# Forward Thinking – *The Financial System Review and superannuation* - Sydney 24 July 2014

The Financial System Review released its interim report on 15 July, and reforms for Australia's $1.8t superannuation sector are very much in scope.

Funds are just completing a round of reforms to streamline the system, yet many argue that more work is needed. Some argue that the industry has a short-term bias. Others argue tax concessions are too high and too focused on high earners and the above-60s. The recent Grattan report, Super sting, showed that superannuation fees are too high. And there is broad agreement that the retirement phase has received far less attention than the accumulation phase. Is the super system investing in the right assets; is it funding the economy effectively and why are there not more products protecting retirees from longevity risk and volatility in retirement?

Listen to this expert panel discussion's Forward Thinking event on the issues facing the Review, the emerging directions from the interim report, and the reform agenda for superannuation.

**Speakers:** Jim Minifie, Productivity Growth Program Director, Grattan Institute
Pauline Vamos, CEO, ASFA
Jeremy Cooper, Chairman, Retirement Income at Challenger Limited

JIM MINIFIE: Well, without further ado, thank you so much for joining tonight's *Forward Thinking* event hosted by the State Library of New South Wales. *Forward Thinking* is a quarterly event series that's run jointly between the State Library of New South Wales and the Grattan Institute and tonight we're focusing on one of the aspects of the Financial System Inquiry's areas of deliberation around superannuation and retirement income. I'm looking forward to a very vigorous discussion and let me just do some quick introductions and first I'll just acknowledge the traditional owners of the land. And I was just musing before we started that those traditional owners managed a system over many thousands of years and we're talking here about an important asset in the Australian economy that's been running in something like its current form for 22 years. So we're very early in that process.

My name's Jim Minifie, I run the Productivity Growth Program at the Grattan Institute. I'm delighted to be here joined by Pauline Vamos to my left, the CEO of the ASFA (Association of Superannuation Funds of Australia). Pauline has been the CEO of ASFA since 2007 and has many years of previous financial industry experience. And also my Jeremy Cooper, who is the chairman of Retirement Income at Challenger and was previously the leader of the previous government's review into the superannuation system that led to the current set of stronger super reforms that are being rolled out currently. So it's a real pleasure to have both of you here, thank you so much for joining.

So, we don't have Financial System Inquiries that often. The last one in fact was in 1997 and that was the first one that had really much to say about superannuation, but even back in 1997 the system really was a much smaller part of the financial landscape, a much smaller part of Australia's capital base, and it's really this review which is the first system-wide review that is addressing issues not just about how super as a product operates for members – which is a critically important issue and it is in scope – but also about how superannuation interacts with the rest of the financial system and with the economy. And for those of you who've read all of the 400+ pages of the interim report that was released last week, you'll see that there is significant attention given to superannuation and to retirement income and that is as it should be. It's a big enough and important enough part of the economy that it certainly warrants careful assessment.

So I think the point of tonight is really to try to draw out perspectives from, I guess, the shared experience in the room, including those sitting in the audience in our discussion, about how the Inquiry appears to be addressing some of the issues in superannuation and about what it might focus on in the next phase of its work. And also I hope to have some active discussion about what type of policy settings are appropriate and should be potentially recommended by the Inquiry's final report, due out towards the end of the year.

So can I just start by noting that the main themes? If I start with the superannuation piece - we'll deal with retirement income a little bit later - there were really three themes that were given attention by the interim report.

The first was around the efficiency of the system and there was concern expressed in the report that on some comparators the Australian system is arguably not as efficient as it ought to be, and that's leading to potentially higher fees and lower net returns and therefore less accumulation than might be possible. So that's the first thing, I think it's an important one, it's appropriate to look at that. The second one is around the liquidity requirements that have been placed on the industry. We're somewhat unusual I think around the world in having a retirement system that is also expected to operate almost like a cash deposit account, and that's slightly overstating it, but perhaps not that much and that creates a number of challenges for the industry. The third area that the interim report looked at was around challenges for the industry associated with very frequent policy change, whether it be tax, regulatory or requirements on trustees and others.

I guess my first question, if I can just put to you Pauline, do those seem to you like the right three areas of concern to be focused on? And do you have perspectives on whether there are others and whether inside those three there are particular priorities that the review team ought to be looking at going forward?

PAULINE VAMOS: Thanks Jim. Look, it's not surprising that the interim report focuses on super. As you said, when the Wallis Inquiry happened a number of years ago the system really wasn't anywhere near the size it is today and the size of the pool is equivalent to Australia's GDP. And it's mandatory and it's the community system, so it has to work and it has to do a number of things and you go back to why it was established in the first place and the first place was that it was about long term savings for retirement. So that it was to really supplement a person's pension and move as many people as possible towards funding their own retirement.

