Super for whom?

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Good afternoon

Now I don't usually start with all the letters after my name! I'm sure you all have your own much more impressive collections of them . Maybe you're thinking, Gee she must be phenomenally insecure to list all that.

But when I last ventured into the public domain to talk about superannuation transparency, even before my report was issued, none other than Gary Weaven took to the media to attack me as unqualified to do so. I let you make up your own minds.

I will argue today that superannuation trustees and asset managers need to be skilled at what they do and we need new laws to force transparency into this cosy club of an industry. I will also argue that the practice of award default funds needs to be abolished and the industrial relations reformers need to make this a priority.

I do not have all the answers on what form reform must take, only that we are corralling ourselves into empowering otherwise fading unions and unionists by the current system. If employers want to even the field they must recognise that the cosy sharing of super spoils by employer association and union officials needs to change.

This is a 1.3 trillion dollar industry, responsible not only for the retirement savings of Australians but a fundamental pillar of our national economy. Yet the only way to become a trustee of the fastest growing class of super funds is to be nominated by either a union or an employer association. There are trustees who have held positions on large industry funds since their inception who have never bothered to formally upskill from when they left school in Year 9. There are employer organisations who are not representative of even half the employers covered by an industry fund they nominate half the trustees for. Millions of Australians who are not union members have no opportunity to have a say in their default superannuation fund and face significant administrative hurdles in choosing their own fund.

The Howard Government introduced member choice after years of development and consultation. It was fought at every stage by the ACTU and some employer groups. In the 12 years since the introduction of member choice only a very small number of eligible employees have taken advantage of the provisions. It remains time consuming and frustrating to try and change super funds. Member choice will never be enough to force change.

Super Funds Snapshot June 2012

Type	Number	Members	Size ($bn)	Market Share
Industry	56	11.4m	264.5	20%
Retail	136	15.1m	376.9	29%
Public	39	3.4m	218.1	17%
Corporate	123	0.6m	57.0	4%
SMSF (Dec 2011)	460,000	0.8m	400.0	30%
Total			1,316.5	

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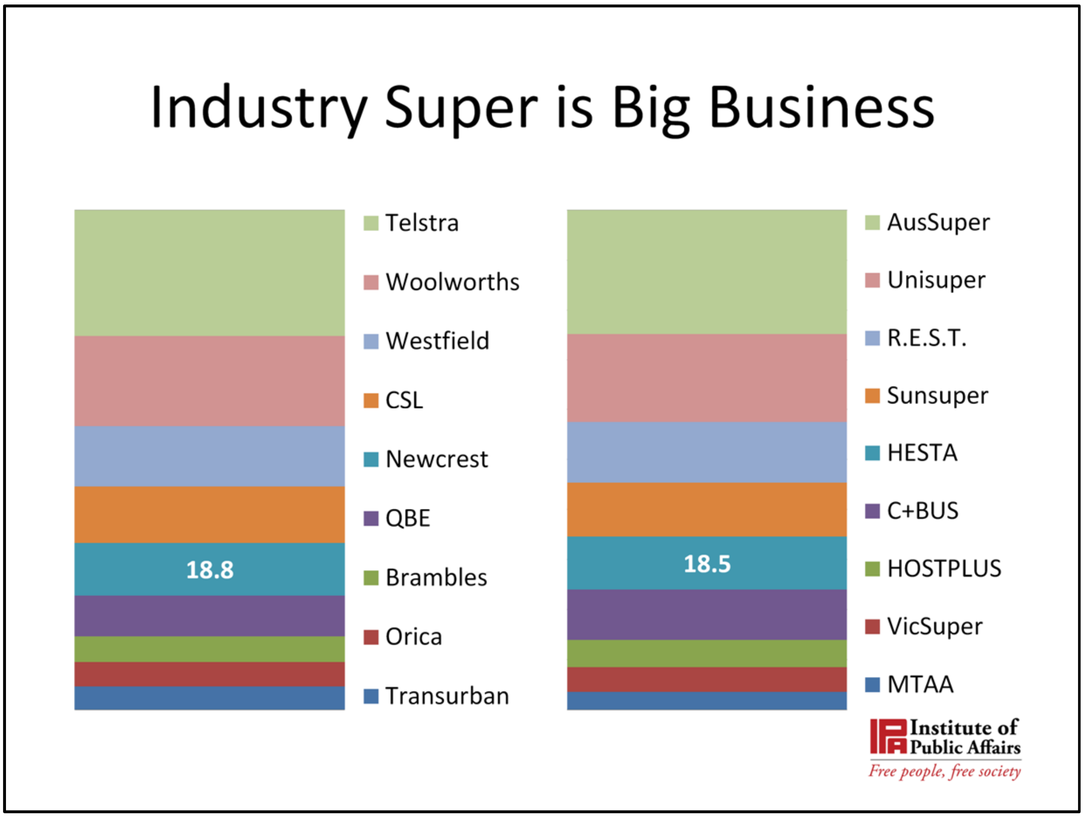
As at December 2011 total superannuation assets were $1.31 trillion. Thanks to the problems in Europe they will be somewhat less than that now!

