

Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Mr Steve Blizzard
Authorised Representative
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21 August 2006

By email: corporations.joint@aph.gov.au

Dear Sir

Re: Inquiry into the structure and operation of the Superannuation Industry

As a Financial Planner of 20 years direct experience, it is timely that the Government is conducting an inquiry into the sometimes curious workings of the Superannuation Industry.

By December 2005 there was \$844 Billion invested in all types of super funds in Australia. Given the amount of funds under management, it is prudent that the Government ensures that the policy objective of retirement saving is regularly reviewed, and that the implementation of those goals is being achieved now and into the future.

1. Whether uniform capital requirements should apply to trustees.

No comment

2. Whether all trustees should be required to be public companies.

SMSF's can have non bankrupt members as trustees, and this should not change.

3. The relevance of Australian Prudential Regulation Authority standards.

No comment

4. The role of advice in superannuation.

Over the past year or so, consumers have been bombarded with \$20 million in advertising highlighting that Industry Super funds have "No Commissions"¹.

Without careful analysis of the IFS "compare the pair" (inferred negative branding) advertising campaign, one could develop two differing perceptions.

¹ \$20 Million was spent on advertising in the 12 months to May 31, 2006, according to data from Nielsen Media - "Asset" Magazine August 2006. P 4,19.

Either members can be a super fund member and receive their financial planning assistance for free, or they can be a super fund member and not receive any advice whatsoever.

Worse still, these members then develop a perception that they don't need any advice because their industry super fund membership has solved all their financial needs.

This is a tragic outcome financially, as the very people in urgent need of good sound financial advice and assistance are developing the notion that they need no advice.

Over the past twelve months I have met some of these young people, and the misconceptions they have now developed about their financial planning needs is simply horrifying.

An Australian Bureau of Statistics survey revealed that 40 per cent of people say they have given their retirement little or no thought and a majority had not collected any information about the subject¹.

While the members' very basic retirement needs may or may not be being met, the IFS advertising campaign seriously devalues the benefit and value of advice. If for no other reason, the regulator should seriously rethink the long term ramifications of these advertisements, and how the underlying message inferred seriously conflicts with the Government's stated policy to improve financial literacy.

For example, a young couple over a twenty year period may accumulate \$581,000 without any paid advice, compared to accumulating \$852,000 following the strategic recommendations of their paid adviser². As understood by financial planning professionals, the value of advice far outweighs the cost of receiving that advice.

Worse still, the IFS advertising campaign can de-motivate members from inquiring about their insurance needs, and this only exacerbates the insurance coverage crisis gripping the nation. Last year it was estimated that there was a \$1.3 trillion gap between the life & disability insurance cover in place and cover needed by all Australians³.

5. The meaning of member investment choice.

Member Investment Choice should mean that the member can invest in the super fund of their choice, not simply elect a choice from within their employer's fund – while being denied the right electing of their own super fund.

Being “the fund of choice” does not mean “choice of fund”. This cunning play on words is misleading and deceptive to the unwary.

For example, if a member and his partner wanted to combine their retirement savings into their own SMSF, there is no logical reason why they should be denied this opportunity.

¹ Forgotten Superhero – Barrie Dunstan – “Asset” August 2006 P 72

² The Value of Advice for Thirty Somethings – MLC Publication

³ Life Insurance heats up – “Super Review” – August 2006 P. 22

Currently hundreds of thousands of State Government employees around the nation (excluding Northern Territory employees) are denied the right to invest in their own SMSF or any other fund of their choosing.

Commentary regarding the possible outcomes of the new Super Choice environment has been greatly exaggerated over the past twelve months, if not bordering on stupidity.

Until recently, many traditional funds in the marketplace have had the luxury of employers acting as unpaid marketing staff to ensure funds continue to be funnelled their way. While this ensured that the coffers continued to grow, the level of assistance and unbiased advice to their members was in many cases woeful at best. The fees may be reasonable, but the advice provided to many fund members has generally been non-existent.

During the past twelve months, many employees are electing choice of fund when changing employer. The net result is that as reported, there has been little in the way of fund churning¹.

The benefit of the new Super Choice legislation is the obvious result of employees now being able to take their existing fund with them as they change employers, and not have to put up with the inconvenience of their employers commencing a string of new funds that they don't want.

If for no other reason, ceasing to roll the growth assets in a member's super fund from one employer super fund to another, helps decrease the CGT collected from the member's funds over the years.

