



A super scandal

By [Stephen Long](#)

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Paul Keating called it his greatest reform for workers - a compulsory superannuation system to ensure that Australians had financial security and dignity in retirement.

But over the past dozen years or so the returns from the superannuation system have been woeful - shockingly low, and far lower than has been generally understood.

The Australian Prudential Regulation Authority keeps statistics going back as far as 1997 on total assets and net contributions in the superannuation system.

APRA provides the aggregate figures but it doesn't spell out what the numbers imply.

From those statistics, though, it's possible to calculate how much of the growth in the size of the total retirement savings bucket comes from contributions - workers' money going in - and how much of it comes from investment returns after costs: the money making money.

[We've done the calculation](#); the net annual compound return is a mere 3 per cent. That's barely ahead of the inflation rate over that time, which averaged 2.8 per cent.

Over the last decade the system-wide returns were below inflation, which averaged 3.2 per cent.

Think about it. Australians have, in effect, had a proportion of their wages compulsorily acquired and put into a retirement savings system that has seen their money stagnate over a dozen years and go backwards over the past 10.

No growth in real terms (adjusted for inflation).

It raises a fundamental question: is this the best way to provide for workers in their retirement?

You would hope that, given workers' retirement savings are being exposed to the potential for losses on volatile asset markets, the superannuation system would be delivering a return to justify the risk.

Yet on any measure, the superannuation system is delivering a negative return for risk.

The system-wide returns are less than the return on cash in the bank and little more than half the average rate of return on the long-term government bond rate over that time.

Let's put it another way. The Commonwealth has created a giant pool of money - \$1.2 trillion now and growing every year - that has spawned a large and largely well-remunerated financial services industry.



Is superannuation the the best way to provide for workers in their retirement? (Thinkstock: Pixland)

Yet that industry, which has taken tens of billions of dollars in fees out of workers' retirement savings, has in real terms delivered no overall return on that money during the period in question.

If the aim of compulsory super was to build the financial services industry in Australia by providing it with a guaranteed and growing stream of funds, the system has delivered in bucket loads.

If the aim was to ensure that all workers would have the income to enjoy a dignified retirement, it is failing miserably.

The public policy implications are profound. If the returns continue at this level, it is highly unlikely that the superannuation system will generate anywhere near enough for workers to live on in retirement.

Australians will, in effect, end up paying twice: the first time, through a lucrative stream of fees to the individuals and institutions that manage Australians' retirement savings; the second time, through their taxes, to provide aged pensions to the citizens failed by the superannuation system.

The superannuation industry and the consultants and analysts who make money off its coat-tails will complain, no doubt, that the system-wide returns are not representative.

They argue that the better measure is the return on the "balanced" funds where most workers have their money invested.

Even here the returns are poor - a median return of about 4.5 per cent a year for the major balanced funds over the past decade, according to the analysis from credible agencies such as SuperRatings and Chant West that track fund performance.

That's no better than cash and significantly worse than putting your money in Ten Year Australian Treasury bonds which over that time delivered an average return of 5.75 per cent.

The industry will complain that the period is biased towards low returns because it encompasses a series of financial crises - beginning with the Asian financial crisis, then the tech wreck, the accounting scandals at Enron and WorldCom, and culminating in the GFC.

That's true - but it tells a story in itself.

Over the past decade or so financial crises have become more frequent and more disruptive than in the past - and they propagate more rapidly.

The Bank for International Settlements is among the institutions that have linked this to globalisation and financial market liberalisation.

Increasing integration of global financial markets means shocks can quickly go viral and spread, pandemic-like, across borders - and modern communication technologies allow for almost instantaneous transmission of shocks.

Ask yourself - which is the more representative era?

The "great moderation", as head of the US Federal Reserve Ben Bernanke once termed it, when benign inflation rates and soaring asset prices in the West led to double digit returns on investment?

Or the Great Volatility, characterised by booms and busts in asset prices?

Volatile markets are not the only cause of the poor system-wide returns on superannuation over the past decade or more.

There is also the poor system design which has produced a vast pool of lost money - literally tens of millions of lost or inactive superannuation accounts holding money left behind by workers when they changed jobs. The account balances are being eaten away by ongoing fees.

Then there's the sizeable fee take from workers' retirement savings all the way along the line.

Fees and commissions paid to financial planners have received the most attention and opprobrium, with good reason.

There's been a massive and untenable conflict of interest in the profit-oriented superannuation sector; salesmen, masquerading as objective "advisors", have made a living from kickbacks and commissions from superannuation providers.

