

Democrats' Supplementary Report

The Australian Democrats support the views and recommendations outlined in the Committee's report on this bill. However, we do not agree with the Government senators' recommendation that the bill be passed.

The Democrats support the principle of choice of funds. This bill has had a long and tortuous history going back to 1996. However, choice of funds is an idea whose time is gradually coming.

Since the first bill was debated in the Senate in 1997, the Government has made a large number of amendments to the second and third versions of the draft legislation. These amendments have arisen as a direct result of negotiations between the Democrats and the then Assistant Treasurer Senator Rod Kemp. These changes include:

- Changes to the default scheme rules, setting the award scheme as the default, or failing that, the majority fund. These changes corrected the original plan to leave these decisions in the hands of employers;
- Allowing choice to be exercised by certified agreement or AWA. This allowed a workplace as a whole to decide which fund best suited their needs, and to have this incorporated into their workplace agreement;
- Increasing the funding for education about choice to \$14 million, including \$2 million in seed funding for a superannuation consumer service. We have welcomed the increase in funding, but, as several witnesses have pointed out, a much larger education and ongoing advisory service will be needed to overcome the low level of understanding of superannuation among many workers;
- Requiring default funds to offer a basic level of death insurance, preferably from the first day of employment;
- Providing employees with a standard choice form, with advice to employees about matters they should take into account in choosing a fund;
- Making it an offence for employers to promote membership of any particular fund;
- Making contributions to the superannuation guarantee quarterly rather than annually;
- Monitoring of fees and charges for the first twelve months of choice;
- Allowing at least twelve months notice of commencement of choice of funds legislation.

However, the Government and the Democrats could not reach final agreement on choice of funds legislation. The matters on which the Democrats will seek further commitments from Government before supporting this legislation are:

- Choice in allocating death benefits. The Democrats believe that workers should be able to choose not just where their superannuation goes when they are alive, but also where it goes when they die. The current restrictive definitions of spouse and dependants in the Act deny many employees choice on where their benefits go. It is particularly discriminatory against same sex relationships, as well as a myriad of other interpersonal and familial relationships. All States have now moved (or are moving) to remove such discrimination from State law, and it is well time that the Commonwealth followed suit, as was canvassed by the Select Committee on Superannuation in April 2000;
- Ensuring simplified and standardised disclosure of fees and charges that show the final impact on benefits in an understandable and comparable form. This issue is addressed in the Committee's main report, and must be resolved.
- Ongoing education and advisory services. The Democrats strongly believe that consumers must have access to ongoing information and education about how choice and superannuation works. We have strongly pushed the proposal of a superannuation consumer service, and continue to do so, as a community-based means of dealing with this real need.
- Future of defined benefit funds. This issue is canvassed in the main report. While allowing for collective choice will probably protect most, if not all, defined benefit funds, it would be appropriate to allow generous funds to be excluded from the legislation. The future of the Commonwealth superannuation funds will also need to be expressly considered, with the Democrats opposed to the Government plans to close the funds without a comparable replacement scheme in place.

The Committee report also highlights a long list of technical problems with the current bill which need to be addressed by Government.

Choice of funds needs to work to the benefit of workers, not just to the benefit of the financial services industry. The Government has come some considerable distance in the last five years in improving and refining its proposal. However, given the low level of understanding in the community about superannuation, the proposed scheme is still not sufficiently robust enough for the Democrats to support it. To ensure that choice benefits employees, the Government will need to address the issues raised in the report, and the additional items on the Democrats list. Then, Australia will have a choice regime that can deliver the real benefits of choice, while minimising those benefits being frittered away by inappropriate commercial practices.

Senator John Cherry
Australian Democrats

Additional Comments by Labor Senators

Overview

Labor senators believe that consumers should have a broad and well-informed choice of fund with full protection – this Bill does not provide the basic elements of this objective.

This Bill potentially impacts on the superannuation retirement savings of 8.8 million Australians. It has major ramifications for their superannuation savings.

This Bill with its deregulation will force employers to offer a choice of fund and will force up to 8.8 million Australians to make a choice of fund.

It effectively deregulates the current retail structures and with that deregulation additional costs will emerge.