So you've got to ask yourself is it doing that today? No, it's not doing that today and the reason it's not doing that today is it's not mature, but also it's only recently that we've got to 9%, more than 9% but that didn't happen until 2002. But by 2026 we're going to have up to 44% of people fully self-funded;

we're going to have a huge proportion of people on part-age pension not full age pension; more of peoples' income in retirement – so it'll be about 14,000 in today's dollars they'll get from the age pension, but they'll get about 19/20,000-odd from their super. So it's not fully matured today; it's not fully working today, but it will in the future. The big gap though is that even though people are taking income streams where they can, the more they retire on the more likely they take an income stream. There's not much choice, there's not many options, and so it's very hard for people to really get that efficiency in post-retirement and really get an income stream that they can rely on, that's flexible because they want to reconvert it to a lump sum if they have to go into aged care. So that's absolutely the right question and I think post-retirement is absolutely key.

In terms of efficiency, there are a lot of inefficiencies with the system, there's no doubt about it, and those inefficiencies contribute to cost. Ironically, when the system was started it was mandatory for employers to pay the SG, still is, and only until last year did they actually have to provide data. And a few years ago I used to run an admin system for a large superannuation provider and I would get the SG cheque from an employer with some scribbled names on the back, no TFNs, no addresses, no employer numbers; and it happened over the years. And what happened is, so for example, I had three accounts: one the employer paid to Pauline Vamos; one PB Vamos and one P Vamos. Still a number of people don't have their tax file number. Think about the cost of finding people. Think about the cost of multiple accounts. We're one of the few systems in the world that provide insurance.

Now, insurance is a magnificent benefit under super. We are one of the few countries, whilst we're still underinsured, most people have some kind of insurance. Now, in superannuation, and it's group superannuation, at the moment 120% of the contributions that are collected are actually paid out in claims. Individual policies it's about 50%. So when you think of what that does for the economy and what that does for the general community it's great. But managing claims, assessing claims, because there's a bit of fraud, there are a lot of issues around the assessment of it; that adds to the complexity and certainly the cost as well. So there's a lot of costs and there's a lot of issues and we welcome the whole focus on cost because we can say, "Well, if you tweak this, if you change that, if you move this requirement which allows anybody to get a benefit, then we welcome that".

And the third point is liquidity. So, why are we different to many other systems? Because you have choice and that means we are obliged, or certainly ASFA members are obliged, if you want to move your money then you can move it within 30 days. So if you've got funds, if you've got people that really want to move their money quickly, then you've got to pay them the cash. So you've got to convert your assets to cash, so you've got to focus on liquid assets as much as possible. Now, I think that will change a bit as we move into post-retirement because the money becomes what they call "a bit more sticky", but that liquidity is a real issue. It limits the ability to really invest in infrastructure, boost productivity, it's great for the community, but it does limit how much assets we can allocate to that and that's why you have a real focus on equities.

The other reason we have a real focus on equities is that the system is young, the system has been growing. We don't have the contributions from employers and the subsidy from employers that other systems have, so we've had to grow the money quickly. One of the best ways to grow the money, even though there's volatility, is with equities but, again, it's early days and I think there's lots of room for improvement, there are, but there are good reasons why we are where we are today and it's great the Inquiry is actually focusing on them.

JIM MINIFIE: Pauline, thank you. If I can turn then to you, Jeremy, again, there was a series of focus areas, are they the right ones and do you share the initial assessment that the Inquiry's put out?

JEREMY COOPER: Thanks Jim. I suppose what we've been given is a sneak preview really. We don't really know what the final view of this Inquiry is and so we've got the interim report. I suppose I was expecting a little bit more on the nation-building sort of question. I think the work they've done in retirement income is very good. They've mentioned vertical integration; I would have thought that's a big issue. Do we really want to go forward for the next quarter of a century with roughly 80% of our industry owned by product? And "vertical integration" is just jargon for a system where a lot of the moving parts of superannuation are all owned by effectively the same company, so the maker of the managed fund, the distribution mechanisms and the advisors are all in the same pillar. And while that might have been an efficient way to get the system going, it does have rather a lot of defects. The quality of advice; we've all been watching on the television about the problems with the Commonwealth Bank financial planners, that's vertical integration in operation. So giving that a really good shake would be part of this for me.

Sure, fees, costs, lack of competition, that just is ongoing, it's like a record going round and round and round, you've always got to give that a little bit of a shake. But the one that jumped out for me I think was, and in the words of the Inquiry, they talked of "a lack of stability of policy settings". Now this is sort of bureaucratese, if you like, for not having a clear vision for what is super for and how is it going and where is it going? And we've been used recently to every Budget night; we wake up in the morning and find that superannuation has shot off in another direction or that the tax has changed in all sorts of incredibly complicated ways that it takes months for us to be able to understand. And really, as Pauline said, it's a community system; it's really a public/private partnership. It's an intensely paternalistic piece of government policy. We've all been corralled to be in it if we have a job and then all the moving pieces are outsourced to the private sector. And unfortunately politicians, as it's grown, the ability to render Budget balances and tax changes by just fiddling with the super system has become all too attractive. And a set of ideas that takes superannuation out of politics, disconnects changes to superannuation from the Budget, so the idea would be that you simply can't make big super changes in the Budget; you've got to build them up slowly and if they need Budget changes well, you take it into the Budget process and you render the change there.