By 2015, even with the financial market problems, it is likely the combined assets in Superannuation will exceed Australia's GDP.

There are 5 types of superannuation funds.
Industry Funds: These were set up jointly by unions and employer associations—usually after 1992. Half of the trustees are appointed by unions and the other half by employer associations. Some funds also have one or two "independent" trustees who are appointed by the other trustees. There are 56 industry funds with combined assets of $264 billion and 11.4 million members.
Retail Funds: These were usually set up and run by major financial institutions such as AMP. Many of these funds were operating well before compulsory superannuation was instituted in 1992. There are 136 retail funds, with combined assets of $377 billion and 15.1 million members.
Public: Government funds are run for public servants. There are 39 government funds with combined assets of $218 billion and 3.4 million members.
Corporate Funds: These are typically run by large businesses for their employees. There are 123 corporate funds, with combined assets of $57 billion and 600,000 members. Telstra Super makes up 20% of the assets in this category. Many of these funds are old-style defined benefit funds and are closed to new members. Their membership and funds are shrinking.
Self Managed Super Funds (SMSFs): These are small funds with four or fewer members. Mostly the trustees are the fund members. Almost 70% of SMSF have 2 members. There are 460,000 SMSFs, with combined assets of $400 billion and 800,000 members.

The fastest growing category are SMSFs as more and more high net worth individuals reach an age where they can devote more resources to superannuation and want to gain greater control over their funds. Small business people and farmers also often use a SMSF to hold their business premises or farm land. At lower balance levels SMSFs face very high compliance, accounting and audit charges making them uneconomic below about $200,000 in assets. It is very difficult for most employees of large businesses to get their super paid into an SMSF and given the small average balance this is not a viable option anyway.

Leaving aside SMSFs as not particularly relevant to most employees, that leaves Industry funds as the fastest growing category of super funds. This will continue to accelerate over time as the default award provisions funnel even greater monies into these funds.



Total value of each column is about 175 billion dollars. These are the 9 largest industry super funds matched with a similar sized ASX company just to give an idea of how large these funds have become. Now of course there is a difference between the funds under management of a super fund and its equivalent market capitalisation if it were a listed company. If these 9 super funds were to list themselves as a single company it would be worth around 14 billion dollars. Just because Industry funds are "not for profit" does not reduce their influence on the Australian economy.

Industry funds are increasingly active as shareholders, voting their shares and having opinions on directors and performance of companies they invest in. Shareholder activism is not necessarily a bad thing but we must be mindful of super funds using their influence to deliver outcomes that are not profit maximising.

These top nine industry funds hold a 65 percent market share of industry funds or 13% of all superannuation funds in all sectors and all are growing.

The unions have clear control of these funds despite the nominal equal representation of employers and employees.

To take a topical example, HESTA, the super fund our dinner speaker was a director of is the fifth largest Industry fund, with assets of 18.5 billion dollars making it similar in size to the market cap of Newcrest Mining. HESTA's union directors come from the ANF, HSU, and United Voice. All the union directors have clear union affiliations. Only 2 of 7 employer directors can be identified as either from an employer body or with specialist funds management skills. One of the employer directors, appointed apparently by VECCI, is Angela Emslie. Gary Weaven's partner of long-standing. This is typical of industry funds, the union people are all clearly union and stick together while the employers are fragmented, not obviously prepared to stand up to union dominance and in at least some cases badly conflicted.

Number 9, MTAA deserves special mention. It is about the same size as Transurban, perhaps that's appropriate as they are both about cars. MTAA was the pin-up of the industry funds winning multiple awards and ranking as best performing on 1, 3 and 5 year returns at one point.

