Why Superannuation has succeeded and why it is still relevant

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Don Russell
Superannuation is a grand achievement

• The boomers would not retire quietly on 25% of AWE

• Needed to safeguard Australia’s needs based pension – the single rate has grown by 43% in real terms since 1992

• 70% replacement income in retirement would require greater self provision and cover everyone; a compulsory SG defers consumption

• Tax preference makes compulsion work and reduces the call on the pension

• A fully funded privately managed scheme would strengthen Australia’s capital market; the SG required the development of new member oriented institutions
Superannuation assets are now very large

- In Mar 2018 super assets were $2.6 trillion
- The five year return to Mar 2018 was 7.6%*

* Entities with more than four members

Source: APRA Annual Superannuation Bulletin June 2017
Equity risk premium (ERP) has fallen

- Capital importer: ERP normally above ROW
- Weight of money and home country bias bids ERP down
- Big fall with lift in SG
- Innovative more competitive capital market

Source: Mellon Capital; data Mar89-Mar18
Real unit labour costs have fallen

- The SG grew out of the 3% productivity round
- Wages are not keeping up with productivity
- There is scope for the SG to rise to 12%
The system has been under continual review

Superannuation: Assessing Efficiency and Competitiveness: Draft Report*

- Concerns include multiple accounts, poor performance tail of default funds, related party service provision and governance
- Poor performance of regulators; confused role for APRA and ASIC

Misconduct in the Banking, Superannuation and Financial Services Industry**

- Exposed inability of trustee directors at retail funds to protect members from wrong doing from related party service providers
- Exposed inadequate response from regulators in dealing with wrongdoing

* Released by the Productivity Commission 29 May 2018
** Royal Commission established 14 December 2017 ongoing
Fund proliferation is a problem

- People open new default accounts when they change jobs
- PC estimates 10 million unintended multiple accounts (35% of total)
- Cost $690m and $1.9b in excess admin fees & insurance premiums
- Employers chose default fund

There is a nasty tail to default performance

- Median return of top 10 default funds 5.7% over 10 years to 2017 (real 3.3%)
- All 10 not for profit
- Median return of 26 underperformers 3.9% (real 1.6%); MySuper median 4.7%
- Default members ½ the accounts and ¼ the assets (two-thirds new jobs default)

Source: Productivity Commission Draft Report Superannuation: Assessing Efficiency and Competitiveness May 2018; see notes page 121
There are still too many funds

- There are 212 APRA-regulated funds
- The median fund size was only $850m
- There are 112 funds with assets of less than $1b

Source: PC Draft Report: Superannuation May 2018
The use of related party providers is worrying

- The PC finds that the transparency of fees paid to related parties is deficient
- APRA does not have good data
- The Royal Commission has taken worrying testimony

Source: PC Draft Report: Superannuation May 2018
Likely recommendations

The Productivity Commission

• The timing of the final report has yet to be advised.
• PC accepts that linking choice of default fund to employers leads to account proliferation and a poor performance tail.
• Solution is to link default choice to members (who are disengaged) and need to be ‘nudged’ to ‘Best in Show’ funds;
• Every 4yrs an Expert Panel advised by the Government Actuary and answerable to a minister will select the short list.
• Open mind on the role of the Future Fund.
• Looking for APRA to move out from ‘behind closed doors’.
• ASIC should be less reactive and be strategic conduct regulator.
• APRA now looks after standards; must resolve ASIC/APRA overlap.
Likely recommendations

The Hayne Royal Commission

- The RC will submit an interim report by 30 Sep 2018 and a final report by 1 Feb 2019
- The RC interim report is likely to be reflected in the PC final report
- Interim report likely to recommend a culture change for APRA and ASIC and more proactive regulation
- The continued grandfathering of adviser commissions looks under threat along with the vertical advice and asset management model
Conclusions

The SG has delivered on its core objectives

- Higher retirement incomes
- The aged pension remains central. It has not become a neglected safety net
- Australia’s capital market is more efficient and innovative
- Higher super balances and a tighter means test mean that the aged pension will fall from 2.7% of GDP in 2017 to 2.5% in 2038. The initial IR projected the aged pension would rise from 2.7% of GDP to 4.6% over 40 years*
- The industry funds have grown into large successful institutions
  The current reviews can deal with short comings and build on strengths
- Member selection of default funds needs to be carefully managed
- Past advice and retail fund business models and the regulators will have to change
- There is scope to lift the SG to 12%

* The Age Pension in the 21st Century: Michael Rice 2018
Speaker background

Dr Don Russell, PhD CFA

Until March 2018, Dr Don Russell was the Chief Executive of the South Australian Department of the Premier and Cabinet (DPC).

Until September 2013, Dr Russell was the Secretary of the Federal Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education.

Don was previously Independent Chairperson of State Super, a role that he held from 1 January 2008. State Super is a $32 billion fund that manages public service defined benefit schemes for the NSW State Government. He was also Chair and then a board member of SSFS a financial planning business owned at the time by State Super.

Until March 2010, Don was the Global Investment Strategist at BNY Mellon Asset Management Australia. BNY Mellon is a global investments company with $26 trillion under custody and/or administration and $1.4 trillion under management. Prior to joining BNY Mellon in 2007, Don was Executive Director with WestLB Mellon Asset Management (Australia). Don joined WestLB in 2001. WestLB was the largest of the German Landesbanks and was based in Dusseldorf.

Between 1997 and 2000, Don worked for Sanford C. Bernstein, a research and money management firm in New York.

Between 1985 and 1993, and again in 1996, he was Principal Adviser to the Hon Paul Keating both during his time as Treasurer and Prime Minister.

Between 1993 and 1995 Don served as Australia’s Ambassador to the USA in Washington.

Don also worked for the Commonwealth Treasury, joining as a cadet, and in 1985, prior to joining Paul Keating’s Office he was Assistant Secretary, Economic Branch.

Don has a PhD from the London School of Economics, a MEc from ANU and a BEc (Hons) (First) from Flinders University. Don also holds the Chartered Financial Analyst designation (CFA) 2007.
Important information

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