The Senate

Select Committee on Superannuation

Provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

November 2002

Commonwealth of Australia

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Terms of Reference

On 21 August 2002 the provisions of the following bills were referred to the Select Committee on Superannuation for inquiry and report on 26 September 2002:

- Superannuation (Government Co-contribution for Low Income Earners) Bill 2002
- Superannuation Legislation Amendment Bill
- Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

On 26 September 2002, the Committee reported on the first two bills.

On 19 September 2002 the Committee sought and was granted an extension of time to present its report on the Choice of Superannuation Funds Bill to 16 October 2002.

On the 16 October 2002, the Committee sought and was granted an extension of time to present its report on the Choice of Superannuation Funds Bill to 12 November 2002.

List of Abbreviations

ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
ACA	Australian Consumers' Association
ACCC	Australian Competition and Consumer Commission
ACCI	Australian Chamber of Commerce and Industry
ACTU	Australian Council of Trade Unions
AIG	Australian Industry Group
AIRC	Australian Industrial Relations Commission
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AWA	Australian Workplace Agreement
Cbus	Construction and Building Unions Superannuation
CPA	Certified Practising Accountants
CSA	Corporate Super Association
CSS	Commonwealth Superannuation Scheme
EM	Explanatory Memorandum
FPA	Financial Planning Association
IFSA	Investment and Financial Services Association
Mercer	Mercer Human Resource Consulting
MTAA	Motor Trades Association of Australia

NFF	National Farmers' Federation
OMC	Ongoing Management Charge
RSA	Retirement Savings Account
RS&R Award	Repair, Services and Retail Award
PSS	Public Sector Superannuation
UNSW	University of New South Wales
SG	Superannuation Guarantee
SOS	Society of Superannuants

TABLE OF CONTENTS

Preface

The Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 is designed to provide employees with choice as to where their superannuation guarantee contributions paid by their employer are directed. The Government believes that providing individual employees with choice will increase competition, efficiency and performance in the superannuation industry, and other things being equal, will ultimately result in reduced fees and charges for individual employees.

The Government has attempted to introduce choice of superannuation fund on two previous occasions, in 1997 and 1998, but it was unsuccessful, with the 1998 bill negatived in the Senate at the second reading stage in August 2001. However, the current Bill differs from the original 1997 Bill in key respects, in that it aims to:

- provide for unlimited choice for employees when choosing funds;
- make available to employees a standard choice form to assist them when choosing between funds;
- provide for the default fund to be selected by reference to a current employee's current fund, and where the employee is a new employee, by reference in the first instance to the relevant Commonwealth or Territory award;
- prescribe minimum levels of insurance in respect of death that the default funds must offer members in order to comply; and
- provide a different and more flexible penalty regime, within a strict liability framework.

During the inquiry, the Committee received evidence from a broad range of parties, including consumer groups, superannuation funds and associations, financial industry organisations, professional financial and human resource organisations, peak employer and employee groups, and government departments. Given the short time frame for the receipt of evidence, the Committee commends participants for the high standard of submissions and oral evidence provided.

The Committee notes that while the majority of evidence supported either the proposed Bill or the principle of choice, most witnesses drew attention to a number of issues which would need to be addressed prior to the successful implementation of choice in Australia. In addition, the Committee notes that concerns have been raised about the constitutionality of the proposed penalty regime.

A key issue associated with choice is portability of superannuation benefits. During the inquiry, the Government released a consultation paper on portability. Under the proposed arrangements, portability would relate to the balance of existing funds at 1 July 2004, while choice would relate to contributions made after 1 July 2004.

The Committee acknowledges and supports the principle of choice, with adequate protections, and the right of individuals to be involved with the selection of their

superannuation funds. However, the Committee believes that there are a number of issues in the Bill which the Government will need to reconsider or clarify, including the proposed arrangements for:

- the default fund;
- defined benefit schemes;
- death and invalidity insurance;
- death benefits;
- the compliance burden on businesses;
- the impact of fees and charges; and
- the level and nature of employer fines, following receipt of advice on their constitutionality.

The Committee also notes that for choice of fund to be successfully introduced in Australia, other issues not directly related to the provisions of the Bill also need to be addressed. Noting that an education campaign is planned, these include:

- improving the existing consumer protection regime by enhancing the current disclosure provisions, including adopting a standardised disclosure regime, which has been consumer comprehension tested, and establishing a special financial advisory unit within ASIC to provide guidance to consumers contemplating the choice of a superannuation fund; and
- clarifying the proposed details of the arrangements for portability.

All members of the Committee recommend the Government examine the issues raised by the Committee in this report and Government members of the Committee recommend that the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 be passed.

Senator John Watson
Committee Chair

Chapter One

Introduction

Introduction

1.1 In addition to providing information on the referral of the Bill to the Committee and the conduct of the Committee's inquiry, this chapter also provides information on:

- the purpose of the Bill; and
- background information on the two previous attempts to introduce choice of fund at the federal level in Australia.

Referral of the Bill to the Committee

1.2 The provisions of Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 (the Choice Bill) were referred to the Committee on 21 August 2002, for inquiry and report by 26 September 2002. This followed the recommendation of the Senate Selection of Bills Committee in Report No 6 of 2002.

1.3 In recommending that the Choice Bill be referred to the Committee, the Selection of Bills Committee noted:

> The Bill proposes a substantial change to the existing regulated superannuation industry and in its current form may result in vastly different retirement incomes for many Australians. The claims made in the Explanatory Memorandum to the Bill must be tested against evidence to the contrary.

1.4 On 19 September 2002, the Senate extended the reporting date for the inquiry from 26 September 2002 to 16 October 2002. On 16 October a further extension was granted until 12 November 2002.

Conduct of the inquiry

1.5 The Committee advertised the inquiry in *The Australian* on Wednesday 28 August 2002, inviting interested persons to make submissions. It should be noted that at the same time as the Committee was considering the Choice Bill, it was also considering two other bills relating to the proposed Government co-contribution and the surcharge. The evidence on the three bills was taken concurrently.

1.6 In addition, the Committee was also partway through a much more broader inquiry into superannuation and standards of living in retirement, during which the issue of choice had also been raised.[1]

1.7 Although the inquiry into the Choice Bill was conducted over a short period, the Committee received a number of submissions and other material in connection with the Bill. However, the short timeframe was criticised by some interested parties as prohibiting the completion of a detailed submission. In some cases personal submissions were made as individuals were not able to gain formal organisational clearance before lodging submissions. The Committee acknowledges the concerns of the industry at the tight time frame for preparing submissions. A list of all submissions received on the three bills is at **Appendix 1**.

1.8 The Committee held initial hearings in Melbourne on 2 and 3 September, with further hearings held in Canberra on 11 and 19 September 2002. A list of those who gave evidence on the three bills is at **Appendix 2**. A list of documents tabled at the hearings is at **Appendix 3**.

Purpose of the Bill

1.9 Currently employers must pay their employees' Superannuation Guarantee (SG) contributions into the fund determined by the relevant award or industrial agreement. In the absence of an award or agreement, the employer may determine the fund. The policy objective of the Choice Bill 2002 is to provide employees with choice as to which complying superannuation fund or Retirement Savings Account (RSA) receives SG contributions made on their behalf by their employer. The Government believes that providing individual employees with choice will increase competition and efficiency in the superannuation industry, leading to improved returns on superannuation savings and placing downward pressure on fund administration charges.

1.10 Proposing an unlimited choice of fund regime, the Choice Bill 2002 includes the following proposed provisions:

a) An employer is required to provide an employee with a standard choice form within 28 days of the commencement of their employment or at the employee's request, although there may be only one such request every 12 months. The employer must also indicate at that time the default fund if the employee does not indicate a choice of funds;

b) The employee may indicate on the standard choice form the fund to which they would like their SG contributions to be made. They must do so within 28 days of receiving the form;

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1 The terms of reference for the Committee's inquiry into superannuation and standards of living in retirement were announced on 14 March 2002, with the report now due to be presented on 10 December 2002.

c) If the employee fails to choose an eligible fund within the specified time (28 days), the employer is required to contribute to the default fund;

d) Employers may be served a contravention notice and be subject to financial penalties if they fail to give effect to valid employee choices; and

e) Choice will be subject to the terms of workplace agreements which provide employees with a choice of superannuation fund for their employer contributions.

1.11 The measures proposed in the Choice Bill are intended to commence from 1 July 2004. Employers will be required to provide superannuation support in compliance with the choice of fund provisions from this date on.

1.12 An outline of the main provisions of the Choice Bill are at **Appendix 4.**

1.13 The Government has attempted to introduce choice of superannuation fund on two previous occasions, in 1997 and 1998, but was unsuccessful. The Choice Bill is similar to the 1998 Bill in key respects in that it:

- maintains employees' unlimited choice;
- maintains the selection of the default fund by first using the fund nominated in the relevant industrial award; and
- makes available to employees a standard choice form to assist in choosing between funds.

