C0RPORATIONS AND FINANCIAL SERVICES COMMITTEE

SUBMISSION: PETER MAIR

INQUIRY INTO THE SUPERANNUATION INDUSTRY'S STRUCTURE AND OPERATION

This submission seeks recommendations to protect consumers dealing with superannuation scheme promoters and to address some emerging concerns about the durability of 'industry funds' as a very welcome competitive force in the Australian superannuation industry.

The way mandatory superannuation was introduced to Australia is best seen as an unfortunate departure from the national culture. The best interests of ordinary Australians were subordinated to a commission-driven life-office culture transposed to superannuation -- in effect a new toll-way was built for the 'man from prudential' to appropriate wealth from ordinary Australians for himself and the owners and employees of 'provident' companies. This matter needs to be addressed.

Australia has long relied on government-owned business ventures to underwrite fair play in a new industry: hands-on players can bring a very practical competitive influence to bear. Nowhere, however, in the superannuation story is there a cultural icon in the style of the Commonwealth Bank or MediBank.

Industry funds – a form of mutual organization – filled this gap, operating much as mutuals have done historically primarily to the benefit of their 'members'. The emergence of the industry funds was seminal and, in retail financial services, they stand as the most significant, independent class of new entrant in the past fifty years or more. Even so, their long-term future is predictably clouded and that is a matter of real concern.

SOME BACKGROUND

For some years I have pointed up how industry funds deliver superior net-earnings to their members mainly by eschewing commission-driven sales agents to underwrite their low-cost, low-fees, operation.

Over the past year alone, seven articles* on superannuation matters have been made available to the Committee along with other provocatively insightful commentary published -- on crikey.com.au -- and there is a substantial file of earlier material. These articles generally illustrate flaws in the perception, structure and operation of Australia's superannuation industry, flaws that became ever more evident as the year unfolded.

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* These seven articles were published in CFO for September, October and December in 2005 and February, May, August and September 2006.

Three of these articles were about the emerging scope to fund retirement income streams from either ‘housing’ or ‘superannuation’ assets; three expose ongoing ethical shortcomings in the marketing of retail superannuation products and the final one raises concerns about the long-term future of industry funds unless these mutuals adopt a more durable structure.

-- housing is super

Storm the Castle – points up the practical equivalence of superannuation investments and owner-occupied housing when a ‘no-repayments’, reverse-mortgage loan can be drawn on to provide retirement income. The sensible acknowledgement of this article by interested observers (including issues about including housing assets in the age-pension means test) contrasted with a recent report from the ‘House ‘Economics’ Committee’ reviewing the superannuation shortfall of the ‘under-40s’: it sidestepped this strategic issue for young households torn between ‘housing’ or ‘super’. As usual, of course, Hamlet without the prince was unedifying.

It’s on for young and old – explores generational issues between boomers about to retire, with access to both an age pension and inflated housing values, and their children, now in the midst of family formation and battling to buy both high-priced housing and save enough super to self-fund their own retirement in due course.

All in the family – puts a little more forcefully the likely need, with an ageing population, for retirement incomes policy to embrace the drawing of income from accumulated equity in the family home. The political acknowledgement so far is a stony silence seemingly denying commonsense even though many retiring boomers are openly planning to use their home as a de-facto superannuation resource.

-- a dud deal for you?

Only the best will do -- contrasts the expectation of consumers to be given the best advice by professional advisers with the disturbing consequences of ASIC requiring only that advisers give advice which could be considered ‘appropriate’ -- and many planners then not even managing to do that. As this unfortunate situation lingers there is a growing stench of the institutionalized corruption inherent in this failure of professionalism as well as undertones of political favour in the regulatory reluctance to address the issues.

Keep super simple – shows how ignorance and contrived complexity are conducive to superannuation consumers being disadvantaged. Many become prey to commission-driven advisors forming inappropriately personal relationships and exploiting the consequent dependencies. There are, of course, few aspects of personal uniqueness that have much practical bearing on the way retirees structure their affairs to maximize their financial well being. Some plain advice aimed at the main demographic segments, and made readily-available, could generally break the back of what most consumers need to be told about superannuation and, so forearmed, they would be less likely to be snowed by a self-serving adviser unfairly capturing their confidence.

We need a new plan – seeks the wholesale reform of an industry generally operating at unnecessarily high cost and typically quite contrary to the public interest. The idea that a free-market, free-for-all would best meet the community's needs for super services was never sound. The community would surely like to have access to an arrangement like the recently established Future Fund as a low-cost funds manager and service provider and otherwise to be better educated about the role being played by industry funds.

-- an uncertain future?

Of mutual concern – an Australian cultural affinity for mutual organizations which developed over two centuries, was largely cast aside in the 1980's and 90's as the managers, members and associated predators cashed in the accumulated reserves and goodwill of most mutuals. On this form guide industry funds will eventually go the same way, absorbed into then, prospectively, one of two remaining national banking groups. If this bleak prospect is best avoided, the regulatory challenge is clearly to adapt mutual organizations to survive as corporate hybrids with a de-facto capital base owned by members.

Other commentary published on 'Crikey' and as submissions to parliamentary inquiries, has variously lamented the parlous state of the superannuation industry with diffident and generally ineffective regulation seemingly favouring a pseudo-professional clique dependent on political patronage. The industry is rife with predictable scandals – e.g. 'Westpoint' and 'AMP' to say nothing about the 'most customers' still being disadvantaged after previously given tainted advice that has not been corrected. ASIC implicitly accepts that much advice given previously has been poor advice for which the customers are still being overcharged, and not the 'best' advice which the customers sought and expected.

These scandals are founded in the institutionalized corruption that attends clearly conflicting interests -- when giving the 'best' advice means giving up excessive sales commissions it is not surprising that clients get relatively poor advice instead. The problem – as with the tobacco industry, for example -- is cumulative and the damage done very likely to become more evident only down the track: the consequences of class actions for redress may well be disruptive eventually as well as too late to be useful.

Not to draw too fine a point from this background, it would be simply irresponsible to let this industry run on into the future on anything like its current basis: root and branch surgery is called for and apparent moral dilemmas, dealt with morally, would bring a sense of determination to the surgeon's task.

A. CONSUMER PROTECTION

Australia's superannuation industry is structured to operate, and does generally operate, in a manner inimical to the best interests of the Australian community: for the most part, it could fairly be called a racket. The racketeering is practically ever more evident while an appropriately determined regulatory response has apparently been stayed in some misguided belief about the advantages of superficially free markets beholden to some protected professional cartel fixing prices.

