Chapter Four

Portability, the Default Fund and Insurance

Introduction

4.1 This chapter examines three major issues raised during the Committee's inquiry in relation to implementation of choice of fund under the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002:

- the portability of funds;
- the default fund; and
- the coverage of individual employees by death and invalidity insurance.

Portability

4.2 The Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 is designed to commence on 1 July 2004. Only SG funds contributed to a complying fund or RSA from that point on are subject to the provisions of the Choice Bill. The Government intends that the balances of existing funds at 1 July 2004 will be transferable under the Government's proposed portability policy.

4.3 The Government formally announced its proposal for portability of superannuation to complement the Choice Bill on 19 September 2002, during the conduct of the Committee's inquiry. To accompany the announcement, the Government released a consultation paper, *Portability of Superannuation Benefits: Enhancing the Right of Members to Move Existing Benefits Between Superannuation Entities*.[1]

4.4 In its announcement, the Government indicated that there are just over 24 million superannuation accounts in Australia which means that there are approximately two to three accounts for every person who can have an account. As a complement to choice of fund, the portability policy will extend to a minority of members who are currently unable to consolidate their superannuation benefits into one account the ability to do so, thereby reducing the impact of fees and charges. In releasing the paper, the Government emphasised that although portability and choice of fund are complementary, they are not dependent upon each other.

4.5 The Committee notes that a considerable proportion of fund members are already able to consolidate their superannuation accounts but don't because of the paperwork involved and/or the exit fees levied on them. The Committee also notes

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1 *Committee Hansard*, 19 September 2002, p. 318.

that, as part of the 'Unclaimed Super Recovery Initiative' launched by the Government, at 31 October 3,028 accounts worth $4.7 million had been reunited with their rightful owners.[2] With over $6.8 billion in 'lost' accounts, and an average of $1,600 per account, this important initiative is an encouraging step towards reuniting some 2.7 million Australians with their accounts.

4.6 In evidence to the Committee on 19 September 2002, Mr Thomas from the Treasury indicated that the Government is seeking responses to the consultation paper by 18 November 2002. Following consideration of these responses, the Government anticipates implementing portability through regulations amending the *Superannuation Industry (Supervision) Act 1993*. Mr Thomas indicated that there are no heads of power available to implement portability through primary legislation.[3]

4.7 The Committee anticipates that the Government's portability consultation paper will attract considerable comment from the industry. Prior to the release of the consultation paper, the Committee received evidence from a range of parties such as SOS, the ABA and ISFA arguing that employees should be able to transfer their existing fund balances, and not just their future SG contributions, to the fund of their choice.

4.8 For example, in its written submission, the ABA argued that an employee is unlikely to take the initiative to become actively involved in planning their superannuation if they cannot access their existing contributions.[4] This position was reiterated by Mr Bell from the ABA in evidence on 11 September 2002:

> One of the big issues with superannuation is that most people do not understand or … are apathetic. Maybe part of that apathy is linked to the fact that they do not have control over their funds. If you give them the ability to deal with their own money in their own way, perhaps you can remove some of that apathy or some of that lack of interest.[5]

4.9 This position was also supported by Dr Pragnell from ASFA in the hearing of 3 September 2002, in which he noted that portability has to mean being able to move current balances, or face a proliferation of accounts.[6]

4.10 Without portability of funds contributed prior to 1 July 2004, various parties such as Mr Engelhardt and Mr Stephens argued that choice of funds would lead to a proliferation of accounts in Australia (the average employee already has three superannuation accounts).[7] In this regard, the Committee notes the written submission

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2 Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, Media Release, *Australians recover millions in 'lost' superannuation*, 31 October 2002.

3 *Committee Hansard*, 19 September 2002, p. 318.

4 *Submission* 34, ABA, p. 2.

5 *Committee Hansard*, 11 September 2002, p. 250.

6 *Committee Hansard*, 3 September 2002, p. 148.