6. The responsibility of the trustee in a member investment choice situation.

Where full choice of super is available, providing the underlying fund is investment grade, this should then be a matter for the member concerned and their adviser.

Where choice of super fund is still currently denied, this should be of some concern to those fund trustees.

7. The reasons for the growth in self managed superannuation funds.

Despite perceptions created by the Industry Super Funds \$20 million dollar advertising campaign², SMSF's continue to grow. Over 2000 new funds per month are still being established, of which over \$180 Billion is managed in SMSF's. In 1999 there were over 190,000 funds. There are now more than 300,000 SMSF's in Australia.³

¹ Choice makes barely a ripple on the shores – "Super Review" – August 2006 P. 24

² \$20 Million was spent on advertising in the 12 months to May 31, 2006, according to data from Nielsen Media - "Asset" Magazine August 2006. P 4,19.

³ "West Australian" 13 February 2006 P.33

One of the reasons for the continual growth of SMSF's is that the minimum Marginal Expense Ratio (MER), including accounting and compliance costs, can be as low as 0.25% pa.

For example, if a prospective member (age 55, assuming no further contributions or withdrawals & a 6% pa cash earning rate) using the HESTA Fee Comparison Calculator¹ comparing a SMSF with \$1 Million in funds under management, to the HESTA Industry Fund (with an MER of 0.5% pa, plus an additional administration fee of \$65 pa); by age 65 the SMSF member would be \$41,643 in front of the HESTA fund, and by age 85 the SMSF member would be \$370,869 ahead of the HESTA fund.

Another example is where members can purchase a direct property within their SMSF. Assuming a commission is paid to the real estate agent of 3% of \$30,000 on the purchase of a \$1 Million dollar property, which is subsequently disposed of after 10 years, the commission cost only equates to \$3000 pa, or an investment MER of only 0.3% pa on the invested funds under management.

Should the property be disposed of after 20 years, this MER reduces to only \$1500 pa, or only 0.15% pa. This is quite competitive compared to some of the Industry Super Funds, who in some cases have total average MER's up to 1.23% pa.

It is reported that Industry Super Funds now have \$25 Billion in Funds under management². An average MER of 1.23% pa over all Industry super funds equates to a massive amount in total fees each year. Even HESTA in their 2004 – 2005 annual report outlaid \$26.6 Million in administrative and operating expenses alone.³

The Chief of Australian Administration Services (AAS) – that administers at least 5 Industry Super Funds - Stuart Korchinski, is quoted recently that the non-investment cost per member of Industry Super Funds had risen from \$0.66 a week in 1999 to \$1.13 a week – something that was likely to ultimately impact on the value proposition of industry super funds.⁴ This is almost a 70 per cent increase in administrative fees.

These facts fly in the face of the perception being created by the “No Commission” negative branding comparison campaign conducted by the Industry Super Funds.

Another advantage of SMSF is that the member gains control over the function controlled by asset management consultants. In a detailed study earlier this year, Rice Walker Actuaries was a little sceptical on the performances from groups such as Intech, ipac, JANA, Mercer, MLC and Russell⁵. The performance of Industry Super Funds are primarily derived from the advice received from their asset consultants – hence the similarity in returns across many of their funds.

While the leading Industry Fund boasted a return of 19% to the end of June, a number of our clients received approximately 30% return on their super funds for the twelve months to the end of June 2006.

¹ Hesta Fee Comparison Calculator link:

http://www.hesta.com.au/content.asp?Document_ID=106&Level=1;247;1165;

² Industry Funds Powerhouse – “Super Review” August 2006 P. 14

³ Hesta 2004-2005 Annual Report – link: http://www.hesta.com.au/files/documents/HESTA-ARReport_A4.pdf

⁴ Admin costs \$1.13 a week – “Super Review” May 2006 P.14

⁵ “Asset” – August 2006 P.73

Not all clients want a high exposure to alternative assets, where the asset consultants direct a higher proportion of industry member's funds into private equity and hedge funds¹.

The lack of advice received by members in one State Government super fund has meant that approximately 80 per cent of all their members are invested in the "balanced" fund². Similar statistics can be shown for members invested in Industry super funds.

While much is made of not accounting for a client's risk tolerance, we may well see the time when litigation maybe commenced for not providing sufficient exposure to growth assets³. Is it good practice for a 20 year old to have an overweighting in their super fund to additional cash and bonds for over 40 years?

