Good Super
Reply Paid 3528
Tingalpa DC QLD 4173
Phone: 1300 788 658
info@goodsuper.com.au
www.goodsuper.com.au

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Senior Adviser
Financial System and Services Division
The Treasury
Langton Crescent
PARKES ACT 2600   by email: fsi@treasury.gov.au

Dear Sir

SUBMISSION IN RESPONSE TO THE MURRAY REVIEW

We welcome the chance to make submissions in response to the Financial System Inquiry Final Report. Our submission relates to issues around superannuation and retirement only.

Purpose of superannuation

We agree strongly with the need to have a national conversation on the purpose of superannuation. While the 'Sole Purpose Test' requires superannuation funds to look solely towards the financial position of account holders, we believe it is time that Australians asked what should be done with the massive amounts of patient capital to help build the social and physical infrastructure needs of the country.

Superannuation funds can be used to not only look after the financial state of the account holder on retirement, but also improve the country into which they are retiring in the meantime. We strongly believe it is time to engage in a national conversation around the nation-building aspects of superannuation.

Linked to this is the need to examine value capture models for funding infrastructure. Could a model be developed to create a business case for superannuation to fund infrastructure and satisfy the sole purpose test?

Query the following hypothetical. If infrastructure causes amenity improvements in local communities, with consequent rises in land values, those land value increases are currently captured in four places: the hands of the land owner, local government council rate increases, state government Stamp Duty increases and Federal Government Capital Gains Tax increases for disposal of non principal places of residence. We query whether in certain circumstances the three levels of taxation increases could be hypothecated to create revenue streams that could supplement other value capture models to help fund a business case for superannuation investment into infrastructure development.

As part of the national conversation on the purpose of superannuation we should include wider discussions on value capture models that could make greater superannuation investment into infrastructure more viable.

Fees: lowering industry wide costs

Whilst it is right to put pressure on industry wide fees, only a certain amount of fee reduction can happen from competition. A focus on removing industry wide costs could also result in industry wide fee reduction. One such cost is compliance.

While the regulators, particularly ACCC, ASIC and APRA do outstanding jobs in regulating an important industry, none of ACCC, ASIC or APRA have private ruling systems similar to the Australian Tax Office's Private Binding Ruling system.

Currently the industry spends many millions of dollars in legal fees in attempts to ensure compliance with the regulatory regime before instituting product, marketing and communications strategies. Only after these strategies go 'live' do the regulators check for compliance. It is our view that if the regulators had 'Private Binding Ruling' style systems where marketing and communications strategies could be checked by the regulators in advance, even if such checks were charged on a fee for service basis, then there would be a radical reduction in industry wide legal expenses (including for the regulators). Lower fees could result.

We call upon all regulators to create an 'ATO style' binding private ruling system.

Collective liquidity

Linked to industry costs is the cost of liquidity. Individual fund liquidity requirements force funds to hold a higher than necessary proportion of funds in low yielding, high liquidity options. Given the nature of the industry, while there may be a run on any one fund, there cannot, by law, be a run on the industry (as opposed to a run on banks, for example). People cannot simply choose to withdraw funds from the entire industry. If a member leaves a fund, their balance must transfer to another fund. Cash does not leave the industry other than on retirement.

We therefore urge an examination of the change in the law to allow for collective industry liquidity to allow for higher balances in higher yielding assets and hence higher balances on retirement.

Wealth destruction: Insurance not fees

While there is a lot of focus on the need to reduce fees, little attention was placed on the wealth destruction impact of over-insurance attached to superannuation. Whilst we recognise that Australia is generally underinsured, the opt-out provision of insurance means that there is a theoretical possibility of massive wealth destruction due to over-insurance of people who are insured multiple times across several superannuation funds.

In the annexure attached we calculate a theoretical high loss over-insurance case at over $1million lost on retirement and a low insurance impact of $108,000 lost on retirement (see attached). We also recognise the benefits of insurance and the potential vulnerability of under-insurance.

The Solution?

We suggest that Tax File Numbers be attached to Permanent Disability, Income Protection and Life Insurance so that the insurance industry, through the TFN, could be regulated so as not to be allowed to offer a second or multiple insurance product without the conscious and written 'opt-in' by consumers.