Superannuation is a highly complex financial product; it is compulsory for all employees at levels of 9% contribution of wage or salary through the superannuation guarantee (SG) and is underwritten by very large tax concessions to the value of \$9.5 billion (last financial year). The SG is a form of compulsory saving to help fund retirement incomes which is passed on to the private sector for administration and investment.

Superannuation is not like a CD, car, or even a house. It is long-term (no access until the age of 55 or 60) and not easily returnable if invested in a poor product. It can take years for the impact of an adverse decision to emerge.

The critical problem is the level of financial literacy of 8.8 million Australians. To what extent should forced decision making be expected of up to 8.8 million consumers and what level of protection should be in place?

The Liberal laissez-faire free market philosophy that deregulation of superannuation will increase competition and should lead to a reduction in costs because 8.8 million consumers will be well-informed as result of disclosure and education is fundamentally flawed.

In the UK the Thatcher Government tried the experiment and it was a disaster. In the US - the often-quoted free market leader – not even the strongest advocates of privatisation of the social security (pension) systems are arguing for choice of fund.

The Government's disclosure model is not comprehensible and their education campaign miniscule.

If adequate disclosure is delivered what will be the behaviour of consumers when forced to make a choice? Many will make poor decisions to their detriment and/or

seek additional advice adding an extra layer of private sector bureaucracy for which they will have to pay from their contributions thus reducing their retirement income.

This is what the major supporters of this Bill – the major retail banks and financial advisors – want to see.

Where choice of fund exists at the present time, and it does exist for the self-employed and some employees who are award free, the outcome has afforded no advantages. These individuals generally choose retail funds, often at the recommendation of an agent remunerated by commission. These funds have average long-term investment returns which are on par or slightly lower than profit-for-member funds with fees, charges and commissions that are certainly much higher. According to industry surveys by ASFA, IFSA and Rainmaker, they are at least double.

Choice exists in another form – investment choice. Eighty per cent of members of funds are now able to pick from a menu of investment options if they wish. Interestingly only a very small minority – less than 10% actually do elect an investment option.

The interests of employers also need to be taken into account. This Bill forces employers to undertake complex and costly compliance with a very specific bureaucratic regime of red tape, potential legal liability and significant fines for breaches.

This unanimous report on the Bill provides a comprehensive and well-balanced outline of the many and complex problems associated with choice of fund. Government members however, while displaying a commendable bi-partisan analysis of these problems, stop short of recommending specific solutions to the numerous flaws in the Bill as a pre-condition to supporting it.

Labor senators do recommend a range of specific amendments that will provide essential and stronger protections to consumers. Without these stronger protections Labor will not support the Bill.

Rationale for the Bill

The stated motivation for this Bill is stated at 1.9 of the majority report. However, there is some evidence to the contrary and that the Government's intention is quite different. It is with concern that the Labor senators note in this context the comments of David Tollner, Country Liberal Party Member for Solomon, in relation to choice¹:

The other day I was at a backbench briefing. The subject matter was superannuation - an area in which I have some experience and I was paying attention. **It was suggested that the freedom of choice in superannuation**

¹ David Tollner, Speech to the Northern Territory Industrial Relations Society, 31 August 2002, pages 2-3

funds to be offered to employees through new legislation was, in part, a union busting exercise. I said: “How does that work?”

I got referred up the line - to a senior parliamentary colleague who maintains a strong anti-union stance on all matters. He said he couldn't tell me how that worked. The moral of the story is that sometimes the cause takes precedence over reason. My superannuation background means that in the past I crossed between those in the lounge bar and those in the public bar. [Emphasis added]

The Labor senators note that there is no such entity as a “union fund” – industry funds have equal employer and employee representation. We also urge the Government to leave aside their ideological fixation with industry superannuation funds and address the real concerns that this model of choice presents.

In the process of attacking industry funds, corporate and public sector funds - the other participants in the “profit-for-members” sector - will also be undermined. These funds generally offer a superior level of contribution and usually the employer sponsor pays the administration and insurance costs. The trend is for these funds to be “wound down” - membership choice would spell their end. At the very least contracted out master trust arrangements will have to be re-written.