The reality of the racketeering is typically glossed over in oblique references to 'a few bad apples' when, according to interested observers, no one would be well advised to bite into any apple picked at random from the whole barrel. It is the simple fact that a licensed financial planner and adviser could not be trusted to give advice that is reasonably in the best interests of their client. That is a damning indictment demanding reform.

Dramatic reform is needed and the following is an illustrative 10-point menu of responses to address the need.

1. **Where are the officially agreed codes of conduct?** It is nonsense to expect an industry association, such as the FPA, to set and police appropriate standards of self-regulation when its voting members are notorious for giving poor quality advice while reliant on excessive commissions that are effectively hidden from the customers? **The superannuation industry needs a proper code of conduct.**

2. **Where is the Superannuation Ombudsman?** seems a fair question to ask in an industry where existing private and public complaints bodies are generally precluded from considering complaints about 'fees and charges' and 'the quality of advice' – the very things for which consumers, realizing they have been misled, want redress. **Please recommend 'review arrangements' so the damage can be fixed.**

3. **Are customers entitled to expect 'the best' advice?**—why can't the regulators shut down the pathetic and seemingly endless dissembling about the semantic niceties of 'best' and 'appropriate' as ethical concepts guiding adviser behaviour? **Fair go, clients want the best, full stop.**

4. **What about previous misbehaviour?** Noisy publicity about recent misbehaviour by the 'men from prudential' does nothing to redress the ongoing damage done to the recipients of bad advice over many years. An undertaking by AMP, to review advice given to some 7000 clients of theirs, does not even start to deal with the 'seven million' or more Australians whose financial security is still being eroded as a consequence of inappropriate advice given previously. This bad advice is implicitly endorsed anew by commission-taking advisers every time they knock-off another trailer from their clients' accounts. **The continuing consequences of bad advice, past misbehaviour, need to be corrected.**

5. **How are confused clients free to choose?** Dissembling nonsense also characterizes the contrived and ongoing debate about (ignorant) customers being free to choose between advisers taking 'commissions' or clients paying 'fees for service'. **The time has come to outlaw commissions** or otherwise negotiate them out – entry, exit and trailing -- so the focus can shift to alternative cost-recovery processes, perhaps allowing limited 'fees for service' to be recovered by installments deducted from customer accounts.

6. **Where is the evidence of competence?** There is no clear evidence of commission-taking advisers selling superannuation, setting out comprehensive lifetime strategies across 'housing' and 'super' among many other financial aspects of present and future lifestyle choices especially for young families facing inflated housing costs? Paid for selling only one product and never likely to give balanced advice about alternative lifetime strategies, **competence is a real issue.**

7. **Are financial advisers professionals in any meaningful sense?** In a community well served, for example, by public medical advice, where is the comparable public understanding about superannuation and related matters? – and is it anyway prerequisite that 'financial advisers' act, like doctors, with a professionally dispassionate candour in prescribing treatment-- **the financial planning profession seems naturally akin to the oldest.**

8. **Do fund trustees have a responsibility to protect member interests?** If so, how is this responsibility monitored when the 'management' of most funds is typically also the 'responsible entity' (trustee) and internal disputes mechanisms are an inherently circular sequence of protests being dismissed by the original decision makers? **Fund members want trustees that are independent of the fund management.**

9. **Input is not output.** The community is seemingly at the mercy of a politically-protected monster. Planners claiming entitlements to be paid for time on the job need to be reminded both that input is not always useful output, and that the odd client falling for their spiel has no responsibility to pay commissions loaded to recover the planner's costs of chasing others. In the wake of this inquiry, any suggested entitlement of planners to continue taking excessive fees or commissions from either new or established clients should be hooked – over the fence and 'out'! **The financial planning profession should be required to behave professionally.**

10. **Are super fund operators prudentially supervised to avoid excessive risk?** How are fund members to be protected against the emerging preference for fund promoters taking big stakes in illiquid, difficult-to-value infrastructure investments? The predictable risks of corruption and bad investments would seem to require the setting of prudent limits on individual risk exposures in these ventures, preferably before someone proverbially buys the Sydney Harbour Bridge and revalues it. More generally, the disciplines of 'unit pricing', fixing the daily price at which members can redeem investments, would seem to be an ever more necessary obligation to put on trustees. **Good intentions are not enough**.

B. A MUTUAL CONCERN

The following remarks may be read as critical of ‘industry funds’, in particular the case-study comments suggesting high-handed behaviour by fund administrators draw on my experiences as a member of UniSuper. These concerns may simply be indicative of high-handed behaviour in the superannuation industry more generally.

I would, of course, like the Committee to address these concerns by encouraging reforms to ensure the structure and operation of industry funds, among others, is demonstrably fair and generally on a sound, sustainable footing for the long-term. Some sense of the management and trustees of funds being accountable to their members would seem a reasonable prereqiusite. Be this criticism as it may, nothing I say about industry funds comes even close to the disdain I have for most prominent and ‘listed’ companies in the superannuation industry and their stables of commission-taking planners and advisers.

These organizations have, as earlier alluded to, taken advantage of people – me included -- while showing callous disregard for the trust that those people placed in them. Nothing comes close to that, nothing is more in need of the Committee’s reforming zeal than the misbehaviour that is ingrained in the retail for-profit funds. However, if industry funds also need to be reoriented, they should be. I could go further in this vein and suggest that one consequence of the high-spending, commission-driven model of the ‘for profit’ retail funds is the pressure that is then put on industry funds to bend their model to be able to defend and promote their position as the best-performing super fund operators for ordinary Australians.

In short, ‘industry funds’ are the best single thing to happen to the retail financial services industry in Australia for many, many years – do not forget that but be mindful that this ‘best’ is now at risk.

THE UNISUPER CASE STUDY

In 2002 UniSuper blandly announced in its annual report that it would impose an annual 0.2% asset fee on the account balances of those members taking allocated pensions: this was done without explanation and without reference to its affected members. On appeal, by me, the fee was reviewed and then capped at $750 which, with indexation increases, had grown to $798 by 2006.

Earlier this year – similarly without reference and without explanation and similarly blandly – a list of fees at the back of a ‘glossy’ fund newsletter indicated that the annual asset fee on allocated pension members was to be increased to 0.25%, capped initially at $1536 subject to indexation – a $700 increase. A cover letter to members made no mention of this very substantial increase, presumably it was just another game of ‘find the surprise’ that these Trustees play with unsuspecting ‘pension’ members. An initial appeal against this increase, lodged in May, was summarily dismissed by the Trustees in late June and a response to a renewed appeal is pending. The June ‘dismissal’ included rejecting a proposal to appoint a mediator to assess the balance of the argument, as a proxy for the members being consulted and properly assured that the decision was made fairly. A review role of this kind is one that an Ombudsman could play.