And really, let's face it, in all honesty a change to the superannuation system just can't be urgent. It just defies logic. You know, it's not an urgent system, it's a system where we participate for 40 years, we've got to have policy settings that we can trust and we can save into, and the idea that as each government comes into power they're going to yank the superannuation system off – I don't care what side of politics we're talking about, that's just an inherently unattractive proposition and, indeed, in other countries they've had a go at trying to solve this. I know in Sweden for a while there was an idea that you had to get unanimous support from all parties to change the pension system. We've just seen an absolutely horrible example of this in the UK where at Budget time, without any consultation including to the Minister as I understand it, the Chancellor there decided to end compulsory annuitisation that they'd had in place since 1921. He just announced on Budget night, gone, largely for fiscal reasons, and now they're mopping up the mess.

PAULINE VAMOS: And he even said publically, "If a person wants to spend their pension money on a Lamborghini, they can".

JEREMY COOPER: Yes, I think that's a politician that's just been run over by a Lamborghini. But yes, so the lack of coherence is a big one and let's hope they tease that out a bit, because that affects all of us.

PAULINE VAMOS: Yes, that's a really good point and it goes back to something that you and I have discussed before, and it is about the policy around superannuation. And I talked a little bit about the purpose, but fundamentally there's a duty of care over this money and because policy has been pulled in all different ways you've got 1.8trillion but the way in which the regulatory structures are over it a different duty of care is applied. So that's why you get different results and I think that's where the policy setting, because nobody is actually saying, "Well, this is what we need that money to do, both in terms of providing retirement incomes and the economy, this is how we should set our policy". So we're on the same wavelength there. We need a separate body to do it. We need to take it out of politics, we need to take it out of Treasury and we need to put some proper settings, almost like an RBA-type of thing.

JEREMY COOPER: Yes, we need to really put on the table the idea of moving superannuation policy out of Treasury. I'm not saying that Treasury are incompetent or anything like that, but they have a deep conflict of interest being central government, balancing the Budget, raising taxes and superannuation comes way down, it just naturally does, way down low in the list of priorities. And a system of this size and this amount of macroeconomic and social impact deserves a much better outcome than that.

JIM MINIFIE: Do either of you sense sympathy for a proposal of that type?

PAULINE VAMOS: Yes.

JEREMY COOPER: More than sympathy, Jim.

PAULINE VAMOS: It's very much in there. It's not leading you by the nose, but just talk about that. Whilst it doesn't use the phrase "duty of care" but all the words I think in the Challenger submission and our submission and in other submissions around recognising that super is not politics and super is not a short term tax grab; super has to be about delivering what it needs to deliver. So we're really hoping if this Inquiry does anything - I mean, there's a lot, we have to respond to 77 issues raised - if it does that one thing then it will be worth it.

JIM MINIFIE: So would you envisage then in an ideal world that there would be a much more stable set of policy settings that potentially might be subject to principles, such as tax changes would only apply to new flows in the system rather than the existing stock? Is that the kind of?

PAULINE VAMOS: Yes, that kind of would help. I mean, it has to be adjusted. Any system that is maturing - and the big issue is the growing link between aged care and healthcare. So how that all links together needs to be adjusted and needs to be adjusted on sound policy grounds, but what is missing at the moment is a lot of the adjustments are on, “Ah, we can save some money here, we can grab some money there”. That’s not pensions’ policy. And people don’t mind change -

JEREMY COOPER: Has to change.

PAULINE VAMOS: As long as they know about it and as long as they’re given plenty of time to plan for it. It’s this changing overnight that really unsettles them.

JEREMY COOPER: This is certainly not to say that it’s not changing; it will change, it has to change.

PAULINE VAMOS: It has to adjust.

JEREMY COOPER: And I think if I could use this sort of analogy, really a system of this side and immaturity needs the level of intensity of thought that’s going on at the moment pretty well constantly, I’d reckon, for the next two decades.

PAULINE VAMOS: Yes.

JEREMY COOPER: Because healthcare, aged care, and we’ll get to the retirement piece, but that’s just barren acreage at the moment that hasn’t been built.

JIM MINIFIE: Yes, and so we should touch on that. But Pauline, can I just turn back to the point you made about the differing trustee obligations? Because that’s something which has become, it seems to me, particularly pressing given the very, very rapid gross of the self-managed sector, which is now about a third of funds under management, it’s almost $600billion now.

PAULINE VAMOS: It’s huge.

JIM MINIFIE: Is that the main issue? Is it the self-managed sector which is the main issue?

PAULINE VAMOS: No, it’s the whole lot. So you’ve got a system that’s 1.8, so you look at where the money is and, putting the different structures aside, you’ve got certainly a third in self-managed funds; you’ve got a third in default vehicles; and you’ve got a third in retirement. Now, most of that in retirement, a lot of that is in self-managed funds. So even in Your Choice, a lot of it is APRA regulated but it’s Choice portfolios. Now, the duty of care and the policy setting that governs most superannuation systems, including how the superannuation system in Australia was designed, is that there is a fiducially obligation over that money. That means fiducially long term investor, broad asset allocation, invested for the benefit of the members for their retirement. So that's the policy parameter.