1.14 A notable change in the current Bill, however, is the inclusion of a strict liability penalty regime for non-compliance by employers with the provisions of the Bill. Proposed sections 32T and 32U outline offences which attract penalties of up to 60 units for each individual offence where an employer fails to provide an employee with a standard choice form, or fails to contribute to a fund or an RSA that is a complying fund. Under the 1998 Bill, the penalty regime was tied to the SG system, which meant that an employer not providing choice would have been penalised in the same manner as an employer not making the SG contribution.

1.15 The Bill does not allow changes to Commonwealth legislation to provide equal treatment for same-sex couples in relation to superannuation, despite this being an obstacle to the passage of the previous Bill.

1.16 In the 2002-2003 Budget, the Government allocated $28.7 million over four years for the implementation of choice, including an extensive education campaign to be run by the Australian Taxation Office (ATO) to inform employees and employers of their rights and obligations in relation to choice of superannuation fund. The ATO's education program is expected to include new pamphlets directed specifically at impact groups (eg. employers and employees), together with use of the ATO's existing Internet facilities and telephone help lines.

1.17 Related to the measures proposed in the Choice Bill is the issue of portability of superannuation benefits, that is, the right of members to move existing benefits between superannuation entities. During the inquiry, the Government released a consultation paper on portability of superannuation benefits. Under the proposed arrangements, portability would relate to the balance of existing funds at 1 July 2004, while choice would relate to contributions made after 1 July 2004.[2]

Background to the Bill

1.18 Generally speaking, there are two types of funds operating in Australia to which superannuation contributions can be made: not-for-profit funds – industry, corporate and government funds (where surpluses are paid to the members of the fund); and profit funds - retail funds offered by the banks and life insurance agencies (where profits are paid to shareholders).

1.19 Australian employees currently receive compulsory employer paid superannuation contributions either under an industrial award (federal or state) or under the SG scheme. Under award superannuation, the fund to which contributions are made is specified in the award. Under the SG scheme, superannuation contributions must be made to any complying fund, provided it is certified under the *Superannuation Industry (Supervision) Act 1993* by the Australian Prudential Regulation Authority (APRA).

1.20 The development of this twin system of industrial and legislated superannuation dates back to the inclusion of superannuation in awards in 1986, when the High Court ruled that the Conciliation and Arbitration Commission as it then was (the current Australian Industrial Relations Commission) had jurisdiction in the superannuation industry. By 1992, up to 70 per cent of the workforce was covered by award superannuation. However, to ensure provision of superannuation to employees not covered by awards, and to strengthen compliance, the Government of the day decided to legislate for minimum standards of employer sponsored superannuation in 1992. By legislating a timetable for increasing the rate of SG contributions to nine per cent by 1 July 2002, the Government expected to achieve its objectives of increasing retirement incomes, increasing national savings and reducing reliance on the pension.

1.21 However, the SG legislation is silent on issues such as choice of fund, which until now has remained to be determined by employees and employers in the workplace relations context. Accordingly, there is currently no legislated choice of superannuation fund at the federal level whereby employees may determine to which fund their superannuation contributions are made.

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2 *Committee Hansard*, 19 September 2002, p. 318, 333.

1.22 An outline of the Government's earlier attempts to introduce choice of fund follows.[3]

The Coalition's 1996 election commitment

1.23 Prior to the 1996 election, the Coalition made the following promise on choice of superannuation fund:

> Awards will be required to offer workers a choice of up to five funds including employer, industry, personal and RSAs. Additional funds may be used with the employer's concurrence. Workplace agreements would include similar choice arrangements.[4]

1.24 Additional details of the Government's choice of fund proposal were announced in the 1997-98 Budget:

- Employers would be required to offer employees a limited choice of a minimum of five complying funds or RSAs, including an industry fund where one existed, a public offer fund, a RSA, a RSA provided by the institution receiving the employee's pay (if the institution offers RSAs) and an in-house superannuation fund (if it exists);
- If the employee did not make a choice of fund within 28 days, the employer could nominate the fund to which they would contribute on the employee's behalf;
- The Commonwealth legislation implementing choice of fund would override Federal awards relating to superannuation but not State awards due to constitutional restrictions;
- The Commonwealth legislation implementing choice of fund would not override workplace agreements made under the *Workplace Relations Act 1996*; and
- The Commonwealth legislation implementing choice of fund would not apply to unfunded government schemes.

1.25 Following the release of this policy, there was considerable concern among employers regarding their potential liability if they failed to provide sufficient or accurate information to their employees under the limited choice option, or if the funds they selected to offer to employees performed badly. As a result, the then Assistant Treasurer announced the following major changes to the policy in a Press Release dated 25 November 1997:

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3 This section is largely drawn from Department of the Parliamentary Library, *Bills Digest No 31 2002-2003: Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002*.

4 *Super for all – Security and Flexibility in Retirement: The Federal Coalition's Superannuation and Retirement Incomes Policy*, February 1996, p. 3.

- The introduction of an unlimited employee choice option in addition to the limited choice option;
- A reduction in the required number of fund choices that employers had to offer their employees under the limited choice option from five to four (the requirement that employers had to offer an RSA from the institution that received the employee's pay, where such an RSA existed, was removed); and
- Employers would not be liable for poor financial returns where they had complied with the requirement giving employees choice of fund.

Taxation Laws Amendment Bill (No 7) 1997

1.26 Following its 1996 election commitment, the Government attempted to implement its choice of superannuation fund proposal through the Taxation Laws Amendment Bill (No 7) 1997, introduced into the House of Representatives on 4 December 1997. On 13 May the proposal was introduced into the Senate as Taxation Laws Amendment Bill (No 3) 1998.

1.27 Importantly, the provisions of the Bill included the so-called limited choice option. Under this option, employers would have been required to offer four or five complying superannuation funds to their employees, from which the employees could then choose.

1.28 The former Senate Select Committee on Superannuation examined the Taxation Laws Amendment Bill (No 7) 1997 as part of a subsequent inquiry into choice of funds. In its report of March 1998, *Choice of Fund*,[5] various members of the Committee raised the a number of implementation issues, including:

a) The need for education of consumers and employers;

b) The need for adequate disclosure of comparable information about funds;

c) The cost to employers of implementing choice;

d) Different federal/state applications of choice of fund; and

e) The adequacy of consumer safeguards, including the need for arbitration of any disputes.

1.29 To enable the passage of the other taxation measures in Taxation Laws Amendment Bill (No 3) 1998, the choice of fund measures were removed from the bill in the Senate and re-introduced in a stand-alone bill, the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998.

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5 Senate Select Committee on Superannuation, *Choice of Fund*, 28th Report, (Canberra, March 2002).

Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998

1.30 The Government re-introduced choice of fund legislation on 12 November 1998 in the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998.

1.31 Importantly, the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998 adopted the so-called unlimited choice of fund option, rather than the limited choice option adopted in the 1997 Bill. This Bill:

- changed the default fund arrangements. Under the previous 1997 Bill, employers could choose a default fund for new employees. Under the 1998 Bill, for new employees or on-going employees whose default fund had ceased by virtue of section 32KA, the default fund would be the Commonwealth or Territory industrial award fund for the employee, or if there was no such award, the 'majority fund'. If neither was available, the default fund was to be any eligible default fund selected by the employer;
- made available to employees a standard form to assist in choosing between funds; and
- provided the Australian Securities and Investments Commission (ASIC) with regulatory authority in relation to Part 3 of Schedule 1.

1.32 The provisions of the Bill were considered at a round table hearing hosted by the Senate Select Committee on Superannuation and Financial Services in December 1999. Some of the notable conclusions from evidence received at the hearing were:

a) Unlimited choice of fund is the most appropriate method of offering choice;

b) Informed choice requires disclosure and education prior to choice being offered;

c) The default fund should be the federal award, or if no award applies, the 'majority fund' in the workplace; and

d) Prudential supervision and consumer protection measures are required to address issues of commission based selling.

1.33 The Senate debated the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998 on 8 August 2001. The Bill was defeated.

Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

1.34 During the 2001 election campaign, the Government again committed itself to choice of superannuation funds in its superannuation policy statement, *A Better Superannuation System*.[6] In turn, the Government introduced the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 into the House of Representatives on 27 June 2002. This is the third attempt by the Government to introduce choice of fund.

6 The Liberal Party of Australia, *A Better Superannuation System*, 5 November 2001.

Chapter Two

Summary of Views

Introduction

2.1 The majority of evidence received during the inquiry supported either the proposed Choice Bill or the principle of choice. However most witnesses drew attention to a number of issues which would need to be addressed prior to the successful implementation of choice in Australia.