Wealth creation

We believe that the focus on 'high fees' in industry literature and press is misguided. A focus on 'returns net of fees' is a more appropriate measure. A high fee/high return product could very well provide a better retirement than a low fee/low return product. The worst of both worlds would be a high fee/low return product.

We call upon the review and the policy makers to speak of low return net of fees rather than 'high fees' in order to help the community focus on the most important wealth creation issue – returns net of fees.

Innovation

Innovation in services and products requires innovation in marketing and communications. We repeat the points we make under the 'lowering industry wide costs' heading. We believe given the absence of a private ruling system, being innovative is simply too risky. Innovation will not occur if the industry and regulators don't have a system of tackling innovation collaboratively, rather than punitively when the regulator feels that innovation has gone too far.

Tax concessions for high superannuation balances

Australia needs to ensure that retirement can be funded by the majority of Australians without recourse to the pension system – which is a “safety net, not a comfort net”, in our view. While tax concessions for young and low income people makes sense to encourage better retirements savings, it makes no sense to give tax concessions to high balance accounts when government tax revenues are as tight as they are today.

It is time to end favourable tax concessions on balances over $1.8 million. We recognise that this is an unusual position for a retail fund to take. Continuing generous advantages in super taxation incentives largely benefiting the baby boomer generation is continuing what is now being called ‘intergenerational theft’.

Tax concessions should end after an objective retirement capital level is met. Good Super proposes the capital level cut off for tax concessions should be set as a function of Average Earnings and interest rates, recognising that Average Earnings provide a ‘reasonable’ retirement.

Good Super proposes that a reasonable cut off limit for tax concessions in super is the amount of capital required to gain Average Earnings on a fixed term deposit. We recognise that there could be debate around where to set a level, however the concept of finding a ‘reasonable level’ of capital to end tax concessions should not be in dispute.

Australia’s current Average Earnings is a little under $75,000 p.a and term deposit interest rates are around 4% (the current rate with ING under certain conditions). To return $75,000 at 4% a retiree would need $1.875m in super. This seems to us to be a reasonable amount – or at least a reasonable amount to engage a public debate.

Good Super’s proposal is to reset the cut-off limit as part of the budget process each year using the AE/interest rate ratio. Using an objective method would remove argument about what is a reasonable level for tax concessions.

Retirement age

We believe the retirement age should not be a fixed age, rather it should be a percentage of average life expectancy. As life expectancy and quality of life improve with health system improvements, then people will live longer. Consider this: when the pension scheme was created the retirement age was approximately 90% of average life expectancy. Today it is approximately 75% for women and a little higher for men.

We propose that retirement age should be fixed to 85% of average life expectancy. Such a link would remove the need to have periodic political debates around fixing retirement age by a numerical age limit. We also propose that as women's participation in the workforce continues to be encouraged, that there should be no differentiation in male and female retirement ages.

Principle Place of Residence to be counted in the assets test for the Pension.

We believe that the principle place of residence should not be counted in the assets test for the pension unless and until there is a more effective drawdown mechanism available to retirees. Such drawdown mechanisms may include new innovations such as the partial sale of houses to enable pensioners to sell part interests in their homes to patient capital providers such as superannuation funds, providing an option for drawing down on principal place of residence capital to part-fund retirement.

Retirement products

We welcome the Review's focus on the creation of new retirement products. Drawdown products such as those mentioned in the previous paragraph, annuity products and other type products should be encouraged. Discussions on types of products should be included in the national conversation around the purpose of superannuation.

Sincerely,

Andrew

Andrew MacLeod
MD Good Super

Andrew.macleod@goodsuper.com.au

Annexure 1: Hypothetical impact of insurance.

Could members be losing $1 million in savings for spending they are doing without knowing, for products that may not need?

According to the recent Murray Financial System Inquiry, there are nearly three superannuation accounts for every employee in Australia.

For each superannuation account there are fees incurred, and you may be paying premiums for Death, Income Protection and Temporary & Permanent Disability (TPD) insurances.

How much could this be worth?

Superannuation accounts often have premiums associated with Death, Income Protection and Temporary & Permanent Disability (TPD) insurances. Premiums are difficult to predict and is dependent on the individual's circumstances. The following *hypothetical* cases show the potential impacts.