Issues arising in this case study include:

- the need for a transparent and respectful relationship between members and management and trustees of industry funds in changing the terms and conditions, including fees and charges;

- proper procedures to notify members of material changes, including fee increases;

- the need for reasonable explanation of the basis for material changes, including fee increases;

- reasonable processes for independent review of the fairness of material changes, including fee increases;

- general concerns about '% asset fees' to recover account administration costs (which are broadly the same across member accounts and do not vary directly or materially with the size of account balances);

- apparent abandonment of the maxims of reasonably equal treatment of equals and proportionality in any different treatment of different classes of fund members in terms and conditions, including fees imposed; and

- a reasonable inference that '%asset fees' are a de-facto trail commission taken from accounts of the most vulnerable members with the proceeds being used to cross-subsidize 'free' advisory services provided to a different class of member, those ordinary members still in transition to retirement.

-- unaccountable management without effective trustee oversight?

Notwithstanding that industry funds, including UniSuper, continue to operate at low-cost (relative to their commercial competitors) and consequently deliver relatively very good investment returns to members, there is some sense of a lack of transparency emerging in this sector.

In this case, the management of UniSuper acts as if they own the business, are answerable to no one and can make decisions in a high-handed manner without regard to a general sense of equitable fair play among different classes of members. One can only wonder if the arrangement for a 'trustee' to protect the interests of members is merely a nominal word-play where 'the trustee' is essentially 'the management'. One would like to think that this is not on: the members want some real sense of the management being accountable.

At the risk of labouring key points, the management of UniSuper is treating its 'pension' members very differently and, in making the decision to do so, there was no notification; no explanation; no prior consultation and no provision for independent appeal. That style of operation is simply disrespectful of member rights and interests – and that is only talking about the niceties surrounding the decision.

The fundamental issues here go to the very heart of decisions arising in incorrect attitudes that a seemingly unaccountable management can foist on fund members while feeling confident to say ‘like it or lump it, take it or leave it’ -- ‘go elsewhere if you are not happy’. This is a bit Orwellian -- hardly the ideals of a mutual organization flying the flag of ‘not for profit’ and ‘all profits for members’ – with some members are apparently more equal than others among those musketeers who threw in their lot with UniSuper.

[In this context it was disappointing to hear ASIC, at its most recent oversight hearing, dismiss the idea of making the management of UniSuper (among others) more accountably subject to independent review when acting high-handedly in regard to vulnerable members. ASIC’s subsequent formal answer to ‘a question on notice’ confirmed that the role of the Superannuation Complaints Tribunal does not extend to determining whether certain fees or charges set by the Trustee are ‘fair and reasonable’.]

Again at the risk of labouring the obvious, there is simply no prima facie case for ‘allocated pension’ members being levied with a special annual % asset fee. Their investments are in exactly the same funds as the other members and there are only minor administrative and accounting differences associated with tax and monthly pension withdrawals instead of fortnightly deposits of contributions. Among all the members of UniSuper, ‘pension members’ are least likely to be looking for advice or needing any special attention – they have already made long-term decisions locking-in the placement of their investments in a retirement income stream.

In the same vein there is a clear expectation that the extra fees taken from existing allocated pension members will be spent funding pre-retirement advisory services for ordinary members of UniSuper – if so, that is hardly equitable on any score. On the contrary, if the purpose of the special fees on pension accounts includes funding ‘free’ advisory services, the levy should be on the accounts of members in the pre-retirement phase of their relationship with UniSuper and likely to be looking for advice in due course. At the very least there should be no difference in the levy on both broad classes of member -- but, for the reasons given, that would be still patently inequitable against allocated pension members.

So, one focal point here is about UniSuper levying special additional fees on some members to fund special additional services to other members free of charge – one can only wonder where the management and trustees got the mandate to do this. One need not wonder long about an Ombudsman deciding that should not have been done.

It is a short step from this expose of a fundamental inequity on foot at UniSuper to see parallels with the much criticized behaviour of ‘for profit funds’ taking trail commissions (to fund the cost of advice given ‘free of charge’ to members shifting from superannuation investments to allocated pension products). It is unfortunately a further short step to see, among industry funds, parallels with the management of for-profit funds claiming some of the spoils of their projected good performance for their own commercial purposes -- a complete contradiction of ‘all profit for members’.

Subject to what UniSuper may say, I invite the Committee to make clear to UniSuper among others, that imposing an annual % asset fee on one class of member without any reasonable basis is both inappropriate and inimical to the essentially mutual ideals UniSuper claims to honour. This inequitable (mis)behaviour should stop.

CONFUSED IDEALS?

A sense is emerging of 'industry funds' being in a state of transition from successful and idealistic beginnings to something else– one fear is that the 'something else' is unlikely to be a ringing endorsement of the mutual ideal and, quite possibly eventually, industry funds may well be just more grist for the major bank mill to grind into dust.

I expect the Committee's inquiries to draw comment that throws light on the implications of industry-fund 'mutuals' jointly owning 'for-profit' banking, fund-management and service-company associates in the absence of an organizational structure requiring accountability to members. If there are no obligations for the management to be accountable, there are presumably uncertainties also about the position of 'the members' as the ultimate owners.

One would expect there is some temptation to divide the total industry-fund business between basic superannuation operations – run like a mutual -- while their retirement income products are run for profit, absorbed into some consolidated industry fund conglomerate financial services business. There is, for example, a sense of IRIS, a relatively-expensive for-profit flagship, fronting for industry funds in offering allocated pension products – a sense that IFS would prefer its member funds to push retiring members towards IRIS for allocated pensions and like products which are run 'for profit'. The same goes for the non-super business known as SMI. Presumably any 'profits' flow back as dividends through to individual industry funds, as joint owners, where they may be distributed as 'earnings' to basic super fund members.

It is possible also that employers are growing less satisfied about being involved in industry-fund partnerships that being open-offer, and looking for business and new members, entail a deployment of employer resources that does not directly benefit their own employees contributing to superannuation or, possibly worse, members no longer working for the employers, including retired members.

On another tack there are potentially disturbing elements in industry funds taking such a high profile in the emerging preference for infrastructure investments, including wholly-owned investments that are difficult to value on-purchase and subsequently. One would like to see some checks and balances on investments in alternative assets and, preferably, a commitment to daily unit-pricing (albeit with some protections on the valuations).

