September 27, 2006

The Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

Dear Sir/Madam,

Submission On The Structure and Operation of the *Superannuation Industry (Supervision) Act* 1993.

CHOICE welcomes the opportunity to contribute to the work of the committee on this subject.

Our submission is attached. For further information please contact Nick Coates, Senior Policy Officer, Financial Services on 02 9577 3349 or ncoates@choice.com.au.

Yours Faithfully

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Submission to the Parliamentary Joint Committee on Corporations and Financial Services

on

The Structure and Operation Of The *Superannuation Industry (Supervision)* Act 1993

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Introduction

In this submission we comment on the following terms of reference of the Inquiry:

- the role of advice in superannuation
- the meaning of member investment choice
- responsibility of the trustee in a member investment choice situation
- the reasons for the growth in self managed superannuation funds
- the demise of defined benefit funds and the use of accumulation funds as the industry standard fund
- whether promotional advertising should be a cost to a fund and, therefore, to its members
- the level of compensation in the event of theft, fraud and employer insolvency
- other issues: the proliferation of multiple superannuation accounts
- other issues: saving objectives and the level of compulsory superannuation contributions

About CHOICE

CHOICE is a not-for-profit, non-government, non-party-political organisation established in 1959. CHOICE works to improve the lives of consumers by taking on the issues that matter to them. We arm consumers with the information to make confident choices and campaign for change when markets or regulation fails consumers.

CHOICE is fiercely independent: we do not receive ongoing funding or advertising revenue from any commercial, government or other organisation. With over 200,000 subscribers to our information products, we are the largest consumer organisation in Australia. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

Our policy voice is widely recognised. We campaign without fear or favour on key consumer issues based on research into consumers' experiences and opinions and the benefit or detriment they face. Our current campaigns cover food, health, financial services, product safety, communications and consumer protection law.

CHOICE conducts research, publishes policy reports and online information, gives presentations and keeps the media informed of our policy views. We provide representatives for many industry and government committees and independent bodies considering matters of concern to consumers.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns and subscribe to CHOICE Campaigns Update at www.choice.com.au/ccu.

Role of Advice in Superannuation

Key points

1. Conflicts of interest are a significant and continuing problem. They erode the quality of financial advice consumers receive about their superannuation.
2. The price of financial advice should be agreed prior to the provision of the advice and selection of a product.
3. The emergence of fee for service financial advice by planning groups is an important step toward improving the quality of financial advice.
4. ASIC should be given the powers to outlaw particular conflicts of interest where it is satisfied that disclosure and management will not prevent inappropriate or bias advice.
5. Consumers should be able to 'turn-off' the trailing commissions if they are not receiving on-going advice. Trailing commissions should be prohibited on compulsory superannuation products.
6. Ways of providing greater access to financial advice need to be considered for those consumers for which advice is commercially unavailable, uneconomic, or otherwise unsuitable to their needs.

Many consumers believe they need advice about superannuation but do not believe there is a readily accessible and cost effective source of unbiased advice. They are right to hold those beliefs. Superannuation is becoming increasingly complex, and the introduction of super choice provides both opportunities and risks for consumers. Yet it is very difficult for a consumer to find any source of cost effective, unbiased and competent financial advice that addresses their personal circumstances.

As superannuation is a system of compulsory contribution there is an *obligation* to provide consumers with quality unbiased advice about their superannuation. Yet conflicts of interest erode consumers' capacity to access quality financial advice. A conflict of interest occurs where someone in a position of trust, say a financial adviser, planner, or even trustee, has a competing professional or personal interest. These competing interests make it difficult for them to fulfil their duty to the client without bias. This is particularly critical when financial planners provide advice on changing superannuation funds. The way a planner is remunerated can influence how they present information about superannuation products.

Remuneration models that can lead to conflicts of interest include:

- *Commissions*. These are generally paid by product manufacturers to planners in a combination of upfront commissions (with some initial premium of funds paid to the planner directly) and a *trailing commission* paid for the life of the investment. The commissions are paid by the product manufacturer to the planner / adviser

from fees that the manufacturer levies on the consumer's superannuation investments. The trail must be disclosed but is effectively hidden from the consumer in the management expense ratio.

