

# **Superannuation choices – what next?**

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There's no doubt superannuation choice is a hot topic at the moment, and it should be; we're talking about people's retirement savings.

For the first time, choice of fund will give millions of people real control over the second biggest asset most Australians will ever own.

And without having to do a thing, consumers will automatically be in a better position because choice of fund will lead to a more productive, more competitive industry for the benefit of consumers.

Markets work best for consumers when they have the information available to them to make informed choices and when they can vote with their feet – or vote with their wallets.

In this climate, consumer-focused, efficient providers will survive. Complacent, inward-looking or high cost providers will not.

And that's going to be a very good thing for consumers, and for our industry over the long term.

But, on a more contrarian note, I don't think choice will fulfil all the predictions currently being made about it.

I don't see the marketing wars depicted by some. I don't see huge industry upheaval and mis-selling, and somehow, I don't see super choice replacing the footy or celebrity gossip as the favourite barbeque topic for most Australians next year.

I do think that only half the choice equation is currently being debated. There has been a lot of focus on fees and charges and that's entirely appropriate. But if you want to maximise the level of your retirement savings, there's no substitute for good advice.

So, let me tell you why I think this way and what I think choice will mean for you, both professionally and personally.

But first, let's talk about what choice won't mean.

As I said, I don't foresee multi-million dollar marketing battles between industry and retail funds over choice next year.

Let me be really frank. AMP is the leading superannuation provider in the market. I can categorically tell you we have no plans to ramp up our advertising budget to focus on choice next year. And I don't know of any retail player who is planning to do so.

Indeed, the talk of a marketing battle suggests a very one-dimensional view of superannuation and suggests little understanding of how consumers approach complex financial decisions.

We also need to get over this simplistic and ill-informed notion that industry funds are generically better or worse than retail funds. There are good industry funds and there are good retail funds. It's about what's best for the individual consumer.

Consumers do need to do their research, get information and advice, and work out what's best for them.

That's not something that they're going to get in a 30-second TV ad.

And most people are likely to decide that they are better off where they are.

Which leads me to my next point – that choice won't mean massive upheavals in the industry in its first few months of operation.

It will cause the industry to change over time – for the better – but I think this will happen more gradually than has been predicted.

There are a couple of reasons why I believe that.

For a start, the majority of Australians are already in very well-managed super funds – whether it's a corporate fund, public sector fund, industry fund or master trust.

Many of these funds give them access to the world's best investment managers, quality technology platforms and competitively priced products and services, including very competitive insurance coverage.

We know from our own research and experience that people usually change their superannuation when something in their lives changes – when they move jobs, get married, start a family, begin thinking about retirement and so on.

Choice may provide another trigger for this sort of review.

One of the barriers that can prevent people making changes to their financial arrangements is a lack of confidence. Most people need to feel they have a good understanding of the costs and benefits involved in making a change, before they'll do it.

That's why financial literacy is so important. Knowledge underpins true consumer sovereignty in any market.

And I think choice will also have a positive impact on consumer financial literacy, especially around superannuation.

Remember that superannuation is the financial product over which most consumers have had the least control. Why would you bother trying to understand super if you couldn't do anything about it?

So the very fact that people will have a choice will, I believe, encourage consumers to take a more active interest and become more informed about their super.

In turn, growing consumer interest – coupled with the power to move their funds – will mean that the industry will become more consumer-focused and more efficient over the next few years.

The other area where I take a contrarian view is that of potential mis-selling.

There seems to be a perception that by merely giving consumers a choice over where their superannuation money goes, we're opening the floodgates to the sort of awful mis-selling the UK experienced in the late '80s and early '90s.

But the people who are concerned about this forget there is a very real difference, particularly at a regulatory level, between the UK industry 20 years ago and the Australian industry today.

These differences make mis-selling much less likely and certainly against the law under the Financial Services Reform (FSR) regime in Australia.

It's areas outside FSR that worry me – and I'll discuss my concerns here with you in a moment.

Finally – and very importantly – choice doesn't mean that every eligible individual has to make a decision about their super funds on the 1<sup>st</sup> or 2<sup>nd</sup> of July next year.

1 July 2005 is not a deadline for consumers. It's simply the time when the 'right' to choose takes effect under legislation.

Consumers don't have to make a choice immediately. There's no pressure and there should be no panic.

Under the regulations we've seen so far, you can make an initial decision whenever it suits you, and you can make a new election at least once a year.

For many people we're talking about their second largest asset, so my advice would be to take your time, really understand your current position and what's best suited to you, do your research, get advice, and make a decision when you're ready.