Overall, there is a sense of something going on that does not bode well for industry funds continuing to contribute to the community with the same net beneficence as they have been doing. Many would think that prospect is an unhappy one. I do.

SAVING INDUSTRY FUNDS

There has to be a better answer, a better prospect than this – and the gist of a better answer and a better prospect surely includes arrangements for recognizing the members of industry funds as the de-facto owners in a way that makes the management accountable to the member-owners.

Of Mutual Concern, my story in the September issue of CFO, floated some general ideas about a modified mutual structure – about the regulatory challenge of finding a hybrid equity instrument to recognize member ownership and associated shareholder voting rights, and to accumulate dividends, all in a framework allowing limited transferability of ownership among members.

There would be something perversely ironic about the most important recent development in Australia's financial institutional structure – industry funds – going the way of all financial flesh in due course and being sold to the major banks, probably one of two.

There is something perversely familiar about the industry funds, as mutuals with unaccountable managements having no truly respectful relationship to their members, apparently going from strength to strength while perhaps being white-anted in a familiar pattern of greed-driven piracy ahead of them being privatized and sold off.

While this Committee has acquired a reputation of antagonism to industry funds it is to be hoped that this current inquiry not only explores these concerns and resolves any lingering issues, but also sets out a plan which will allow these generally well-regarded and pace-setting institutions to survive and prosper.

Australia's best chance of a locally-grown competitive counterforce to the all-powerful major banks is probably the industry funds (and their associates) and the Australian community would surely want this Committee to ensure that they remain a viable feature of the structure and operation of Australia's superannuation industry.

Peter Mair
31 August 2006

PETER MAIR

Keep super simple

FINANCIAL ADVISERS EXPECTED TO HELP EMPLOYEES MAKE GOOD SUPERANNUATION CHOICES HAVE AN INTEREST IN MAKING THE SYSTEM SEEM COMPLEX.

A more mobile workforce and a more demanding regulatory regime imposed by the Australian Prudential Regulation Authority are factors leading chief financial officers to question the balance of costs and benefits of operating in-house superannuation schemes.

One open question is the availability of independent advice for employees newly faced with the challenge of choosing a superannuation fund and the role CFOs can play in ensuring employees are encouraged to seek out the best independent advice.

This is where the case for decisive political and regulatory action to reform the financial planning industry is now overwhelming. Responsibility for needed reforms cannot sensibly be left to the self-regulatory discretion of the Financial Planning Association.

The saga unfolding around the Westpoint scandal – excessive sales commissions dictating bad investment advice – highlights the generality of like practices entrenched in the financial planning industry. Although it finally admits its members' entrenched conflicts of interest and related misbehaviour, the FPA is baulking at the root and branch surgery needed to outlaw commissions and further stem loss of its credibility.

Ratings agencies and industry commentators consistently show how industry funds typically offer good value for our superannuation savings, but most financial planners never recommend industry funds to their clients. The conflict of interest is palpable: most financial planners push the products of high-cost operators of retail funds, taking a raft of commissions for themselves, instead of the industry funds that do not pay commissions and, as a consequence, deliver higher net earnings to clients' accounts.

Deftly worded principles announced by the FPA in March to manage these conflicts of interest fall well short of what is required. Not only do these principles confuse pleasant sounding rhetoric with meaningful action, the leisurely timetable for their adoption is mainly next year or the year after. Saying it is embarking on a journey to work in the interests of clients and remove conflicts of interest shows a lack of genuine contrition at the FPA and does nothing to redress the continuing disadvantaged position of many existing clients.

The ethos of the industry needs to be reoriented away from contrived personal relationships

The FPA's principles suggest that nothing done in the past warrants correction, and that the need is simply for cosmetic changes to planner's marketing practices. Deferring these needed reforms unfairly legitimises past misbehaviour and will likely see planners using the transition to manipulate their continued access to unnecessarily high fees.

The FPA is showing no genuine commitment to the leadership necessary to ensure its members work within a framework that serves the community efficiently and faithfully as honest brokers: if those having political and regulatory responsibility for superannuation accept this shoddy compromise offered by the FPA, their own integrity will be compromised.

The ethos of the financial planning industry needs to be reoriented away from contrived personal relationships conducive to planners exploiting their clients. The balance of power between planners and clients must be made more even.

As it is, many employees and pending retirees are drawn into dependent relationships with financial advisers that are overly personal and unnecessarily costly. Clients are misled into believing they need financial advice carefully tailored to their personal uniqueness when, in fact, whatever may be personally unique about them has little bearing on the financial advice that would sensibly be given to them. These issues are especially acute for employees coming to retirement.

Reoriented to more openly transparent advisory processes, the advice of financial planners to pending retirees would be more about deciding the placement of clients' funds, cajoling as best they can a mix of risk and return in the portfolio that strikes a comfortable balance between undue conservatism and excessive risk-taking.

In this context, one useful community service the FPA could provide would be illustrative case studies of typical allocations of superannuation funds across the alternative income streams sensibly preferred by different groups of retirees. The probability is that these illustrative case studies would mainly replicate the preprogrammed, "uniquely personal" advice now being given to retirees with similar demographic characteristics and in similar financial circumstances. Made widely available, pending retirees would be made aware, in advance, of the sensible advice they would ultimately be well advised to accept.

The subject of financial planners giving poor, commission-driven advice to their clients has been a recurrent focus of this column. As the need for reform is more widely advocated and the pressure for fundamental change increases, the tipping point for planners is probably near.

CFOs and other management professionals are sensibly precluded from giving employees financial advice. Nonetheless, an awareness of the issues may help ensure that employees who are making choices are encouraged to consider independent professional assessments of where the best superannuation deals are to be found.

CFO. September 2005

Only the best will do

A partisan political tone and regulatory intervention are undermining the benefits of superannuation choice

By Peter Mair

Choice of fund, the new competitive force in Australian superannuation, is a damp squib because politicians and regulators are not yet determined to make it work for the community. The new choice regime fails a critical test - financial planners are still not obliged to give advice in the best interests of their customers, and that is unacceptable.

In June, the Australian Securities & Investments Commission (ASIC) issued instructions to advisers giving switching advice*. Suspicious of some planners' motives, the instructions head off various semantic excuses for giving questionable advice. The lamentable bottom line, however, allows acceptable advice to be different from best advice. "You do not have to say that your recommended product is 'best', but it must be 'appropriate' ...". When sales commissions are involved, overlooking "best" for "appropriate" runs the risk that advisers will misappropriate the property of their customers.

Customers want professional advice to be the "best" in their interests; they do not want "appropriate" advice. ASIC should encourage customers to get written assurances that advice given is considered best for them, and ASIC auditors should be particularly alert if investors are advised to leave industry funds.