7 *Submission* 12, Mr Stevens & Mr Engelhardt, p. 3.

of the Cbus, in which it indicated that currently there is around $6.8 billion, or an average of $1,600 per person, waiting to be claimed in 'lost' superannuation.[8]

4.11 The Committee also notes that in its written submission, Cbus also argued that a portability protocol should include information that is required for a rollover to occur, a standard rollover form approved by the industry regulator to facilitate transfers, and established times for rollovers to occur.[9]

4.12 Finally, the Committee notes concerns that entry and exit fees pose a barrier to consolidation and portability. These concerns include those expressed by Cbus that, where they exist, some substantial exit fees, which are not the norm, undermine the intention of this legislation and contradict the position of some of its strongest supporters, as follows:

> For the superannuation industry to be competitive in a choice of funds regime it is not acceptable that some consumers, who may have made decisions that they are not happy with in the past, are locked out of making a choice because of the exorbitant fees they would incur if they transferred their superannuation to a new fund. It is not acceptable for some retail superannuation funds to argue for choice on the one hand, but prevent their own clients from exercising choice.[10]

4.13 The issue of entry and exit fees is discussed in more detail in Chapter 8.

The default fund

4.14 As previously noted, the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 proposes that the default fund for existing employees will be the employee's current fund, while for new employees under a choice environment it will be the Commonwealth or Territory industry award fund, followed by the 'majority fund', followed by any eligible fund chosen by the employer. Proposed subsection 32K(2) states:

> The default fund is:
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> (a) the selected Commonwealth or Territory industrial award fund for the employee (see subsection (5) and (6)); or
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> (b) if there is no Commonwealth or Territory industrial award fund for the employee – the employer's selected 'majority fund' (see subsections (7) to (11)); or
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> (c) if there is no Commonwealth or Territory industrial award fund for the employee and no 'majority fund' for the employer – the eligible default fund selected by the employer (see subsection (4)).

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8 *Submission* 16, Cbus, p. 9.

9 *Submission* 16, Cbus, p. 9.

10 *Submission* 16, Cbus, p.8.

4.15 During the inquiry, various parties noted that at least in the first instance under a choice regime, a majority of employees would continue to have SG contributions made to the default fund by their employers.[11]

4.16 The provisions of the default fund met with broad support during the inquiry from parties such as the Industry Funds Forum, the ACA, the NFF and ASFA. For example, ASFA noted in its written submission:

> ASFA supports a clear and effective mechanism for selecting the default fund. This is especially important as many employees are unlikely to exercise their choice. ASFA believes the current proposal for default fund selection better respects existing practices than previous attempts to establish a default mechanism.[12]

4.17 The Committee notes, however, that parties expressed their support for the default provisions for different reasons. In its written submission, the ACA supported the default provisions on the basis that default award funds are well-managed, established funds that have the endorsement of the Australian Industrial Relations Commission (AIRC). By contrast, the NFF also supported the default provisions, but on the basis that they place minimal responsibilities on employers, other than to indicate to the employee during the choice process what the default fund is.[13]

4.18 The Committee also notes the concern of Mr Watson from the MTAA Superannuation Fund that there may be confusion under many awards which is to be the default fund, since many awards specify several funds for the delivery of mandated superannuation.[14]

4.19 The view that employers should not be subject to a multiplicity of default funds was also emphasised by IOOF Funds Management. IOOF Funds Management further submitted that, in its view, it was not necessary to specify a default fund in the legislation and that an employer should be able to select an appropriate fund for contributions where an employee has failed to exercise choice.[15]

4.20 The Committee notes that the ATO advised that it is not aware of significant fund selection or access issues experienced by employers in choosing a superannuation fund since the introduction of the Superannuation Holding Accounts Reserve (SHAR) in 1995. However, the ATO also advised that prior to 1995 some employers had reported difficulty in getting superannuation funds to accept their small superannuation contributions and that the SHAR is still in use today.[16]

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11 *Committee Hansard*, 3 September 2002, p. 149.

12 *Submission* 17, ASFA, p. 2.

13 *Submission* 1, NFF, p. 11.

14 *Committee Hansard*, 3 September 2002, p. 139.