- *Volume based incentives / soft dollar commissions*. These are bonuses paid by product developers if planners and advisers write a certain volume of their product. Initially, soft dollar commissions began as payments for writing a minimum amount. However, the formula is being revised by many product developers in response to criticisms of these commissions. Despite a watering down of the various soft dollar formulas the majority remain volume based.
- *Base salary adjustments*. Planners employed by a product manufacturer can have their base salary lowered if they don't sell enough in-house products over a specific period of time. This is in addition to performance pay.
- *Shelf fees* can be paid by funds managers to list their product on a planner group's approved "recommended product list". Whether a product is listed depends on how much is paid to the planner group. This can limit the availability of quality superannuation products that don't pay for shelf space. The potential conflicts of interest caused by shelf fees were recently documented in ASIC's *Managing Conflicts of Interest* discussion paper[1]. These fees can create conflicts of interest when a trustee decides which investment managers to select.

The quantum of commissions is not trivial and provides substantial financial incentive to planners and advisers. What seems like a small amount of money to one consumer can amount to a significantly large amount across a class of consumers and products. We asked Rainmaker Information to prepare a yearly estimate of commissions on compulsory superannuation contributions. These are paid by master trusts to financial planners or advisers. Based on $25.7 billion in contributions from July 2005 to March 2006, with an estimated average commission of 3%, a staggering $772 million was paid in commission on *compulsory* superannuation investments. If we include existing trailing commissions (which range from between 0.20% and 0.8% of assets) the figure is far higher. From March 2005 to March 2006 there was $93 million paid in ongoing trailing commissions, assuming an industry average trail of 0.35%.

These remuneration structures can link financial advice about superannuation with how the adviser is remunerated. Fund managers compete with each other based on the commissions and other enticements that they can offer planners to promote their superannuation products. These incentives can distort how advice is framed to consumers and this can lead to inappropriate advice.

Evidence on how commissions can lead to inappropriate advice is mounting. In April ASIC released its latest shadow shopping survey on superannuation advice[2]. It provided a sad snapshot of how commissions can lead to poor and inappropriate product recommendations. It found that:

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[1] ASIC (2006) *Managing conflicts of interest in financial services*, April, www.asic.gov.au.
[2] ASIC (2006) *Shadow Shopping Survey on Superannuation Advice*, March. www.asic.gov.au.

- 16% of advice was not reasonable given the clients needs (where reasonable is defined as the client not being financially worse off).
- Unreasonable advice was six times more likely if the adviser has an actual conflict of interest over the advice given. Conflicts being found where the adviser stood to gain a higher remuneration if the recommendation was followed.
- Where advice recommended the consumer switch funds a third of this advice lacked credible reasons and risked the consumer being worse off.
- And in the most damning indictment of our disclosure regime of conflicts of interest, the report found that "consumers were unable able to tell when they received unreasonable advice".

ASIC's Enforceable Undertaking on AMP Financial Planning in July 2006[3] also illustrates how commissions, even though there are conflict management plans in place, can still lead to poor or inappropriate advice. ASIC's review found:

- planners' files did not disclose a reasonable basis for advice;
- planners' failed to make proper disclosures about the costs of acquiring the recommended product and the significant consequences of replacing the existing product;
- AMP made statements on its website and in its Financial Services Guide that suggested AMPFP Planners could consider a broader range of products than permitted, which could have misled consumers; and
- AMP may not have had adequate arrangements in place to manage conflicts of interest.

Some industry groups argue that conflicts of interest arising from commissions and other incentives can be "managed" and disclosed (either by self-regulation schemes or under FSR disclosure provisions). We believe some of the methods used in financial services for managing or avoiding conflicts of interest do not solve them. In particular merely disclosing the conflict of interest does not solve the problems. How is the consumer able to assess how much weight to give to advice based on knowing an adviser will receive a 5% rather than a 2% commission? Indeed economic research suggests disclosing conflicts increases consumers' trust in an adviser rather than acting as a warning to treat the adviser with caution[4]. The adviser also feels that they have done their duty and disclosed a conflict and can then give biased or poor advice freely. Commission related conflicts can only be prevented when the way planners, or advisers, are remunerated is separated from the advice they give. Only then will these planners be able to give competent unbiased advice.