2.2 This chapter provides:

- an overview of the current options available when investing SG contributions; and
- a summary of the views of the parties giving evidence to the inquiry.

Current choice in Australia

2.3 It is important to note from the outset that while there is currently no legislated choice of superannuation fund or RSA at the federal level in Australia, up to 80 per cent of employees do have choice as to how employer SG payments are invested within their fund. Such investment options may include investing in overseas equity, Australian property, Australian shares and so forth.[1]

2.4 In addition, many industrial awards already offer limited choice of fund, while some also allow an employer and employee to agree upon a fund.[2] For example, the Repair, Services and Retail (RS&R) Award currently prescribes the Motor Trades Association of Australia (MTAA) Superannuation Fund, the Superannuation Trust of Australia and the Australian Retirement Fund as complying superannuation funds.[3] Commenting on employees' exercise of choice under the RS&R Award, Mr Watson from the MTAA Superannuation Fund indicated:

> It is an amalgam. We see every situation. There are situations where employers will initiate the discussion and make the choice but at the moment, in the workplaces we are involved in, those are far more often community decisions within the workplace.[4]

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1 *Committee Hansard*, 11 September 2002, p. 204.

2 *Committee Hansard*, 3 September 2002, p. 124.

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

4 *Committee Hansard*, 3 September 2002, p. 140.

2.5 Similarly, Ms Harris from the National Farmers' Federation (NFF) presented the Committee with evidence that employees in primary industries also often have choice of funds under awards. However, Ms Harris indicated that a vast majority of employees in primary industries do not request any fund other than the default fund, the Australian Primary Superannuation Fund, simply because they are not interested in superannuation.[5]

2.6 Finally, Western Australia, NSW and Queensland have all implemented choice of fund at the state level, under varying regimes and to varying degrees. The relevant legislation is the *Industrial Relations Act 1979 (Western Australia)*, the *Industrial Relations Act 1999 (Queensland)* and the *Industrial Relations Act 1996 (New South Wales)*.

2.7 In the hearing on 2 September 2002, the Committee took evidence from Mr Rosario from Westscheme in WA, where choice of fund has been operating since 1 July 1998 under section 49C of the *Industrial Relations Act 1979 (Western Australia)*. Mr Rosario indicated that the incidence of choice is growing rapidly in WA, citing evidence that more than 50 per cent of new employees wanted their SG contributions to be directed to their pre-existing fund:[6]

> … when we first started we did not see a very high incidence of the exercise of [choice]. We are now beginning to see that, as people are moving between jobs, they are saying that they want to keep the fund that they are with. The new employer has to provide them with that entitlement. It is an increasing requirement.[7]

2.8 The Committee also notes evidence from Construction and Building Unions Superannuation (Cbus) that in WA, the introduction of choice has led to a large and rapid expansion of members of the fund from outside the construction and building industry. Currently, 80 per cent of new employees who register with the fund are from areas outside Cbus's core constituency.[8]

Organisational commentary

2.9 As noted above, the majority of evidence to the inquiry supported either the proposed Choice Bill or the principle of choice. The supporters of choice of fund and the current Bill argued that the implementation of choice would give individuals greater ownership and control over their superannuation funds, in turn fostering greater competition and efficiency in the industry.

2.10 The principal advocates of this position were organisations representing specialist financial product providers such as the Australian Bankers' Association

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5 *Committee Hansard*, 11 September 2002, p. 199.

6 *Committee Hansard*, 2 September 2002, p. 58.

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

8 *Submission* 40, Cbus, p. 3.

(ABA), the Investment and Financial Services Association (IFSA), and the Financial Planning Association (FPA) of Australia.

2.11 However, the support expressed by these groups was somewhat qualified, with additional comments and suggestions for improvements being made. For example:

- the ABA submitted that the effectiveness of the proposed Bill could be strengthened through simplifying the default fund provisions, and the introduction of the Government's proposed portability arrangements;[9]
- IFSA opposed the default fund provisions of the Bill as anti-competitive, and argued that the employer penalties in the Bill were excessive;[10]
- While the FPA also expressed concern about the default fund provisions of the Bill, on the basis that they were overly prescriptive and inflexible.[11]

2.12 Employer groups also broadly supported the Bill but with some qualifications. For example, the Australian Chamber of Commerce and Industry (ACCI) broadly supported the Bill, although it expressed concern about the default fund provisions, the status of defined benefit schemes, and the maintenance of superannuation provisions in awards.[12] In the hearing on 3 September 2002, Mr Anderson from ACCI indicated that ACCI would be looking for amendments to the Bill in respect of these issues, but declined to speculate on ACCI's position if those amendments were not made. ACCI also raised concerns about the compliance burden for businesses. [13]

2.13 Similarly, the NFF, representing primary producers, broadly supported the Bill, provided it did not place significant additional costs on employers.[14] However, in the hearing on 11 September 2002, Ms Harris from the NFF also indicated that the NFF would need to reconsider its support for the Bill if the Government did not revisit the employer penalty regime.[15]

2.14 Consumer groups also broadly supported the provisions of the Bill. For example, the Australian Consumers' Association (ACA), in concert with the Financial Services Consumer Policy Centre at the University of NSW (UNSW), supported the Bill, although they again expressed concerns about the default fund, entry and exit

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9 *Submission* 34, ABA. See also *Committee Hansard*, 11 September 2002, pp. 247 – 265.

10 *Submission* 36, IFSA. See also *Committee Hansard*, 11 September 2002, pp. 231-246.

11 *Submission* 37, FPA. See also *Committee Hansard*, 11 September 2002, pp. 213-230.

12 *Submission* 25, ACCI.

13 *Committee Hansard*, 3 September 2002, pp. 191-193.

14 *Submission* 1, NFF.

15 *Committee Hansard*, 11 September 2002, p. 205.

fees, insurance and education.[16] Taxpayers Australia also broadly supported the Bill.[17]

2.15 Finally, the Committee also notes that the Certified Practising Accountants (CPA) of Australia advocated implementation of choice as bringing about better long-term outcomes in Australia's superannuation system, but that organisation too expressed concern about certain provisions of the Bill.[18]

Ownership and control

2.16 The principal argument made by the parties in favour of choice of fund and the current Bill was that individuals should have the right to choose their own funds. For example, in evidence to the Committee on 11 September 2002, Mr Bell from the ABA stated:

> … the point we would like to make—and it is a very strong point of principle—is that people work hard for their money and should have the ultimate say as to whether they wish to invest their money in a particular fund.[19]

2.17 Moreover, various parties argued in their written submissions that providing individuals with the right to manage their superannuation funds would increase their awareness of fund alternatives and the need to plan for retirement. For example, the CPA argued that choice should encourage employees to take greater interest in and ownership over their superannuation, leading to better long-term outcomes in Australia's superannuation system.[20] Similarly, the FPA suggested that giving employees greater choice and control would engender a greater sense of ownership and generate a savings culture in Australia.[21]

2.18 Furthermore, the ACA argued in its written submission that with the exponential growth of superannuation funds, the interest of individual employees in their superannuation funds is only likely to increase. Indeed, the Association suggested that for a majority of Australians, more money is vested in their superannuation accounts than they have ever saved, and as such, they are demanding a say in where that money is invested.[22]

2.19 The Committee was presented with similar views during hearings. For example, in evidence to the Committee on 3 September 2002, Ms Smith, representing

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16 *Committee Hansard*, 2 September 2002, p. 19.

17 *Submission* 23, Taxpayers Australia.

18 *Submission* 10, CPA

19 *Committee Hansard*, 11 September 2002, p. 252.

20 *Submission* 10, CPA, p. 2.

21 *Submission* 37, FPA, p. 1.

22 *Submission* 27, ACA and FSCPC, p. 2.

Taxpayers Australia and Superannuation Australia, claimed that employees are demanding choice of fund because contributions are being made to funds that are performing badly.[23] Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW, also indicated his belief that a choice of fund regime would go a long way towards engendering a more proactive engagement by consumers.[24]

2.20 The Committee notes that the choice of fund proposal offers individuals some additional opportunities to consolidate their superannuation into one fund, thereby avoiding paying multiple fees on different accounts and possibly minimising the number of 'lost' accounts. As claimed by Ms Smith from Taxpayers Australia, under this scenario, individuals could elect to have their SG contributions made to the one account even when they change employers and industries.[25]

Competition and efficiency

2.21 Flowing on from greater ownership and control, some of the parties in favour of choice and the current Bill also argued in their written submissions that choice will lead to greater competition and efficiency in the superannuation industry. For example, in its written submission, the ABA argued that competitive forces will place downward pressure on costs and encourage rationalisation of the industry, while allowing individuals to spread exposure and adapt as their circumstances change. The ABA continued:

> It will not be necessary that consumers in fact change funds for these effects to occur. As with other markets that have been deregulated, the mere threat that someone can change behaviour is sufficient to provide a competitive stimulus to the market. Allowing people greater control over "their" money is particularly important given the compulsory nature of our superannuation system.[26]

2.22 The FPA also argued in its written submission that greater competition and efficiency would lead to lower costs.[27] Similarly, ACCI stated in its written submission to the inquiry:

> Choice is an important element of a sound retirement incomes policy. Where there is an environment of genuine competition there will be the pressure on funds to keep their costs down and to perform in the

23 *Committee Hansard*, 3 September 2002, pp. 155-156.