But there's been far less focus on the pay of the people who make the big money - the investment managers.

Typically, the investment managers get paid a percentage cut of the funds under management - so the bigger the pot, the more they get, regardless of performance.

You can see why the industry was overjoyed at the Government's decision to increase the superannuation guarantee from 9 per cent to 12 per cent.

It's money for nothing: it takes no more effort to buy a half a billion dollars worth of BHP shares, say, than it does to buy half a million and, aside from a marginal cost for brokerage, no more expense.

"The great thing about being an investment manager," said a member of this fraternity over drinks, "It costs no more to invest \$2 billion than it does to invest \$1 billion but we get paid twice as much."

Nice work if you can get it.

So why don't the investment managers get paid a flat fee, with a bonus if they achieve superior returns?

The bonus would, of course, need to be carefully crafted to avoid an inducement to excessive risk-taking.

After our analysis was first aired, the head of the superannuation system review, Jeremy Cooper was interviewed and his response was: that's standard practice the world over, so how can Australia buck the trend?

He said that Australian superannuation funds lack the size and scale to demand a better deal.

Yet, from the outset, the Cooper review rejected an option canvassed in a research paper published by APRA in advance of the inquiry: establishing either one or a small number of publicly-run, low-cost "default" option super funds.

This might have created funds with the size and scale to push-back against the power of the financial services industry.

If Parliament does implement its recommendations, the Cooper review will address some of the problems that have driven down system-wide returns.

It proposes remedies to stop retirement savings falling into an abyss of lost accounts and to stop lost accounts being eaten up by continuing fees.

It exposes terrible inefficiencies in the system - for example, superannuation still being processed manually, through paper cheques sent in the mail - and recommends reforms.

Cooper's "MySuper" option - endorsed by the Government but strenuously opposed by the Opposition and by the profit-oriented super sector - holds out the prospect of lower cost, simpler "default" options.

If it's adopted, and that's still a big if, it will go some way towards changing the scandalous situation where workers can have their compulsory superannuation placed by default in high-cost funds with poor returns because their boss has done a deal with a financial services firm or a financial planner.

The Government maintains it will make a major difference to retirement savings for most workers over the course of a lifetime.

Yet some experts are sceptical. Dr Mike Rafferty, an economist with the Workplace Research Centre at the University of Sydney, inquired at an industry briefing on the Cooper review whether default schemes could have financial planning fees built-in.

The answer, he says, was yes. Could they build in fees for life insurance and disability insurance? Yes, again.

"I can't see how it's going to make much difference or achieve anywhere near the reductions in fees that the review suggests," he says.

Even so, the Cooper system is a major breakthrough in the public policy debate.

The findings of the Cooper review implicitly recognised that superannuation has failed to deliver on the promise of the market-based system - that competition would drive down prices and costs and deliver the best outcomes for consumers.

It exposes the reality that, at least when it comes to superannuation, our financial services regulation rests on a false edifice.

The regulations assume the world is populated by the species *homo economicus*: rational individuals who spend their time looking for ways to maximise their interests.

The reality is that most people have neither the wherewithal nor the inclination to navigate the maze of choice; neither the confidence nor the desire to make active decisions about where the retirement income should best be invested.

They just want to know their money is safe and they're not being ripped off, which is far from assured under the present system.

But while it proposes many worthwhile reforms, Cooper only goes so far. This was not a "root and branch" review.

It took the existing superannuation system as the model and looked at ways to tweak it or "clean it up", in the words of the Federal Minister, Chris Bowen.

There was no appetite for questioning what the former Macquarie Bank deputy chairman Mark Johnson, architect of a plan to make Australia a regional financial services hub, has called "the privatising of old age".

It canvassed more radical and far-reaching options for reform, but it is no surprise it rejected them. Look at the make-up of the inquiry.

Aside from Jeremy Cooper and the Treasury official David Gruen, all of the members of the advisory panel were, in one way or another, superannuation industry insiders representing those with a vested interest in the existing system.

Why is Australia unique in the world in putting such a high proportion of workers' retirement savings invested in equities (company shares)?

Why is it that 60 per cent of the OECD nations have defined benefit pension schemes that provide a guaranteed retirement income, while Australia has a system that leaves workers bearing the risk?

The Government's response is that defined benefit schemes run the risk of being hit by large unfunded liabilities in the corporate sector. It's a cogent critique.

Yet our system runs the risk of working people, despite years of contributions, being left unfunded for their retirement.

The debate about how to provide decency and security in retirement isn't over; it may be just beginning.

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