Now, in self-managed funds there is no policy. They really developed out of attacks arbitrage, there's no public policy around self-managed funds. That's why you do not have diversified assets. And then they bought the borrowing into it, so you've got people who borrow against their domestic home through their super, through trustees, into an investment property. Investment property values go down, they can't sell their home; suddenly they've lost their super and their home. It doesn't happen often, but it happens because there's no policy around how you should invest it. And the same with Choice, so under a master trust I can put all my money in one equity, so I can put it all in a start-up or a top 200, cash, whatever. There's no diversity required.

Now, I think we've got to stand back and say, "This is compulsory money" but, more importantly, I know people say, "Well, it's my money". Absolutely, except for one thing: the tax concessions that go into it, the tax concessions of 16billion-odd are paid for by everybody. Everybody. And when we're all paying for a system, we expect the wheels to be appropriate. But that's what I don't like about it so that's why we're saying – and I know it's scary, but that's what we've got to do.

JIM MINIFIE: Terrific. Jeremy, can I just put you back to 2009/2010 when you were intensively involved in the super system review? Now, the government didn't do everything that was recommended in that review, there were a few key omissions that I think we might touch on in the retirement income piece shortly. But at what point would you begin to say the system's run for long enough that it's fair to assess whether stronger super is delivering what had been hoped for?

JEREMY COOPER: Well, look, there are two main areas where the government went a bit soft. One was in the area of governance over the running of super funds, and that was always going to be a slow-burn process. I wasn't too fussed about that. But where the can was really kicked down the road was in the retirement income phase, so really nothing out of the review that I chaired in relation to what this is all about, in other words, saving up the money and then living off it in retirement. Absolutely nothing was done in that area, so that's why so much work has been done on it this time around. So thankfully it's being dealt with.

JIM MINIFIE: Great and we should touch on that shortly. But specifically, if I can just probe a little bit more deeply into efficiency, one of the main themes in your review was that super ought to be for members and that should be manifest in strong delivery and efficiencies through to account holders.

JEREMY COOPER: Yes.

PAULINE VAMOS: Absolutely.

JIM MINIFIE: As you know, Grattan put out a piece of work a couple of months ago asserting that the pace of improvement in that area was much slower than would be achieved under some alternative methods, particularly of managing the allocation of defaults. So we came out with, I guess in some senses, quite an aggressive point of view that says waiting for another five or eight years to see whether what, in our view, has been shown overseas not to make a significant dint into fees feels like the wrong answer. But of course there's been a range of voices in response to that including, "Well, look, it's far too early. Stronger Super's just been introduced". What's your view?

JEREMY COOPER: Look, a bit of both. It is a bit early. I use the personal example of how a superannuation year is a very different thing from a normal year, so I was 48 years old when the government asked me to do the review and I've just turned 54. So it's amazing and a lot of discussions and, "Oh gee, we can't implement this, give us another year". So a lot of the ideas have actually been just quietly shifted into the distance because the industry just can't get its house in order quick enough. So stuff like auto-consolidation and the actual hard implementation of My Super. I mean, it's hilarious. My Super is in a sense in a trial period at the moment, it really started on the 1st of January but only in a trickle, and within a couple of weeks you've got academics coming out saying, "Oh, it all doesn't work. Look, it hasn't done anything, the whole thing's hopeless". So you've got to give it decent time.

But I think the market has already shown us all the players out there have anticipated some of this and we've got a product out there that says it has no fees attached to it, the ING Living Super product. A major bank, the ANZ, has come out and said, "Well, we'll do a product that you can have at your iPhone fingertips for 50 basis points". So things are definitely happening. I think the Murray Inquiry is basically saying, "Yes, we can see that happening, we don't want to dismantle that. Let's give it some time". People whinge about SuperStream costing a lot of money, that was only because the system was about to fall to pieces through undercapitalisation. So technology does cost money and over time that will pay itself back dramatically. I wish I owned it because the payback will be dramatic.

PAULINE VAMOS: The issue with SuperStream and the slowness to SuperStream is really a couple of factors and, again, the Australian system is so different to other systems. One of the biggest stakeholders beside members and the community are the employers. There were 800,000 employers. Now, what SuperStream does is say to them, "You have to transfer your money and your data electronically". So employers have gone from sitting at a kitchen table, not giving us all the data, sending off a cheque, to actually having to verify the full name of their employees, their address, their tax file number, their date of birth.

JEREMY COOPER: Sounds like rocket science, doesn't it?

PAULINE VAMOS: But it's time, it's time. So we've been involved with Oracle, MYOB, all the clearing houses, all the payroll houses, all of the accountancy software packages, and all the hundreds of thousands of small business, particularly rural business, who do it manually. Who, for them, it's much quicker to do it manually than verify and if you've got a lot of transient workers, you know, we often get the same tax file number with one number changed for 20 employees, they were all born on the 25th of December - you would not believe in Australia how many people are born on the 25th of December - and then the insurance benefits are wrong. So a lot of it is trying to clean up that mess because we could never insist on that data before. So that's why SuperStream is a nightmare.