Financial literacy will remain important in providing consumers with quality advice about their superannuation. The Commonwealth Government's Financial Literacy Foundation is a significant and welcome measure designed to address consumer's ability to protect

[3] http://www.asic.gov.au/asic/asic.nsf/lkuppdf/ASIC+PDFW?opendocument&key=AMP_enforceable_undertaking_pdf
[4] Cain, D., Loewenstein, G., and Moore, D. (2005) The Dirt on Coming Clean: The Perverse effects of disclosing conflicts of interest Journal of Legal Studies, vol. 34 (January).

their own interests in relation to financial matters. We wait with interest to see the work to be undertaken by the Foundation and hope that some efforts will be given to educating consumers in making good decisions based about their superannuation.

The National Information Centre on Retirement Incomes (NICRI[5]) is also an important source of information about superannuation for consumers. It is disappointing that the government did not provide additional resources to NICRI in the run up to the introduction of Superannuation choice on 1 July 2005. NICRI describes its role as 'helping to provide up to date independent information to assist people to make the best possible investment decisions they can.' It is not currently part of NICRI's role to provide financial advice to particular consumers.

We urge the Committee to consider providing greater access to financial advice for those consumers for whom commercially available advice is either uneconomic or otherwise unsuitable to their needs. A model for such a service has been proposed in the UK and should be examined by the Committee.

The Meaning of Member Investment Choice

Key points

1. Some investment choice is important to allow consumers to manage risk-return profiles on accumulation accounts. However, consumers can have too much choice on investment options.
2. Increased investment choice increases administration costs and impacts on accumulation of retirement saving.
3. Research shows that increased investment choice creates product complexity. Faced with this complexity consumers often defer decisions about investment choice or make impressionistic or impaired decisions about the best option for them.
4. The vagaries of the default option need to be standardised.

Member investment choice allows consumers to select from a menu of investment options that are generally arranged as a continuum of risk versus reward profiles (from low risk low return to higher risk and higher return). Typically these investment options are provided by the fund trustee 'in-house' with each one relying on a different investment manager to run that option.

The introduction of investment choice is largely a response to the wide spread adoption of accumulation accounts. Accumulation accounts shift investment and longevity risk on to the consumer (away from the fund). Member investment choice, in theory, allows consumers to raise and lower their risk/reward combination as a means of managing increased risk exposure. In that context investment choice from a menu of investment

[5] http://www.nicri.org.au/.

options provides alternatives for consumers with different personal risk profiles at different stages of their life cycle.

Recently there has been a shift in industry thinking on member investment choice. Funds have begun 'adding-value' to their investment products by diversifying their investment menus and providing niche (specialist) investment options (even direct share trading options). In short, there is a trend towards the proliferation of investment options. This is done on the basis of a belief that the best way to improve service to consumers is to increase the number of investment options they can choose from. After all, classic economic theory teaches us that the greater the choices the greater our abilities as consumers to manage our economic affairs.

But as "the number of investment options increase, the associated administration costs increase"[6]. At some point proliferation of investment options can become detrimental to the goal of retirement income maximisation. The costs of running superannuation accounts, with twenty or thirty investment choices, can start to impact on accumulation of contributions. CHOICE is aware that some platforms offer hundreds of investment choices. One fund manager told us that around 80% of investors in some 'full-service' platforms have money in just 20% of the available options. Clearly this level of choice is expensive and not necessary.

A growing body of research from behavioural economics provides rigorous evidence that there can be too much choice (sometimes called the 'tyranny of choice' or 'choice overload'[7]). The research focuses on the difficulties that consumers have in managing complex choices[8]. As the complexity of decision making increases consumers tend to simplify their decision making processes. Experiments show that as the availability and complexity of choice increases consumers have difficulty making a decision and can make sub-optimal decisions. Greater choice creates consumer inertia and procrastination.