Disclosure

The Government claims that employees will be protected by improved disclosure and an education campaign. It argues that the \$28 million over four years that the ATO will spend on establishing choice/deregulation (only \$14 million will actually be spent on education – the rest is for ATO administration) is sufficient to educate up to 8.8 million superannuation fund contributors on the complexities of superannuation to enable them to make an informed choice. This is clearly not the case.

A vital aspect of informed decision-making is meaningful disclosure. Since the Government refused to regulate for a meaningful disclosure regime in September 2002, there is no requirement in the regulations to provide for the disclosure regime required.

Recommendation: That the Treasurer undertake in writing to bring back the disclosure regulations the Government proposed earlier this year with a sunset period of 1 July 2004 and to introduce enhanced disclosure requirements, for both superannuation funds and for other managed funds, after that in line with market testing they will carry out or participate in (such as the ASFA testing already underway that they have been involved in) over the next 12 months (as proposed by the Labor Party in September 2002).

Fees and Charges

Despite the claims from the Government that choice will reduce fees and charges as a result of competition, Labor senators believe that the evidence, including the evidence

on commission-based selling, rather than mere assertion, is that fees and charges will increase.

In the UK and Chile where choice has been implemented it has led to massive increases in charges.

Charges are driven up because of a combination of factors such as advertising campaigns and intermediaries, agents and planners on commission ‘advising’ consumers. A 1 or 2 per cent annual fee reduces the final retirement accumulation by 22 and 40 per cent respectively. A 5 per cent fee reduces retirement savings by 60 percent.²

Analogies

Superannuation is compulsory, it is preserved until retirement and serves a vital function in terms of providing an adequate income in retirement. For this reason, it is not like other financial products which people enter into voluntarily and can liquidate when they choose. It is very similar in its national importance to other key products which the Government currently regulates in terms of price.

- **Medical insurance** - The premiums charged by private health insurance funds are regulated under the *National Health Act 1953*. In short, Private Health Insurance funds are not able to increase their premiums without the support of the Minister for Health and Ageing, although recent changes do allow for automatic annual indexation. These price increases, along with those above the cost of living are still subject to the Minister’s veto.
- **Aged care** – Maximum fees for aged care facilities are mandated under division 58 of the *Aged Care Act 1997*. They are very specific in relation to the different elements that make up the total cost of care.³
- **Phone calls** – There is a 22c cap on local calls made under standard connection packages, which is determined by disallowable instrument linked to the *Telecommunications Act 1997*.

For the reasons outlined here and in the main report, Labor senators argue that it is both sound public policy and stronger protection for consumers to regulate fees and charges that apply to the compulsory 9% SG on a standard product. The level of cap is based on both Treasury estimates of a reasonable fee used to predict final retirement incomes and industry surveys of existing fee levels.

Recommendations:

The Bill should be amended to:

² Assumes 40 years of accumulation. Bateman, Hazel *Disclosure of Superannuation Fees and Charges* (August 2001)

³ For details of these charges see: <http://www.health.gov.au/acc/finance/resfees.htm>

- **Cap ongoing fees and charges that can be debited against the SG contributions and accumulated SG savings of new members at 1.2 per cent per year or an appropriate combination of dollar and percentage amounts. Funds could apply these caps to non-SG contributions and savings and/or other members if they wished.**
- **Prohibit entry, exit, and switching fees that can be debited against accumulated SG savings of new members beyond reasonable administration costs associated with processing the entry, exit or switch;**
- **Cap the total cost of insurance that can be debited against the SG contributions and accumulated SG savings of new members at an appropriate dollar amount per year unless a member elects otherwise;**
- **Provide reporting and public disclosure of all fees and charges made by superannuation funds and their intermediaries; and**
- **Prohibit the employers and/or providers and intermediaries from linking superannuation with other benefits for the employer (such as cheaper insurance or banking for the employer).**

Defined Benefit Funds

Defined benefit funds often provide substantially greater superannuation benefits to their members. Ninety-five per cent of corporate defined benefit schemes provide benefits for their members about SG. Labor senators also note the commentary in paragraphs 5.2 to 5.10 and believe there is a strong case for the employer sponsors of defined benefit schemes to be exempt from choice. To make this easier for employers and to provide a consistent approach, all defined benefit schemes should be covered by this exemption.