As the choice regime dawned, a basic decision stood out for those free to choose among retail super fund operators. Media commentators and ratings agencies overwhelmingly assessed industry funds as offering most Australians the better retail superannuation deal because, being low-cost, they typically return higher net earnings to their members. Commercial retail funds generally compared unfavourably, mainly because they pay dividends to shareholders and hefty commissions to financial advisers - additional costs that substantially erode investment returns paid to their members.

Choice of fund has a key focal point: when two comparable products are expected to perform equally well, before fees and charges, the lower-cost product will prospectively give customers a much better overall outcome.

This message is slowly hitting home, and a preference for lower-cost operators will unfold further. Members of commercial funds will reconsider their situation, perhaps seeking redress if misleading advice has been given previously, - particularly so if "exit" fees are not waived.

There are other reasons for disquiet about the new super regime. Choice is not good for everyone, apparently. Many remain locked into funds under industrial agreements.

We will know that politicians are genuinely committed to choice when super arrangements for public servants (and themselves) are put on the open market. Nothing else will be so effective in underwriting a sound national super system as policy-makers - such as ASIC staff - having to choose from the same product range as the community.

The best interests of the community are unlikely to be served by a politically partisan tone in the public debate. Prime Minister John Howard, for example, seems not entirely independent as an observer of the super industry. Having lauded commission-driven financial planners as quintessential small businessmen in 2002, he recently extolled the advocacy of an associated lobby group as "well-targeted, and always in the public interest" - sentiments that are generally rejected. To give no comparable acknowledgment of industry funds suggests a churlish disdain for an initiative of the union movement widely held in high regard. Industry funds have taken the high ground, and that should be applauded, not ignored.

Questions also linger about regulatory intervention in commercial disputes over marketing tactics. As choice loomed, the Australian Prudential Regulatory Authority reminded fund trustees they had limited discretion to spend member funds on promotional activities beyond information and education for existing members. Competing commercial funds concurrently ran extensive marketing campaigns, presumably staking shareholder funds that would later be recovered from management fees.

An advertising campaign was eventually mounted by industry funds, showing how lower management fees made a dramatic difference in the money accumulated over a working lifetime. These facts mobilised lobbyists defending commercial funds, and ASIC suspended the industry fund campaign. ASIC later allowed its resumption, with the qualification that the underlying substantial difference in fees (and prospective net earnings) may possibly change and that other fund features, besides fees, may be relevant to customer choices.

Fair enough, possibly - but why are commercial funds free to talk up their advisory role, offering vague vistas that may seem very favourable to potential customers without acknowledging that relatively high fees will constrain the accumulation of net earnings?

Different constraints on different classes of fund operators may somehow be justified, but dampening competition is not clearly in the public interest. Open disclosure of the long-term effect of higher fees is critical to sound customer choices, and the evident fear of it is the very essence of beneficial competition.

** Super-switching advice: Questions and answers - an ASIC guide*

PETER MAIR

All in the family

HOW ARE WE GOING TO SUPPORT ALL THOSE AGEING, RETIRING BOOMERS? PERHAPS BY TAKING A NEW LOOK AT THE FAMILY HOME.

Few issues will colour looming policy debates so richly as the balance to be struck about workers subsidising a burgeoning community of retirees.

This issue is well known to be hot among the mandarins, along with a pressing need for community discussion to build a workable consensus before they get cracking on the detail, including proper regulation of related financial innovations. The air nonetheless remains thick with the brinkmanship of silence, again risking unsound policy-making in the heat of an election.

Official voices addressing "ageing" rarely go beyond the platitudes of "work longer" and "invest more" even though, for many about to retire, the working and saving die has been well and truly cast. Meanwhile, a raft of contentious policy issues is studiously avoided.

One recent presentation from the Reserve Bank of Australia about the financial implications of an ageing population made the arresting observation that by mid-century there may be only two workers for every person aged over 65, compared with five now.

However, only by reading between the lines of "Finance and the Ageing Population" (written by Reserve Bank deputy governor Glenn Stevens in November) does one find carefully worded allusions to some consequences of an ageing Australia for our financial system – and for housing prices in particular.

An ageing community, needing to come to terms with available options, was given an oblique reference to reverse mortgages. After Stevens raised vague speculation about "boomers ... selling assets to facilitate consumption, leading to a slump in asset values", he went on to warn that "instruments which facilitate the transformation of assets into long-run income streams will presumably be increasingly needed".

If the RBA was meaning to imply that retired Australians will probably need to sell or borrow against their homes, and one consequence of that expectation may be lower house prices, it went through to the keeper, unreported. It needs to be stated clearly, not just vaguely implied.

For one thing, first-home buyers would welcome a reduction of house prices from inflated levels. For another, it makes sense to take policy initiatives now to corral the windfall gains of home owners before those gains are irrevocably – but shortsightedly – incorporated into the long-term wealth of "winning" home owners.

On the other hand, when pending retirees discuss the financing of their retirement, they quickly cut to the chase: their home, their most valuable asset, is recognised as a considerable financial resource they can draw on.

Another report, from the Australian Housing and Urban Research Institute, sends the message even louder. "Ageing in Place: intergenerational and intra-familial housing transfers and shifts in later life" (*AHURI Research and Policy Bulletin*, issue 67, October 2005) reports the results of a national survey, revealing older Australians' attitudes to housing and home ownership.

Put bluntly, when emerging boomer retirees look ahead and consider the equity tied up in their houses, many see themselves as OWLS ("oldies" withdrawing loot sensibly) and SKIers (spending the kids' inheritance). These acronyms, as themes, pepper the survey report.

The AHURI survey results, if discussed openly and plainly in the wider community, could well be a catalyst for changing traditional expectations about retirees bequeathing the homes they own. A less sentimental view of the family home is needed. Treating it as a business asset would free up resources, enabling retirees to be more self-sufficient in meeting their needs for day-to-day spending – and reducing their dependence on taxes paid by those still working.

The survey also opens the way for public discussion, effectively generational, about the sense of retirees' still-working children paying higher taxes now in exchange for an inheritance later. A moment's reflection suggests this discussion is probably best given some guidance from the political bench: too great is the risk of retired home-owners ultimately yielding to temptation and spending the inheritance, as well as taking the benefits up front.

In short, applying the rule of "a bird in the hand", it makes sense for workers to risk a prospective inheritance going bush and paying lower taxes now, concurrently bolstering their own retirement resources. Advised properly, both working Australians and their elders might well agree about that outcome being a sensible compromise.