So what we're doing with employers, and it started 1 July this year, this is when it all started to kick-in in terms of contributions, we're taking them through by groups and, of course, what happens when you do anything by groups? Some people want to be part of the group, some people don't, some people are slow, some people are straight through. So this is what we're doing with SuperStream. My Super, Jeremy's right, it's really started off with a bang. We've got 120-odd out there and some are absolute dynamite, some of the innovation – and I've been in the industry 30-odd years - some of the innovation in products I've seen, particularly in lifestyle and glide path investing is fantastic, absolutely fantastic. So it's very exciting from our point of view. And they're efficient and they're lower cost and you're seeing products fully funded well under 1%, and that is very competitive when you look at international, and that includes the insurance.

Remember, that's the big issue for us and that's why auto-consolidation and transfer between funds was so difficult for us because the big fight was, "Well, I'll lose my insurance benefits". And some people need those insurance benefits, so that's sometimes been a bit of a furphy, a bit of an excuse, but other times a bit, "Oh, this is actually a real issue" particularly in the event of a claim. And we just cannot, unlike other systems where it's just your money you're transferring, and that's why the auction tender process won't necessarily work in Australia. Great idea, did some great things in Chile, but those funds have massive, massive margins. We don't have those in Australia.

JIM MINIFIE: Well, they're not charging the equivalent of 20 basis points, which is a full 100 below what we pay in Australia.

PAULINE VAMOS: It is, but they don't have the insurance. So when you transfer between funds, what do you do with the insurance? And this is why a lot of that clumsiness in our system, we've got to think of solutions that address the clumsiness and that's why the big questions of do we stop the insurance; what does that mean? But the value of what that provides in the economy is massive, it's absolutely massive. So it's a difficult issue, but it's a good conversation.

JIM MINIFIE: We've created a very complex system.

PAULINE VAMOS: Really, yes.

JIM MINIFIE: Now, Jeremy, if we can then turn to the issue of retirement income, why is this even on the table? What's missing in what we've got at the moment? It seems like we've already got a very complex system and a whole range of products, so why is the government or why is the review even thinking about this?

JEREMY COOPER: Well, it's an odd thing for me to say, but really both us and the Americans built systems that really are only saving systems. So we looked around the world in the early '90s when superannuation was first gathering up a head of steam, there were a number of ways that superannuation could have been done and the way that was chosen was a so-called defined contribution system which is where what you get at the end is what you put in and the investment returns from it. It's your little account. There's nobody else guaranteeing or helping you guide that money to retirement. And so that's the system that we've got.

We've got a whole lot of little bank accounts that are called superannuation. When we retire, there's your money, how long you're actually going to live is an unknown, how much you're going to need to spend and what the markets are going to do to you over the 30-odd years you might be retired are all unknowns which you, the individual, under our system actually have to manage. And it's an outcome of the structure that we've built where really our superannuation funds don't have balance sheets to be able to make promises to us that we don't really need in the accumulation cycle as we're building up this money, but when retirement comes and our regular paycheque stops and all we've got is this bank account and possibly some entitlement to the age pension.

Now, I just said the age pension. The thing about the age pension is, it's AAA rated because it comes from the Australian government; it turns up every fortnight; and at the moment, until Hockey and Abbott get to change it, it's got some very beneficial price and wage and inflation adjustments going on. It's actually the best retirement product in the world. The only problem is it's not enough to live on. And we don't have anything else out there like the age pension. All of the other products that we're given in superannuation, bar a few, are really just these bank accounts where a cash flow doesn't turn up every fortnight, you've just got this money and you can spend the whole thing if you wanted to or you could spend a tiny little piece, but you need a lot of help to get yourself through retirement.

So there's a great deal of heavy lifting for us to do in order to get the sort of products out there. And the sort of products that are being talked about in the review are things like annuities, so it's a life insurance product that pays you a regular payment that can be adjusted for inflation. And, oddly enough, we have almost none of those in Australia whereas in the UK it currently is, but they're just about to change it, it was actually compulsory to be offered one of these things when you retired and if you didn't get around to do anything you were forced at age 75 to annuitize 75% of your savings.

JIM MINIFIE: So leasing the Lamborghini as opposed to buying it?

JEREMY COOPER: Yes. So we've got these two systems that are very, very similar in some ways, but we've adopted an absolutely opposite way of doing things in retirement. And I think the strong message coming through in the Inquiry here is that we need to shift the dial back a little back and really ask more of our superannuation funds who are, as Jim's report says, taking a lot of fees out of the system but they're not giving the members the benefit of a bit more certainty in retirement. So that's really in simple terms what the debate's about.

PAULINE VAMOS: Jeremy is right, so our system stops at 65. All the rules, the way it's framed, it is half the system and it was developed when people didn't live much past 65, it was that new. So now of course people live into their hundreds and they're retired for 30 years, so that's the big design piece that's missing. And if we start to re-look at the rules, and certainly this is where the governance piece is so important and the duty of care, if you know you've got the majority of your members who can actually move into retirement in the same vehicle you can start investing for the longer term; you can start creating products like longevity risk insurance that might kick in at age 85 because you can start it a bit early so it's a bit cheaper. So, it can change the planning for both the community, but for the fund providers as well, and that's what we want to see, we really do. There are no rules, there's nothing in it.

