



**ASIC**

Australian Securities & Investments Commission

# **ASFA Luncheon**

# ***Observations on Retirement***

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## Setting the scene

1. Since starting at ASIC nearly five years ago, I have spent a very large amount of time doing precisely this; talking to people. I would have made hundreds of presentations to external audiences around Australia, and overseas, on a wide range of topics. I have done my best to simplify the complex, get to the point; and even have some fun along the way. (I will have to leave it to my audiences to rate the experience.)
2. But there's one presentation I would find very difficult: an explanation of fees in super. I don't think I could get up here and explain super fees to you; let alone a lay audience. Where would I start? How could I explain the web of charges and commissions, splits between players, volume and other sorts of rebates, shelf fees, contribution fees, exit fees, asset level versus account level, buy/sell spreads and maybe even arrangements I don't yet know about? Surely, nobody could follow it without studying a diagram, unless, of course, they have been living with it for years.
3. So, as chair of the Super System Review – my number one priority is the total abolition of all fees in super.
4. Only joking! You can all take a deep breath and relax.
5. Fees are, of course, here to stay. Super is about saving for retirement, but those providing services to the industry are running a business and I understand that as well as anyone. But, fees are a big issue in long-term investing and there is a view that the super industry is not yielding the 'costdowns' that should be happening with such a vast pool of savings and a guaranteed increase in scale. My bones tell me this is right. There is also a view that there are too many layers and moving parts in super and too much ticket-clipping. We will try get to the bottom of this in the Review.
6. But there are many more issues than just fees. So today I would like to give you a flavour, a sample, of what I see are some of the issues for the Review. Today is not about answers, or solutions, but marks the first step in what I hope will be a productive and informative engagement with industry.

### ***The market***

7. What are some of the big issues in super? It is only partly about the recent market gyrations. But, having said that, we have to feel empathy for those who are about to retire, are concerned about their predicament and have been adversely impacted by the GFC. The Review will look at how funds might be better prepared to cushion the impact of market gyrations on members approaching retirement, while still providing them with acceptable returns.

8. We must also remember that retirement is not a death sentence and certainly should not be seen as a time when all investing (which inherently involves risk-taking) stops.
9. As we all know, markets go up and down and the GFC has been a salutary reminder that super is not a separate asset class with guaranteed double-digit returns!
10. There is also the question whether super in Australia is too exposed to the equities market in general. Some critics have pointed to the fact that the industry overall is more exposed to the share market than in other comparable countries. I do not have a view on this, but I am sure we will look at it in the Review .

### **Confidence**

11. A big issue in any financial system is confidence. All the stakeholders in the super game must have confidence in the product. That will also be a big theme in the Review. Having said that, Australians already deserve to have confidence in the super system. The aim is to increase that level of confidence.
12. But right now, the economic downturn is impacting people's confidence in the value of their super. It has meant that one in eight retirees, or soon to be retired, will delay retirement to try and claw back some of their lost wealth. One in six will be forced to accept a lower standard of living. Almost half have had to readjust their expectations about their standard of living in retirement.<sup>1</sup>
13. Some commentators say that around one in ten people switched asset classes into cash,<sup>2</sup> although a leading super researcher<sup>3</sup> says that this figure is a much lower - 3.4% for members who are still in the accumulation phase. It is quite likely that those who have already retired would have acted more conservatively. Other data show that around 17% of members switched or considered switching to a more conservative fund with the same provider and 11% switched or considered switching to a more conservative fund with a different provider.<sup>4</sup>
14. These figures are worrying. Worrying because people have lost money? Absolutely. Having one's hopes and expectations for retirement dashed must be very confronting. But the statistics are worrying on another level. Worrying because they demonstrate that many Australians do not understand

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<sup>1</sup> BankWest, Retiring in the Downturn, *Media Release* 11 June 2009.

<sup>2</sup> Karina Barrymore, 'Hitch in switch to cash' *The Herald-Sun* (Melbourne), 23 May 2009 <<http://www.news.com.au/heraldsun/story/0,21985,25524203-664,00.html>>

<sup>3</sup> Jeff Bresnahan, SuperRatings, *The Australian*, 16 June 2009, p21.

<sup>4</sup> AIST, 'Most super investors expect their returns to be worse this year' *Media Release* (23 March 2009) <[https://www.aist.asn.au/Pages/PolResAdv/SubPage\\_Media/documents/AISTSupersurveyresults.pdf](https://www.aist.asn.au/Pages/PolResAdv/SubPage_Media/documents/AISTSupersurveyresults.pdf)>

super. The boom years created unrealistic expectations – expectations that could never be fulfilled.