24 *Committee Hansard*, 2 September 2002, p. 19.

25 *Committee Hansard*, 3 September 2002, p. 155.

26 *Submission* 34, ABA, p. 1.

27 *Submission* 37, FPA, p. 1.

> marketplace. Fund choice is one of the pre-requisites to having a more competitive superannuation fund market.[28]

2.23 These arguments were reiterated during hearings. For example, in evidence to the Committee on 11 September, Mr Loveridge from the ABA expanded on the ABA's position. He noted that deregulation of the banking sector allowed many more entrants to provide banking services, with the result that interest rate margins on home loans and small business loans have declined steadily since the mid-1990s.[29] Similarly, in evidence to the committee, Mr Wyatt from the CPA argued that competition amongst superannuation providers would see fees and charges come down, on the basis that the public would become much more aware of fees and charges.[30]

2.24 The Committee also heard the evidence of Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW, that one of the principal reasons choice of fund may potentially reduce costs is that it will force industry consolidation. Mr Hajaj argued that currently, there are several hundred industry funds which basically replicate each other, leaving scope for enormous savings to be generated if economies of scale are applied.[31] However, the Committee notes that consolidation may lead to opportunities for lower fees and charges, as has been seen in some sectors of the banking industry.

2.25 The Committee raised these issues with Mr Boneham from the Treasury during the hearing on 11 September 2002. He indicated Treasury's belief that under a competitive choice environment, fees and charges would be expected to come down. He attributed this to more discerning decision making on behalf of employees, the consolidation of funds leading in turn to economies of scale, and the entrance of niche players that provide better services and/or offer additional products.[32]

2.26 Other witnesses contended that the choice model under the current Bill would lead to higher fees and charges. For example, Ms Fiona Galbraith from Superpartners (the large industry fund administrator which manages the superannuation accounts for over 3.5 million fund members) asserted that increased competition can sometimes lead to increased fees and charges because of the cost of marketing and product development.[33]

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28 *Submission* 25, ACCI, p. 4.

29 *Committee Hansard*, 11 September 2002, p. 254.

30 *Committee Hansard*, 2 September 2002, p. 80.

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

32 *Committee Hansard*, 11 September 2002, pp. 299-301.

33 *Committee Hansard* , 2 September 2002, p.1.

Alternative views

2.27 The Committee notes that a small number of parties giving evidence to the inquiry, most notably the Australian Council of Trade Unions (ACTU), were opposed outright to the implementation of choice of fund in Australia. The ACTU argued in its written submission that choice of fund will increase retail selling opportunities for large financial institutions, forcing up costs and weakening returns for fund members, to the long-term detriment of employees.[34]

2.28 Similarly, the AUSTSAFE Superannuation Fund submitted that, in its view, the proposed Bill would not have the desired outcomes and will be detrimental to the future accumulation of superannuation for the majority of Australians. Citing its experience over 14 years, AUSTSAFE emphasised that the Bill would result in reducing returns on members' superannuation savings.[35]

Implementation issues

2.29 However, while a small number of parties opposed any introduction of choice of fund in Australia, and others, such as the Association of Financial Advisers, favoured limited choice rather than full choice,[36] the majority of parties to the inquiry supported the principle of choice, but argued that the current Bill and supporting measures before the Senate would not lead to successful implementation of choice. This position was adopted by:

- superannuation funds and associations such as the MTAA Superannuation Fund,[37] Quadrant Superannuation,[38] Cbus,[39] the Industry Funds Forum,[40] Superpartners,[41] the Corporate Super Association (CSA)[42] and the Association of Superannuation Funds of Australia (ASFA);[43]
- professional financial and human resource organisations such as the Australian Institute of Superannuation Trustees (AIST),[44] the Institute of Actuaries[45] and Mercer Human Resource Consulting;[46]

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34 *Submission* 5, ACTU.

35 *Submission* 52, AUSTSAFE, pp. 1-2.

36 *Submission* 24, Association of Financial Advisers, p.1.

37 *Submission* 11, MTAA Super Fund.

38 *Submission* 14, Quadrant Superannuation.

39 *Submission* 16, Cbus.

40 *Submission* 30, IFF.

41 *Submission* 26, Superpartners.

42 *Submission* 13, CSA.

43 *Submission* 17, ASFA.

44 *Submission* 29, AIST.

45 *Submission* 15, Institute of Actuaries Australia.

- peak employer groups such as the Australian Industry Group;[47] and
- superannuation lobby groups such as the Society of Superannuants (SOS).[48]

2.30 The fundamental concern expressed by these parties during the inquiry was that many individual employees would not be able to make an informed choice of fund, due to inadequate fund disclosure rules and financial education standards in Australia. This is turn would leave those employees vulnerable to commercial exploitation in relation to the investment of the compulsory SG contributions made on their behalf by employers. According to these parties, the result could possibly be a decline in superannuation retirement incomes due to higher fees and charges and lower returns, resulting in an increased burden on the social security system, and coupled with increased costs for employers. Accordingly, these parties argued that:

a) Current financial disclosure standards and education standards in Australia need to be improved to support informed choice;

b) The Government's portability proposal needs to be further developed;

c) The provisions of the Bill in relation to insurance, the default fund, and defined benefit schemes need to be reconsidered;

d) The Bill places significant costs and penalties on employers which need to be examined further;

e) The Government needs to consider the impact of competition on fund costs and returns, and retirement incomes in Australia; and

f) Consideration should be given to a cap on certain fees and charges and/or a prohibition of commission-based selling in relation to compulsory superannuation.

2.31 The following chapters analyse these and other issues arising from the provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002.

46 *Submission* 20, Mercer.

47 *Submission* 9, AIG.

48 *Submission* 4, SOS.

Chapter Three

Disclosure and Education

Introduction

3.1 During the inquiry, various parties argued that employees need to have access to adequate financial information, and have adequate financial education, if they are to make an informed choice of fund under the provisions of the Choice Bill.

3.2 This chapter considers:

- current financial disclosure standards;
- financial education and literacy standards in Australia; and
- other consumer protection issues.

Financial disclosure standards

3.3 In order to make an informed choice about where to invest SG monies, individuals need funds to disclose adequate and comparable information about such matters as fees, charges, commissions, and rates of return. Product disclosure statements, including reports of fund returns, are important aspects of an effective disclosure regime which evidence to the inquiry suggests is an essential precondition for the implementation of choice.

Product disclosure statements

3.4 The *Financial Services Reform Act 2001*, and associated regulations, has been designed to provide a framework for adequate disclosure. However, some parties submitted that the current disclosure provisions of the Financial Services Reform Act are inadequate and do not permit comparisons between funds. Within this framework, product disclosure statements provide details of fund returns, fees and charges associated with the fund, investment profiles, and other such information.

3.5 To regulate reporting in product disclosure statements, the Government introduced regulation *7.9.10 and 7.9.11(1), (1)(a), (1)(b) and (2)* under the *Financial Services Reform Act 2001*, which came into effect on 11 March 2002. The regulations required superannuation funds to disclose an 'ongoing management charge' (OMC) in their product disclosure statements.

3.6 However, on 16 September 2002, the Senate disallowed these regulations, following a notice of motion moved by Senator Conroy on 18 June 2002. In the

absence of the OMC regulations, underlying disclosure regulations and obligations are now provided by the *Corporations Act 2001*.[1]

3.7 During debate on the motion to disallow the regulations, Senator Conroy expressed his opinion that the OMC did not assist consumers, on the basis that it excluded entry and exit fees from its calculation.[2]

3.8 The Committee notes that a broad number of parties also expressed this position during the Committee's inquiry into the Choice Bill, at which time the OMC was still operative. They included Quadrant Superannuation,[3] Cbus,[4] the Industry Funds Forum,[5] the AIG,[6] the ACA,[7] Quadrant Superannuation, ASFA and the MTAA Superannuation Fund. For example, ASFA noted in its written submission that the OMC did not provide a means for consumers to compare costs between funds:

> ASFA fully supports the objective of providing prospective fund members a means to compare costs between funds. However, the current OMC requirements do not achieve this end. They are misleading and will be incomprehensible to most people.[8]

3.9 Similarly, the MTAA Superannuation Fund argued that the provisions of the *Financial Services Reform Act 2001* fell short of full disclosure of all fees and charges:

> It is simply not good enough, in our view, for separate parts of the industry, essentially divided along the not-for-profit and for profit retail or wholesale product lines, through a "self regulation" approach, to establish different interpretations of what is in or left out of an OMC, particularly when these could relate to matters as important as entry and exit fees.[9]

3.10 The Committee also notes that the Parliamentary Joint Committee on Corporations and Financial Services tabled a report into regulations made under the *Financial Services Reform Act 2001* in October 2002. In that report, the Committee

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1 *Committee Hansard* , 19 September 2002, p. 323.