JEREMY COOPER: I thought we'd see a bit more. So if you think of putting a dollar in at age 20 when you start work and keeping it in the superannuation system until you're 90, that's 70-year finance and there are very few structures anywhere in the world that can provide 70-year finance. If we just looked at it slightly differently our super system could do that and I was interested that there wasn't much talk about that kind of thing. But let me just give you a few longevity numbers because the reason why this is so serious is we are seriously living longer and it's happening at an incredibly fast pace.

So in 1992, the most common age at which males and females died in Australia was 78. In 2012, that number has shifted up to 87. So that's a fact, that's not a projection. So you can go to the ABS and you can see what's the modal age of death for men and women, so the most common age at which males and females died in Australia in 2012 was 87. And then if you project that outwards for 65 year-olds at the moment, you're looking at – and these are quite conservative – the average for a male would be 87, so that's a 65 year-old male today, and for a woman 90. And what an average is of course, it's just the peak of the bell curve, so you've got half the population will be dead by then and the other half will still be alive. So a system that just gives you a little pot of money at 65 and says, "Knock yourselves out" is seriously in need of a shake-up.

PAULINE VAMOS: It is, and there's a bit growing social issue. So we all think about people not having enough in retirement and that's true for many, but it's getting better because the average account balance now when people retire is getting much better. So for females it's 100,000, for males it's 200,000. You can convert that pretty good and that is getting better. The big issue we have, which is what see - and my mother is exactly the same, she's Maltese so she'll go right into her hundreds, she won't spend enough.

So what happens, there's a lot of people who are living so frugally because they haven't got the right product that says to them no matter how long you live, you're going to get this much money and you can rely on this for the rest of your life. When you've got that certainty, which most people want, it's like your salary, you know how much you're getting, then you'll spend it if you know you're going to get more. But a lot of people don't spend so they don't put proper food on their table because they're scared of running out and then they die with a whole pile of money. That's not the purpose of the system. The system is supposed to mean that when you die there's nothing left. Don't leave it to your kids.

JEREMY COOPER: Well, the kids might already be retired, you see, this is one of the things. Seriously.

PAULINE VAMOS: Let them do their own super, yes.

JEREMY COOPER: Some research needs to be done into two generations in retirement.

PAULINE VAMOS: Yes, that's true.

JIM MINIFIE: Well, let me open up the discussion to the rest of us and some people who registered were kind enough to leave questions. I want to encourage those of you who don't want to ask a question to get in early because time is of the essence. But let me just kick it off with a very open-ended question – some of them have already been touched on – and it's a question to both of you, which is if you could each make one change to the super system/laws, what would that be?

PAULINE VAMOS: Besides post-retirement? What would you do?

JEREMY COOPER: Well, I suppose I've already given it away. I think the way policy is made, the way changes are made to super and who has control -

PAULINE VAMOS: Yes, independent, get it out of politics.

JEREMY COOPER: Over that process and the visibility of it and the warnings that things are going to change and the opportunity for all of us to have a say in that, I think that's the big one because that could sweep up absolutely everything.

JIM MINIFIE: Terrific. Well, let me open it up to the floor.

AUDIENCE: This is just a curiosity question, everyone's talking about super in terms of it being how it's worked, what compulsory superannuation has delivered over the last 22 years. I'm interested in what superannuation looks like for self-employed people and is it delivering for self-employed people, given it's actually not compulsory for them and there's over 2million small businesses in Australia?

PAULINE VAMOS: That's a great question. We've done research on that and, not surprisingly, small business owners that really do run a good small business manage their super well. Those small businesses that don't run it well, particularly those small businesses where "I am the only labour", then I end up with nothing to sell and no super. And the issue with self-employed is how do you calculate how much they contribute? So we've come up with some models and, again, it goes back to the point, it is so political. Bringing in self-employed is so political, so you've got to look at what does that mean? So, with a lot of industries, taxi drivers, builders, a lot of agricultural, there's a lot of people who have absolutely no super and you're right, there are many people who do run their own business who don't have super. They're aging and they will be the people who will need the pension. So there'll be a great reliance by them on the pension.

JEREMY COOPER: Yes. I think it's a good question, but I think it actually hides a deeper issue and that's the number of what I might call fake self-employed people that are out there, you know, people who have been pushed by various industrial relations policies into being contractors when they're not really contractors. If you look at another sector of self-employed people, the doctors and lawyers and so on, there are very strong incentives of course if you've got the money to put it into super, you get a tax deduction, so they're fine. But it's the people who are struggling, who have been forced into being so-called "self-employed". I have the super conversation with many taxi drivers and none of them have got super. And I should also add that more than one-third of adult women in Australia have no super whatever, zero.

PAULINE VAMOS: Nannies, hospital staff, lots in hospitality; they have nothing, absolutely nothing. My daughters are lucky, I nag them like crazy so they've got super, but it is a real issue, particularly for women, yes.