Let's assume a 20-year-old white collar non smoking male with insurances bundled with his superannuation. Let's also assume he has three superannuation accounts.

On a ***high insurance option*** a 20 year old may be losing up to $1 million of retirement capital just by spending too much on insurance (detailed calculations below).

On a ***low insurance option*** a 20 year old may be losing $108,000 capital on retirement (detailed calculations below).

On a ***no insurance option*** the problem is different. Too much insurance could destroy your wealth through premiums. Not enough insurance could destroy your wealth if an uninsured event takes place. In other words, have you checked that you have the right insurance for your personal circumstances?

Hypothetical financial calculations.

The $1 million hypothetical calculations

How do we calculate a possible $1million loss on retirement?

We assume Income Protection cover at $2,500 per month, Life Insurance at $1.5 million, and Total & Permanent Disability Cover at $1million. While this is a mid level insurance coverage overall, it is at the high end for a 20 year old.

As at February 2015 a *competing superannuation fund* offered this set of insurance for $24.30 per week. This equates to a little over $1,200 per annum for the set of insurances. If this person holds 3 superannuation accounts each with similar insurance, and if it is assumed that one set of insurances is needed, then the 2 additional superannuation accounts incur *$2,400 each year* in extra insurance premiums.

Fees may also be incurred on the 2 additional accounts. For an account with administration fees of $1.50 per week or $78 per annum, the person may be paying *$156 each year* in fees on these 2 additional accounts.

Fees plus premiums on two accounts totals $2556 per anum.

If that the person is 20 years old, and has their superannuation on a 'Growth' portfolio in which the Australian Government assumes an expected return of 8% (for more information click here), the compounding impact of $2556 spent at age 20 amounts to lost retirement savings of over *$80,000* due to compound interest. (For compounding interest calculations to get this figure we use the Australian Government Money Smart calculator here).

If the person does not consolidate their account until retirement, assuming premium levels paid for the full 45 years of working and no change in super, this person would have lost over $1,000,000 in savings through fees and insurance premiums incurred, and the compounding impact of the lost savings, through additional two accounts over their working life.

The $108,000 hypothetical calculations

The Australian Tax Office sets minimums insurance coverage standards (see here). With the minimum insurance level at the same *competing fund* as the example above, premiums and fees come to around around $130 per year per account, or $260 extra per year for two extra accounts.

Assuming that the person is 20 years old, and have their superannuation on a 'Growth' portfolio in which the Australian Government assumes to have an expected return of 8% (for more information click here), fees plus premiums amounts to lost retirement savings of over *$8,300* due to compound interest. (For compounding interest calculations to get this figure we use the Australian Government Money Smart calculator here).

If the person does not consolidate their account until retirement, assuming premium levels paid for the full 45 years of working and no change in super, this person would have lost over $108,000 in savings through fees and insurance premiums incurred through additional two accounts over their working life.

No insurance hypothetical

If paying too much insurance scares you, have you thought about what happens if you have no insurance? Our Managing Director Andrew MacLeod has a personal story that highlights the issue.

“When faced with a family tragedy we don’t think about cost. Cost only enters into thinking after the event.

“My younger brother died overseas unexpectedly last year, it cost me thousands to fly the family over, deal with the autopsy, medical, legal and diplomatic issues that come about when someone dies overseas. I assumed these costs would be lost and non recoverable.”

“While my brother’s death remains tragic, at least the life insurance payout from his superannuation meant that a financial burden was lifted. Thank fully we had the insurance.”

NATSEM at the University of Canberra (see here) says Australia is radically under-insured. According to their report:

Based on 2008 statistics, 18 Australian families lose a working age parent every day. Every year, 235,790 working age parents suffer a serious illness or injury and over 17,000 of them are forced to stop working, either permanently or for an extended period of time. Over one million working-age parents with dependents will be impacted by death, serious accident or illness.

These figures mean that more than one in five families will be impacted by an insurable event in their working lives. Most of these people will have some level of insurance, usually death cover, within their superannuation. Often the level of cover is inadequate. Income protection is also only offered as an option by the minority of funds and again, these levels are not sufficient for most families to maintain their lifestyle. While a concerted effort by the superannuation industry means this situation is improving, the fact is most Australian working families will not have adequate levels of cover to protect themselves from financial hardship and secure their way of life.