# Submission to the Senate Select Committee on Superannuation

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# Superannuation: There Has to be a Better Way!

Summary

This submission is from the perspective of the superannuant and retiree – an often forgotten group, despite what the superannuation industry says.

It details some of the difficult problems faced by the end customers of the current system. Problems that can easily result in the so-called retirement "nest egg" disappearing with the retiree either going onto welfare (if they are under the Pension age) or taking up the Old Age Pension.

The submission also puts forward a proposal for paradigm shift in the provision of self funded retirement pensions for all Australians that eliminates many of the current problems but seeks to utilise the positive features of the current system.

However it does require leadership that seeks to provide a better balance between all the interested parties.

## Introduction

Most people don't think about retirement until their 40's or 50's. Superannuation is something they pay into regularly but because it is not accessible, little interest is paid to the things that make up the system. Over the long term the fund increases in value but few, if any people, would have any appreciation as the adequacy of the returns or whether the amount being accumulated is sufficient for retirement.

When a person retires they are forced to make decisions as to what to do with their superannuation. Decisions include whether to take some or all of the money in cash, whether to roll over the money into an allocated pension or an allocated annuity, how the money should be invested and so on. The majority of people are ill equipped to do this and require the assistance of financial advisers whose capability varies enormously. A retiree can easily lose part or all of their retirement superannuation savings with no recourse whatsoever.

Furthermore, the current superannuation system (which includes the superannuation pension system) is unbelievably complex, biased towards superannuation industry self interests, subject to the vagaries of the stock market and exposed to the risk of superannuation companies either not performing or going into receivership.

This submission is being made on behalf of the end customer (the superannuant and retiree) who is not represented by any formal lobby group and is generally last to be considered. Yet they are the people we should in fact be considering foremost.

Outlined below are some of the problems and deficiencies with the current system and a set of proposals to achieve a step change for the benefit of all involved.

<u>Problems and Deficiencies of the Current System</u>

The problems with the current system can be summarised as follows:

- While there is plenty of written material about the amount that should be put away for retirement, most people either don't think about the issue or simply don't have the financial means and therefore will have insufficient superannuation accumulated to be a fully self-funded retiree for their entire retirement period. As a result their funds will be depleted very quickly or the income will be restricted.

- Performance of superannuation funds is highly variable (ignoring stock market, property and money market fluctuations). Returns vary significantly. Yet fund managers still take their "management" and "administration" fees. Despite each fund having trustees, there appears to be little real accountability. APRA cannot possibly supervise all of the funds, as has been illustrated in the past. The statement by Simon Ibbetson of Aon Consulting that superannuation funds " …. are not profit-making and exist purely for the benefit of the members and not shareholders or management" is stretching the imagination.

- At present, the incentives to become a fully self-funded retiree are not there. Few people can make tax deductions for their contributions and the returns on the funds are taxed.

- Once people are about to retire, they are faced with numerous decisions about what to do with their accumulated superannuation amount which few are capable of making without knowledge and advice.

  Firstly they need some understanding of the system and its rules so as to make sense of any advice given to them. I venture to say that the average person has little hope of understanding such things as:

  - Taxed vs untaxed elements
  - Undeducted contributions vs other kinds of contributions.
  - The different taxation structures and tax calculations (try understanding the ATO booklet "Superannuation and Other Termination Payments").
  - Superannuation surcharge liability on ETP's and employer "contributions" (even the ATO has trouble understanding this).

- Tax on various cash withdrawals.
- Treatment of ETP's (there are 6 components all treated differently).
- Commutation.
- Preserved versus unrestricted non-preserved versus restricted non-preserved benefits.

Secondly, and of much more concern, is the need to obtain financial advice from so called investment advisers. Such advice is highly variable (to put it kindly) and people have no way of ascertaining the quality of that advice. Nearly all receive entry fee commissions of up to 4% and on going rolling commissions. Furthermore, they usually belong to a firm selling superannuation products and therefore their advice is biased and, worst of all, they take no responsibility for that advice. You only have to look at some of the misleading advertising that is presented to the unwary these days eg the ANZ Bank advertisement about leaving work early. Most information provided by the superannuation, funds in the form of newsletters and advertising, is basically geared to selling and is therefore designed to paint a rather rosy picture – "invest your money with us and your retirement is assured". Nothing could be further from the truth. Furthermore, it is "all care and no responsibility" as the disclaimers readily point out.

- Both superannuation funds and allocated pension funds are in nearly all cases tied to the performance of the stock market as well as the capability of the investment managers. Over a long period (15+ years) the stock market does provide an equitable return and hence superannuation funds should give reasonable returns. But, as noted above, poor investment management can still lead to poor results. However, the allocated pension is over a much shorter horizon in that regular sales must be made to pay the pension. Stock market variations are therefore much more crucial as is the capability of the fund managers. Yet most financial advisers will present calculations quoting 7% or 8% return giving the impression of stability. Again, nothing could be further from the truth.

- While a retiree has the option of taking an allocated annuity, the returns are relatively low and you are relying on the continuing solvency of the providing company.

- Superannuation investment companies can go bankrupt for one reason or another as exemplified by the case of Commercial Nominees. This can result in the sudden disappearance of part or all of a person's retirement "nest egg" with little recourse by the superannuant or retiree. One might argue that "buyer beware", but this is easier said than done.

