

RESPONSE TO COMMISSION'S HEARINGS ON SUPERANNUATION

1. I put two submissions to the Commission demonstrating disregard for legality and misconduct in Australia's superannuation (super):

- (1) "*Super Fails Community Expectation and Need*", January 2018
- (2) Addendum submission, May 2018

2. The matters raised can be summarised as:

- (i) trustee failure against critical SIS statutes on investment strategy (s52(6)(i) which leads to breaching s52(2) requiring care, skill and diligence);
- (ii) regulatory neglect by ASIC of this same legislation, and actively misleading Australians on their retirement prospects;
- (iii) lack of transparency into industry funds' key related-party services.

3. No trace of these issues has been evident to me in the Commission's hearings. I maintain that identifying such serious omission is as valid and valuable an input as commentary on issues already raised in Commission's hearings. During the period allocated by the Commission for inquiry into super, valuable insights were obtained into damaging practices. However, the damage caused by the issues raised in (i) to (iii) dwarfs the total of that exposed by the Commission. The Commission's priorities are puzzling, bypassing misconduct and illegality of a structural kind which affects past and future generations profoundly while pursuing an expense account extravagance within one fund, repugnant as that behaviour was.

Issue 1: Funds Breach of Investment Strategy Statute and Wealth Foregone

4. For investment strategy to be relevant it must be linked to objectives, logically. The objective of super is to deliver a financial retirement benefit. Therefore retirement outcome should be the objective of investment strategy. Yet end- benefit simply does not exist as a factor in funds' investment strategy.

5. Moreover, funds' strategy generally is derived from the average values of annual asset returns. By definition averages have no greater chance than 50% of eventuating (the gamblers chance, think 'two-up'). Because this even-money chance is the basis of funds' investment strategy, it therefore centres on outcomes that are not likely. Simply again, trustees do not even address benefit likelihood and risk as required by s52(6)(i).

6. A valid investment strategy is unattainable without having regard to the likely return to a working lifetime of super saving – this is both the law and members' primary interest. Instead, the industry focusses on mere components which are not likely (average annual profit/loss of portfolio).

7. Funds' practice places benefit assessment as a separate exercise from investment strategy, usually in the client relationship/ marketing arm. The exercise consists of naïve compounding of current portfolio value by the average return. The upshot of compounding averages is that the end result is not likely. Risk plays no role.

8. What better could demonstrate damnable levels of trustees' care, diligence and skill over the entire period of super's existence than the absence of reflection and discourse on investment strategy, benefit likelihood and risk? The super industry has simply fallen in behind an entrenched money-management mentality (using techniques developed in the US for a fundamentally different investment challenge), and has been hiding there for twenty five years.

9. Much of the misconduct identified so far by the Commission causes subtractive loss of retirement wealth. It remains for the Commission to address wealth foregone by this trustee failure. My Submission 1, para 119 shows that typically retirement benefits could be expected to be 20% greater with lesser risk if statutory requirements for investment strategy are observed. **Thus, the value of current super assets should be expected to be almost \$500bn greater.** That is, wealth foregone by Australians due to trustee negligence concerning SIS s52(6)(i) amounts to hundreds of billions of dollars. And the loss will be orders of magnitude greater for the coming generation.

ISSUE 2: ASIC – Intellectually and Functionally Barren

10. The law and common sense require that investment strategy for a fund portfolio or for a product or for a fund member have as defining objectives the likely retirement benefit and risk. Defining investment strategy and forecasting the end-benefit probabilistically are one and the same exercise.

11. Comprehensive argument was put to ASIC to this effect in 2007, when ASIC was requested by government to develop the means for people to comprehend their expected retirement result. The evidence I put before the Commission in Submission 1 shows that ASIC was incapable of comprehending the issue and the law. ASIC's focus was on meeting the wishes of funds, also blind to the law, at great cost and detriment to members' engagement and planning. ASIC sought to shield material from scrutiny via FOI. I note from the Commission's hearings that an ASIC official, [REDACTED] with a role central to the regulator's dereliction still holds office.