## **What choice will mean to you professionally**

Let me briefly cover what I think choice will mean – and from a business or professional point of view first.

And the picture is a little different than it is for individuals, because 1 July 2005 is a real deadline for employers. And they need to get ready.

It's estimated that about 40% of the Australian workforce – or around 5 million Australians – will have the right to choose where their super money goes when choice takes effect.

They are the workers who are covered by a Federal or Territory award, who are award free or who are among certain groups of Commonwealth employees.

Choice does not apply to workers who are covered by state awards, who are federal and state public servants (subject to certain Victorian government arrangements), workers covered by a certified agreement or an Australian Workplace Arrangement, or members of a defined benefit super fund.

That means around 60% of the Australian workforce won't be offered choice and real control over their retirement savings.

Frankly, I think that's inequitable. It's not fair, and state governments should be considering ways of extending choice to the majority of working Australians as a high priority.

That would also make life a little easier for employers, because their first step is to work out who in their workforce is entitled to choice – and who is not.

It's possible in some businesses covered by different working arrangements to have a group of employees who will have choice – and a group who will not.

You need to know how your business is placed before 1 July next year to ensure you comply with the legislation.

If you don't comply, not only will there be legal, reputational and HR issues you'll have to deal with, you will also be hit with additional costs – with penalties applying to those who don't comply.

Second, employers need to understand the administrative duties they are responsible for under choice and get their processes in place for implementation.

If, as an employer, you've outsourced your super to a master trust or industry fund, we'd suggest you work with them to understand how your employees are affected and what should be done to help them understand their choices, and so get ready for 1 July.

## **What choice will mean to you personally**

From a personal point of view, if you're wondering what to do about your super choice, the very first thing you should find out is whether you are eligible.

If you are, there are five aspects of your current super plan, or any super plan you are thinking of switching to, that you should consider.

First, is to use this opportunity to look at what you are currently saving for your retirement and work out if you can fund the life you want when you do retire.

While employers are required to contribute 9% of your annual salary to super, for many people this probably won't be enough – this is especially so for high income earners.

So use this opportunity to review the adequacy of your retirement savings and, if it's not enough, do something about it.

Number two: ask yourself how you feel about your current superannuation provider.

We know from our own research and experience that the single biggest need consumers have in their relationship with financial services providers is trust. They need to be reassured about the security of their savings, and that's why in Australia we're so lucky to have such a strong regulatory framework and very capable regulators.

But superannuation is by its nature a long-term relationship.

You can't get your hands on your retirement savings for a long while and you need to be confident that your provider will manage your retirement savings well and in your best interests in the meantime.

And while choice gives you more options here, it won't do away with the need for you to trust your provider. That's a key consideration.

Number three, review the fund's fees and charges in context of the services the fund provides.

These range from the investment options and investment managers you can choose from, to how you contribute to the fund and what kind of reporting you want on the fund's performance.

Are these appropriate for you, at your stage of life? Do they represent value? When you look at other funds, are you comparing like with like?

This can sometimes be difficult to evaluate which is why we are big believers in the value of good financial advice.

Many master trusts do come with an advice option or component. If your plan does, take advantage of it when you're considering your super choices.

Master trusts actually cop a fair bit of criticism for the fact that they charge extra for advice. In most cases, that criticism is uninformed and simplistic.

To begin with, as IFSA points out in a recent paper<sup>1</sup>, the fee differential between the larger employer-sponsored master trusts and large industry funds – which is the most valid comparison for most employees – is very small.

But the difference good financial advice can make to your total retirement savings is very large.

One of the most under-estimated benefits of good advice is simply disciplined saving. Most people know they should be saving more for their retirement. And many could afford to save more.

But very few of us – me included – have the self-discipline to actually do it. There are always more immediate things to spend money on. A good financial planner helps get that discipline into your financial life.

It's a bit like having a personal coach. Every one knows the only trick to losing weight is to eat more sensibly and exercise more. But who actually has the discipline to just do it?

The fourth thing you need to review is your fund's performance over the long term.

Don't get distracted by short-term performance or try to chase quick returns. Good investors consider the long-term performance.

In fact, over the long term – say 10 years – the difference between the top and bottom performers is much narrower than over a one, three or even five year period.

One of the most destructive things you can do to your retirement savings is to continually chase past performance.

Most importantly, your investment choices need to reflect your risk appetite and your long term savings goals. Every one is different, and that's why seeking financial advice is so important.

Finally, does the fund offer insurance – and if so, does it suit your needs?

The insurance question is an important one because it's often an overlooked benefit of a super plan.