2 Senate Hansard, 16 September 2002, p. 4132.

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

4 *Submission* 16, Cbus, p. 11.

5 *Submission* 30, Industry Funds Forum, p. 3.

6 *Submission* 9, AIG, p. 2.

7 *Committee Hansard*, 2 September 2002, p. 21.

8 *Submission* 17, ASFA, p. 3.

9 *Submission* 11, MTAA Super Fund, p. 11.

noted that a number of witnesses to its inquiry also raised concerns about the former OMC. [10]

3.11 Given concern regarding the provisions of the former OMC, Superpartners argued in its written submission that Government regulations should require full financial disclosure of fees and charges on accounts, contributions, rollovers and benefits/exits (which were not measured by the OMC). Superpartners argued that it is fees and charges that largely determine members' final benefits rather than the OMC. This point was reiterated by Ms Galbraith from Superpartners in evidence:

> What is much more critical with fees and charges are those that are actually levied on members' accounts and the effect that that has on their account balance. To a certain extent, it is almost irrelevant what a fund's ongoing management charges are. A fund may have significantly higher ongoing management charges, but if it is managing by doing that—to yield higher returns, it might be actively investing as opposed to passively investing or it might be doing a multitude of things—if, at the end of the day, it is producing higher returns and they are not reflected in higher fees and charges on members' accounts, then that is really what counts.[11]

3.12 Superpartners further argued in its written submission that the only way to meaningfully compare two or more alternative fee structures is to determine their impact on the final value of the benefit. To achieve comparability and consistency in doing this requires 'a set of standardised, realistic assumptions' which can be utilised to assist fund managers to project the final benefit to illustrate the effect of fees and charges.[12]

3.13 The Committee also notes that in evidence on 3 September 2002, Dr Anderson from ASFA indicated that the Association is currently conducting its own research into disclosure of fees and charges. ASFA anticipates having the results of that research available by November 2002.[13]

3.14 The Committee subsequently raised this matter with Treasury officials, who are participating in the steering group for the study. Mr Thomas from the Treasury indicated that the study is being conducted with a group of 20 individuals, and is looking at a template product disclosure statement and that ASFA is also looking at an

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10 For example the ACA, ASFA and Freehills and Rainmaker Information Pty Ltd. See Parliamentary Joint Committee on Corporations and Financial Services, *Report on the Regulations and ASIC Policy Statement made under the Financial Services Reform Act 2001*, pp. 39-44.

11 *Committee Hansard*, 2 September 2002, p. 2.

12 *Submission* 26, Superpartners, p. 2.

13 *Committee Hansard*, 3 September 2002, p. 144.

alternative to the OMC.[14] Mr Rosser from Treasury stated that the early results from the testing indicated that 'people had difficulty understanding the OMC'.[15]

3.15 The Committee notes that the ACA is also currently engaged in the process of consumer comprehension testing of different models of fee disclosure, and that the Association has urged the Government to re-engage in this process.[16]

3.16 Under the FSR regime, ASIC, as the regulator, has a key role. The Committee notes that on 26 September 2002, ASIC released a report entitled 'Disclosure of Fees and Charges in Managed Investments: Review of Current Australian Requirements and Options for Reform.' The report was prepared for ASIC by Professor Ramsay from the University of Melbourne. The report made a number of recommendations including:

a) Standardised description and definition of fees;

b) Separate disclosure of administration and investment fees;

c) Improved disclosure of entry/contribution fees and exit/withdrawal fees including the use of common terminology across all products;

d) The effect of fees on returns should be shown over various periods via a table; and

e) There should be disclosure of fees paid to advisers.[17]

Reporting of fund returns

3.17 In its written submission, the MTAA Superannuation Fund suggested that in the absence of adequate disclosure regulations, funds would be tempted to highlight only positive aspects of their particular products, and ignore less desirable aspects. As a result, it will be very difficult to compare products and make an informed choice:

> In an 'open slather' market place, funds will only be as good as their latest crediting rates - even their last monthly interim return will be scrutinised, tabulated, benchmarked and on-sold by researchers to third party advisers and gate-keepers. Inevitably, this will lead to trustees adopting investment policies that address this shorter term investment outlook, to the detriment of Australia's retirement income investment pool.[18]

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14 *Committee Hansard*, 19 September 2002, pp. 310-311.

15 *Committee Hansard*, 19 September 2002, p. 311.

16 *Submission* 53, ACA, p.2.

17 Prof Ramsay, *Disclosure of Fees and Charges in Managed Investments: Review of Current Australian Requirements and Options for Reform*, Report to ASIC, 25 September 2002.

18 *Submission* 11, MTAA Super Fund, p. 12.

3.18 The Committee notes the concern of various parties that the introduction of choice without sufficient disclosure standards may lead individuals to take short-term investment decisions based on returns over a short time period. Ms Kelleher from CPA Australia cited the example of moving from a fund that achieved an eight per cent return in the last year to another that achieved an 8½ per cent return, only to move their funds again the following year.[19]

3.19 The Committee also notes that the issues associated with advertising fund returns is currently being addressed by ASIC in its recently released discussion paper and guide on the use of past performance in investment advertising.[20] The Committee shares ASIC's concerns in relation to a range of misleading, or potentially misleading, advertising practices. The Committee also shares the concerns expressed by ASIC's Executive Director of Consumer Protection, Mr Peter Kell, that 'an undue emphasis on past returns can lead to consumers having unrealistic expectations and making poor investment decisions'.[21] The Committee notes that ASIC is seeking comment on the draft guide by 15 November 2002.[22]

Financial education standards

3.20 In addition to perceptions that the current Commonwealth financial disclosure standards are inadequate, various parties also submitted during the inquiry that individual employees in Australia lack the financial education necessary to make informed choice of fund decisions. As stated by Superpartners in its written submission:

> While meaningful disclosure in superannuation fund documentation is a vital first step, as people are often greatly influenced by what is said to them, it is vital that they possess the requisite skills to be discerning and discriminating. Given that financial products and services are abstract and intangible, and that people are frequently intimidated by matters financial, it is even more important that people are armed with the necessary tools to evaluate different choices.[23]

3.21 During the inquiry, Senator Hogg cited figures from an Australian Bureau of Statistics survey which, using the latest data available, showed that 19.7 per cent of the Australian population aged 15-74, or approximately 2.6 million people, have very

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19 *Committee Hansard*, 2 September 2002, p. 83.

20 ASIC, *Discussion Paper, The use of past performance in investment advertising*, 30 September 2002 and accompanying draft guide on the use of past performance in promotional material.

21 ASIC, Media and Information Release, *ASIC issues discussion paper on the use of past performance information in investment ads,* 30 September 2002.

22 This material is available at the ASIC website at www.asic.gov.au.

23 *Submission* 26, Superpartners, p. 2.

poor prose literacy skills.[24] The survey also showed that up to six million Australians could have some difficulty in adequately reading and understanding printed material they could be expected to encounter in daily life. Currently, approximately 8.8 million Australians have superannuation funds.

3.22 Members of the Committee also cited during hearings the product disclosure statements issued by superannuation funds which describe their product, the fees and charges attached, the returns achieved by the funds and so forth. Some sample statements provided to the Committee ran to in excess of 60 pages. Senators on the Committee suggested that often these statements were overly complex and detailed and would be unintelligible to many Australians.[25]

3.23 Similar concerns were expressed to the Committee in written submissions and in evidence. For example, the MTAA Superannuation Fund argued in its written submission that the workforce is ill-prepared to make an informed choice of fund, due to a lack of understanding of superannuation legislation, investment fundamentals and the income retirement system generally. The MTAA Superannuation Fund continued, 'These are not paternal platitudes – this is fact'.[26] Similarly, Ms Kelleher from CPA stated in evidence to the Committee on 2 September 2002:

> I think in practice a lot of people will do whatever the next-door neighbour is doing or will go with whatever they think looks good without understanding everything behind it or what it means to them in entry and exit fees and ongoing management fees for the time that they are in there. Yes, they get the statements that say, 'These are the charges that you are bearing,' but I question whether they understand what it is that they are bearing. I would hate to see choice implemented without there being a thorough education program.[27]

3.24 In response to these concerns, however, Ms Harris from the NFF argued in the hearing on 11 September 2002 that individual employees are becoming better educated on financial issues, and that most have a greater ability than they had ten years ago to make superannuation decisions.[28]

The 2002-2003 Budget education allocation

3.25 Given concerns regarding current financial literacy standards in Australia, various parties argued during the inquiry that the commitment to education accompanying the Choice Bill is insufficient. As discussed previously, in the 2002-

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24 ABS, *Aspects of Literacy Survey: Assessed Skill Levels Australia 1996* (ABS Cat. No. 4228.0); *Committee Hansard*, 2 September 2002, p. 8 and *Committee Hansard*, 3 September 2002, p. 175.