Driving boomer retirees towards acting selfishly is the necessity for them to consider different strategies to fund long retirements. Liquidating housing assets will obviously be a key to better lifestyle choices for many retirees otherwise reliant on the age pension. This makes a lot of sense if there is less public funding for pensions and benefits in future.

Avoiding this intergenerational debate is hardly consistent with the leadership needed to ensure that the issue is dealt with sensibly. Silence is not always golden and this silence needs to be broken. One wonders what else the Treasurer, Peter Costello, might like to add to this important debate.

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PETER MAIR

It's on for young and old

SUPERANNUATION NEEDS TO BE MADE MORE ATTRACTIVE, AND HOUSING INVESTMENT LESS SO, TO AVOID SOCIAL DISCORD.

The seeds of social discord – workers versus retirees – are germinating in Australia and the kernel is a political culture that is blind to the substitutability of "housing" and "superannuation" for providing income in retirement.

Young families that carry hefty mortgages, yet are expected to save for their own retirement, will resent retiring "boomers" living it up at their expense. Based on the rules now in place, most boomers will be entitled to an age pension, which they will supplement with "incomes" drawn first from their modest superannuation savings, and then from a reverse mortgage loan against their home. Boomers have been lucky: just as they were wondering how they would make ends meet in retirement, the value of their houses doubled. Intergenerational anger will crystallise as working families are taxed to pay pensions to many boomers only technically "needy" because the rules exempt their homes from the means test.

That a parliamentary committee is now asking why young families (with parents aged below 40) do not contribute more to superannuation is symptomatic of the looming problem – as was a 2004 review by the Productivity Commission of the "[un]affordability of housing for first home buyers". On long-established evidence, and current policy settings, a young family voluntarily putting money into superannuation instead of housing would probably be considered nuts. That ingrained belief is a substantial issue for the young-families inquiry.

It was an indelible lesson for young families: to see how beneficial it was to their boomer parents to own a house. The net worth of most boomers is far more attributable to passively owning a home than to any superannuation savings. Anyone who did not get this message a decade or more ago could not have missed it recently when housing prices doubled. This dangerous lesson now needs to be unlearned.

It is beyond comprehension that crass political expediency fed a community addiction to buying ever-more expensive housing, when the national need was directly to the contrary. On the national policy stage, it was an act of political and bureaucratic vandalism to let run the tax breaks that fed an already unhealthy dependency on owning houses – as investments as well as homes. A Senate economics committee recently, and courageously, renewed the call from the Productivity Commission to reduce the tax breaks favouring investment housing.

Submissions to the young-families superannuation inquiry are a predictable mix of common sense and self-serving nonsense. Among the obvious common sense: a 9 per cent superannuation-guarantee contribution is recognised as patently inadequate to self-fund the retirement that most expect. Similarly, it would only exacerbate the overall problem if young families were given access to their existing superannuation savings to fund a deposit on a home mortgage. Among the less obvious nonsense submitted is an idea that retirees should be compelled to take their superannuation as a lifetime pension and denied the option of taking a lump sum.

Any such compulsion would reinforce the prevailing inclination to build retirement savings outside the "locked" superannuation system, probably in housing assets. Peace in our time, between young and old, demands more political imagination than is being displayed by the chamberlains in charge of the national coffers. The necessary offensive must be on two fronts – with housing to be more affordable and superannuation to be more attractive. Achieving more affordable housing will take political courage, because cutting the tax breaks that are propping up prices will not be popular. Changing the age-pension means test to include the homes of retirees would be one very useful step towards lower house prices and lower taxes. Negatively geared investment housing demands specific policies offsetting the addiction to bricks and mortar – imposing a higher capital gains tax on investment housing is one proposal finding support.

Making superannuation more attractive is equally fraught with difficulty. Action is needed to "outlaw" the objectionable culture among commission-driven brokers presenting themselves as financial planning advisers. There are some hopeful signs. The Australian Securities and Investments Commission is asking financial planners to address the structural conflicts of interest that prompt them to give "advice" that's more in their own interests than those of their clients.

For the same reason, the Australian Prudential Regulation Authority has foreshadowed "please explain" notices to high-charging superannuation operators who consistently underperform for their customers. The inevitable bottom line will be much tighter restraints on commissions taken as entry fees, exit fees and money-for-jam "trails", but higher net returns for individual clients.

The young-families inquiry could add its weight to the regulators' good intentions. There is little point asking why the under-40s do not put more into superannuation except as a means of exposing the bad policy that promotes housing over superannuation. Embracing retirees' homes in the age-pension means test would be one useful and credible step towards helping the under-40s achieve a better balance between their investments and aspirations in housing and superannuation. If this step is not taken, it will soon be on for young and old.

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PETER MAIR

Storm the castle

OWNER-OCCUPIED HOUSING SHOULD NO LONGER BE EXEMPT FROM MEANS TESTING FOR THE AGE PENSION

The traditional dream relationship between Australians and the family home is looming as a nightmare. As the boomer generation comes to retirement, owner-occupied housing will need to be embraced by the means test that limits eligibility to receive the age pension.

Households of people approaching their mid-60s typically have net wealth of about $500,000. They aim to combine the age pension with an income stream purchased with their "tested" assets of some $200,000 additional to the family home, which is currently exempt from the means test. One prospect for them is a more comfortable retirement financed by borrowing against the home, boosting spending power with the proceeds of a reverse-mortgage loan repayable only when the house is eventually sold.

The general idea of using reverse mortgages as a "my-home" superannuation scheme will catch on in Australia, as it has in Britain and the United States. It is particularly likely to appeal to Australians facing means-test restrictions on their eligibility to get the age pension: their counterparts in Britain and the US are entitled to an age pension (social security) without means tests.

Many approaching retirement will plan to exploit loopholes in the means test. One strategic ploy will see "ineligible" retirees qualifying for the pension after cashing-in superannuation assets to buy a more expensive home. Those taking this course would boost current spending by "borrowing" each year a small part of the value of a home they will continue to live in, but which is exempt from the means test.

For many happy to play outside the square, an apparently contrarian strategy like this would almost surely deliver more spending power in retirement. The mechanics are simple enough: a lump-sum tax paid to cash-out superannuation investments is effectively converted, via a more expensive home, to an entitlement to receive the age pension. The age pension would supplement both a smaller allocated pension and the proceeds of loans drawn against a mortgage on the home (probably paid by instalments, to avoid lumpy deposits to bank accounts breaching thresholds on means-tested assets).

