



Abacus
Australian Mutuals

Association of Building Societies and Credit Unions

19 February 2010

Mr Jeremy Cooper
Review Chair
Super System Review
info@supersystemreview.gov.au

Dear Mr Cooper

Abacus – Australian Mutuals appreciates the opportunity to contribute to the *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System*.

Abacus is the industry body for customer-owned financial institutions, representing 105 credit unions, 9 mutual building societies and 25 friendly societies. Our member institutions serve 6 million Australians and hold total assets of \$70 billion.

Credit unions and mutual building societies are Authorised Deposit-taking Institutions (ADIs) regulated by APRA under the *Banking Act 1959* and provide a full range of consumer banking services. Friendly societies provide investment and insurance services to members to assist in planning for life events. Most societies are registered under the *Life Insurance Act 1995* and regulated by APRA.

This submission is focused on Retirement Savings Accounts (RSAs). Eight of the nine ADIs providing RSAs are credit unions and members of Abacus.

RSAs provided by customer-focused mutual banking institutions have considerable potential to play a larger part in the superannuation system. Abacus hopes the Review Panel will recognise the contribution RSAs can make to one of the Panel's "key goals": reducing complexity in the superannuation system.

Retirement Savings Accounts

The Review's Issues Paper¹ notes that the asset base of RSAs increased from \$1.2 billion to \$6.2 billion in the year to June 2009 while also commenting that RSAs "have generally not been a success."

RSAs provided by ADIs are a simple product in a complex and changing environment and a safe, low-risk product in an environment where the reality of investment risk has become painfully clear.

The Issues Paper's "two main reasons" why RSAs have not been successful – that they are capital guaranteed and they do not suit the existing product distribution model – raise some obvious questions.

¹ Phase Three: Structure (including SMSFs) – Issues Paper

The dramatic inflows to RSAs during the global financial crisis show there is significant demand for a simple, capital-guaranteed product. This is the product's key strength.

The fact that RSAs do not suit the commission-driven distribution model for other superannuation products is a poor reflection on the distribution model rather than on the product.

As suggested elsewhere in the Issues Paper, commission driven marketing by financial advisers may explain why self-managed super funds are over-represented among the creditors to several high profile corporate failures such as Westpoint.

Advisers should be alerting those consumers suited to RSAs to the RSA products that are available. This can be expected to happen more in future as the discredited commission-driven distribution model is phased out.

An Abacus member credit union says "as the industry moves to fees for advice and advisers are paid by clients, if an RSA is beneficial for the client the adviser should be recommending it, irrespective of whether an incentive is paid or not."

We do not accept the blanket statement that RSAs are "very expensive for holders". This comment in the Issues Paper seems to be based on an assumption that the interest rate margin of the RSA provider is an "implicit fee" imposed on the RSA holder. In fact mutual ADI RSAs are distinguished from other superannuation products by having very few fees, very low fees and any fees that are imposed are quite explicit and tend to be flat dollar amounts rather than a percentage of the balance. RSA holders are not paying for commissions to advisers.

The relatively small number of RSA providers may reflect factors such as:

- the preference of banks to pursue more lucrative products in the superannuation and wealth management sector; and
- regulatory hurdles and ongoing regulatory risk for providers.

The benefits of RSAs to consumers include:

- funds are capital guaranteed and protected when markets plunge;
- the product is simple, straightforward and easily understood;
- various investment options may be available, such as variable interest rate, fixed rate, or a combination of both;
- ease of transition to retirement with account based pensions.

An Abacus member credit union says RSA account based pensions "really come into their own during the post-retirement phase. There is fair amount of discussion around encouraging annuities and managing investment risk. RSA account based pensions have no investment risk (although longevity risk is relevant) and currently pay similar returns to annuities. RSAs also offer more flexibility around withdrawal than annuities."

