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- 2.** This submission comments on the interim report observations concerning: -
 - a.** superannuation leverage;
 - b.** self managed superannuation funds (SMSFs);
 - c.** superannuation policy stability;
 - d.** retirement income – the retirement income system;
 - e.** retirement income – barriers to the development of product
 - f.** consumer outcomes – effective disclosure

- 3.** To me the most important issue and most important outcome I would like to see is the recognition of the desirability of group self annuitisation for superannuation funds of all sizes.

Superannuation leverage

- 4.** Leverage applies to the largest superannuation funds, be it through their participation in infrastructure trusts or investment in listed property trust that are geared. Even if the Panel wished to prohibit gearing, it would be difficult to do so. The questions are thus in what circumstances is gearing inappropriate and what should be done to control it.

- 5.** For funds other than SMSFs, I consider members are sufficiently protected from bad leverage decisions by the existence of: -
 - a.** competent trustees and managers;
 - b.** investment policies requiring adequate advice and
 - c.** the range of investment options catering to individual members' risk appetites.

- 6.** Within SMSFs, there can be no objection to gearing that takes the form of a proportionately small investment in a public offer geared share fund on behalf of a young member of the fund. One can, however, find objections to a person approaching retirement being induced to mortgage his or her home to make concessional contributions to a newly established SMSF and the fund then gear into overvalued speculative property projects.

- 7.** In this latter situation, it is important to note that no taxpayers' funds are at risk. I acknowledge, however, that it is possible for some tax subsidised funds to be at risk in less extreme cases.

- 8.** Governments cannot legislate to protect the stupid and the greedy from themselves but can aim to protect them from the smart and greedy who would prey on them. Governments also need to be careful that legislative responses stop undesirable outcomes before they occur rather than penalise them after they are discovered by auditors. Remember, also that the egregious property "spruiking" is a small part of the SMSF landscape. For these reasons, I do not favour detailed regulation to tackle this problem.

- 9.** Any legislative response to the spruikers should aim to stop them preying on the greedy and gullible without interfering in the efficient operation of the vast bulk of well run SMSFs.



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10. I suggest that the “light touch” method of preventing the worst excesses of the property and other spruikers is to harness the self interest of lending institutions. Encouraging discipline on them will dry the well from which the spruikers drink.

11. This can be done by ensuring that superannuation borrowing is of more limited recourse. Currently, the limited recourse requirements prevent recourse to other SMSF assets if a loan on a geared asset is not repaid. They do not prohibit recourse to the SMSF’s members or trustees through personal and other guarantees of the loans. If the legislation were amended to void guarantees given for superannuation fund borrowings after a Commencement date, lending institutions would take more notice of the security of proposed limited recourse loans.

12. A heavier touch approach to curbing the excesses might be to require independent advice on the investment of more than, say, a third of a SMSF’s gross assets in a single particular investment other than bank deposits and government bonds. To ensure that this does not shut the stable door after the horse has bolted, it might be appropriate to either: -

- a.** put the onus of establishing that advice was sought and given on the promoter;
- b.** permit reversal of transactions when auditors discover the failure to seek advice or
- c.** both.

13. There is no reason to restrict the above suggestions to SMSFs as other funds would largely be already comply and hence be unaffected by them.

Self Managed Superannuation Funds

14. Through the actuarial practice, I see a large number of SMSFs in the transition to retirement phase. I see no evidence of what I would regard as inappropriately aggressive investment but some evidence of, in my opinion, inappropriately cautious investments. I have also seen, through the financial planning practice and as a trustee of the superannuation fund of a government instrumentality, instances of inappropriate caution from members of non SMSF funds. To me mature SMSFs are no different in this respect from other funds.

15. I do not doubt abuses such as artwork ownership existed in the SMSFs in the past and expect there are unknown abuses occurring as I write. However, I expect these are small in proportion.

16. While SMSFs do benefit from favourable tax treatment, the money they hold is more the members’ money than the taxpayers. The members generally are good stewards of their own money and there is, in my opinion, no need to prohibit such funds or to impose any more differential regulation on them.

Superannuation policy stability

17. Much of the change in superannuation policy has affected fund trustees and administrators. Fund members have largely been screened from this (except to the extent that it has contributed to higher management charges).



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18. While there is a perception in the industry that frequent changes in rules destroy confidence in superannuation, members experience little change. Most, if not all significant changes in the system have involved “grandfathering” of former practices. Indeed, it is argued by many that this has been a source of added complexity.

19. Absolute policy stability is petrification. Changing circumstances need changing policy. What is needed, from a consumer perspective, is a clear direction and suitable lead times. Generally, I think this has been done reasonably well.

20. At the fund level, problems are created, not by the existence of new policy, but by change in policy. It is change that imposes costs as IT and other systems have to be changed. Revoking existing legislation can be as burdensome as letting it continue if the revocation imposes costs. I therefore urge caution in this respect.

