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Time to get engaged with super?

It all depends on the proposal

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TAI

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Introduction

Australians spend more money each week on superannuation fees than they do on electricity, yet only a small portion of those with superannuation pay close, if any, attention to the decisions made on their behalf by their superannuation 'trustees'.

Similarly, while Australian households now hold nearly $1 trillion in institutional superannuation funds few, if any, people with superannuation pay close attention to how the companies they own are behaving or how their super fund is voting at shareholder meetings on their behalf.

The superannuation industry, which receives almost $20 billion in fees each year, acknowledges the extent of 'disengagement' among superannuation customers. Indeed, CEO of the Financial Services Council, John Brogden has condemned government efforts to protect disengaged superannuation customers from fee gouging as 'entrenching disengagement'.[1]

In order to overcome this 'disengagement' much has been said by successive governments and the superannuation industry of the need to increase the 'financial literacy' of consumers. But what if there was another strategy? What if the problem wasn't financial literacy, but financial interest? What if superannuation companies tried to engage with their customers by asking more interesting questions about more interesting topics, such as whether executive remuneration is too high, corporate donations to political parties should be banned or whether individuals want their money invested in environmentally harmful industries.

Similarly, what if superannuation companies were receptive to approaches from both individual customers and organisations who were interested in discussing the ethical and environmental implications of their investment portfolio? That is, though all superannuation companies are receptive to both individuals and organisations who want to discuss financial returns, fees or investment strategies it is not obvious that these institutions have clear points of entry for those seeking to 'engage' in relation to broader issues.

The implicit assumption by the industry appears to be that if their customers were interested in such issues then they would have invested their funds in a dedicated 'ethical' fund. However, given that the premise of the MySuper reforms is that most individuals do not make active decisions in relation to their superannuation that are consistent with their financial interests it follows that most superannuation customers are similarly disengaged from the corporate governance and ethical aspects of their investments.

This paper presents new evidence to support earlier work by The Australia Institute and others that suggests that a significant proportion of Australians with superannuation believe that ethical and environmental considerations should be taken into account by the trustees of their superannuation funds. Indeed, the survey evidence presented below shows that more Australians with superannuation believe that ethics and environmental considerations are important than those who believe that maximising financial return should be the only consideration. The paper argues that the lack of engagement that people have with their superannuation companies may stem from the determination of those companies to largely ignore the ethical and environmental dimensions of fund performance in their communication with their customers.

Further, this paper argues that if the customers of superannuation funds were given more interesting information and asked more interesting questions they may 'engage' more actively with their superannuation fund.

[1] Brogden, J (2010) *20 years on, time to improve a good system.*

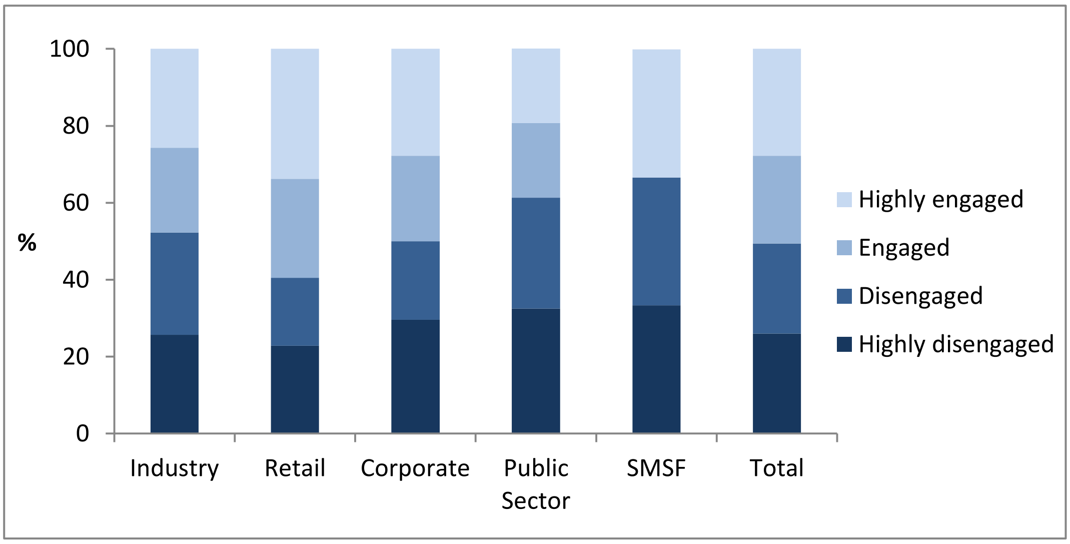
Superannuation – The second most expensive thing you have to buy?