25 See for example *Committee Hansard*, 11 September 2002, p. 207.

26 *Submission* 11, MTAA Super Fund, p. 9.

27 *Committee Hansard*, 2 September 2002, p. 82.

28 *Committee Hansard*, 11 September 2002, p. 198.

2003 Budget, the Government allocated $28.7 million over four years (from the ATO's existing budget) to an education and implementation campaign, to be administered by the ATO, to inform employees and employers of their rights and obligations in relation to choice.

3.26 During the Senate Economics Legislation Committee's consideration of Budget Estimates, the ATO advised that in 2002-03 and 2003-04, it will spend $14 million on education and communication functions for the 8.8 million fund members and 650,000 employers impacted by choice. Over four years, the ATO will spend a total of $14.5 million on changes to its own infrastructure and other administrative costs.[29]

3.27 In its written submission, CPA Australia questioned whether the expenditure of $28.7 million over four years, which is fully from the existing resources of the ATO, would be sufficient to create genuine understanding of choice of fund in Australia.[30] Similarly, in its written submission, the CSA stated:

> We have concerns regarding the adequacy of the pool of funding set aside for the public education campaign to prepare employees for Choice. It is of paramount importance that choice should be exercised by individuals who are fully informed about the characteristics of superannuation as a long term investment. … We believe that if individuals are to exercise choice, they must be better informed about investment as a whole and about the characteristics of long term investment pools and stock market cycles and fluctuations.[31]

3.28 The NFF also agued that the commitment to education accompanying the Choice Bill appears inadequate, suggesting that the allocated $28.7 million over four years could be predominantly spent on administrative costs. The NFF continued:

> It is critical that there is sufficient education at the workplace including additional resources including TV advertising or funding to employer and union groups to undertake seminars.[32]

3.29 Similar concerns were expressed in hearings. Dr Pragnell from ASFA indicated in the hearing on 3 September 2002 his belief that the allocation of $28.7 million would not 'go very far in a campaign that would catch most people' over four years.[33] Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy

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29 Senate Economics Legislation Committee, 2002-03 Consideration of Budget Estimates, 4 June 2002, answer to Question E187.

30 *Submission* 10, CPA, p. 2.

31 *Submission* 13, CSA, p. 7.

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

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

Centre at the UNSW, also argued that $28.7 million over four years is inadequate.[34] Finally, Mr Silk from the Industry Funds Forum stated in evidence:

> I think that, by any measure, $28.7 million spent over four years is not going to achieve the sorts of objectives we would say are appropriate for an education campaign.[35]

3.30 The Committee notes, however, that some parties indicated their belief that the funding level for education is adequate. For instance, the FPA suggested in its written submission that the allocation of $28.7 million, with an 18-month lead-time, should provide the government and industry with ample opportunity to successfully implement choice.[36] Mr Breakspear from the FPA reiterated this position in the hearing on 11 September 2002. At the hearing the FPA indicated that a good model of an education campaign was the private health insurance lifetime cover campaign. [37]

3.31 The Committee also explored with witnesses the possibility that the superannuation industry could potentially meet part of the cost of the education campaign. In response, however, Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW argued that the education campaign should be government funded, on the basis that it needs to target a broad range of parties including consumers, industry groups and government agencies.[38]

3.32 While endorsing the principle that the education campaign should be Government funded, the ACA also submitted that the introduction of choice will require the kind of education campaign which accompanied the introduction of the GST.[39]

3.33 In response to questions about the proposed education campaign, the NFF advised that the government education campaign should not be seen to supplement employer group education campaigns but vice versa. Further, that the form of the government education campaign should include direct mail to employers, TV, brochures, internet and through third parties such as employer groups. In addition to commencing at least six months prior to the introduction of choice, the NFF considers that education from the government would need to be ongoing beyond the introduction of choice, particularly to assist new employers and to ensure continuous compliance.[40]

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34 *Committee Hansard*, 2 September 2002, p. 23.

35 *Committee Hansard*, 11 September 2002, p. 269.

36 *Submission* 37, FPA , p. 2.

37 *Committee Hansard*, 11 September 2002, p. 213.

38 *Committee Hansard*, 2 September 2002, p. 23.

39 *Submission* 53, ACA, p. 2.

40 *Submission* 46 and 47, NFF.

Targeting of education

3.34 During the inquiry, various parties also highlighted the targeting of the ATO's education campaign. They expressed concern that it may alert individuals that choice of fund is available, but without actually educating and equipping them to make an informed choice. [41] For example, Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW, stated:

> Maybe seven or eight years ago there was a massive education campaign for superannuation with the money tree campaign. That was done by the Australian Taxation Office. All feedback shows that that was not a particularly efficient education campaign, and we need to learn the lessons of that. The main lesson that came out of that was that we need far greater proactive engagement with all the stakeholders—and that was not done before.[42]

3.35 Others expressed additional concerns that the resources available for the education campaign should not be diverted into a public relations exercise aimed at promoting the purported benefits of choice without aiding decision making. For example, ASFA, in its submission, cautioned against:

> … either a 'feel good about reform' campaign (along the lines of the 'Unchain My Heart' campaign for tax reform) or a campaign chiefly focussed on employer compliance.[43]

3.36 In response to this concern, the Society of Superannuants (SOS) advocated that the Choice Bill should prescribe how the education program would be delivered.[44]

3.37 Various parties also argued that education of individuals on financial matters such as superannuation has to begin at school, so that school leavers have the ability to make informed choices.[45] Ms Wolthuizen from the ACA noted in the hearing on 2 September 2002 that the UK has begun an extensive financial education campaign in schools.[46]

3.38 In this regard, the Committee notes that ASIC's *Consumer Education Strategy 2001-2004* includes a commitment to a financial literacy in schools project, to encourage the provision of financial education to children and teenagers through

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41 *Committee Hansard*, 2 September 2002, p. 23.

42 *Committee Hansard*, 2 September 2002, p. 23.

43 *Submission* 17, ASFA, p. 4.

44 *Submission* 4, SOS, p. 1.

45 *Committee Hansard*, 2 September 2002, p. 14.

46 *Committee Hansard*, 2 September 2002, p. 23.

school education. ASIC intends to work with relevant agencies to review curricula in Australia.[47]

3.39 The Committee also notes the written submission of the NFF, in which it argued that the education campaign should also target employers, so that they are fully informed of their obligations under a choice environment, and can provide employees with practical guides such as checklists and template standard choice forms.[48] Similarly, in evidence to the Committee on 3 September 2002, Dr Pragnell from ASFA noted his belief that employers will need assistance in determining both who should be offered choice, and what their default fund should be. He suggested that small employers in particular are likely to need assistance:

> I think particularly when you start to get to smaller employers, who may have less formalised industrial relations arrangements, they are going to be in some pretty murky water in terms of coverage and in even murkier water in terms of what the default fund actually is. I think that when you start to deal with larger employers with more sophisticated industrial relations arrangements it is going to be more straightforward.[49]

3.40 Finally, the Committee also notes the evidence of Ms Dyson from the AIST that funding should also be set aside for education of fund trustees under a choice regime. Fund trustees will need to make more information available to their members under a choice environment, but should be aware that they cannot offer financial advice unless they are licensed to do so by the APRA.[50]

3.41 In response to these concerns, Mr Murtagh from the ATO indicated that the ATO is currently designing a choice education campaign, including costing of research, evaluation and monitoring elements, together with deliberate marketing and education activities using TV, radio, press advertising and the like. In addition, the ATO has set aside $2 million in funding for a consumer information centre.[51]

Other consumer protection issues

3.42 A number of other issues relating to mechanisms to strengthen the consumer protection regime were also raised by the ACA in a supplementary submission to the inquiry. In its supplementary submission, the ACA emphasised that the success of the Choice Bill will 'ultimately depend on the quality of information and advice provided to consumers looking to make a choice'. To assist consumers to make a choice, the ACA recommended that the Government establish an independent advisory and information service, which should be located within ASIC.

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47 ASIC, Consumer Education Strategy 2001-2004, October 2001, p. 22.

48 *Submission* 1, NFF, pp. 10-11.

49 *Committee Hansard*, 3 September 2002, p. 150.