The research has been applied to investment choice in pension funds. A US study on 401 (K) pension plans found that as the investment options increased, participation rates in selecting an investment option fell with the default investment option becoming predominant. In other words, increasing the number of investment options by Australian funds is likely to result in higher numbers of superannuation members in default investment plans (currently it is estimated that somewhere between 84% and 90% of superannuation members are in a default plan). This research also showed that where

[6] Gallery G, Gallery, N. Brown, K (2004) Superannuation choice: the pivotal role of default options, *Journal of Australian Political Economy*, 53, www.jape.org.
[7] Schwartz, B. (2000) Self-determination: the tyranny of freedom. *American Psychologist*, 55, 79-88.
Iyengar, S. & Lepper, M. (2000) When Choice is demotivating: can one desire too much of a good thing?*, Journal of Personality and Social Psychology,*70, 6, 995-1006.
[8] Shafir, E. Simpson, I. & Tversky, A. (1993) Reason-based choice. *Cognition*, 49, 11-36.
Choi, J, Laibson D, Madrian, B. & Merrick, A (2003) Passive Decision and potent defaults, Working Paper 9917 NBER Working Papers, August.
Mitchell O & Utkus, S (2003). Lessons from Behavioural Finance for Retirement Plan Design, Working Paper, Pension Research Council Wharton School, University of Pennsylvania

consumers did make a choice, increasing the number of choices actually lowered consumers' abilities to select the right option for them[9]. Often they were influenced by how the investment options are framed (that is how the various investment options relate to each other) rather than which option best suited their risk-reward characteristics[10].

Regardless of the number of investment choices on offer, default investment options remain a critical component of a compulsory superannuation system. There is an obligation on Government and policy makers to ensure that consumers' who do not take an active role in investment choice still earn reasonable returns on their retirement investments. The default investment option provides a critical role in this regard.

Nonetheless, we note that the investment characteristics behind each default fund can vary significantly from fund to fund, based on different trustee criteria. Some default funds hold more growth assets in the portfolio while others can be conservative. This creates differences in default fund returns. For example the five year average spread on industry default funds varies by 1.4% and the average spread on master trust default funds is estimated to be more significant[11]. These vagaries of the default option need to be standardised with some consideration given to adjusting the SIS Act, and /or APRA's interpretation, to achieve consistency on default options.

Responsibility of the Trustee in a Member Investment Choice Situation

Key points

1. CHOICE supports the general direction of APRA's Circular (II.D.1) regarding the role of the trustee in member investment choice.
2. Trustee fiduciary responsibilities under the SIS Act provide the best way of regulating responsibility on investment choice.
3. Conflicts of interest in financial advice remain a barrier to planners and advisers having more discretion over investment selection.
4. Trustee appointments of investment managers need to be more open selection to also avoid problems associated with conflicts of interest.

The APRA Circular (II.D.1) provides a guide for trustees on investment choice. The circular argues that trustees must take responsibility for mitigating risk on behalf of the member when presenting investment options. Trustee deliberations over investment options form part of their fiduciary responsibilities and are a core form of consumer protection in superannuation.

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[9] Benartzi, S. and Thaler, R., (2002) "How much is investor Autonomy worth?" *The Journal of Finance Vol. LVII, 4. 1593-1616*

[10] Mitchell O & Utkus, S (2003) Lessons from Behavioral Finance for Retirement Plan Design, Working Paper, Pension Research Council Wharton School, University of Pennsylvania

[11] Gallery G, Gallery, N. Brown, K (2004) Superannuation choice: the pivotal role of default options, *Journal of Australian Political Economy*, 53, www.jape.org.

Conflicts of interest remain an ongoing problem that leads to poor and inappropriate financial advice. Commission arrangements could influence how investment options are framed, presented and recommended to consumers by planners and advisers. There is the potential for this to influence the recommendation of investment options by planners or advisers if they were to have more discretion or the trustees' responsibility on investment choice. Secondly, as yet there is no compensation scheme for advisers and planners giving poor or inappropriate advice, despite allowances for such a scheme under FSR arrangements. This means the risk of investment choice would be entirely shifted onto consumers if planners and advisers were given greater responsibility to recommend investment options. For an example of the possible of consequences of this we need look no further than Westpoint, where advisers recommended high risk promissory notes for a combination of commissions of up to 12%. There was no compensation scheme in place to cover consumers for the inappropriateness of this advice.