15 *Submission* 50, IOOF, p. 2.

16 *Submission* 48, ATO.

Simplifying the default provisions

4.21 While many parties supported the default provisions, a number of parties argued that employers should be given the right to simply choose the default fund in the event that an employee does not exercise a choice, so as to minimise the burden on the employer. This position was adopted by ACCI in its written submission, and reiterated by Mr Anderson from ACCI in the hearing on 3 September 2002.[17]

4.22 Similarly, the FPA also argued in its written submission that the current default fund requirements are overly prescriptive. The FPA submitted that the principle that employees should have unbridled choice of fund should equally be applied to the default fund. The FPA argued that providing employers with 'unbridled choice' of default fund would further enhance competition in the superannuation industry – employers as well as employees will shop around for an appropriate complying super fund.[18] Again, Mr Breakspear from the FPA restated this position in evidence on 11 September 2002.[19]

4.23 IFSA also argued in its written submission that the default scheme is unnecessary and anti-competitive, on the basis that it would have the effect of extending the reach of funds prescribed in awards, under pain of criminal penalty. Moreover, IFSA suggested that the default scheme would lock in structural rigidity, and would mean a significantly reduced level of competition in the default fund market.[20] This position was reiterated by Mr Bissaker from IFSA in evidence on 11 September 2002:

> When SG was introduced, no restriction was placed around the complying fund that the employer would make contributions to—of course, with the exception of industrial relations requirements, and those requirements remain and will stand. The current bill seeks to start to place restrictions around the default fund in excess of what we have seen in history. Our view is that the default fund has served us well and will continue to serve us well as it remains …[21]

4.24 Finally, the ABA also argued that for both employees and employers, the essential elements of a default fund are equity, security, competition and simplicity. In the view of the ABA, 'these are met if the employer can nominate any complying superannuation fund as the default fund, to apply to all SG payments that are not subject to an award.'[22] Mr Loveridge from the ABA again expanded on this position in evidence on 11 September 2002:

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17 *Submission* 25, ACCI, p. 12. *Committee Hansard*, 3 September 2002, p. 181.

18 *Submission* 37, FPA, p. 4.

19 *Committee Hansard*, 11 September 2002, p. 215.

20 *Submission* 36, IFSA, pp. 3-4.

21 *Committee Hansard*, 11 September 2002, p. 232.

22 *Submission* 34, ABA, p. 2.

> The point there is that the default fund would then be subject to the market forces of the employees. Say you had an employer with 100 employees. If a high percentage were happy with the default fund, that would indicate that the default fund was popular and probably a good choice. If a low percentage were happy with the default fund, or if there were swings one way or the other, that would serve as a barometer—which, I think, was the language we used—to indicate whether the employer's arrangement was judged by the employees as being a superior or inferior arrangement.[23]

The 'majority fund'

4.25 The Bill proposes that the default fund for an employee in the absence of a Commonwealth or Territory industry award fund is the 'majority fund'. The 'majority fund' is the eligible choice fund to which the employer contributes on behalf of more employees than any other fund (proposed sections 32K (7), (8) and (10)). If an employer contributes on behalf of the same number of employees to two or more funds, the employer must choose one of them as the default fund for the employee (proposed section 32K(9)).

4.26 In its written submission, Mercer raised the possibility that the 'majority fund' will change over time as the workforce changes at a company. Accordingly, employers will have to regularly review the 'majority fund', thereby placing additional administrative costs on employers.[24] This possibility was also raised by Mr Bissaker from IFSA:

> The problem with that is that, if you think about a typical workplace, over time the workplace changes. The workplace can add divisions, sell off divisions, et cetera, so there could be a different default fund from time to time in that workplace. An employer may be contributing to one default fund, then they sell off a division and buy another division, and the 'majority fund' becomes another default fund because separate award based funds or another master trust comes into that new division they bought. From time to time the employer will have to maintain a database of which default fund applies to which individual employee because, remember, this legislation defines the default fund at the employee level. So the employer has to be very careful about that level of complexity.[25]

4.27 During the hearing on 19 September 2002, the Chair raised the provisions of proposed section 32K(5)(b) of the Choice Bill which states:

> A fund is a Commonwealth or Territory industrial award fund for an employee if:

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23 *Committee Hansard*, 11 September 2002, p. 248.