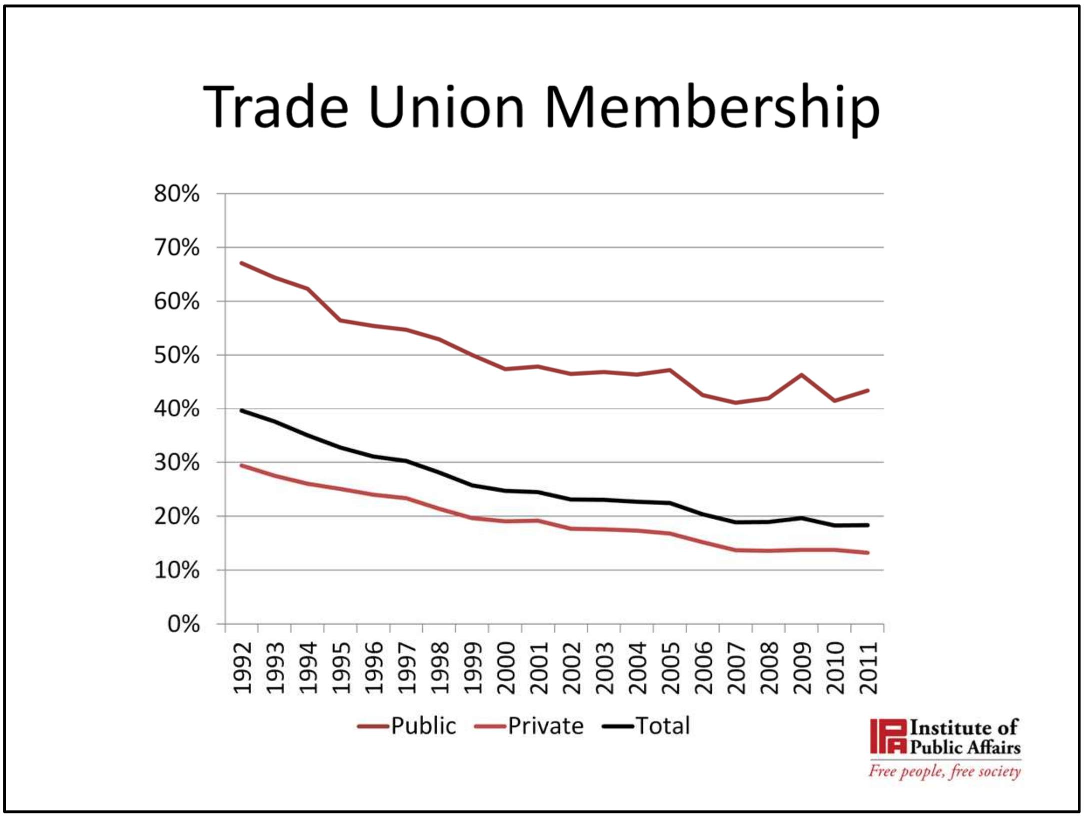
Yet MTAA is now best known for crashing to the bottom of the performance tables, investigation by the tax office and controversy surrounding foreign exchange hedging losses. To put the poor performance into perspective, in June 2008 members' funds totalled $6.1 billion, compared with $6.01 billion three years later, yet over the same period almost $3 billion came into the fund in contributions.

The reason MTAA did so well and then so poorly was because it had an investment structure with over 70 percent of assets in illiquid investments. When the GFC hit these all looked great because they are only revalued once a year whereas other funds with more liquid assets such as listed shares had to revalue immediately. Then when the revaluation came around for MTAA not only were there very large falls in what were very speculative assets, some of these assets had to be sold at impaired value to raise cash to fund withdrawals.

Then the ACT tax office started asking why MTAA only paid payroll tax on 1.2 million dollars of directors fees when the ASIC filings said they were paid 2.9 million dollars.

Thankfully for the members there have been major changes at MTAA. The CEO of 22 years left on 15 November 2011. The Chairman pleaded ill health and went earlier in August 2010 and two other directors left not long after. In April 2011 John Brumby became the new permanent chairman and the employer group replaced most of their nominees.

But 2 of the 3 union nominated directors from the crisis are still directors of MTAA today as is one of the employer nominated directors. The only real option members have to express an opinion on this is to transfer to another fund.



Since the Superannuation Guarantee legislation was introduced trade union coverage has fallen from 40 percent to 18 percent of the workforce. Private sector union membership is now only 13 percent.

Since 2006, the law has required employers to give employees the right to choose the superannuation fund into which their money will go. However, under Australia's award and enterprise agreement system, if an employee does not make a choice, the contributions must be paid to the superannuation fund stipulated in the appropriate award or enterprise agreement. The award/agreement funds are known as default funds. The overwhelming majority of compulsory superannuation contributions are allocated to the default fund and within that to the default investment option.

Most of the so-called 'modern' awards include default superannuation fund clauses. The number of default funds varies between 1 and about 5 in each award (although the Educational Services General Staff Award manages to mandate 18 default funds). Each award superannuation clause also has a provision for existing employers to continue to pay into any fund they were already paying into as at September 2008.