15. It is one of the many facets of investor behaviour that people suffer from loss aversion; the negative impact of losing a given amount of money is much greater than the satisfaction of earning it in the first place.
16. But, as the saying goes, in chaos, there is opportunity. Indeed, we might look back at the GFC as a watershed in the evolution of our super system. Many more people are now thinking about super. How much do I have? Who is it with? "Oh, so it is not a separate asset class, but is connected with the market – I didn't realise that."
17. A big part of the success of the Review will be about confidence building. Confidence as a nation: that we have the world's best super system. Confidence as an industry: that the system works - is flexible, reliable and stable, but can adapt and improve.

### **Macroeconomics**

18. We also need to be very clear about the macro-economic impacts of our super system. It appears that over the last six months, the repatriation of a large amount of superannuation money from offshore investments has facilitated some vitally important things in getting us through the down-under impacts of the GFC.
19. Providing the liquidity necessary to fund the lion's share of capital raisings done over the last six months to repair damaged corporate balance sheets, initially in the banking sector and then more broadly. For those, like me, who were wondering where on earth all this money was coming from, it now looks like we have the answer.
20. The corollary of this is that this ready source of serious and mobile liquidity was an enormous relief or backstop for our banking system. There was not an additional strain on the banking system to provide this liquidity, because it was coming from super.
21. In addition, this flow of funds has actually had a significant impact on our national accounts. The GFC has cut the current account deficit in half (to \$36 billion), a fact which Goldman Sachs JBWere chief economist, Tim Toohey, attributes in part to the net equity inflow resulting from the repatriation by super funds' offshore investments.<sup>5</sup> It is this inflow which is financing the economy's external deficit.

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<sup>5</sup> Michael Stutchbury, 'Economy cushioned from the crunch as super comes home' *The Australian* (11 June 2009) 26 <http://www.theaustralian.news.com.au/business/story/0,28124,25617419-5018063,00.html>

22. As the super pot grows, its macroeconomic significance will also increase. What is it going to mean when super materially exceeds both GDP and the market capitalisation of the Australian stock market - as it is scheduled to do in the relatively near future?

## The challenges

23. So, what are the challenges in shoring up confidence in our already leading super system? Let's start by looking at what could be improved.

### *Fees*

24. Fees are the equivalent of reverse compound interest in super. There are really only two levers in super: good investing and the costs taken out of what is earned. In some detail, the Review will ask how fees in super work; what they are for; who gets them, what value they add and what fees look like in other jurisdictions?
25. Who has a mobile phone? I am assuming that pretty well everyone does. But, who knows whether they have the best plan, or even whether their plan is competitive, or even remotely competitive, with other plans? Why is this? We are all busy, the plans are complex, the phone companies don't make it easy for us and the amounts seem relatively insignificant and so on. But it is still annoying. We all feel that we could get a better deal, but we don't know where to start.
26. What about our super? Is it any different? Who could say they are in the super fund with the most competitive fees? Let's take a walk through the maze of super fees.
27. **Investment management fees** (charged by internal or external managers). The Review will look carefully at what these fees are for, how they compare internationally, whether they could be reduced, whether people understand them and a range of other aspects.
28. However, what is already obvious is that there is a structural problem with the way fees are charged on an asset-based or percentage basis. For example, the investment management fees increase, rather than decrease, with the size of the funds under management. This is in spite of the economies of scale that a larger fund brings. This feels like it is not the right setting for super. Also, it's interesting that percentage fees are only still enjoyed by a few players in our economy, such as real estate agents and investment bankers.
29. Now, a discussion about the relative merits of charging in those industries is for another time and place! However, in a compulsory system aimed at maximising the long-term savings of all Australians, percentage fees should be looked at very

carefully and trustees should be asking why fees structured in that way are appropriate.

30. What other services do we pay for in this way? These fees operate like a wealth tax; they attach themselves to your super savings. You can be sure that this will be a key theme in the Review.
31. **Commissions** in super are, of course, an issue; with the most egregious being trailing commissions paid in respect of members who are in their employer's default fund and who have never received advice from anyone.
32. **Performance-based fees.** A number of super funds now pay investment managers extra fees based on short-term out-performance (ie looking at a 12-month period and sometimes even monthly) with no downside for the manager, often without regard for past losses and with no clawback for future losses.
33. In fairness, some do apply a 'high watermark' approach so underperformance is recouped before these fees are payable again. Having said that, the other gripe is that it is very hard to see any reduction in base fees as a quid quo pro for agreeing to pay performance fees in the first place.