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<sup>1</sup> Shining a light on super fees and returns August 2004

Most Australians are covered by death and disability insurance as part of their super plan, although very few Australians insure their biggest asset, their income.

Indeed, even among those Australians who have death and disability insurance, the majority are under-insured.

It's very important then that you assess your insurance needs and how your super meets those needs. This is difficult to do well without seeking advice.

So there are more than a few things to think about when you are reviewing any super plan.

That's why we don't think there will be a huge rush on 2 July next year – and it's also why we're big supporters of people seeking and getting good financial planning advice.

### **Self-managed super funds**

Before I finish up, let me just say a few words about self managed super funds, or DIY funds as they're commonly known.

There's been a lot of talk about these funds lately and they've grown very strongly.

Frankly, as I said earlier, if there is a consumer risk involved in choice, I believe it lies here – in areas not fully covered by FSR protection, where consumers may be persuaded to move out of their regulated industry fund or retail fund into a self-managed super fund.

We already have about 300,000 of these funds in Australia and about a third have less than \$100,000 invested in them; and you have to wonder, with so little invested, how this could be a sensible strategy.

It worries me that people setting up these funds, aren't making fully informed decisions.

Many people think we need to improve financial literacy levels in order to make an informed choice about pretty standard super funds, so it makes you wonder why aren't we more disturbed about the growth in these complex and legally onerous self-managed funds?

They carry inarguably bigger and more complex regulatory burdens than anything on offer from professional wealth managers.

The legal obligations and time commitments involved in managing a DIY fund mean they are suitable for a very specific type of investor: those who are financially sophisticated, have got the right level of funds, the right assets and the time to manage their own affairs.

Overall, that's a small proportion of people.

I was disturbed, but not surprised, at the findings of some recent research by CPA Australia<sup>2</sup>, which found that up to one third of DIY members don't even realise they are trustees.

How can people be discharging their legal obligations if they don't even know that they have any?

To even start your DIY fund, you have to source, understand and execute a trust deed.

Then you have another 18 to 20 separate, distinct actions you must take – many of them ongoing – in order to have a complying DIY fund.

While DIY funds do suit some people, they are simply not appropriate retirement savings vehicles for the majority of Australians. Most are better off in well run public offer funds.

At a minimum, in order to provide the appropriate regulation and consumer protection in this area, we need to ensure an adequate level of funding and resources for the ATO.

And I was pleased to hear last week that the ATO is developing a methodology to target high risk self managed funds for increased audit scrutiny.

I would also expect that the complexities of self managed super would be one of the focus areas of the Government's financial literacy programme next year.

If you're thinking about a self-managed super fund, I'd urge you to get the right advice.

And, if you want to make sure that you have the full consumer protection available to you under the law, check that your adviser is licensed under the FSR regime. All financial planners must be. Many accounts are not.

It still puzzles me that accountants can give some advice in this area, without having to comply with FSR. Why are the consumer protection rights of accountants' clients less important than other Australian consumers?

## **Conclusion**

So let me sum up.

AMP is a strong supporter of choice; we see choice as a major contributor to improving consumer sovereignty in the superannuation industry.

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<sup>2</sup> Self Managed Super Funds A Financial Advisory Services Research Report CPA Australia October 2004

Choice will be great for consumers, because it will give them control over – and a much greater reason to be interested in – one of their largest assets. It will give them the right to vote with their feet.

And I strongly believe that choice should be extended to all Australian workers. State governments should take the initiative here.

Choice will bring some challenges for our industry but ultimately I believe it will help the industry become more efficient, more productive and more consumer focussed.

Employers need to think about getting ready to implement choice and, in particular, understanding to whom in their workforce it will apply.

Critically, individuals need to understand there is no need to panic about choice. And let's be clear here – scare tactics are no substitute for education or good advice. Anxious people usually don't make good decisions.

1 July next year is not a deadline for consumers – it's the starting point of a new opportunity.

Consumers should take their time and make sure they are comfortable with any decision they make.

Understand that choice is not just about fees and charges, though they are very important. There is no substitute for good advice if you want to maximise your retirement savings.

Importantly, consumers must have complete trust in the capacity of their provider to manage their retirement savings well and to do the right thing by them as customers.

If there are consumer risks involved in choice, I think it's in the rapid and, most likely, inappropriate growth of self managed super funds.

This is the area of greatest potential risk for mis-selling or poor advice because some providers can operate outside the consumer protection of FSR. And it's an area that needs prudent oversight to ensure the safety of many people's retirement savings.

For me, choice is one of the key ingredients necessary for a productive and effective wealth management industry.

So that's why I'm excited – but certainly not alarmed – by the prospect of choice next July.