In a Senate Committee review of these provisions strong concerns were expressed as to the lack of transparency in the process of choosing which funds gain the privileged positions as default funds.

The CEO of the retail super funds association, ISFA, noted that despite a number of retail master trusts applying to be recognised as default funds that in many cases, the commission has not agreed to their inclusion. This could have a substantial impact on the viability of these funds.

There is no mechanism to appeal these decisions and this continues with Fair Work Australia. The Act appears to prohibit appeals of decisions by the full bench of Fair Work Australia. The only review mechanism IFSA is aware of is the requirement that Fair Work Australia review the awards every four years.

A useful reform for government would be to create an appeal mechanism with a stipulated set of criteria for inclusion and appeal. The criteria should be investment and governance not industrial related. The judges of Fair Work Australia are not superannuation exports and cannot be expected to adjudicate on the suitability of a particular superannuation fund.

An analysis of 166 'modern' awards highlights the dominance of Industry Superannuation as the default option.

Award Default Funds

Fund Type	Market Share	Proportion of Default Funds
Industry	20%	85%
Retail	29%	8%
Public	17%	7%
Corporate	4%	0%
SMSF	30%	0%

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As this table makes clear, Industry funds dominate the default funds in modern awards. While this is a count of names, rather than actual industry fund flows and is therefore not a perfect measure, the dominance of industry funds as far outstripping their market share of the superannuation industry is plain.

As time goes on and new people enter the workforce the market share of Industry funds will continue to grow. Even over the past 2 years when I first started looking at this issue, industry fund market share has grown 1.5 percentage points largely at the expense of corporate funds who as you can see are missing from the lists of default funds. There is a bit of rounding here, I did identify 3 corporate funds listed as a default fund, compared to 477 listings of industry funds.

The number of industry and retail funds is expected to decline considerably in the medium term while the asset bases expand. By 2025, total superannuation assets are expected to grow to $2.2 trillion. The number of industry funds is expected to decline to 21, and the number of retail funds is expected to decline to 47.

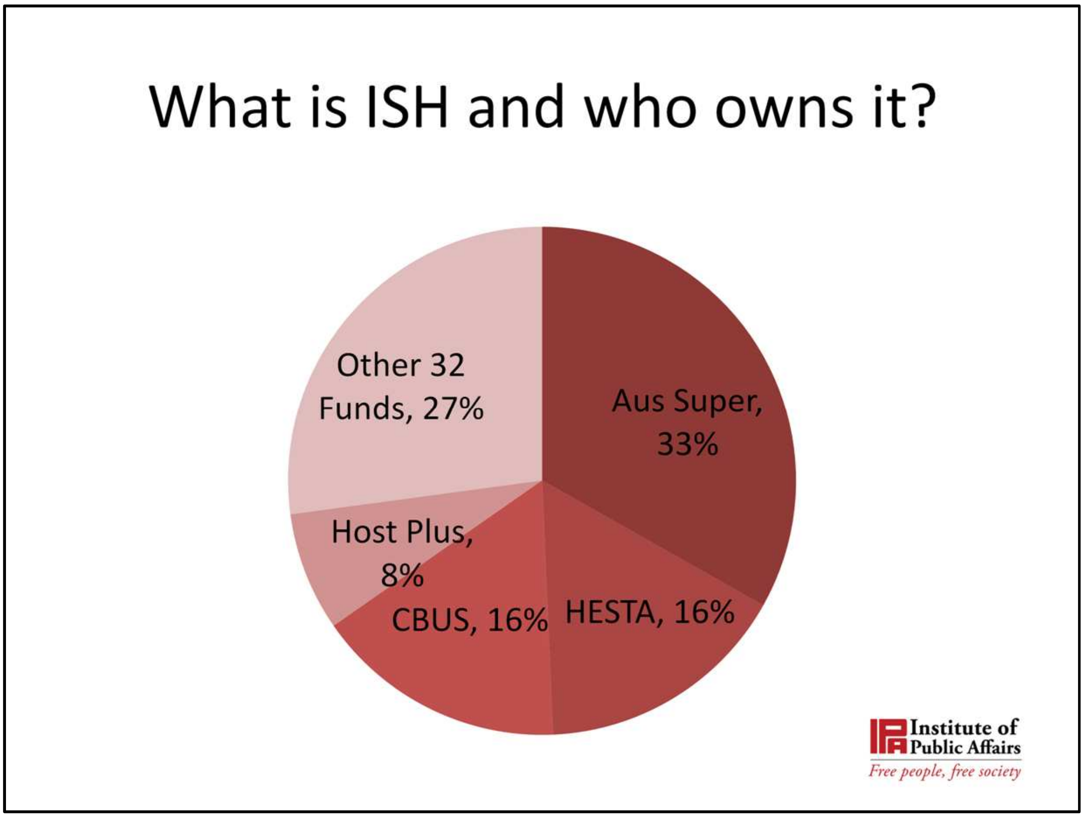
This will result in a heavier concentration of workers' money being controlled by a smaller number of financial managers and fund trustees in the retail and industry funds sectors.

