Appendix A

Financial Review - A super opportunity to right a wrong

C O M M E N T   A N D   O P I N I O N

A super opportunity to right a wrong
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The review by the Federal Government of the Commonwealth government securities market provides the opportunity to rectify a major anomaly in the practice of superannuation management in Australia, where trustee directors of public-sector funds are severely limited in developing investment policy for the total assets of funds.

It provides the framework to fund the unfunded superannuation liability by securitising the obligation the government has in regard to superannuation liabilities, which would re-establish the government securities market as the primary debt on issue. It can be done at a saving to government expenditure.

The Federal Government has an unfunded liability for super in excess of $80 billion. Under the regime for super this government established, it is expected that the private sector will fully fund super liabilities for all schemes through contributions, and that the accumulated assets will be invested.

Super funds are separated from the sponsoring employers and individual members. Responsibility for the funds resides with a trustee company, with a board of directors representing employers and members.

Directors are responsible for the policy and management of the super funds. Many functions are delegated to external organisations. In the public sector, the unfunded liability is represented by an obligation, or IOU, from the sponsoring employer, being the federal, state or territory government. The expectation that the obligation will be met is provided for in legislation.

Consequently, at the federal government level, the assets of the super fund comprises two distinct elements: there are funded investment assets, which the trustee directors will manage generally by delegation to external investment managers; but the majority of the assets are represented by the obligations of the government, which represent more than 80 per cent of the total assets of the funds.

This imposes a limitation for the trustee directors of the funds. If they have more than 80 per cent of assets as a government obligation, how do they construct an asset allocation that meets prudent diversification principles? Equally significant is the determination of appropriate investment objectives for the super funds when less than 20 per cent of assets are investment assets.

Securitising the obligations would provide the ability to consider the asset allocation framework with a perspective that the obligation is a debt security which can be transacted in the capital markets. Trustee directors would then be able to make a judgement about maintaining more than 80 per cent of investment assets in Commonwealth government debt securities.

The obligation for the super liability is recognised in certain federal government financial reports that reflect accrual accounting principles. Global financial analysts will recognise this factor in their credit assessment of Australian government debt securities, and the interest rate attaching to such debt.

Securitisation of this obligation brings the prospect of reducing the uncertainty factor attaching to the liability. This may reduce the premium in the interest rate on Australian debt raisings.

The obligation for the super liability is on the balance sheet of the Federal Government. Securitisation of the obligation would increase the debt on issue by more than $80 billion, thus re-establishing the Commonwealth securities market as the primary debt issue. It does not change the total financial obligation; it does reduce uncertainty.

There has been an opportunity cost in the liability being unfunded.

We have carried out an examination of a 25-year historical return profile of investment in a broadly diversified equity-based superannuation fund portfolio

Unsurprisingly, this confirms the expectation that growth assets will generally outperform debt (see table).

Real returns of the level indicated would have been a significant factor in either reducing the cost of superannuation expenses to the Federal Government, as employer, or enhancing benefits for members.

The nominal return indicated would have exceeded the cost of borrowing, so that a net benefit to government revenues would have arisen.

Securitisation of the obligation of the Commonwealth government would achieve several outcomes:

Introduce in the public sector super funds management of investments on a comprehensive basis.

Re-establish the Commonwealth government securities market as the primary debt issue.

Prospectively achieve a net benefit to government revenues.

As an extension of the review of the Commonwealth government securities market, it is opportune to consider strategic public sector superannuation management.

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