Again, these fees do not seem right in super. They are very focused on the short-term. Having said that, there is nothing inherently wrong with performance-based fees – the notion of only paying a premium for genuine 'alpha' might actually be the solution in super. But a performance fee that works in super might look like this:

- (a) cost, plus a transparent margin;
- (b) a rolling five-year calculation of performance against an appropriate benchmark; and
- (c) the manager having 'skin in the game' on the downside as well as the upside.

What is currently on offer in the market seems to have been copied from the '2 & 20' model used by hedge fund managers. The Review will try to find out why trustees think fees like this are in the best interests of their members.

What this might also suggest is that a lot of investment managers have more bargaining power than our super funds. If this is right, it will be something else for the Review to ponder.

34. **Shelf fees** payable to dealer groups, master trusts and licensees for having the super fund on their investment menu or approved product list. These come out of the issuer's own pocket, but they are still part of the cost of the system, no doubt being subsidised by other fees and charges applied to members' account balances.

35. **Contribution fees**, which are then either kept by the trustee on its own account; used to pay up-front and trailing commissions paid to advisers; or partly or wholly rebated to the member (or a combination of all three).
36. **Buy/sell spread**. The Review will look at whether the current way this works is optimal. At first glance, typical buy spreads in super look high and, although they are for the benefit of the fund, they skew performance and penalise active members.
37. **Exit fees**. These have been criticised over a long period and the Review will look closely at them. The 2007 PJC Inquiry into super recommended they be prohibited.
38. **Insurance premiums** (these are typically marked-up to enable commissions to be paid to advisers, in super, generally around 20% per annum)
39. There are many other fees, including switching fees, rebates of investment management fees (ie lower fees for a larger account balance or investment), additional service fees (if applicable – for example, excess switching), fees for service charges paid direct to an adviser.
40. Now I appreciate that none of this will be news to any of you. Many of you will also have views about why some of these fees are structured in the way they are and these will all get a fair hearing during the Review.
41. But, whether reality, or only perception, there is a general view that fees in super are too high and are not aligned with better outcomes for members. There is an increasing sense that things could be improved. Is this one of the reasons why there is an increased exodus to self-managed funds? If these hunches are right, what better incentive for many of you to really engage on this issue?
42. I also appreciate that segments of the industry are working to address some of these issues. For example, the FPA has released its discussion paper on remuneration practices for advisers, which clearly touches on issues such as trailing commissions.
43. Yesterday, IFSA released its Super Charter, which seeks to standardise and unify the way certain fees are described and charged in super.
44. These initiatives are to be applauded. The Panel will welcome constructive debate, good data and recent thinking on these issues. However, let's be clear. Nothing is sacred. Everything is on the table. But, for all of to come to these age-old problems with open minds, prepared to consider them afresh, is an excellent place to begin.

## Choice

45. More than 90% of Australian super fund members do not avail themselves of their right to choose how their super is invested, and end up in their funds' default option.<sup>6</sup> In light of this inertia, too much choice might be just as bad as not enough. One might ask: what is the point of a master trust with hundreds of options? Might we be back to the mobile phone situation; a 'choice illusion'? An illusion that might be adding quite a lot of cost to the system. The Review will look at why there are so many choices in super and who they are intended to benefit.
46. What about choice in relation to an employer's default fund itself? Evidence suggests that the vast majority of Australians do not choose a different super fund from the one nominated by their employer.<sup>7</sup> Perhaps we should accept this and do more work on making sure that the defaults are world's best practice.
47. The decision by the AIRC in January of this year to nominate a significant number of the default funds under the new industry awards is clearly a contentious issue for many of you.<sup>8</sup> The Review will also be looking at this issue.

## Diversity

48. Composition of the boards of trustees and succession planning is another issue. Research commissioned by AIST shows that 77% of all trustees are male and that 76% are over 50 years old.<sup>9</sup> Given the compulsory nature of super, and the fact it affects all Australians, is it a problem that the boards are not more reflective of society or do members want 'blokes with grey hair' when it comes to the people running their super fund? The Review will also look at this and will consult widely. After all, the Panel itself is made up of blokes with grey, or greying, hair!

## Competition

49. In some respects, the market for super looks competitive. You can choose between various sectors and a large number of products and providers, but is this real? Inertia, lack of

<sup>6</sup> Michael Laurence, 'Bear trap' In the Black (May 2009) <[http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-6375EBB/cpa/hs.xsl/724\\_32009\\_ENA\\_HTML.htm](http://www.cpaaustralia.com.au/cps/rde/xchg/SID-3F57FECB-6375EBB/cpa/hs.xsl/724_32009_ENA_HTML.htm)>

<sup>7</sup> Josh Fear and Geraldine Pearce, 'Choosing not to choose' *Discussion Paper 103* Australia Institute and Industry Super Network (November 2008) <https://www.tai.org.au/file.php?file=dp103.pdf>, 29-30.