24 *Submission* 20, Mercer, p. 6.

25 *Committee Hansard*, 11 September 2002, p. 233.

(a) a Commonwealth industrial award or Territory industrial award requires the employer to make contributions to a fund on behalf of the employee; and

(b) the award does not provide that the employee may choose the fund to which contributions are made or provides that the employer must agree to any such choice; and

(c) contributions by the employer to the fund for the benefit of the employee would satisfy the requirement in the award; and

(d) the fund is an eligible default fund for the employer.

4.28 The effect of proposed section 32K(5)(b) is to preclude the selection of a fund prescribed in an award as the default fund if that award provides the employee with a choice of fund. In that scenario, the default fund becomes the 'majority fund' under the current Bill.[26]

4.29 The Chair expressed his concern that the text of proposed section 32K(5)(b) does not provide any precise linkage to indicate that where an award fund is not eligible for selection as the default fund, then the default fund becomes the 'majority fund'.[27]

4.30 In response, Mr Thomas from the Treasury indicated that the linkage is in proposed section 32K(2), as reproduced above, which provides that the default fund is the Commonwealth or Territory industrial award, subject to subsection 5 as discussed. The Committee had difficulty following this explanation and addresses the matter in Chapter 9.

The 56-day compliance period

4.31 Under proposed sections 32N and 32Q of the Bill, the employer must give employees a standard choice form within 28 days of the employee commencing work, or within 28 days of the employee requesting a choice; the employee must then give the employer written notice of the chosen fund within 28 days of receipt of the standard choice form.

4.32 In evidence to the Committee on 2 September 2002, Mr Rosario from Westscheme noted the possibility under the proposed choice environment that employers could be required to make an SG payment before the 56-day period for an employee to make a choice has lapsed. In that scenario, Mr Rosario questioned whether the employer should delay the SG payment, or make the payment to the default fund.[28]

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26 *Committee Hansard*, 19 September 2002, p. 342.

27 *Committee Hansard*, 19 September 2002, p. 343.

28 *Committee Hansard*, 2 September 2002, p. 61.

4.33 The Chair raised this matter with Mr Boneham from the Treasury in the hearing on 11 September 2002. Mr Boneham indicated that during the 56-day period, the employer is able to pay SG contributions to the default fund, in lieu of the employee indicating a choice of fund. Whether any such compulsory contribution to the default fund can then be retrieved if the employee chooses a different fund, and who will bear the cost of doing so, will be dealt with under the government's portability proposals.[29]

Death and invalidity insurance

4.34 Currently, superannuation fund and RSA providers are not compelled by the *Superannuation Industry (Supervision) Act 1993*, the *Retirement Savings Accounts Act 1997* or the *Superannuation Guarantee (Administration) Act 1992* to offer their members death and disability insurance. However, many funds nevertheless provide death and disability insurance, with premiums funded out of compulsory employer contributions.

4.35 For example, in its written submission, Cbus noted that contributing members of the fund have access to death and total and permanent disability insurance cover from the date of their employment without the need for medical inspections. However, Cbus suggested that prior to the establishment of this cover by Cbus in 1984, building and construction industry workers found it difficult to get cover due to the hazardous nature of their occupation.[30]

4.36 Similarly, in evidence on 2 September 2002, Mr Rosario from Westscheme indicated that Westscheme offers insurance coverage to employees from the date their employment begins. He noted several instances where people had died even before Westscheme had received a contribution, but they were nevertheless covered by insurance.[31]

4.37 Given the current capacity of large industry and corporate funds to offer comprehensive life and disability cover, various parties argued that this may be lost in a choice of fund environment, due to the greater potential turnover of fund members. This in turn raises the possibility that individuals would need to seek their own insurance coverage, at retail rates and conditions based on a medical assessment.