8. The demise of defined benefit funds and the use of accumulation funds as the industry standard fund.

Depending on the investment climate at the time, when defined benefit funds are good they can be very good, and when they are bad they can be disappointing. Defined benefit funds commonly operate surpluses, and should a member leave the fund due to retirement or death, these retained surpluses can impact on the members end result in various ways.

9. Cost of compliance.

Consumers are now paying a very high price for the compliance requirements that now have to be met. While consumers should have full and clear disclosure, there is probably a middle ground position that needs to be established to ensure an appropriate balance for all parties concerned.

10. The appropriateness of the funding arrangements for prudential regulation.

No comment.

¹ Fighting Funds – "BRW" 9 March 2006 P.22

² GESB 2005 Annual Report – P. 7

http://www.gesb.wa.gov.au/publications/corporate/annual_reports/2005/GESB%200234%20Annual%20Report%20Web%20Sm%20all.pdf

³ Judging Risk – the newest Dimension by Ray Griffin – Money Management – 18 April 2006

11. Whether promotional advertising should be a cost to a fund and, therefore, to its members.

It should be of great concern to the regulator that tens of millions of dollars of members' funds are being wasted each year on so called comparative (negative branding) advertising campaigns, purely for distribution reasons only.

Members too should be worried that the trustees of their super funds are wasting their money purely for distribution reasons - such as who can control or influence distribution; when in reality those fund trustees should simply get back to the coal face and direct those millions of dollars of advertising expenses each year toward providing better advice to their poorly serviced members.

This wastage did not appear to occur when the Industry Super Funds had a monopoly flow of funds being funnelled to them and their underlying fund managers and asset consultants.

With the introduction of super choice legislation in 2005, and the new Workchoices laws, there are fewer industry awards to conveniently funnel workers superannuation guarantee money into industry super funds. This means industry super funds are finally being forced to compete with retail super funds and SMSF's for member's money¹.

For those questioning the wisdom of Choice of Super legislation, the removal of the unrivalled monopoly status of the Industry Super Funds has forced them to start delivering like their competition - by improving returns for members and start thinking about how they might even provide better advice to their members.

But while IFS is headed up by Executive Chairman Garry Weaven, who has the view that "financial planning advice will become less relevant over time"², one then wonders how genuine he is about the recent move into financial planning by the IFS subsidiary Industry Fund Financial Planning (IFFP)?

For example, last week an employer in Perth received a barrage of inflammatory promotional material from CBUS championing the services of IFFP.

The advertising material declared:

- "Commission Free Investments for Industry Super Fund Members"
- "Don't get ripped off! (by other funds or planners)"
- "Avoid the commission trap!"
- "Like your industry super fund, Industry Fund Financial Planning ...works for you and no-one else"
- "No hidden costs".

On the surface, an unwitting construction worker (a fund member) might be pleased to receive this marketing material in the post – his boat has just come in. Or so it seems. Whether on TV on a Sunday night, or on their industry super fund web site³, their industry super fund trustees are burning \$20 million a year of members funds to help create the perception that they might be getting something for nothing. But has this construction worker been sold a pup?

Industry Super Fund REST has at least a temporary solution – which offers a phone based service providing limited "fee for service" advice to members via a third party financial

¹ Super Special – "BRW" 25 May 2006 P.30

² News – Financial Services – "BRW" 25 May 2006 P.16

³ "No Commissions" branding on IFS website - See link: <http://www.industrysuper.com.au/>

planning firm¹. Unfortunately the service is limited. Considering the member is consulted over the phone, how can the member know for sure that their needs are really being catered for properly without a fact find being completed? Or is this “financial planning” on the run – McDonald’s style?

In getting serious about financial planning, the IFS established IFFP. The IFFP division is now owned by Members Equity bank, with “about 65 people working in (their) financial planning business, including 39 financial planners and 11 paraplanners”².

Assuming that the average financial planner’s salary is \$100,000 pa, and the average paraplanner earns \$55,000 pa, this means that IFFP has a total wages bill before office rent and all other overheads of approximately \$4.5 million pa.

Assuming these millions in costs are not fully being covered in “fees for service – billed by the hour”, where are the funds coming from to pay for this cast of Industry fund financial planners? The IFFP doesn’t take commissions? Or do they?