However, conflicts of interest are not limited to financial advisers and planners and remain an ongoing issue for trustees as well. A recent RiceWalker newsletter had a extensive discussion of the types of conflicts of interest that trustees can encounter[12]. Trustees have a responsibility to make sure the appointment of investment managers and associated investment options are free of conflicts of interest. CHOICE has concerns about the use of 'shelf space fees' that more than recover the administrative costs of listing a product. We would also not like to see the selection of investment managers influenced by soft dollar commissions and other non financial inducements.

The process for selecting investment managers needs to be clear and fully disclosed. Fees to third parties must be better disclosed and where conflicts of interest cannot be managed, they should be prohibited. The role of investment policy committees within funds needs to be strengthened legislatively if necessary.

[12] RiceWalker (2006) *Caesar's Wife*, June.

The Reasons for the Growth in Self Managed Superannuation Funds (SMSFs)

CHOICE notes that many consumers receive advice on establishing SMSFs from accountants which are exempted from FSR obligations. This is critical lack of consumer protection.

While there are significant advantages for financially literate consumers' setting up SMSFs, proving investment flexibility and personal empowerment of ones' superannuation, CHOICE has concerns about potential abuse of SMSFs.

Previous CHOICE research on "DIY" superannuation found that about half of all SMFS had less than the recommended minimum amount invested[13]. This suggests that some accountants and advisers are recommending SMSFs (that is Less than $250,000) inappropriately. Professional fees can sometimes be more than investment returns.

The Demise of Defined Benefit Funds and the Use of Accumulation Funds as the Industry Standard Fund

Key points

1. The move from defined benefit plans to accumulation accounts pushes investment and longevity risk onto households. Strategies need to be considered in other areas that help them manage that risk and provide appropriate protections where required.

The move away from defined benefit accounts toward accumulation accounts is significant because it is a part of a broader trend to shift risk onto households. In particular the move to accumulation funds shifts investment and longevity risk away from the employer or fund and onto households and individual employees. In the April 2005 International Monetary Fund (IMF) Financial Stability Report the IMF noted, that "…the household sector has increasingly and more directly become the "*shock absorbers of last resort*" in the financial system."[14] The IMF argues that households now have substantial exposure to economic shocks in ways that they have never previously seen. The previous post-war collectivised risk-regime largely insulated households from financial market, investment and longevity risk.

Importantly, the IMF Report sounds a warning on the fact that most consumers do not have the required information or understanding of their levels of exposure and this in turn could create significant difficulties for the finance industry and Government. The IMF states:

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[13] *Choice* Money and Rights (2004) "The nuts and bolts of DIY super", Oct/Nov pp17-21.
[14] IMF (2005) *Financial Stability Report*, April.

> "Households need to understand the financial responsibility they have shouldered and have access to information – including unbiased advice and quality financial advice – about investment and saving options, as well as the available products to manage their risk … [.]
>
> In the case of widespread failure of the household sector to manage complex investment risks, or if households suffer severe losses across the board on their retirement investments … there could be a political backlash demanding government support as an "insurer of last resort." There could also be a demand for the re-regulation of the finance industry or, at the very least, more litigation would ensue."[15]

You do not have to view these developments as either positive or negative to recognise that they represent a shift of risk to consumers. The IMF sees this shift as positive as it represents part of the dispersal of risk more broadly throughout the financial system. This makes that system more resilient against shocks. Nonetheless, they also clearly point to the dangers that this risk-shifting raises for households, *with the clear implication that regulation will be required to ensure that the household sector can better manage these risks*.

To that end the move from defined benefit plans to accumulation accounts provides an impetus for the Committee to consider how households manage their risks more generally on their superannuation. This makes the issues of quality of financial advice and adequate compensation schemes for that advice even more important.

Whether Promotional Advertising Should be a Cost to a Fund and, therefore, to its Members

CHOICE believes that commission payments to financial planners and financial advisers should be considered in the context of this discussion about promotional advertising (please note our yearly estimates for costs on commissions in the "section on advice on superannuation').

