrity. But they will.

References:

Grattan Institute (2014) – “Supersting : How to stop Australians paying too much for superannuation”; John Minifie; Published by the Grattan Institute; April 2014.

Liu (2013) -, Australian Superannuation, Operational Structure, Investment Performance and Trustee Governance; Kevin Yi Liu; Doctoral thesis; The University of Sydney; June 2013