50 *Committee Hansard*, 3 September 2002, p. 171.

51 *Committee Hansard*, 19 September 2002, p. 331.

3.43 In order to test the legality and quality of advice, the ACA also submitted that ASIC should increase the level of auditing of financial advice from once every three years to an 'ongoing basis'.

3.44 The Committee notes that, while expressing its concerns about the lack of a swift compensation mechanism under the SIS Act, the ACA is also in the process of preparing a submission to Treasury on an appropriate compensation regime, in the event of fund failure.[52]

52 *Submission* 53, ACA, pp. 3-5.

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:
>
> (a) the selected Commonwealth or Territory industrial award fund for the employee (see subsection (5) and (6)); or
>
> (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
>
> (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]

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.

Chapter Five

Other Implementation Issues

Introduction

5.1 This chapter examines a number of other implementation issues, in addition to those discussed in the previous chapter, which were raised during the Committee's inquiry into the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002:

- the impact of the Bill on defined benefit schemes;
- the interaction of the Bill with AWAs and certified agreements;
- the collection of arrears;
- the provisions of the standard choice form; and
- the commencement date of the Bill.

Defined benefit schemes

5.2 The Committee understands that the Government's intention is that defined benefit funds should fall under the provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002, with the exception of unfunded Commonwealth schemes (including the CSS and PSS schemes). However, employers will not have to offer choice where they have met their SG obligations and are on a contributions holiday (in effect employers are ahead in their contributions), and where they meet the following criteria under proposed section 32V(2) of the Bill:

a) An actuary has provided a certificate in accordance with the regulations under the *Superannuation Industry (Supervision) Act 1993* stating that the employer is not required to make contributions for the quarter and there has been such a certificate covering all times since 1 January 2004; and

b) An actuary has provided a certificate stating that, in the actuary's opinion, at all times from 1 July 2004 until the end of the quarter, the assets of the scheme are, and will be, equal to or greater that 110 per cent of the greater of the scheme's liabilities in respect of vested benefits and the scheme's accrued actuarial liabilities; and

c) The actuarial certificate has been provided no earlier than 15 months before the end of the last quarter.

5.3 In addition, under proposed section 32V(3), an employer does not have to offer choice to an employee who has reached their accrued maximum benefit.

5.4 In evidence to the Committee on 19 September 2002, Mr Thomas indicated that it is up to the individual actuary to make a judgement whether a scheme meets the above requirements, taking into account factors such as market conditions and expected changes in scheme membership. Mr Thomas also indicated that following the passage of the Bill, the Government would consult further with the Institute of Actuaries with a view to issuing guideline on the new certificate requirements.[1]

5.5 The Committee also raised with Mr Thomas the cost of seeking an actuarial certificate. In response, Mr Thomas noted that the costs involved in assessing whether a particular scheme meets the relevant requirements would vary depending on the financial position of the scheme. For example, it would be less costly to assess a scheme whose assets were far in excess of the requirements.[2]

5.6 Given that choice is not available to all members of a defined benefit fund under the Bill, and that choice can be satisfied where a fund is nominated in an AWA or certified agreement, the Committee notes that where defined benefit fund members do have a choice, there are difficulties in determining the balance of their fund. The withdrawal benefit of defined benefit schemes can usually only be calculated at the point of retirement. Accordingly, it is very difficult to advise a member of a defined benefit scheme who is thinking of moving to an accumulation fund of the advantages and disadvantages of such a move.

5.7 In its written submission, AIST argued that where an employee leaves a defined benefit scheme, they should be required to acknowledge in writing that they are leaving a guaranteed benefit scheme, which is underwritten by the employer, and moving to an accumulation fund where they (the employee) bear the risks.[3]

5.8 The Committee notes that the possible departure of employees from defined benefit funds under the choice regime creates possible concerns for the ongoing viability of those funds. That said, the Committee notes that defined benefit funds currently face more serious difficulties in relation to actuarial adequacy standards than those posed by a choice environment.[4]

5.9 The Committee also notes that the ACCI raised a number of 'special problems' with the inclusion of defined benefit funds in the proposed legislation. These included the potential for:

- an increase in labour costs for employers where there is a contributions holiday because the fund is cashed up;
- the difficulties of providing advice about the consequences of leaving defined benefit schemes; and

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1 *Committee Hansard*, 19 September 2002, pp. 344-345.

2 *Committee Hansard*, 19 September 2002, p. 344.

3 *Submission* 29, AIST, p. 2.

4 *Committee Hansard*, 11 September 2002, p. 236.

- possible problems with the viability of these funds when members leave.[5]

5.10 Accordingly, the ACCI recommended exempting defined benefit schemes from the proposed legislation.

Proposed section 32G(3)

5.11 Proposed section 32G(3) of the Bill states:

> A fund cannot become a chosen fund for an employee under this section if, immediately before the employee gave the written notice to the employer, either
>
> (a) a defined benefit superannuation scheme of which the employee was a defined benefit member was a chosen fund for the employee, or
>
> (b) there was no chosen fund for the employee and the default fund for the employee was a defined benefit superannuation scheme of which the employee was a defined benefit member.

5.12 The Committee Chair, Senator Watson, raised his concern that under proposed section 32G(3), an employee could not opt out of a defined benefit scheme which they had chosen.[6]

5.13 In response, Mr Boneham from the Treasury indicated that proposed Division 4 of the Bill, which includes proposed sections 32F and 32G, provides two options for employees to choose a new fund. One is to go through a formal choice process under proposed section 32F using a standard choice form. The other is to make a choice under proposed section 32G. However, through the inclusion of the words 'under this section' in proposed section 32G(3), employees in defined benefit schemes cannot use proposed section 32G to make a choice but must instead use proposed section 32F to make a formal choice.

5.14 In turn, Mr Boneham indicated that the purpose of placing this restriction on the choice of employees in defined benefit schemes is to ensure that they understand that they are moving from a defined benefit scheme to an accumulation scheme.[7]

5.15 Mr Thomas from the Treasury further argued that although the wording of the proposed sections 32F and 32G of Division 4 may be confusing to non-lawyers, the majority of employers will be getting their information from information documents provided by the ATO.[8]

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5 *Submission* 38, ACCI, p. 1.

6 *Committee Hansard*, 19 September 2002, p. 328.

7 *Committee Hansard*, 19 September 2002, p. 328.

8 *Committee Hansard*, 19 September 2002, p. 330.

AWAs and certified agreements

5.16 As previously noted, proposed sections 32C of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 provides that SG contributions under an Australian Workplace Agreement (AWA) or certified agreement made under the *Workplace Relations Act 1996* or the *Industrial Relations Act 1988* satisfy the choice of fund requirement.

5.17 In its written submission, the AIG supported recognition of AWAs and certified agreements as satisfying choice, on the basis that they are negotiated at the workplace between the employer and the employee/employees/unions.[9] However, a number of parties such as the MTAA Superannuation Fund[10] and the ACTU[11] argued that the appropriate mechanism for implementing choice is the industrial system, and that it was contradictory for the legislation to significantly reduce the role of awards in fund selection while allowing some industrial instruments (that is, AWAs and certified agreements), to override choice. The SOS argued that AWAs and certified agreements should not override choice.[12]

5.18 For example, the MTAA Superannuation Fund argued that it is inconsistent that AWAs and certified agreements override the choice of fund requirements, yet existing awards, which are also a product of the industrial relations process, do not. Accordingly, the MTAA Superannuation Fund argued that choice of fund should be introduced via the industrial relations system.[13]

5.19 Similarly, the ACTU noted that the Full Bench of the AIRC has varied a number of awards as part of the award simplification process to include the option for employers and employees to negotiate their own fund agreements.[14] Ms Rubinstein from the ACTU developed this point in evidence to the Committee on 3 September 2002:

> We believe that that is the best protection for employees. The reality is that there has not been a case of superannuation failure, a fund that APRA has found has not met its obligation in a proper way, where there has been either union appointed member representatives or effective directly elected employee representatives—that is, not chosen by management and effectively snowed by them.[15]

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9 *Submission* 9, AIG, p. 2.

10 *Submission* 11, MTAA Super Fund, pp. 4-5, 14.

11 *Submission* 5, ACTU, pp. 5-6.

12 *Submission* 4, SOS, p. 1.

13 *Submission* 11, MTAA Super Fund, pp. 4-5, 14.

14 *Submission* 5, ACTU, pp. 5-6.

15 *Committee Hansard*, 3 September 2002, p. 124.