**In summary, superannuants and retirees are exposed to:**

- **An extremely complex superannuation tax system**
- **The vagaries of the stock market.**
- **Poor decisions and performance by fund managers.**
- **Incompetent fund managers.**
- **Possible greed, fraud or bankruptcy.**
- **Poor financial advice (sometimes at significant cost)**
- **Financial advice they don't really understand.**
- **Misleading advertising.**

**There is currently no one really looking after the interests of the superannuant or retiree. It certainly is not ASFA (they represent the fund managers), it isn't the government (they seem to be more interested in the tax collections) and it is not the financial adviser (who is more interested in his or her commissions).**

What Needs to be Done?

There is a dire need to do something! In a nutshell, we need to:

- Simplify the system.
- Really encourage people to save for their retirement.
- Remove investment and other risks as much as possible.
- Stop using superannuation as a tax vehicle.

In other words, we need a system where someone is looking after the interests of the superannuant and the retiree. This currently **NOT** the case.

What Are the Options?

In my view radical surgery is required while still retaining the positive features of the current system.

Superannuation

- Form one Master Superannuation Trust to which every employee and employee contributes a minimum amount relative to their wage or salary. The Trust to be run by a non-profit Federal Government Authority whose sole purpose is to deliver a pension to the beneficiaries. The Trust would have the following features:

    - The Master Superannuation Trust would invest in existing private wholesale superannuation funds. That is, it does not make any direct investments but utilises the existing superannuation industry and spreads the risk. The impact of one company going under will not be that significant to the individual superannuants.
    - Existing industry superannuation funds to be rolled over into the Master Trust (the superannuation industry will simply take up the resulting slack with expanded wholesale funds).
    - Wholesale funds would be selected on the basis of strict performance criteria with a variety of management styles and investment allocations (as judged by the Master Superannuation Trust Authority).
    - The prime purpose of the Master Superannuation Trust is to deliver earnings performance to the superannuation beneficiaries (and not profits for the shareholders, as is currently the case).
    - The Master Superannuation Trust to be a defined benefit fund based on contributions and the timing of those contributions.

(Note: Superannuation funds outside the Trust would continue for those that want to have superannuation over and above the Master Trust Superannuation fund. This may need different tax treatment)

- Eliminate the following with respect to the Master Superannuation Trust

:

    - The 15% tax on superannuation earnings. Only tax the money when it is withdrawn at marginal rates (no special tax rates except on death).
    - The need for pre and post 1983 contribution differentiation.
    - The surcharge tax.
    - Taxed and untaxed elements
    - Preserved and non-preserved benefits.

    - Different categories of contributions.
    - The two-tier RBL system. Have only one RBL indexed annually.

- Allow deductions for both employers and employees with the total limited to MDC (allowing deductions for employees increases the incentive to save for retirement)
- Do not allow contributions to be made once the RBL is reached. Any earnings that take the amount above the RBL prior to a pension being taken, are to be paid out annually and taxed at the marginal rate. Alternatively cap the contribution rate dollar value at an indexed amount.

Pensions from the Master Trust

Pensions would be in the form of an allocated annuity (ie. a pension for life but no residual) similar to the Canada Pension Plan.

- Eliminate the following with respect to the Master Superannuation Trust:

    - The undeducted contribution rebate.
    - Any tax fee withdrawal of superannuation (the tax deduction and the tax free nature of the investment should be sufficient).
    - Commutation.
    - Lump sum withdrawals.
    - Allocated Pensions and Set Period Annuities

- Upon retirement, the only option is a life pension (from the Master Trust).
- The pension income to be taxed at marginal rates with a 15% rebate as at present.
- Upon death of the pensioner, the pension continues to a dependant.
- People to be eligible for a pension if over 55 and have retired. Retired means earning less than 25% of the average wage.
- People delaying their pension until 65 will be eligible for a higher pension (similar to the Canadian system).

Superannuation Legislation, Rules and Regulations

- Eliminate the regular changes to the legislation, rules and regulations.
- Change the system to one focussed on the end customer and not on the superannuation industry and government revenue collection.
- Stop making things complex.

What Are the Benefits for the average person?

- It is a much **SIMPLER** system.
- It encourages people to save for retirement.
- It avoids people having to make decisions about which they have little or no knowledge.
- It eliminates the need to obtain investment advice in relation to superannuation and pensions.
- It eliminates complex retirement strategies.
- It gives more security in retirement.
- It eliminates a lot of unnecessary administration.
- It eliminates superannuation sales commissions (an unnecessary cost impost)
- It reduces the impact of poorly managed funds.
- It reduces the impact of superannuation companies going bankrupt.

- It eliminates the need for people to have to make decisions about the stock market as far as superannuation and pensions is concerned (unless you want additional superannuation over and above the basic system).
- It makes life for pensioners so much simpler and gives them peace of mind.
- It provides real portability.
- It eliminates the need for unqualified individuals to make decisions about superannuation funds (the so-called "choice" option).
- It uses the existing superannuation industry.
- It reduces the Government Pension liability.
- It increases the net savings of Australians.
- It really isn't that difficult to do!

While I do not have all the issues covered, I believe there is a basis here for further development. **What it requires is a <u>will</u> to do something for the average Australian without the prime concern being "lost" tax revenues and superannuation industry self interest.**

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