Swapping superannuation assets for a more expensive home to gain the age pension is conceptually similar to retirees moving to a cheaper home and investing surplus proceeds in an allocated pension that, though also an asset drawn down over time, may erode the entitlement to even a part age pension.

My-home superannuation plans bring a different dimension to do-it-yourself superannuation. Policy makers would be well advised to build an understanding in the community about the essential equivalence of all assets available to finance retirement, including owner-occupied housing.

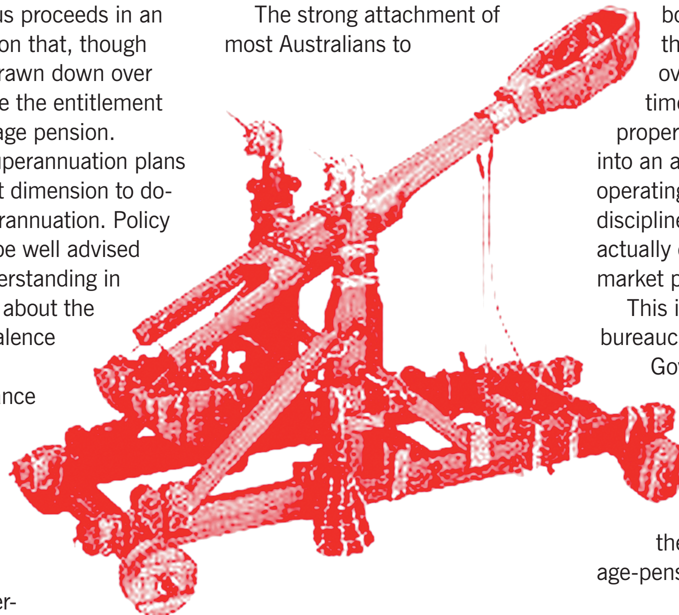
Continuing to exempt owner-occupied housing from the age-pension means test is no longer tenable as a plank in a responsible national economic policy. Any substantial switch from conventional superannuation investments to owner-occupied residential real-estate could further inflate housing prices initially and presage a housing-market bust subsequently. Australia, with an already fragile housing market, is flirting with a veritable Ponzi scheme — an illusory expectation of ever-higher housing prices funding a life of luxury on the never-never. It is not on.

It is hardly tenable that public policy idly accommodates such possibilities. They are conducive to further sustained growth in both household debt and current consumption spending, at the expense of the savings of those still working or otherwise funding business investment in Australia and abroad.

The strong attachment of most Australians to home ownership has historically been rewarded handsomely. The recent episode was exemplary. Falling stockmarket equity prices, and the lowest interest rates for a generation, combined with tax breaks to fuel an unsustainable surge in housing prices and household debt. It is playing with petrol around the fire to risk housing prices surging again — and again as a consequence of inappropriate tax policy settings.

One would like to think alarm bells are ringing in the Reserve Bank of Australia and the Treasury: both were badly caught napping when the booming market recently pushed prices for residential real estate to ever-more-unsustainable highs. The bloom may now be off lending for investment housing, but banks and others with a liking for mortgage-backed assets will easily find retirees with unencumbered homes keen to borrow to live it up. If so, the dangers include banks over-lending against boom-time housing valuations for properties being only part-sold into an artificial market, a market operating without the sobering discipline of complete properties actually changing hands at open-market prices.

This is no time for the usual bureaucratic reluctance to tell the Government things it may not want to hear. The next Treasurer would prefer the present one to wear the nightmare of taking action to net the family home with the age-pension means test.



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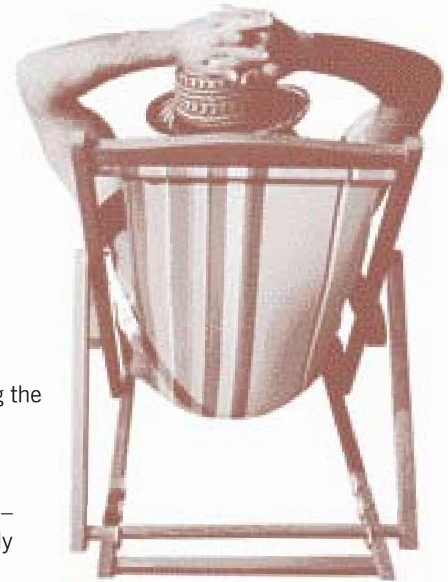
PETER MAIR

We need a new plan

THE RECENT CHANGES TO THE TAXING OF RETIREMENT FUNDS ARE A GOOD START, BUT THE INDUSTRY AND ITS REGULATORS NEED A COMPREHENSIVE SHAKE-UP IF AUSTRALIANS ARE TO GET A FAIR DEAL IN THEIR SUPERANNUATION PLANNING.



Australia's superannuation industry, widely agreed to be unnecessarily high-cost, operates contrary to the public interest and seemingly beyond the reach of political and regulatory processes to keep it in line.

Apart from the dramatic reform of the taxation of superannuation savings and retirement income streams, a recent flurry of political and regulatory noise on the superannuation front has, by and large, delivered little. There is a lingering sense of instability about the industry that sits uneasily with apparent official reluctance to negotiate a better consensus.

The report from the house economics committee, *Improving the Superannuation Savings of People Under 40,* is perhaps best described as sensible but stolid. Mainly it acknowledges the importance of education to boost superannuation literacy and the inadequacy of the current 9 per cent superannuation levy. But it is in no way a reference point for a lifetime strategy for young workers managing the competing pressures of buying a house, rearing and educating children and providing for a comfortable retirement – a retirement likely to be partly financed by liquidating housing equity if a family home is in the portfolio.

The challenge needs to be addressed differently.

Well-rewarded, competition-seeking concise proposals from financial planners – or anyone – setting out sensible lifetime strategies for young workers could reorient the superannuation policy debate, along with prevailing attitudes to personal financial management.

What would winning entries advise young workers to do about managing their financial future – about leaving home before moving steadily through family formation and on to retirement, expecting a comfortably self-sufficient old age? How would the winning proposals fit with the current thinking of young workers?

A process like this would deliver a sobering reference point for politicians, young workers and the planning and funds management industry.

The private sector could make a useful contribution here: a group of independent businesses might promote a catalytic discussion of superannuation and related issues. The recent *Corporate Responsibility* report from the parliamentary joint committee on corporations and financial services encourages businesses to embrace broader commercial and social objectives. Businesses planning for sustained success build good relationships with key stakeholders, not least their employees and the wider community.

On the regulatory front, one wonders about the role of the primary regulator, the Australian Securities and Investments Commission. ASIC apparently has quite diffident attitudes to protecting consumers in their dealings with the superannuation industry. This sense of diffidence is, frankly, unchanged in the wake of the oversight hearings of ASIC by a parliamentary committee.