Abacus accepts that an RSA is unsuitable as the sole savings vehicle for much of the accumulation phase of retirements saving (as is duly disclosed in RSA PDSs), but an

RSA may have a role in any retirement saving portfolio and may particularly suit the following consumers:

- those who have small amounts of super like part-time or casual employees or those in the early stages of saving for retirement; and
- those nearing retirement who want to minimise investment risk.

An Abacus member credit union commented on the tension within the Review's objective of "an outcome that is in the best financial interests of members and which maximises retirement incomes". The credit union says that "maximising retirement income opens up increased risk. This is because exposures to market linked investments create timing risks for retirees (as the GFC has borne out). Our own experience is that imminent retirees have postponed retirement because their market linked investments, designed to maximise retirement income, had performed so very badly they risked realising very substantial capital losses. While RSAs do not pretend to offer superior financial returns over the longer term/accumulation phase, they do offer a safe refuge due to their capital guaranteed nature and therefore suit investors with a certain risk appetite and/or investment timeframe. For example, if imminent retirees had switched out of growth assets in 2007 they would have avoided losses in the range of 40-50% and instead earned a cash rate equivalent."

Another Abacus member credit union says RSAs "don't require the costly and complex trustee structure of super funds and enable older members without self managed super funds to access term deposits and high variable rates. Many financial planning firms use term deposits as part of their platforms and charge fees accordingly but returns for members are reduced. We distribute our high deposit rates through our RSA structure which doesn't charge entry or contribution fees. This enables members to have access to and receive higher rates. Direct distribution with less regulation for these transparent deposit and pension products is a better form of distribution."

This credit union says RSAs "are suitable for individuals over 55 who are entering retirement. The current default options in superannuation have failed this group, many of whom have had to postpone retirement due to losses in superannuation and those over 65-70 have lost much of their saving which they can no longer recover through accumulation."

Issues Paper Questions

Could RSAs be enhanced by removing the capital guaranteed nature of the product and allowing any prudentially regulated entity to provide an RSA? What would be the advantages and disadvantages of an enhanced version of this product playing a larger part in the superannuation system?

Removing the capital guaranteed nature of RSAs would fundamentally change the nature of the product. One of the disadvantages of such a move would be losing the distinct character of RSAs as the simplest and safest superannuation option.

The capacity to offer market-linked investments – for example, a hybrid offering, 50% capital guaranteed and 50% market linked - would improve the appeal of RSAs during the accumulation phase. However, this would raise a range of prudential and consumer protection issues.

RSAs in their current form can play a larger part in the superannuation system with:

- better promotion and marketing;
- easier transfers between superannuation funds; and
- a reduction in the regulatory burden and regulatory risk for RSA providers.

An Abacus member credit union says “a lot of members may have their super in a cash-only fund, but are not aware that we offer them the same service and the return is usually better.”

Licensing, conduct and disclosure obligations that apply to RSA providers are a barrier to entry and it is likely that more RSA providers would enter the market if this barrier were to be lowered.

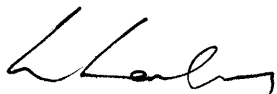
For example, RSAs are a “Tier One” product for the purposes of ASIC’s regulatory standards for training of financial product advisers (Regulatory Guide 146). Frontline staff in mutual ADIs would typically not have this level of training and therefore are strictly limited in how they can engage with members about RSAs.

Consideration should be given to categorising ADI RSAs as a “Tier Two” product, along with deposit products, First Home Saver Accounts, general insurance and consumer credit insurance.

ASIC Regulatory Guide 200 sets out the framework for “intra-fund” advice to super fund members, including class order relief for super fund trustees in relation to s945A of the Corporations Act. However, the relief (conditional and complex as it is) does not apply to RSA providers. Consideration should be given to extending this relief to RSA providers.

I can be contacted on 02 6232 6666 or at llawler@abacus.org.au to discuss any aspect of this submission.

Yours sincerely



Luke Lawler
Senior Adviser, Policy & Public Affairs