Recommendation: The provision of a defined benefit scheme is considered to satisfy choice.

Same Sex Couples

This Bill represents substantial changes to national legislation that purports to provide choice for all Australians. Given that Australians have a fundamental right to choose a partner, we believe that this Bill should also make amendments to the provisions that currently discriminate against those who are in same-sex relationships.

It is ironic that the Liberal Government argues for choice as a fundamental right in so many contexts and yet in this Bill that is intended to provide superannuation choice of fund it doesn't also provide for choice of domestic partner for superannuation purposes.

Recommendation: A specific amendment to the Bill to ensure equity for same-sex couples.

Employer Compliance

The attached flow diagrams of the choice maze for business, with its 35 main steps, presents the substantial burden imposed by choice on employers, which will be particularly onerous for small businesses. By Treasury's own admission,⁴ over the 5 years that choice has been proposed by the Coalition Government, not a single small business representative group has been consulted. An insight into the views of small business on this model of choice can be gleaned from a letter published in the *Australian Financial Review* on 24 September 2002. In the letter from the Queensland Retail Traders and Shopkeepers Association the following question was posed: "*When will bureaucrats and politicians realise there is a limit to the ability of a small business to cope with all of this?*"

The Labor senators condemn the Government for failing to consult with small business representatives, especially as the Treasury did find the resources to consult with the representatives from the major banks and other financial institutions.

Recommendation: Small business should be exempt from the choice regime and the status quo should be maintained as to the process for selecting an eligible fund.