There are various negative consequences which will arise from this concentration. The major risk is significant fund underperformance like that experienced by MTAA. Industry funds are more likely to suffer such risks for two reasons, firstly major retail fund managers such as AMP, NAB and CBA are ASX listed entities. They have a bevy of analysts pouring over their every move. Also most retail funds use daily unit pricing, investors get an idea of the performance on a daily basis. As a result any poor performance is likely to be seen more quickly. The other reason industry funds face higher underperformance risk is the nature of their boards. Most industry funds have boards with no financial asset valuation skills. Portfolio risk is a highly technical field, especially in these days of hedge funds. It was a lack of understanding of risk that led MTAA down the investment path it went on. It is not alone in having what investment professionals would describe as highly risky portfolio construction.

Now while it is undoubtedly true that industry funds have as a group outperformed retail funds in the league tables, but what we are talking about here is catastrophic underperformance and potential fund failure.

There must be a higher standard of probity for all default funds – no matter what type they are. This means more investment professionals on the board. Managing a super fund should not merely be about representation, it should be about skills. After all it is the entitlement to super that is the industrial matter, not the fund performance. Whether not for profit or for profit, all default funds should be required to demonstrate their board has the risk management skills to run an investment company. An appropriate model would be similar to listed companies whereby the members can vote in or out directors rather than a representative model.

And employer organisations should be seriously asking themselves how it benefits their members to be on the board of a super fund. At some point, one of these default funds will get into trouble and employees will be entirely justified in coming after those who put them into those funds. For most employers they will have deeper pockets than their union.



The 56 industry superannuation funds control $264 billion in Australians' retirement savings. The 10 largest industry super funds controlled nearly 70 per cent of that $264 billion. The men and women who are the trustees and executives of these 10 largest funds are therefore in an extremely powerful position given they choose where over $180 billion of workers money is invested.

Industry funds have spun off a web of interlocking companies and trusts that undertake much of superannuation administration and management. At the heart of this web is an entity called Industry Super Holdings Pty Ltd (ISH) which is owned by a clutch of industry funds.

Industry super holdings is a diversified financial services provider offering funds management (FUM $31 billion), infrastructure funds, financial planning, a property trust, a fund for "lost" super, and fund administration. It also used to own ME Bank but this has recently been devolved to individual industry funds.

ISH is Gary Weaven's empire. He is a director or chair of the largest component parts of ISH.

Each of these entities provides funds management and other services back to industry funds as 'outsourced' providers. But each of these service providers are owned by a corporate structure (ISH) which is in turn owned by industry funds. That is, there is a structural 'round robin' of ownership and control though which much of the industry superannuation 'industry' operates. This makes for a highly complex and confusing disclosure regime. Many of these assets pay no dividends and their return potential is difficult to assess.

Industry Super Holdings is owned by 36 super funds. However, just as the ten largest super funds control about 70 percent of industry fund assets, the top four funds in ISH control 73 percent of ISH. However it is not the largest of the industry funds which have the largest shareholdings in ISH. Four industry funds have taken large shareholdings in ISH at levels way beyond their overall market share.
Australian Super, HESTA, C+Bus and HOSTPLUS are all big top ten industry funds but they are well over-represented on the share registry of ISH. This magnifies their power within the industry funds.

In my view, the lack of coordination or what the comrades would call caucusing by employers has led to a situation where increasing amounts of super funds monies are being managed by union controlled entities and this further entrenches the dominance of unions in the IR landscape.

[[NOT FOR SPEECH JUST INFO] For Australian Super their core unions are AWU & United Voice which is the old Missos and Liquor Unions.

HESTA unions are the nurses, the HSU, ASU and United Voice

CBUS unions are CFMEU, AMWU, AWU, CEPU, and ETU

HOSTPLUS union is United Voice (again!)

Brian Daley is a director of Australian Super, HOSTPLUS and the ISH Property trust, ISPT.]

Today I have shone a small light into a few of the problems with the way superannuation is structured. There are many others.

Super reform has not been high enough on the radar for IR reformers. It is time that changed.