Predictably, disturbing revelations in the wash-up of a recent shopper survey, testing the quality of advice given by financial planners, have not flowed through to concrete proposals for remedial action – especially for clients previously poorly advised and still handicapped. Nor does ASIC seem much concerned about the aggressive marketing of high-cost schemes offering excessive commissions coexisting with a general lack of community appreciation of alternative, well-performing low-cost schemes.

One wonders about the role of the primary regulator. ASIC apparently has quite diffident attitudes to protecting consumers in their dealings with the superannuation industry

Among independent industry commentators, so-called industry funds are widely considered superior but are typically ignored and not listed by advisers for whom low-cost means that no commission is payable to them.

There is still no prospect of proper professional standards among financial planners, who seem to accept, then disregard, a fiduciary responsibility to provide advice in the best interests of their clients. Reflecting on the run of events with the tobacco lobby, in decades to come could courts be awarding damages because the "professional" advice now being given was judged to fall well short of the best advice that a professional adviser should give?

For the time being, an ill-informed, confused community is stumbling towards self-reliance in its superannuation decisions. Many individuals will come a cropper while the regulatory stand-off continues: a 1 per cent difference in fees each year can mean a 20 per cent difference in funds eventually available.

In earlier times these risks would have been managed differently. One Australian tradition is to intrude a government-owned enterprise into the commercial mix as a new industry finds its feet and a workable regulatory framework is put in place. Banking and health insurance are two among many examples.

A convenient opportunity to do this with superannuation has opened with the Future Fund now accumulating resources to meet superannuation commitments to retiring public servants. Once this infrastructure is in place, it would be a short step to make relatively low-cost superannuation products available to the wider community.

Changing mores in Australia's evolving regulatory culture may seem to preclude this but bear in mind that the jury is still out on the political acceptability of market free-for-alls where ordinary Australians can be clearly disadvantaged.

PETER MAIR

Of mutual concern

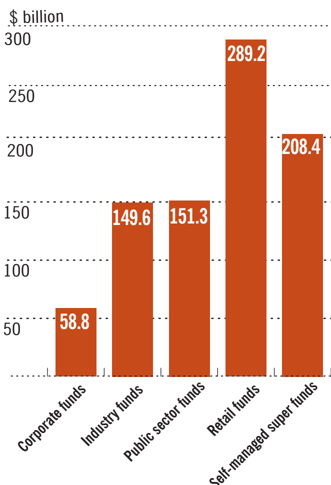
INDUSTRY FUNDS PLAY A LEAD PART ON THE FINANCIAL SERVICES LANDSCAPE, BUT IN ORDER TO ENSURE THEIR FUTURE, SHOULD THEY CONSIDER A FORM OF DEMUTUALISATION?

An inquiry into the structure and operation of the superannuation industry by the Parliamentary Joint Committee on Corporations and Financial Services will investigate the so-called industry funds which, many say, offer most Australians the best deal for their superannuation investments.

Antagonism between key players may colour this investigation and could compromise its findings. Even so, it is clearly in the public interest that lingering issues about industry funds be re-examined.

Comparative performance, earnings put in members' pockets after all fees and charges have been paid, is important. The findings will likely confirm the rating agency assessments now driving industry fund promotions – the very real consequences for fund members of different cost structures, especially trailing sales commissions.

ASSETS UNDER MANAGEMENT



SOURCE:APRA QUARTERLY SUPERANNUATION REPORT, MARCH 2006

The prominent role being played by industry funds is remarkable in an industry dominated by four banks. Over the past half-century, industry funds rank as the new entrants of real consequence in Australia's retail finance sector. The governance of industry funds typically brings together leaders of both unions and associated employer groups in a welcome display of Australia's political maturity.

There are similar portents in the planned benchmarking of Australia against international experience. National pension schemes and supplementary arrangements in other countries will be seen to have done better and worse. On the Australian ledger it may be useful to have a pro-forma product disclosure statement for the Future Fund; it might set the mark for low-cost funds management operations. Australia got off on the wrong foot with superannuation because the default option was a discredited commission-based, life-office, model – it was lucky that the industry funds emerged to set the current standard, one which should fare well in international comparisons.

That luck, however, remains at risk: a sleeper about industry funds is at the heart of all organisations akin to co-operative, mutual enterprises variously paraded as "not for profit" and "all profits to members".

Unlike companies generally, which may have eternal life, mutual and co-operative organisations seem destined to die.

The common bond linking members of mutuals typically decomposes leaving a plain customer base continually subordinated to management interests that are forever inclined to privatise, to sell-out and distribute among members the valuable goodwill.

The form guide, writ large in the wholesale transformation of a raft of mutual financial institutions over the '80s and '90s, was unfortunate and is often regretted to the point where common-bond hybrids are re-emerging in retail banking.

The mutual model in place is at risk and in need of reform.

It may seem that a death wish infects mutuals, which typically metamorphose into conventional companies. A more rational explanation is that mutuals die because they do not adapt as the business grows, do not adopt characteristics needed to survive. The worm in the bud is the predictable disconnection of the owner members from management cabals that are unassailable and not accountable. There is nothing commendable about a managerial autocracy moonlighting as the self-appointed trustee of member interests while shielded against takeover and without effective regulatory oversight.

As is, and on disclosed form, the mutual model in place is at risk and in need of reform if mutual ideals are to be preserved. On the matter at hand, the prospect is for disenfranchised members to sit by while an ever more valuable goodwill is susceptible to piracy and self-serving mismanagement. The issues are further confused as industry funds are drawn into complex arrangements as joint-owners of associates that may not be mutuals. Not-for-profit mantras have little practical meaning and none at all when operational surpluses may be dissipated as soft costs overpaid to associates. Low-cost is what matters to members.

Straight-thinking investigators will see industry funds taking low-cost leverage mainly by not paying dividends to owners: one corollary, however, is that without owners the business is doomed to die with the valuable goodwill sold and distributed somewhat randomly among a current membership probably bloated with new, bounty-hunter members.

The regulatory challenge is partly about finding a hybrid equity instrument that would allow an annual distribution to members of in-kind dividends (and voting rights) on terms that protect the viability of a modified mutual structure, including clear management accountability.

Industry-fund superannuation funds seem ideally suited for reconstruction as modified mutuals. Annual distributions of accumulating equity entitlements would be de facto capital, especially if entitlements were not transferable before retirement.

Something usefully innovative could and should be done to ensure that industry funds live on to set the mark in Australia and internationally.