Senator the Hon Nick Sherry

Senator Geoffrey Buckland

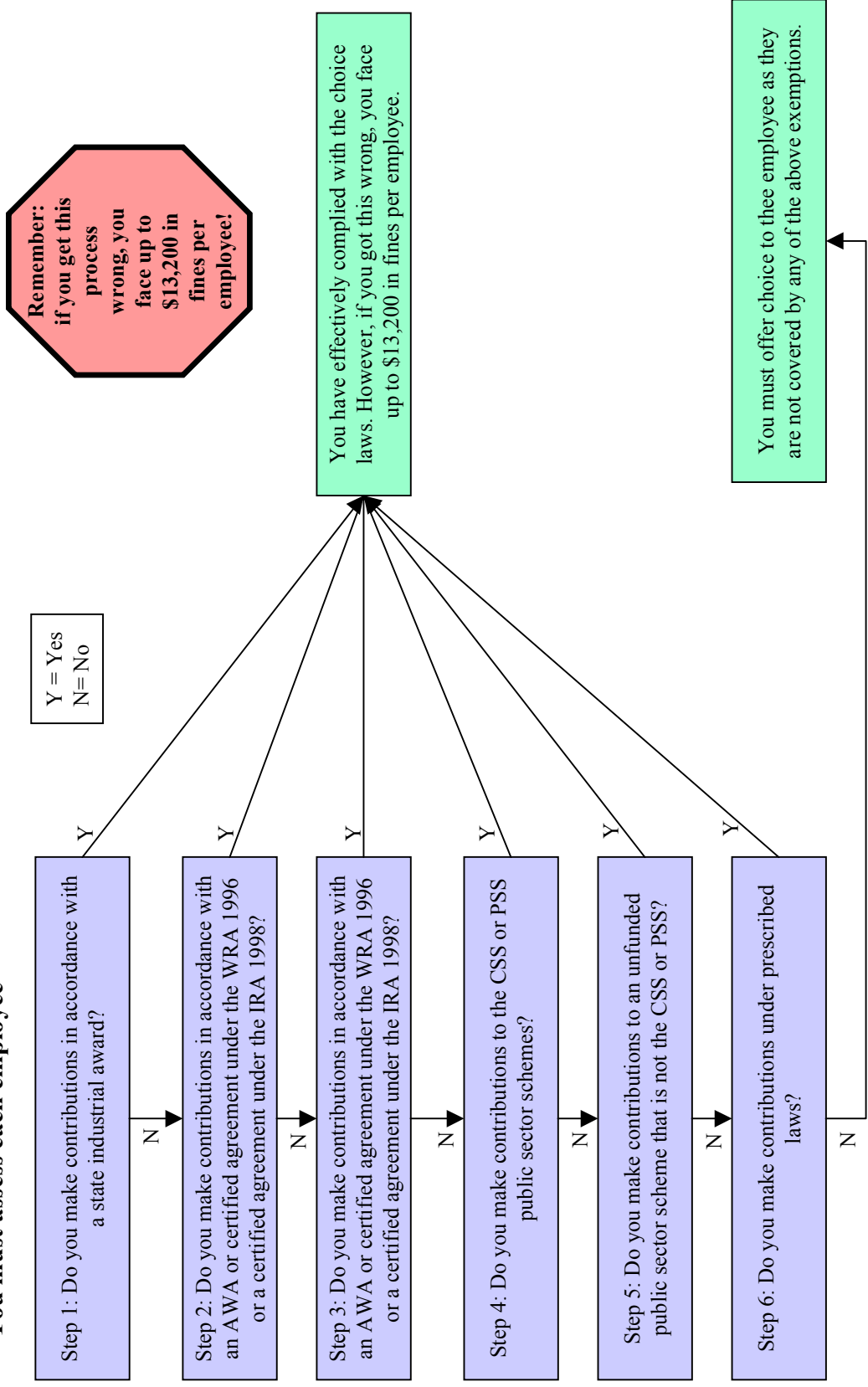
Senator John Hogg

⁴ Response to questions on notice, 15 October 2002

The Liberal's Super Choice Maze for Business

Part A – Which employees are covered by choice?

You must assess each employee

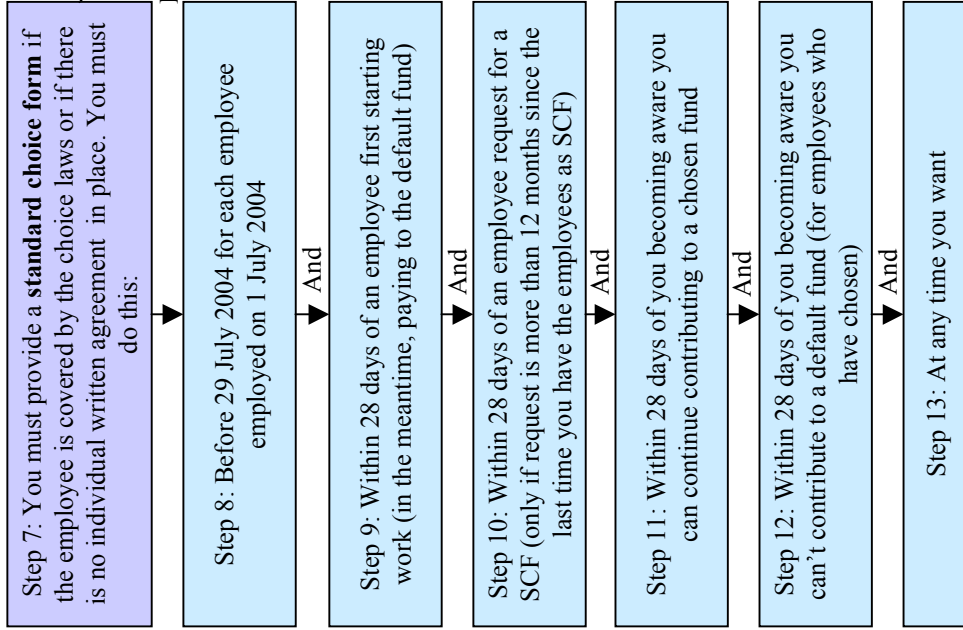


The Liberal's Super Choice Maze for Business

Part B – How choice must be offered... page 1

Y = Yes
N = No

Formal choice process (FCP)