When viewing the IFFP website, members discover that they can pay for financial services by cheque, credit card, or by “a deduction from the sum invested (where available)”³.

Last time I checked my Internet Dictionary for the definition of “Commission”⁴, the following definitions for “commission” could be found:

- A fee or percentage allowed to a sales representative or an agent for services rendered.
- A fee paid to an agent or employee for transacting a piece of business or performing a service; *especially* : a percentage of the money received paid to the agent responsible for the business
- A service charge assessed by an agent in return for arranging the purchase or sale of a security or real estate
- A fee for services rendered based on a percentage of an amount received or collected or agreed to be paid (as distinguished from a salary); "he works on commission"

In other words, the Industry Super Fund Financial Planning arm IFFP are happy to charge a “commission”, when their parent body has just spent \$20 million dollars in the past 12 months advertising that they don’t charge commissions. Is this the commission you have when you don’t charge commissions?

We then went on to investigate the web site of Health Super which proudly proclaims that they are “your Industry Super Fund”. No commissions – right? Wrong again.

When “realising your dreams” with the Health Super Allocated Pension fund, we discover on Page 20 of the Health Super Product Disclosure Statement (PDS)⁵ under the heading “Adviser Remuneration” that a 0.5% trailing commission is paid to Health Super Financial Planning. This trailing commission represents half of the 1% administration fee charged by Health Super.

¹ Just the ticket – “Asset” July 2006 P. 26

² IFA Magazine – 17 July 2006

³ Methods of Payment – IFFP website: see link http://www.ifs.net.au/iffp_advice.htm#ques05

⁴ Dictionary Web Site Link for “Commission” <http://dictionary.reference.com/browse/Commission>

⁵ Health Super Allocated Pension PDF P. 20
http://www.healthsuper.com.au/pdfs/Allocated_Pension_PDS_06.pdf

This 0.5% trailing commission paid to Health Super Financial Planning is not negotiable or rebatable. It entitles all members of Health Super who have an allocated pension with the fund to obtain an annual review of their personal financial situation from a Health Super Financial Planning Adviser at no additional charge. They are also entitled to obtain additional financial advice from a Health Super Adviser if their personal financial situation materially changes.

Assuming a member has a \$1 Million pension fund with Health Super, it means that member is paying \$10,000 pa in fees, of which a non-rebatable amount of \$5,000 each year would be paid to the Health Super's Financial Planning firm. A Health Super member would expect a review considering they might be paying \$5,000 in adviser fees each year.

While the trailing commission charged by Health Super could be classed as being high, to their credit at least it is fully transparent and fully disclosed in an honest manner to consumers within their PDS.

But the question still remains, exactly how qualified and unbiased is the advice that this member is receiving, assuming that their well paid adviser is probably only authorised to discuss Health Super products and very little else?

It appears therefore that some of the industry super funds who are paying Industry Funds Services to advertise on their behalf to state that they are not paying commissions on innumerable TV and radio adverts, as well as in their own publications, newspapers and web sites – in direct contradiction to their Industry Funds own Financial Planning web site which admits it can take commissions (a deduction from the lump sum invested).

It is possible that this could constitute false and misleading practice under Section 52 of the Trade Practices Act. The particular industry funds that are prepared to allow commissions to be deducted from their member's funds for financial advice through IFFP are taking advantage of their industry fund status by marketing the claim that they do not pay commissions – when in fact some of the Industry Super funds actually do pay commissions.

While it is true that some of the Industry Funds do not pay commissions, and I have no problem with those funds. However, there are some Industry Funds that do (as indicated by "where available") on the IFFP.

As such, this advertising campaign could be argued to be somewhat misleading. The Industry funds that do pay "commissions" should not be allowed to shelter under the banner of the Industry Super funds that claim they do not pay commissions in their mass advertising.

There is no clear distinction made in the campaign, and as such requires clarification at the consumer level, considering the multi-millions of dollars being spent by Industry Super Funds to create such an impression in the minds of consumers in the marketplace.

12.The meaning of the concepts “not for profit” and “all profits go to members.”

While these concepts have been used by Industry Super Funds, and retail super funds before demutualisation; the concept of “all profits go to members” is increasingly being used by various Public Sector Super funds around the nation.

Recently the NSW **FirstStateSuper** formally went public offer, primarily concentrating on their former members ¹. Similar moves are being made by the WA Government Employees Super Board (**GESB**).