JEREMY COOPER: Well, it was a really big question that I had when I got given this job of looking at the super system is why the government, via the Future Fund or any other vehicle, had never been a player. You know, there wasn't even a sort of lost soul super fund where if you weren't in any other fund you could come along and the government would look after. It was a very conscious decision not to do that. And I actually asked Paul Keating that question and I think the answer was – it was a multifarious answer – but one was he didn't want politicians to ever be able to get their hands on the super money. And when you think about the way the system's structured, there have been various murmurings but it's all out in private hands. We've got it and the private fund managers and not-for-profit super funds have all got the money, so that's a tick to that one.

But you make a really good point because it creates a very good benchmark which is what the Future Fund has actually done. The Future Fund has set benchmarks in investment governance, performance, all sorts of areas, you know, a late arrival in the overall scene. And, of course, you look around the rest of the world and it's extremely common.

JIM MINIFIE: And you would have thought that now there's a case, given that there's choice in the system, to reconsider some of those initial calls about not wanting to have public sector control? Because at this point you'd think that the prospects of a political interference, even with a publically-run fund, would be much?

PAULINE VAMOS: If you just look at some of the government funds, believe me, they're getting a lot of political interference. Look, I think you've got to look at what's happened, particularly in the pooled super space. So 15 years ago there were about 3,500 pooled superannuation vehicles. It's now down to just under 300. When you look at some of the superannuation funds, their performance, their disclosure, their service, they are some of the best in the world. They are full diversified portfolios, they have access to all the hedging, all the derivatives. There are some that brand themselves ethical, so you've got that choice. To be frank, in terms of entrepreneur private equity, funds generally, including the Future Funds, have been burnt a bit. Private equity is just starting to come back because we're learning in Australia how to commercialise a lot of the start-ups. A lot of the risk is now shared, so that's starting to happen. And because the pools are bigger, you can take more risk.

Now remember, you've got to take limited risk where you've got limited pools, but now you've got bigger funds and the scale in the Future Fund, that scale, you can take some risk. And I think you're right, in terms of really developing some of these growth companies, new technologies, the more we can allocate that, but we can't do that unless it's long term. So you think, we've still got the 30 days, funds are measured on a monthly cycle, so it makes it very hard, there's that tension. So one of the rules I'd love to change is just the way we measure because it just drives that short termism which is in nobody's interest, particularly the start-ups.

PAULINE VAMOS: Look, really good governance, very strong prudential regulation to make sure you beat your fiduciary duty is absolutely vital. Investment governance, with Jeremy's changes we went from one line in the Superannuation Act and it basically said, "You must act in the best interests of your fund members". It's now about nine pages. Five of those pages are on investment governance and what that has done is really ratchet it up in terms of really that proper fiduciary, broad asset allocation. But really that accountable, know your risk, know your cost, know exactly where the money is, which is absolutely core to your fiduciary. So that takes us back to that other issue.

In terms of people who are on government benefits, I mean, one of the great things about the recent announcements by this government on parental leave is that they are going to pay SG. One of the issues, and I'm trying to say this in a positive way, as Jeremy said, the age pension will be there and these people who are on long term disability will go on the age pension. So the age pension is reserved for the most vulnerable and it has to be, so that means most of them have to get off it or at least go to partial because you've got to protect the vulnerable and that's why you think about Australia, the age pension costs in terms of GDP, it's under 3%. In other countries, France and others, it's up to 9/10%. That's why when they adjust the pension there is absolute screaming in the streets, you would have seen that a couple of years ago, because that's all their money and as their populations age they can't fund it.

So we will have to keep it under 4%, that means less people and that's why the super system has to work.

PAULINE VAMOS: They actually don't. You can give the long answer, I'll do a quicky. Last year for the first time there was over 100billion paid out of the system, for the first time ever more than half was paid out of income streams. People want income streams; they just can't get access to it. Over to you, because he can fix that.

JEREMY COOPER: Well, I guess the lump sum thing goes back to what people were told when they were first forced to hold back a little bit of their wages and put it into this thing called superannuation. It was kind of, "Oh, don't worry, it's your money" and so that mantra was used right throughout and so come retirement they were encouraged to take their money in a lump sum. It goes with our psyche a little bit, there's a behavioural bias, a lot of people would value $100,000 far more than they value $10,000 a year for the rest of their life, when actuarially the $10,000 is just a complete, you know, wouldn't take you two seconds on a piece of paper to work that out. So that's what we've got. Even the income stream is really still a bit of a fake in the sense that there's nobody standing behind it to sort of help you with your longevity risk or the inflation or anything else.

So still, the so-called income stream that we have in Australia is really just a resprayed accumulation account that allows you to draw money out of it. So that really needs to be not entirely bulldozed, but supplemented with proper guaranteed retirement income streams. So there are a lot of balance sheets that are going to have to come back into the Australian superannuation system to get it right in retirement.