<sup>8</sup> See, for example, Stephen Bartholomeusz 'Industry super funds in AIRC bonanza' (7 January 2009) <http://www.crikey.com.au/2009/01/07/industry-super-funds-in-airc-bonanza/>; Lucinda Beaman, 'AIRC action creates super fund monopoly' (12 January 2009); <http://www.moneymanagement.com.au/article/AIRC-action-creates-super-fund-monopoly/434509.aspx#>; Industry Super Network, 'Award modernisation recognises existing default fund arrangements' (24 April 2009) <http://www.memberconnect.com.au/ACTUSuperSite/SuperannuationNews/Awardmodernisationrecognisesexistingdefaultfundarrangements.aspx>

<sup>9</sup> Dr Shey Newitt, 'What drives superannuation trustee board performance?' AIST Fund Governance Conference (5 May 2009) [http://www.aist.asn.au/Pages/Events/SubPage\\_SFGC/Program.aspx](http://www.aist.asn.au/Pages/Events/SubPage_SFGC/Program.aspx).



knowledge, complexity, lack of transparency and comparability on fees and performance, employer funds, awards and so on might mean that price competition in super is a lot less intense than it appears. The Review will endeavour to assess whether there is genuine competition in super.

50. Consumers in super also seem to be under-represented. There are roughly 11 million people in super, but there is not one single body that just represents members and advocates their issues. Do we need something like an Australian shareholders' association for super?
51. It is true the trustees work very long and hard for their members, often for little or no reward. But is this enough? Would members be better off if they could unite and demand lower fees, better information, more services, less complexity and so on right across the system? It is also interesting that there is no annual general meeting equivalent in super. The Review will ask whether these are missing links that make super a bit less competitive, and perhaps a bit less transparent, than it should be.

### ***Lack of diversification and liquidity***

52. Another disconcerting aspect of the current structure of super is how members have found themselves invested through master trusts into a frozen investment option (eg a cash-enhanced option). Sometimes, this has shown just how undiversified their superannuation savings are. What's more, they will still be paying for the advice that got them there.

### ***Complexity and Disclosure***

53. The Financial Services Working Group did some research recently about how consumers react to product disclosure statements in super. One man, after grappling with a particularly lengthy and dense PDS, called it "Shakespeare for dogs"; another took one look at the PDS and decided to read his newspaper for the remaining two hours of the focus group session.
54. Everyone knows that super disclosure documents are too long and complex. Even if we simplify them, will people read them? Also, how is it that in a country where internet usage is among the highest in the world, super funds largely communicate with members in paper? If we are to retain our dynamic, cutting edge super system, these issues must be addressed. But they are hard issues and the Review will need to choose its priorities carefully.

## The solutions

55. Where to from here? As I flagged earlier, today is just about a few things that the Review is likely to look at, not about the ultimate solutions. The Review is about consultation and debate. It is about gathering together experts with inquisitive minds and lateral thinkers to come at our super system from potentially new angles. To stretch ourselves again to maintain our place in the trophy cabinet of retirement savings systems. After all, this is a once in a generation shot.

## The pay-off

56. That said, I know some will ask: is it really worth it? Is it the right time? Isn't this just yet another government inquiry? Do the issues really justify a year-long review? These are questions well worth asking. Minister Sherry spoke about the need to renovate the house, to tidy up the system. 'Renovate.' 'Tidy Up.' These are not the words of revolution. The system certainly is not broken. It has served us very well.
57. But is it a system equipped to deal with the needs and expectations of the next generation? Does it produce the optimal outcomes for members? Are there ways in which it can be improved while preserving existing benefits? These are the sorts of questions that will confront the Review.

## How can you help?

58. Fine-tuning the system for the next generation is a massive undertaking and one that the Review will not undertake alone. In addition to the Review's experienced five-member part-time Panel and full-time secretariat, we will be looking to you – the super industry, the experts - to assist, guide and debate with us.
59. This is a unique opportunity for us all to engage, to participate and to renovate our system so that it remains something we can all be proud of; something in which we all have confidence.
60. And the measure of success? Well, super is now in the spotlight, it is centre-stage. Success might be when people don't talk about super so much, because they are not only confident it works, they are confident it works for them.