In setting a fair regulatory framework for the marketplace, serious questions need to be asked regarding the operation and privileged position of the various constitutionally protected State Government superannuation funds.

The State Government super funds do not pay income tax; in general are not fully complying with Freedom of Choice legislation for State Government employees; and in some cases may even cross-subsidise the expenses they incur.

In addition, some State Government Super funds pay their salaried marketing staff conduct hundreds of seminars each year², more often than not taking the opportunity at these seminars to highlight the fees and expenses of retail super funds, with the explicit aim of encouraging members to roll their personal retail super funds into the very Government super fund they are being paid generous salaries to promote.

The comparisons provided between Government and retail funds can be misleading, when the salaried marketing staff and the publications of the Government Super fund indicate that the MER of their fund is 0.33% pa³.

i.e. When a retiree member joins a State Government Pension / Retirement Access retirement pension product, the new member ends up paying a MER of 1.2% pa⁴, in some cases investing with the erroneous perception that they will be only paying a substantially lower MER of 0.33% pa.

On a \$1 Million dollar pension fund, a non-rebatable 1.2% MER equates to a non-rebatable management fee from that particular Government Super Fund of up to \$12,000 each year.

The aggressive targeting of retail super funds by State Government salaried marketing staff is often backed up by subjective case studies involving curiously

¹ FirstState goes public offer – “Super Review” May 2006 P.3

² GESB 2005 Annual Report – P 19
http://www.gesb.wa.gov.au/publications/corporate/annual_reports/2005/GESB%200234%20Annual%20Report%20Web%20Small.pdf

³ GESB Super Outlook News – What Super Fees really cost you P.8
http://www.gesb.wa.gov.au/publications/newsletters/super_outlook/super_outlook_wss_june05.pdf

⁴ GESB 2005 Annual Report – P 95
http://www.gesb.wa.gov.au/publications/corporate/annual_reports/2005/GESB%200234%20Annual%20Report%20Web%20Small.pdf

willing third parties¹ - real case studies that escape rigorous factual analysis - for the sole purpose of fund marketing and distribution.

In each case the member service representatives conducting these somewhat questionable State Government Super Fund seminars do not provide any Statements of Advice with respect to fund transfers, and do not appear to warn those attending the seminars the risk to those members of cancelling the personal insurance cover held within their private super funds.

In addition to the Government Super funds, the Industry Super Funds also choose to utilise the concept of “no one makes any profit – but the members”.

This may be true, after all the other participants contracting to the Industry Super Funds have taken their profits. Some serious questions need to be asked about who is making money out of the Industry Super Funds?

The Industry super funds generally contract out the services of numerous Investment Managers, Auditors, Lawyers, Asset Consultants and Administration Service Companies.

Considering all the various services contracted out, it could be asked what the various Industry Super Funds trustees actually do, apart from waste their members funds on negative comparative branding campaigns, and sit on high profile boards from which some of their directors can launch a future Parliamentary career.

It is worth noting that a large section of the Industry Fund membership have low account balances (under \$1000 – protected from fees). Therefore it is safe to assume that the costs of maintaining these accounts are being cross-subsidised from elsewhere. It is of some concern regarding the rather mixed level of disclosure provided with regard to the shortfall created by low balance accounts.

One thing is clear, it is costing Industry Super Fund Members a lot more than \$1.25 a week in administration costs.

¹ GESB Super Outlook News – Trevor the Boilermaker P.11
http://www.gesb.wa.gov.au/publications/newsletters/super_outlook/super_outlook_wss_june05.pdf

13. Benchmarking Australia against international practice and experience.

While the recent changes to Superannuation as announced by the Treasurer in May 2006 are both necessary and welcome, anecdotal evidence suggests that there is a much higher maximum contribution amount available for super fund members in the United Kingdom – possibly up to 4 to 5 times higher than currently announced here in Australia.

In time perhaps a review could be conducted about increasing the new maximum contribution levels. At the least these levels should be indexed each year so that retirees can keep pace with inflation.

14. Level of compensation in the event of theft, fraud and employer insolvency.

As a general rule, there are now fairly strict regulations in place in Australia, even by international standards, compared to the late 1980's.

If the staff of Ansett had been investing their retirement savings in their own personal super funds or SMSF's, they would not have had to worry about losing part of their super funds when their employer went into receivership. With quarterly minimum SGC payments required by law, this is probably less of an issue today.