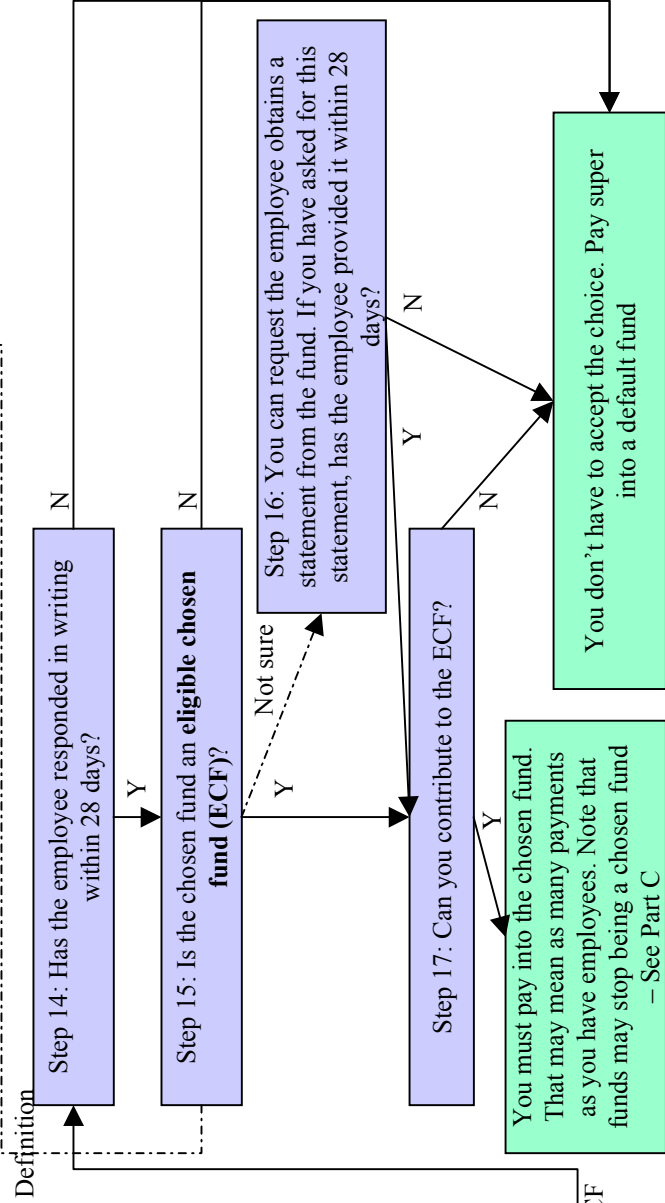
Standard choice forms(SCF) must contain:

- a statement that the employee may choose any eligible funds
- the date which the form is given and the response required date
- the default fund if not choice is made
- disclosure information in relation to the default fund
- other info as required by regulations

A fund is an **eligible choice fund (ECF)** at a particular time if:

- it is a complying super fund
- it is a complying super scheme
- it is an RSA
- at that time a benefit certificate is conclusively presumed under s24 of the SGAA to be a certificate in relation to a complying super scheme, or
- contributions are presumed under s25 of the SGAA 1992 to be contribution to a complying super scheme