After paying income tax, being forced to spend nine per cent[2] of your income on superannuation is likely to be the second most expensive thing that Australians are forced to do. Indeed, for low income earners it is highly likely that their 'compulsory contribution' to superannuation is in fact larger than their tax bill.

The degree of compulsion that underpins Australia's compulsory retirement savings system is likely to be the major explanation for why so many people are ambivalent, or even disinterested in their superannuation. Put simply, if people were highly interested in saving for their retirement it is unlikely that they would need to be forced to do so.

As shown in Figure 1, 50.6 per cent of superannuation customers surveyed by CoreData described themselves as being either 'highly disengaged' (27.8 per cent) or disengaged (22.8 per cent). Indeed, 'highly disengaged' was the most common category into which the respondents placed themselves.

Figure 1 – Degree of engagement with superannuation by type of super fund



Source: Starke, A (2012) *Super members thirsty for financial advice* (citing CoreData 2012)

This disengagement is not just widespread, but expensive. Many Australians pay fees of over two per cent per annum to have their compulsory superannuation 'managed' on their behalf when it is possible to have funds managed for around 0.5 per cent per annum. This means a person with a fund balance of $200,000 could reduce their fees from around $4,000 per year to around $1,000 per year simply by filling out a form.

In estimating the potential savings to consumers associated with the introduction of the MySuper default reforms the Treasury estimated that the average Australian would see a reduction in fees of around 40 per cent.[3]

But while the superannuation industry and successive governments have called for improved 'financial literacy' as the means of overcoming this apathy, an alternative course of action is to encourage the superannuation funds to have more engagement with their customers on

[2] Which will be gradually increased to 12 per cent by 2019-20.

[3] See for example Treasury (2013).

more interesting dimensions of their decisions. Indeed, as discussed above, if the superannuation funds are serious about promoting engagement then they should not only seek the views of their customers on a wide range of ethical and environmental issues but they should also be receptive to unsolicited feedback and advice from individuals and interested organisations.

That is, while economic theory suggests that fee structures and fund performance relative to the relevant index should be of the utmost concern to those with superannuation, economic theory also suggests that nobody would voluntarily purchase bottled water, buy a new car or renovate their kitchen every few years. Put simply, many consumers are interested in the non-price characteristics of their products, yet most superannuation funds typically ignore the ethical aspects of their services and focus heavily on the financial aspects.

What do Australians want their super funds to do?

The rationale for compulsory superannuation is to provide higher retirement incomes for those who have engaged in paid work than that provided by the age pension. However, the disengagement described above suggests that maximising such incomes is a low priority for most Australians.

A recent survey conducted by The Australia Institute for Market Forces, found that a greater proportion of respondents believed that in order for a superannuation company to make investments that were ‘in their long term interests’, funds should consider ethical and environmental implications (40 per cent) rather than simply maximising financial returns (36 per cent). A substantial portion of respondents were not sure (23 per cent).

Table 1 shows that support for the view that superannuation funds should focus exclusively on maximising financial returns is steady across all age groups. The proportion of those who believe that ethical and environmental considerations should be included tends to rise with age as the number of people who are not sure tends to decline. It is interesting to note that the proportion of people who think that ethical and environmental issues should be taken into account is higher than those who believe the focus should be purely financial in every age group except the 25-34 year olds. Women are much more likely to support the pursuit of ethical and environmental objectives over purely financial objectives (43 per cent compared to 30 per cent) while men have the opposite view (38 per cent compared to 42 per cent).

Table 1 – Perceptions on the desirable objectives of superannuation funds, by gender and age

	Gender		Age						All
	Male	Female	18-24	25-34	35-44	45-54	55-64	65+	
Restricted to financial return	42%	30%	37%	40%	34%	33%	36%	38%	36%
Investing in companies that behave ethically … as well as providing a financial return	38%	43%	38%	34%	43%	41%	44%	46%	40%
Not sure	19%	27%	25%	26%	24%	26%	19%	16%	23%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
n	565	561	140	242	229	218	159	136	1126

Source: The Australia Institute Survey – February 2013 (Q. 42)

Table 2 shows how attitudes to the objectives of superannuation funds change with income. Support for the inclusion of ethical and environmental objectives is higher than the pursuit of maximum returns for the low to middle income bands. However, in the high income bands (above $80,001) support for ethical investment is less than that for financial returns. Interestingly, the percentage of those in the income bands above $100,000 who desired ethical behaviour was either equal to or above the average of all respondents. The only income band that was below the average for desired investment in ethical behaviour was the $80,001-$100,000 group.