Level of Compensation in the Event of Theft, Fraud and Employer insolvency

Consumers increasingly rely on financial advice in relation to their superannuation decisions. Unfortunately there is a risk that where consumers are mislead or defrauded by an adviser they lack adequate recourse should the adviser be or become insolvent and lacks adequate professional indemnity insurance.

Current arrangements for compensation are inadequate. There are three areas of concern:

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[15] *Op cit* p5.

1. Where a licensee is solvent, the ASIC approved external dispute resolution schemes are generally effective in compensating consumers, so long as the claim is less than the maximum amount the scheme can award. The dollar limits of most schemes need to be significantly raised. In the first instance this is a matter for the schemes and ASIC.

   Where a licensee is solvent, but the claim exceeds an appropriately increased jurisdiction of the relevant EDR scheme, the courts should continue to be the main compensation mechanism.

2. Mandatory professional indemnity insurance should underpin EDR determinations and court judgements.

   For insurance to work as a compensation mechanism, consumers must have a right to know the name of the insurer and the terms of the policy. At present consumers can spend tens of thousands of dollars in legal fees just to get this information. Licensees must be required to provide the name of their insurer and the general terms of the policy in their Financial Services Guide. This should be in a standard format to be settled by ASIC.

   The government and ASIC should tightly prescribe the terms of mandatory PII to stop insurers trying to "screw down" contract terms to limit their liability. A broad form civil liability policy with mandatory fraud and fidelity extensions would better meet the needs of both licensees and consumers, rather than the typical narrow negligence policy commonly in use at the moment.

3. Insurance is not enough.

   Insurance will not cover all losses. Insurers regularly deny claims where a licensee has been acting outside license conditions or selling non approved products, as has happened in Westpoint. A compensation fund is an essential element of any effective compensation regime.

   Where a licensee is insolvent or unable to pay, a broad compensation scheme like the stock exchange's National Guarantee Fund should apply. That scheme should include:
   - A broad ability to hear claims
   - A "reasonable grounds to believe" misconduct test
   - Subrogation of rights in order to recover funds if available from a liable adviser.

A second area of concern is the way a number of funds are shifting fraud and insolvency issues onto fund members in their PDS. We recommend that the Committee consider legislative changes that may be needed to prevent funds doing so.

Making it Easier to Find and Transfer Superannuation

Key points

1. CHOICE supports the key elements of the Government's Simplifying Superannuation proposals as they relate to portability of superannuation.
2. ATO or another agency should be given overall responsibility for responding to the multiple superannuation accounts problem
3. A new real time electronic superannuation transfer system based on Tax File Numbers should be established.
4. A central fund should be established as a default fund for casual employees and for account balances now held in ERFs.
5. The proposed time limit of 30 days a requested transfer needs to take effect starting from the date on which the transfer request was lodged by a member rather than from when the fund has gathered together all required information.
6. Legislation or ASIC guidance should make it easier for funds and financial advisers to provide basic and targeted financial advice about account consolidation.

CHOICE supports a standardised form to transfer benefits between funds, the reduction in the maximum transfer time to 30 days (from 90 days), and a pro-active role of the ATO in consolidating 'lost' accounts using TFNs as proposed in the Commonwealth Government's *Simplifying Superannuation* proposals released earlier this year..

'Lost' superannuation has grown to $8.2 billion[16]. Unless pro-active action is taken much of this money will not be available to consumers when they retire. But 'lost' super is only a small part of the problem of multiple superannuation accounts (that is situations where consumers can hold more than one super account, be that 'lost', 'active', or 'inactive'). Multiple superannuation results in consumers paying additional fees to funds, consumers suffer opportunity costs from having funds in low growth ERF accounts, and they pay relatively higher administrative fees as funds pass on the costs of having more small balance accounts.

CHOICE to this end believes further issues require consideration. We recommend the following additional issues be considered.