12. Despite its inability to comprehend this critical law ASIC has actively offered advice to Australians on their retirement prospects, through an online forecasting tool. **Typically the advice of ASIC is around 40% too optimistic for a likely result** (Submission 1 para 28). Knowing the likely benefit (with something like 80-90% chance) opens up a very different planning perspective for members compared to the advice of ASIC.

13. Thus, ASIC induces Australians to plan a future which is not likely to materialise, with no advice as to chance. Inescapably, super is a gamble - by far the largest bet almost everyone will lay, by government fiat. Yet Australians are kept in the dark about the odds they face.

14. It is untenable that people's super prospects cannot be identified honestly, in everyday language like the weather. The nation's entire super industry has proved itself incapable of, and uninterested in, that elemental obligation.

ISSUE 3: Industry Funds Related-Party Issues

15. I commend the Commission on its probing of related-party dealings of retail super funds – perceptive, detailed and exhausting. It is disappointing that the inner workings of the

industry funds corporate structure have not been opened up similarly; in particular the money flows of [REDACTED] which manages private equity and alternative investments.

16. Confidence in industry funds related-party dealings is important not just to satisfy concerns about sole purpose but also for the increasingly critical role that its private equity assets will play in funds' soundness.

17. Whereas no uncertainty exists around the value of most super portfolio assets which are valued continuously by highly liquid open markets, major industry funds invest in private equity for which valuation takes place 'manually' only periodically. Value at any time is comparatively uncertain. Doubt about return on liquidation is inherent.

18. Because these assets are not readily liquidated, funds' finances have to be net cash flow positive. That is, funds require assurance of sufficient member contributions and other inflows to meet contingent outgoing obligations. Without such cash flow a fund can take on a Ponzi tinge.

19. Private equity allocations are a significant and increasing proportion of the portfolios of most large, high performing industry funds. That means increasing fund vulnerability to changing environment eg government policy, competition. As the vulnerability depends partly upon related-party enterprises it is important that their dealings are beyond reproach.

20. At another level, the public cannot have confidence that 'independent' asset valuations which are the sole basis of the funds' claimed wealth are free of conflict. These valuations should be above suspicion but lack of transparency, even for super trustees, prevents that.

21. As with retail funds, members expect related-party expenditures to be efficiently spent solely to maximise their retirement prospects. It is unacceptable that lack of transparency prevents this being seen to be so. In particular it is unacceptable that large and growing payments by [REDACTED] for staff and consultants are impenetrable - Submission 1 para 107 from that company's financial statement to ASIC is updated below.

[REDACTED]

Salaries, Consultants, Recruitment (\$m)			
	2015	2016	2017
Consolidated	84	147	184
Company	43	67	76

22. Sufficient evidence exists to suggest an underlying business motive existed in the creation of Australia's peculiar form of super. Is it unreasonable for citizens to expect the Commission to probe such large and growing payments through to the utility and pedigree of recipients, given the stakes and the Commission's own concern about members' interests being incidental behind the closed doors of the super industry?

23. I submit that extraordinary obligations of transparency should be applied to public offer super funds and related entities. This transparency should not be limited to members but open to public generally. Some 14 million Australians hold super accounts. Taxpayers are deprived

of some \$30 billion in revenue annually for super. It is in the wider public interest that the management of these exposures be seen to be trustworthy. Without that, public discourse on super will remain naïve and misleading, perpetuating members' confusion, with profound consequences for us all inevitably.

In Brief

24. It is difficult to imagine how the Commission can command credibility without addressing the issues above. Because of these failings, Australia's super industry, as a body of taxpayer- supported trusts and associated services, is unable to articulate its product honestly rendering retirement planning deceptive, has deprived funds' members of retirement wealth through investment strategy favouring interests of funds narrowly, within inept and mendacious regulation, with little transparency thereby inviting reasoned speculation that some funds conceal serious patronage.

25. I ask that the Commission extend its hearings to complete its task on superannuation.

M.F.Gilligan

10 September 2018