Table 2 – Perceptions on the desirable objectives of superannuation funds, by income

	Annual household income								All
	$20,000 or less	$20,000 - $40,000	$40,001 - $60,000	$60,001 - $80,000	$80,001 - $100,000	$100,001 - $150,000	More than $150,000	Not sure/rather not say	
Restricted to just the financial return	22%	32%	30%	37%	43%	45%	42%	36%	36%
Investing in companies that behave ethically … as well as providing a financial return	42%	40%	44%	44%	35%	40%	41%	38%	40%
Not sure	36%	27%	26%	19%	23%	15%	17%	26%	23%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
n	55	186	186	181	141	155	76	146	1126

Source: The Australia Institute Survey- February 2013 (Q. 42)

These results are entirely consistent with the behaviour of superannuation customers described above. That is, if most customers were primarily concerned with maximising their financial returns then there would be very few people effectively donating thousands of dollars per year in excessive fees to their superannuation company.

They are also consistent with earlier focus group research conducted by The Australia Institute and the Industry Super Network on how people make decisions about their superannuation.[4] Some focus group participants expressed concern that they had no information on the exact nature of their investments and suspected that some fund managers act in ways that are ethically dubious or purely profit-driven:

> *If you look at the dodgy stuff some of these companies do, they justify everything on the basis of maximising returns to shareholders. (50–70, Adelaide, higher income)*
>
> *Sooner or later, if greed isn't limited, it's going to become a destructive force. (50–70, Adelaide, higher income)*

With so much money now tied up in Australian superannuation funds, there was a feeling that this should contribute to nation-building and long-term infrastructure rather than speculation and profiteering:

> *They're putting all this super money into shopping centres and things we don't need, rather than important stuff like infrastructure. (50–70, Adelaide, lower income)*
>
> *We don't know where the money is invested. I'd hate to think that there's so much money invested in things that are only financial rewarding and not useful in other ways. (50–70, Adelaide, lower income)*

Indeed, some people felt that the super system is deliberately structured to encourage the consent of the 'investors' in what would otherwise be regarded as morally questionable economic activity.

> *If we weren't all shareholders of Woolworths through our super, would they get away with it? (50–70, Adelaide, higher income)*
>
> *We're guilty by association—all of us that have super funds. (50–70, Adelaide, higher income)*

Are Australians willing to switch their funds to achieve their non-financial objectives?

As discussed above, Australians have shown what seems to be a wilful determination to ignore the fees and relative returns of their superannuation companies. While further attempts to improve 'financial literacy' may help to overcome this 'disengagement', an alternative strategy may be to seek engagement on a broader range of issues.

That is, rather than try to tell their customers which characteristics of their superannuation are important perhaps the superannuation industry could ask their members what is important. While such an approach may seem counterintuitive to an industry that is built on the notion that their customers are forced to purchase their product, this does not mean such an approach may not have significant benefits.

[4] Fear and Pace (2008).

In order to better understand the expectation of super fund customers when it comes to how their investments are managed survey respondents were asked 'Would you be prepared to move your superannuation to another company if it was found to be investing in coal or coal seam gas extraction, based on their negative environmental impacts?'. The results are summarised below in Table 3 and 4.

Table 3 – Willingness to switch superannuation funds on the basis of investment in coal or coal seam gas - by gender age

	Gender		Age						All
	Male	Female	18-24	25-34	35-44	45-54	55-64	65+	
Yes	25%	26%	30%	27%	26%	23%	22%	23%	25%
No	48%	38%	40%	39%	38%	42%	51%	55%	43%
Not sure	27%	36%	30%	34%	35%	35%	28%	23%	32%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
n	565	560	140	242	229	218	160	137	1125

Source: Australia Institute Survey – February 2013 (Q. 43)

Table 3 shows that a quarter of respondents report that they would be willing to switch their superannuation to another company on the basis of the environmental consequences of investments in coal or coal seam gas extraction. Less than a half of respondents (43 per cent) stated that they would not be prepared to move their superannuation. The willingness to move superannuation tends to decline with age from 30 per cent of 18-24 year olds to 23 per cent of the over 65s. Males are more likely to keep their superannuation with their current fund (48 per cent) compared to females (38 per cent).