Issue 1: The role of the ATO or another authority

The process for transfer and consolidation of superannuation must be streamlined. One of the key deficiencies in the current approach is the absence of any coordination or overall responsibility for what is an industry-wide problem. A more focused response is required, and this will come from a body whose primary purpose is to assist with the consolidation of superannuation accounts

[16] As at 30 June 2005: ATO *Annual Report 2004-05* table 2.34.

The ATO has an important role to play in the consolidation of superannuation accounts and reuniting lost members with their compulsory contributions. However a recent Australian National Audit Office report found that the ATO was struggling to administer lost superannuation and reunite consumers with their lost and forgotten superannuation. CHOICE believes a central authority with overarching responsibility is better able to address the problems of fund transfer and account consolidation but it can only do this with a legislative direction, adequate powers and sufficient resources. Wether this coordination function remains within the ATO or in another agency or regulator is not of key importance, but there needs to be a more focused and centralised authority with appropriate funding levels.

CHOICE sees a well resourced authority as a better alternative to penalising employees by charging them the top marginal tax rate, where an employer or fund has not recorded a tax file number on an account.

The authority should have the following functions:

- to monitor progress towards meeting agreed targets for account consolidation,
- to implement a real time electronic transfer system based on tax file numbers
- to provide education to consumers about the benefits of consolidation,
- to resolve disputes between funds and between a fund and a consumer in relation to portability, choice of fund and account consolidation,
- to monitor the superannuation market in relation to existing and future barriers to consolidation, including through establishing improved data collection procedures, and to recommend further reform if required, and
- to review the level of exit fees and exit fee charging practices.

The authority either within the ATO, another regulator, or a standalone agency should be established for a set time-frame of say 5 years. After this time responsibility for ongoing management could be given directly to the ATO.

Issue 2: establish a new real time electronic superannuation transfer system based on Tax File Numbers.

The Federal Government, in its Simplifying Super statement in the 2006 Federal Budget, announced that it would require the ATO to use tax file numbers to direct-mail any 'lost' superannuation members. This change is welcome but a more consistent consumer focus is necessary if we are to progress.

We also believe that the portability system must become a real time online system. One of the remarkable inefficiencies associated with the current system for transferring superannuation from one fund to another is that it relies on a paper based funds transfer system[17]. There is no reason why a real time electronic system based could not be developed.

[17] Note that consumers lose here too - their money is 'out of the market' while the cheque is in the mail.

Tax File Numbers (TFN) would be an ideal identifier for an electronic super matching system. This proposal goes beyond the Government's recommendation to use TFNs to find lost super; we propose the use of TFNs to consolidate multiple accounts. Using the member's TFN would eliminate the need to introduce a totally new system. Those with multiple superannuation accounts would be identified by the ATO through the matching of industry records with tax return nominations. Procedures could be set in place for the relevant superannuation consolidation authority to contact these individuals and alert them to the consolidation process. In the same way the ATO would be able to match employees with lost and inactive superannuation accounts. Some procedures will also need to be implemented to protect individuals' privacy but we do not see these being a barrier to a more efficient transfer system.

Once the electronic system was in place, the superannuation consolidation authority could establish an electronic interface for consumers to use this transfer system to consolidate their accounts.

Issue 3: ERFs, 'Lost' superannuation and a casual employee fund

CHOICE supports the House of Representatives Standing Committee on Economics, Finance and Public Administration[18] proposed Government-determined default fund for casual employees. In its recent *Improving the superannuation of people under 40s inquiry*, the Committee recommended (p xxvii):

> … that government introduce a default superannuation fund for casual employees, so that when a casual employee does not wish to choose their superannuation fund, that employee is automatically placed in a government-determined default fund.

CHOICE strongly supports this proposal but would extend it to also cover account balances now held in ERFs.

Administration of the fund could be allocated by tender to the private operator willing to perform this function to the required standard at the best price or it could be run in conjunction with the Future Fund. Unlike the ERF system this central fund must not be prevented from engaging in investment strategies which set out to provide reasonable returns for members. The pooling of ERFs and lost superannuation into this central fund would increase economies of scale for the fund and provide a holding point until employees enter full-time employment. Due to economies of scale and the absence of market failure it would be likely to charge lower fees than most existing ERFs.