JIM MINIFIE: Did people hear those observations? So essentially the point of view is that making saving and super compulsory is associated with essentially inefficiency because not everybody wants to do that. And I guess my one observation in response is that you might be able to think about that compulsion as a sort of default. It's possible and indeed many households did borrow such that their net saving did not increase, even though they were saving through this vehicle –

JIM MINIFIE: Well, that's, that's my point. So my point is I think the received view seems to be that there might have been something of an uptick in household saving, although it is quite difficult to pull that out of the numbers. So one, I guess, additional perspective would be that when you ask people when they're at retirement or after retirement whether they feel that they provided enough, many people do express regret that they didn't make provision early enough. And so, there's a view, particularly when you consider that we do societally provide the backstop of an age pension, but to offset, if you like, the moral hazard of providing that social insurance it's appropriate as a quid pro quo to say, "Well, we expect you to save" and to essentially condition the right to that social insurance on that basis.

JEREMY COOPER: I really like a lot of those points and what that proves to me is you need an independent and powerful and well-resourced policy box to hold the system to account in the precise ways that you're talking about. We have got an oversized stock market, capital does go in particular directions, compulsion does cause externalities. Now, it seems to me you can't unbolt the system and just disband it, that would just be way too disruptive, but you do need a very powerful and independent, you need a miniature Reserve Bank to sit. You take the Reserve Bank 50+ years, it was very humble beginnings it started with and this system has got a lot of force and power and it's going to get a lot bigger and there are some things that really do need to be done with it, and I think you need a powerful little agency to hold it to account in exactly the ways you're talking about. It has a vast macroeconomic effect that hasn't been properly looked at and properly measured.

JIM MINIFIE: Yes, so the question was around how an auction system of the type that Chile operates might interact with asset allocation and there are a couple of aspects to that. Clearly, what matters to people in their retirement is the net returns, given the risk that they might have been exposed to. Not the fees per se or the gross returns; it's the net returns and the risk return that really matters and therefore just looking for low fees but ending up in a cash product or in a very risky product of some other type would be the wrong answer.

The way it's managed in Chile is that the fund that wins the auction actually has to provide five different asset allocation funds. People who don't make a choice of fund themselves are allocated to one of those on the basis of their age, so essentially it's a lifecycle-type product. Now, I think contrary to what I perceive to be the received view in Australia, it's possible to get very good exposure to diversified equities at low cost through an index-type product and the evidence that active management is destroying value in addition to that on average is very, very strong. It's not a matter of an absence of evidence, there's really strong evidence that active management doesn't pay its way, although of course there's always going to be a lucky or a very brilliant fund manager over some period.

JEREMY COOPER: Indeed, it systemically cannot.

JIM MINIFIE: It systemically cannot do it arithmetically. And so that's how it works in Chile, so there's a degree of, I guess, government involvement in the sense that they have specified those asset allocations.

JEREMY COOPER: More than a degree, I mean, you have to be very careful cherry-picking foreign jurisdictions.

JIM MINIFIE: Yes, but I would just note one other point. So in Chile the government and many other jurisdictions have felt comfortable in specifying those asset allocations. There's no reason in Australia that we couldn't have an auction system resulting in more than one winner with a range of asset allocations that would then be selected by employers or Fair Work Australia, say, if that process continues.

PAULINE VAMOS: Let's go back to the asset allocation and it's a good example in terms of the Australian stock market. So there is no doubt in Australia the pooled superannuation funds invest mainly in the top 200. One of the main reasons is liquidity. You start going past the top 200 and there's 1,500-odd stocks, they're just not liquid. They are closely held. We cannot invest in them. That's one of the great things about self-managed funds; they're more likely to invest in the smaller end of the stock market. So that's one of the conversations we're having with the ASX, how do we really get that liquidity in the lower end of the market? Because that's where you get the innovation, that's where you get a lot of these, sort of, future growth-type organisations, but because of are liquidity needs we just cannot do it.

PAULINE VAMOS: No, we actually have. They're saying it's 30billion but they assume on the 30billion, it's actually around 16billion. And why it's wrong is a couple of reasons, and look at today, if you suddenly started to reduce the tax concessions in super what would many people do? They would look for other ways to invest their money that gave them tax savings. So they would put a lot of money into negative gearing. Now, what happens with the Treasury numbers, one of the issues with them is they assume everybody will just pay all the tax.

AUDIENCE: It's not though.

PAULINE VAMOS: Oh yes, we are horribly worried about it. Again, you've got so many moving parts including your 800,000-odd employers. Data, data quality, insurance claims, it's all got enormous complexity to it and that needs to be reduced, it needs to be streamlined, it needs to be reduced, absolutely right.

JEREMY COOPER: But there are changes afoot to deal with that, it's just that they've been a little slow in actually hitting the ground. We've had changes of government and industry's asking for delays and so on, but it's all in train.

PAULINE VAMOS: And it will work, eventually.

JIM MINIFIE: I can see there's appetite to continue, we've come to the end of our time. These are always much shorter than one would like. Thank you so much for joining us for what I found a very interesting and absorbing discussion. I look forward to seeing you all in one capacity or another at another one of these events. Thanks to our hosts, the State Library of New South Wales, for a terrific venue and for the partnership and all the best in getting through what, from a Melbournist standpoint, looks like a pretty mild winter. Thank you.

END OF RECORDING