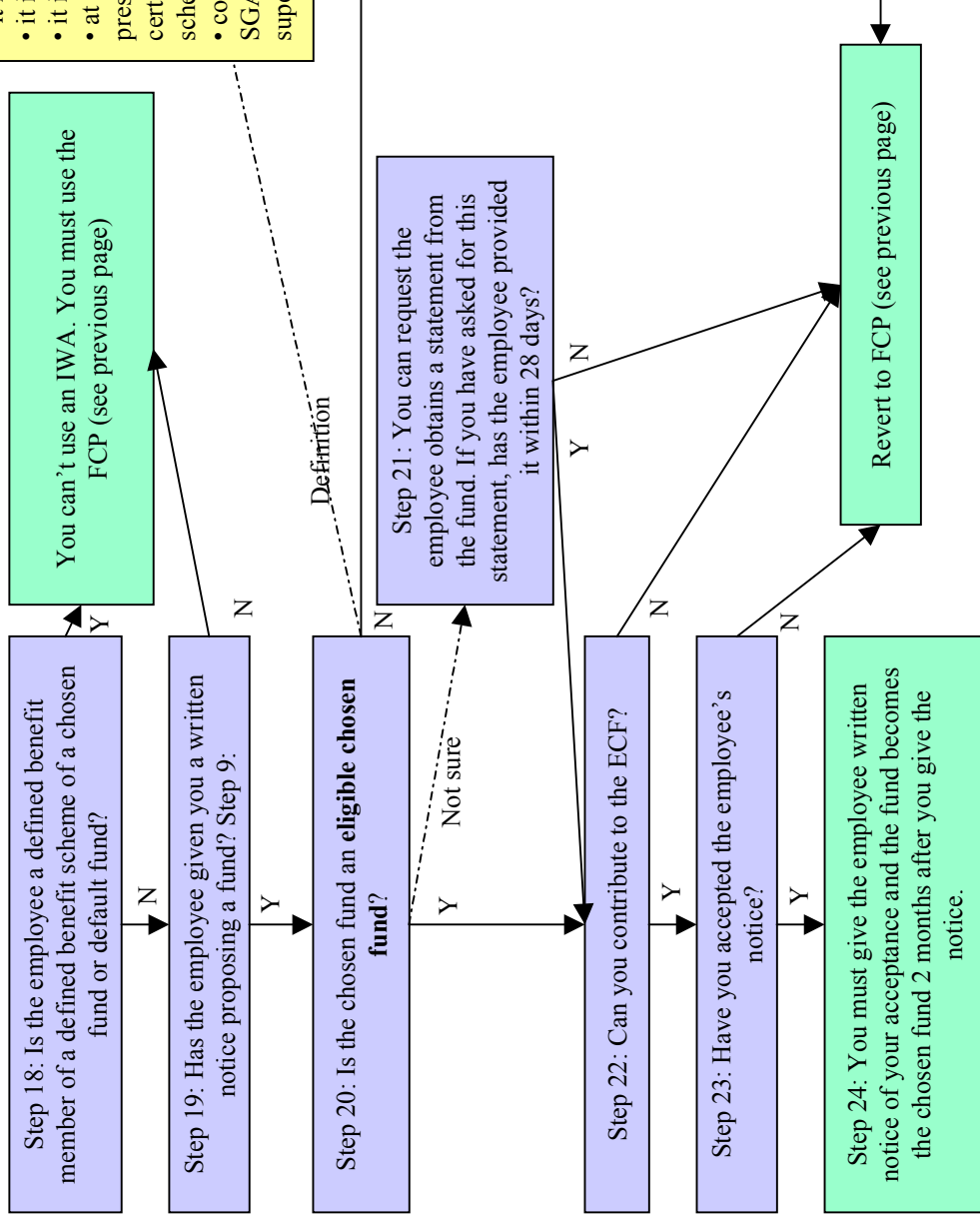
Remember: if you get this process wrong, you face up to \$13,200 in fines per employee!



The Liberal's Super Choice Maze for Business

Part B – How choice must be offered... page 2

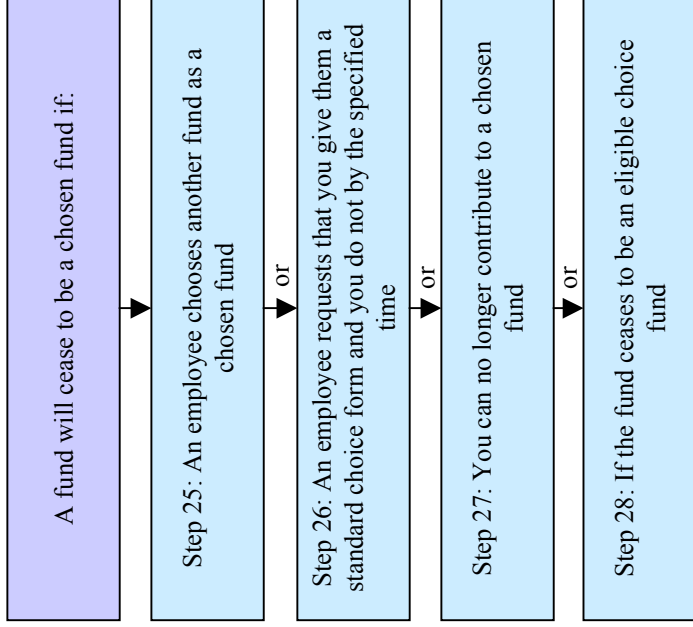
Individual written agreements (IWA)



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Part B – How choice must be offered... page 3

When does a fund cease to be a chosen fund?



Remember:
if you get this process wrong, you face up to \$13,200 in fines per employee!

The Liberal's Super Choice Maze for Business

Part C – What fund is the default fund?

When a fund is the default fund