When an employee (re)enters full-time and selects a private super fund, any amount held to their credit in the central fund would be transferred automatically to their new fund.

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[18] Commonwealth of Australia (2006) House of Representatives Standing Committee on Economics, Finance and Public Administration *Improving the superannuation savings of people under 40*, Parliament of the Commonwealth of Australia at http://www.aph.gov.au/house/committee/efpa/super/report/front.pdf.

Issue 4: Reduction of transfer time limit from 90 to 60 days

The new proposed time limit of 30 days a requested transfer needs to take effect starting from the date on which the transfer request was lodged by a member rather than from when the fund has gathered together all required information.

There are currently many administrative barriers in the interpretation of portability rules that frustrate consumers in their efforts to consolidate superannuation accounts. Portability problems arise when funds use different rollover forms, have different ID requirements, or use 'dirty tricks' as part of member retention strategies.

We agree that one month is ample time for a transfer. But the 30 days should apply from the moment the consumer requests a transfer and the fund should then work with the consumer to process the correct information before that date expires. Currently super funds can frustrate the transfer process for significant periods of time because the 30 day. Funds should be benchmarked on their performance in 'funds transfer and acceptance' in relation to account consolidation and reported annually.

Issue 5: Advice on Account Consolidation.

Legislation or ASIC guidance should make it easier for funds and financial advisers to provide basic and targeted financial advice about account consolidation.

Consumers often need information and general advice to make informed decisions about account consolidation. For example they need to know whether exit fees apply and the nature of the insurance that is available in their previous and current or proposed superannuation accounts. While some funds provide consolidation forms to new members, funds usually fall short of the kind of simple situation specific advice that is required by consumers.

With a consumer's consent, funds should be allowed to search for missing accounts on behalf of a new member and, with the consumer's authority, to locate and consolidate additional superannuation monies into the new account.

There is some possibility that in doing so under current law the fund would be required to issue a Statement of Advice and/or risk incurring potential liability under the financial advice provisions. ASIC has power to grant relief from the application of these provisions and should do so in relation to basic and targeted advice about account consolidation. .

Provided the member's new fund kept its advice within the boundaries of a strict ASIC checklist then it should be possible to avoid potential abuse.

Other Saving Objectives and the Level of Compulsory Superannuation Contributions

There is currently discussion by many in the superannuation and funds management industry about the need to increase the level of compulsory superannuation contributions. The proposal may sound appealing.

Superannuation, however, is already highly privileged in comparison with other forms of saving, and it can easily be extended to the point of diminishing or negative returns.

For younger people there are significant constraints on their income. They typically face some of the highest cash flow needs of their lives. This is even more so if they have children. Most notably this involves savings for housing in an inflated market. Other activities or products that consumers will generally need to save for could include the purchase of vehicles, education, the establishment of businesses and expenses relating to children. We would note that this may involve both pre-saving (eg. putting money aside prior to purchase of a car) and post-saving (for example paying off a HECS debt).

It is recognised the implementation of compulsory superannuation has not increased national savings in any amount near original Treasury predictions[19] (as distinct from asset appreciation). There has been an increase in household debt as compulsory superannuation has been implemented (though the increase in household debt greater than the impact of SGC). Voluntary saving has declined. The impact of any increase in the contribution rate needs to be considered due to the potential to increase household debt levels further. Credit card debt for example is at an all time high and recent interest rate increases combined with oil price rises has seen a worrisome increase in cash advances on credit cards.

If the committee is concerned about contribution levels then it could examine those ways existing leakages from compulsory superannuation can be ‘patched-up’. A reconsideration of the use of trailing commissions on compulsory superannuation would increase effective contribution rates.

ENDS

[19] Edey M and Gower 92000) National Savings: rends and Policy in Gruen and Shrestha et *The Australian Economy in the 1990s*. See al. Connolly E and Kohler, M. (2004), The Impact of Superannuation on Household Saving, RBA Research Discussion Paper RDP2004-01. For a Review of this issue see Coates, N. (2004) “Still Saving the Nation 12 Years On? *Journal of Australian Political Economy* No. 54.