4.38 Such concerns were raised by Quadrant Superannuation,[32] Mercer[33] and Cbus, which questioned whether it would be able to continue to offer its members blanket

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29 *Committee Hansard*, 11 September 2002, pp. 290-291.

30 *Submission* 16, Cbus, pp. 9-10.

31 *Committee Hansard*, 2 September 2002, p. 60.

32 *Submission* 14, Quadrant Superannuation, p. 2.

33 *Submission* 20, Mercer, p. 8.

coverage without medical assessment.[34] Ms Butera from Cbus emphasised this evidence in the hearing on 2 September 2002:

> In a choice of funds environment, low risk members may be able to secure improved life insurance benefits, however the danger is that this may increase the risk for the remaining pool of members. The ability of Cbus to offer its members blanket coverage without medical evidence in these circumstances would be compromised as a result of the introduction of choice of funds.[35]

4.39 By contrast, however, Mr Bissaker from IFSA argued that the vast majority of employees will remain with employer-based funds or with the default funds, and that accordingly the ability of those funds to provide a reasonable insurance cover will continue.[36]

4.40 In response to the insurance issue, Mr Thomas from the Treasury indicated in evidence on 11 September 2002 his expectation that the market will develop to offer insurance to funds members where funds are unable to offer universal coverage.[37] Mr Thomas reiterated this in evidence on 19 September 2002:

> The insurance market will develop and change. Evidence from Western Australia suggests that that happens. The particular fund that I am thinking about—Westscheme—is not a single employer scheme of the like where a workplace would have a certain percentage of people as members in order to provide that death cover from inception, but that scheme does provide that sort of arrangement for people who have not selected against them as the default fund. Our expectation is that large default funds—again with the economies that come from that—may well give insurance players the comfort they need to be able to offer that cover from inception.[38]

4.41 Mr Thomas also suggested that choice gives individual employees the opportunity to select fund that offers death or disability coverage if they want it.[39]

Mandated default insurance coverage

4.42 During the inquiry, various parties argued that in response to the possible loss of death and invalidity insurance by some employees under a choice environment, the Bill should mandate death and invalidity insurance through the default fund provisions. For example, Cbus recommended that the introduction of choice of funds should be accompanied by standards that ensure that all super members are covered

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34 *Submission* 16, Cbus, p. 9.

35 *Committee Hansard*, 2 September 2002, p. 46.

36 *Committee Hansard*, 11 September 2002, p. 233.

37 *Committee Hansard*, 11 September 2002, pp. 292-293.

38 *Committee Hansard*, 19 September 2002, p. 338.

39 *Committee Hansard*, 11 September 2002, pp. 292-293.

by life insurance arrangements.[40] Similarly, the ACA argued that the proposed Bill should mandate:

- automatic insurance for all new employees from the date of their employment;
- compulsory cover by way of an amount of premium per week (rather than a fixed level of cover with the premium calculated as a result); and
- the cover of both death and temporary or permanent disability.[41]

4.43 The Chair raised in the hearing on 2 September the appropriate level of protection that could be mandated under the Bill. In response, Mr Noble from Cbus indicated that the average protection for member of Cbus is $50,000, and that this would be a reasonable level of cover that could be mandated in the Bill.[42]

4.44 The Chair similarly raised this with Mr Rosario from Westscheme. He indicated that Westscheme offers $30,000 death and total disablement cover for 77c a week for people under 30, but suggested a premium of up to $1 a week might be sufficient to provide for $70,000 in death cover alone.[43]

4.45 In response to this proposal for mandated insurance coverage, Mr Thomas from the Treasury indicated in evidence on 19 September 2002 that the Government will enter into consultation with the industry following the passage of the Choice Bill to examine the possibility of prescribing a minimum default funds insurance level.[44]

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40 *Submission* 16, Cbus, p. 10.

41 *Submission* 27, ACA and FSCPC, p. 3.

42 *Committee Hansard*, 2 September 2002, p. 47.

43 *Committee Hansard*, 2 September 2002, p. 62.

44 *Committee Hansard*, 19 September 2002, p. 338.