Retirement income – the retirement income system

21. I see no realistic alternative to the current three pillars system of retirement provision.

22. I worry at the “get big or get out” emphasis of the Cooper report and APRA’s reaction to it. While scale does reduce costs, it does so at the expense of innovation and diversification. The Panel is doubtless well aware of the “too big to fail” debate in respect of banks. There needs to be caution that the rush to scale does not create unintended problems in superannuation.

23. I consider the optimum superannuation arrangement is a defined benefit pension system, but this was rendered unattractive many years ago by social security means testing and tax treatment of lump sums. Defined benefit lump sum schemes are a poor substitute due to the influence of market levels at the time of retirement on income throughout retirement. For this reason, I am content with the trend to accumulation funds in the pre retirement phase.

24. Post retirement, there has been strong uptake of account based pensions, but slower uptake of life time pensions and annuities.

25. The Panel’s interim report mentions group self annuitisation (GSA). Mutual Pensions® Pty Ltd, and Barton Consultancy before Mutual Pension’s incorporation, have done considerable work on the concept of Mutual Pension® overlays of account based pensions.

26. GSA or Mutual Pensions® provide non guaranteed longevity protection. This is protection against living longer than the participant group, but not against everyone living longer. In other words, the protection is relative, but not absolute.

27. The fact that Mutual Pensions® and GSA schemes are not guaranteed frees them from the constraints of capital requirements and the necessity for a conservative investment policy. This means that the expected outcome, in the absence of significant mortality improvements, of a non guaranteed arrangement is better than a conventional guaranteed annuity. Members may see it as important that they retain control of investment policy.

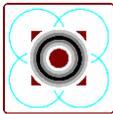


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- 28.** Mutual Pensions® and GSA schemes have the added advantage of transparency. Members can see that funds forfeited on death go to other people, not an amorphous institution. This, and the better expected results, should make them attractive. However, major institutions have been reluctant to embrace them for reasons set out below.
- 29.** Without going into detail, SMSFs need not be excluded from GSA or Mutual Pensions® arrangements. This can be arranged through a clearing house.
- 30.** The Panel sought comments on whether the private sector could manage longevity risk.
- 31.** A significant improvement in mortality rates in retirement will obviously affect members of GSA arrangements or Mutual Pensions®. It should not be thought, however, that guaranteed annuities will be immune from the improvements. An improvement will be reflected in one or more of: -
- a.** provider insolvencies;
 - b.** provider mergers or
 - c.** more expensive new annuities.
- 32.** The Commonwealth is already the insurer of last resort for longevity risk through the age pension. Many taxpayers would question the wisdom of it providing further protection in the changing demographic climate we face. So, in my opinion, it falls to the private sector to manage longevity risk.
- 33.** Contrary to popular belief, there is no current impediment to Mutual Pensions® and GSA schemes. Conventional wisdom is that Section 10 of the Superannuation Industry Supervision (SIS) Act prohibits other than guaranteed life time pensions and account based pensions. SIS Regulation 1.06 defines these arrangements as pensions. However, SIS Section 10 includes these regulation defined pensions but does not restrict pensions to those defined by the Regulations. So any arrangement to provide a “pension” in the common usage of the word is a pension for legislative purposes.
- 34.** I think that the concept of lifecycle investment is misdirected to investment to retirement, rather than investment through retirement. I suggest the Panel makes no recommendations concerning this matter

Retirement income – barriers to the development of product.

- 35.** I have found in my efforts to convince major institutions to embrace Mutual Pensions®, that the greatest impediment to product development is the regulatory burden. Without exception, major institutions that I have approached have acknowledged the merit of the concept. Some have had reservations about acceptance by the market, but the dominant response has been “we are too busy implementing regulatory change”. The sheer burden of regulation has clearly acted to stifle innovation in this aspect. Doubtless, this has occurred in other areas of retirement income.



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36. As I indicated in paragraph 33 above, there is no legislative impediment to GSAs or Mutual Pensions®.

37. I acknowledge that there has been a well documented taxation impediment to deferred annuity provision.

Consumer outcomes – effective disclosure

38. The Panel sought comments on effective disclosure of conflicts of interest in the context of vertically integrated providers of investment advice and investment product. This applies also to insurance products.

39. In my opinion,; -

- a.** there is little difference in the investment products of major institutions and consumers are not greatly disadvantaged by being sold (sic) products of Bank A over those of Bank B but
- b.** it is an irreconcilable conflict for an employee of a bank or bank subsidiary to act as an investment adviser and they should not be permitted to describe themselves in any way that connotes advice or independence and
- c.** the concentration of investment advice to bank employees and investment manufacturing is a barrier to innovation.

40. I consider that ideally, banks should be required to divest both their financial service manufacturing and distribution operations. If this is not possible, they should, I submit, be required to divest either.

Conclusion

41. I thank you for the opportunity of making this submission and trust it will assist your deliberations. I would be pleased to discuss it with your Panel or its officers should you wish.

Yours sincerely,

**Dennis E Barton
Director
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**Japhener Pty Ltd
Mutual Pensions Pty Ltd**

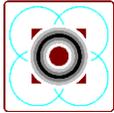


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