Table 4 provides responses to the same question by income. Table 4 illustrates that across all income groups, the willingness to switch away from superannuation companies that invest in coal is consistently above one fifth of respondents. While the willingness to switch investment rises somewhat with income, so too does opposition. That is, those earning more than $150,000 per year are more likely to express a willingness to switch than average (26 per cent compared to 25 per cent) yet the same income group is also the most likely to express opposition to the idea (51 per cent compared to 43 per cent). This apparent disparity is explained by a significantly smaller number of high income earners reporting that they are unsure (22 per cent compared to 32 per cent).

Table 4 - Willingness to switch superannuation funds on the basis of investment in coal or coal seam gas – by income

	Annual household income								All
	$20,000 or less	$20,000 - $40,000	$40,001 - $60,000	$60,001 - $80,000	$80,001 - $100,000	$100,001 - $150,000	More than $150,000	Not sure/rather not say	
Yes	25%	24%	26%	29%	23%	28%	26%	21%	25%
No	29%	46%	40%	38%	48%	47%	51%	42%	43%
Not sure	46%	30%	34%	33%	30%	25%	22%	37%	32%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
N	56	186	185	181	141	155	76	146	1126

Source: Australia Institute Survey – February 2013 (Q. 43)

The potential value of ethical superannuation fund balances

At December 2012 the funds invested by Australian households in superannuation (excluding self-managed funds) were $987.5 billion[5]. Taking the survey results from Tables 3 and 4 the 25 per cent of those with superannuation who say that they would be 'prepared to move their superannuation to another company if it was found to be investing in coal or coal seam gas extraction, based on their negative environmental impacts' represent a pool of funds of around $247 billion dollars.

If the ethical considerations people may be motivated by was extended to include investing in tobacco or land mines the proportion of people who would be prepared to move their superannuation would likely be greater. Therefore, the figure of 25 per cent could be considered to be a minimum figure.

The data for avoiding investment in coal and coal seam gas presented above suggests that the potential market for ethical investment is significantly larger than the current market for ethical investment. According to the Responsible Investment Association of Australia the value of super responsibly invested[6] at June 2011 was $19.55 billion.[7] This represents only eight per cent of the estimated potential investment of $247 billion calculated above. There are two explanations for this which are not mutually exclusive.

The first explanation is that survey respondents do not seriously wish to sacrifice any financial return in pursuit of environmental and ethical objectives.

The second explanation is that people are so confused by, or disengaged with, their superannuation that they are unable to act on their underlying preferences when it comes to their superannuation.

The superannuation industry has itself stated repeatedly that there is widespread and significant disengagement amongst Australians. This paper argues that this may because superannuation funds do not engage their clients in a way that generates interest. If, on the other hand funds were to engage clients about the ethics of their investment portfolio there is a very substantial pool of potential investment funds. Through engagement with clients about ethically based investment, over time, people may choose to move their superannuation into funds that pay greater attention to the ethical and environmental considerations of investment portfolios.

Given the enormous turnover of superannuation funds, small changes in either regulation or policy within superannuation companies would likely result in large changes to the number of people investing in funds that emphasise ethical and environmental objectives. That is, in the year to June 2012 there were 3,468,000 new member superannuation accounts created. These new accounts accounted for 11 per cent of the total number of superannuation funds in existence.

[5] APRA (2013) Statistics: Annual superannuation bulletin.

[6] The definitions of 'ethical' and 'responsible' investment are not necessarily interchangeable.

[7] Responsible Investment Association of Australia (2011) *Responsible Investment Annual 2011*.

Conclusion

The survey evidence presented above shows that environmental and ethical considerations are of concern to a substantial proportion of Australians. While it is widely acknowledged that many Australians are ‘disengaged’ from their superannuation it is also widely assumed that the solution to this problem is to provide superannuation customers with more information about financial performance or to educate people to pay more attention to such information.

This paper argues that an alternative strategy may be required, namely, for superannuation companies to engage with their customers on a wider range of issues, in particular, the kind of ethical and environmental issues that 40 per cent of them report are important to them. If such communication is to be effective in increasing customer engagement, however, it will be necessary for information about ethical considerations to flow in both directions, that is, from funds to customers and from customers to funds.

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