5.20 The Committee raised the exclusion of AWAs and certified agreements from the choice provisions with representatives of the Treasury during the hearing on 11 September 2002. Mr Thomas indicated that AWAs and certified agreements are excluded on the basis that in the process of negotiating these agreements, employees and employers may have already discussed superannuation provisions, thereby giving effect to choice.[16]

5.21 By contrast to these parties, ACCI advocated in its written submission the removal of superannuation obligations entirely from the industrial award system. ACCI noted that at present, employees are required to meet a dual regulatory regime - one stream of regulatory obligation (the SG legislation) that is neutral as to choice of fund, and the other (industrial awards) that is prescriptive as to fund selection.[17]

5.22 Finally, on another issue, the Committee notes that in the hearing on 3 September 2002, Mr Cerche from CSA argued that currently many employers are contributing more than nine per cent under award provisions. He argued that many employers contribute an additional three per cent productivity component that was made available under award superannuation during the 1980s prior to the introduction of the SG charge. In addition, Mr Cerche argued that many employers contributing to corporate funds under awards also meet administration and insurance costs, making the effective contribution in the order of 13½ per cent. Mr Cerche argued that under the Bill, unscrupulous employers could take the opportunity to drop back their contributions to nine per cent.[18]

Collection of arrears

5.23 In evidence before the Committee on 2 September 2002, Ms Butera and Mr Noble from Cbus argued that choice of fund in Australia would lead to an increase in the likelihood that funds will not actively pursue arrear payments from employers.[19] As stated by Mr Noble:

> Cbus takes a very proactive approach to the collection of arrears. Our industry is such a changing industry that we believe we need to collect superannuation as and when the income is earned. But we know that other superannuation providers do not have our approach and that if you have an environment where we are collecting superannuation arrears but we are the only ones collecting arrears, other employers will start to get the message that if they are paying in to other funds they are not going to have anyone chasing them up.[20]

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16 *Committee Hansard*, 11 September 2002, p. 282.

17 *Submission* 25, ACCI, p. 7.

18 *Committee Hansard*, 3 September 2002, pp. 117-119.

19 *Submission* 16, Cbus, p. 11. *Committee Hansard*, 2 September 2002, p. 46.

20 *Committee Hansard*, 2 September 2002, p. 51.

5.24 Given this concern, Mr Noble from Cbus strongly advocated additional resources for the ATO to actively target and approach employers who do not meet their superannuation obligations so as to ensure that employees do not lose their superannuation entitlements. [21]

The standard choice form

5.25 In its written submission, AIST argued that the standard choice form should include a list of checkpoints to assist employees to research their decisions properly. Those checkpoints should include a comparison of fees, whether funds provide disability and death benefits, the cost to the employee of changing to a new fund, and whether a fund is for profit or not for profit.[22] Ms Dyson from the AIST reiterated this evidence in hearings.[23]

5.26 In response, Mr Thomas from the Treasury indicated in evidence on 19 September 2002 that the standard choice form will be developed in consultation with industry and consumers, and will be available well before the choice regime commences.[24]

Commencement date

5.27 In its written submission, the NFF indicated its belief that the 18-month delay before commencement of the Bill on 1 July 2004 is sufficient for all parties to be prepared, on the proviso that the Government invests additional funds in its education program.

5.28 By contrast, in its written submission, ASFA argued that the Bill should not commence until 12 months after the implementation of provisions to replace the OMC. As a result, ASFA argued that 1 July 2004 is the earliest the choice of funds regime could commence.[25]

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21 *Committee Hansard*, 2 September 2002, p. 52.

22 *Submission* 29, AIST, p. 1.

23 *Committee Hansard*, 3 September 2002, p. 170.

24 *Committee Hansard*, 19 September 2002, p. 339.

25 *Submission* 17, ASFA, p. 4.

Chapter Six

Employers

Introduction

6.1 During the inquiry, witnesses broadly acknowledged that the implementation of the Bill may lead to additional costs for employers. This chapter examines the:

- impact of the implementation of choice on employers' costs;
- concerns in relation to the potential fines for employers for failing to comply with the provisions of the Bill, including the constitutionality of the proposed fines; and
- the legal liability of employers under the Bill.

Employer costs

6.2 An estimated 654,000 employers will be subject to choice; 500,000 of whom will not be covered by workplace agreements. The Explanatory Memorandum (EM) to the Choice Bill notes that the provision of choice of funds under the Bill will place additional administrative work on employers. Initial costs to employers are estimated at $27 million, with additional ongoing costs of $18 million per annum. These costings are based on an estimate of three hours initially to comply and two hours thereafter.

6.3 However, in its written submission, Mercer argued that these estimates dramatically underestimate the real costs. Mercer cited ABS statistics that there were 566,500 employing businesses in Australia in 1998-99. Using this figure, the estimate cost of $27 million in the first year translates to an average cost for each business for implementing choice of $47.66. Mercer stated:

> Even if we assume that only half of these businesses will incur any costs, the average estimated cost per business is less than $100. In other words, perhaps enough for half an hour of advice from the local accountant but with nothing left for implementation, determining default fund, changing systems, preparing necessary forms etc etc.[1]

6.4 ACCI also noted in its written submission that the costs of compliance suggested in the EM to the Bill 'appear to be a real stab in the dark', and to be an underestimate of the real cost impact.[2]

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1 *Submission* 20, Mercer, p. 5. See also *Committee Hansard*, 2 September 2002, p. 99.

2 *Submission* 25, ACCI, p. 11.

6.5 In calculating the real impact that the Choice Bill is likely to have on employers, parties giving evidence to the Committee pointed to a range of considerations.

6.6 First, it was argued that employers under the choice model proposed in the Bill will need to be involved in educating their employees about choice. In its written submission, CPA Australia cited member feedback to the effect that average employers who offer choice currently spend between ten minutes and half an hour per month per employee in education measures.[3]

6.7 Second, Cbus suggested in its written submission that employers will face additional administrative costs. In this regard, employers will have additional responsibilities forwarding and collecting standard choice forms, confirming that chosen funds are complying superannuation funds, registering an employee with a superannuation fund, and selecting the default fund where a choice is not made.[4] The high level of employee mobility in certain industries will only increase these high compliance costs.

6.8 Third, employers will be required to make contributions to a greater number of funds, entailing additional financial costs.[5] In their written submission, Mr Engelhardt and Mr Stephens cited the example of a major employer in WA that currently must meet the requirements of 45 different funds under WA's choice of fund legislation, together with the cost of transfers (including electronic transfers).[6]

6.9 Cbus also cited an example of an employer with 20 employees, who goes from making contributions to 1 fund to 10 funds. Cbus argued that this represents an additional 108 cheques per year, an increase in transaction fees with the Commonwealth Bank of $59.40 a year. In addition, the employer would need to complete 10 separate remittance advices and post 10 different envelopes at a cost of $48.60 a year. As at June 2002, only 6.28 per cent of Cbus employers made contributions for their employees via electronic commerce.[7]

6.10 Given these additional costs, parties such as the AIG expressed concern at the impact of the Bill on Australian industry's international competitiveness.[8] The Committee also notes evidence from Ms Harris from the NFF suggesting that the compliance burden of fund choice is likely to be particularly hard for small businesses.[9]

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3 *Submission* 10, CPA, p. 3.

4 *Submission* 16, Cbus, p. 4.

5 *Committee Hansard*, 2 September 2002, p. 80.

6 *Submission* 12, Mr Stevens & Mr Engelhardt, p. 2.

7 *Submission* 16, Cbus, pp. 4-5.

8 *Submission* 9, AIG, p. 2.

9 *Committee Hansard*, 11 September 2002, p. 205.

6.11 In response to these concerns, however, the NFF argued that any increase in costs will be limited by the use of the unlimited choice scheme under the Bill. At the same time, the NFF accepted that any increase in costs is outweighed by the importance of allowing an employee to determine which fund they want to go into. This position was reiterated by Ms Harris in the hearing on 11 September 2002:

> At the end of the day, the position was it is an ability of the employee to determine which fund they want to go into and they are not hampered or restricted to one particular fund. That is our concern and that in the long term should in some respects outweigh the issue of cost.[10]

6.12 That said, Ms Harris acknowledged the concern of the NFF that the compliance burden may be harder for small businesses and farmers that perhaps do not employ a payroll officer.[11]

6.13 The Committee also notes the evidence of Mr Rosario from Westscheme that the fund has attempted to limit the compliance burden on employers by no longer requiring application forms to join the fund. Westscheme simply deems employees to be a member of the fund where the employer gives them the employee's name and address. In that instance, Westscheme simply writes to the employee's home address to give them information on the fund.[12]

E-commerce

6.14 In its written submission, the NFF suggested that any increase in cost to employers from the Choice Bill may also be limited by the introduction of standard provisions of e-commerce between employers and superannuation funds, allowing the seamless transfer of money electronically.[13] Similarly, Mr McNaught from Connect Internet Solutions Pty Ltd argued that under a choice environment:

> Payroll and accounting software as well as payroll bureaus will move quickly to support processing of superannuation to multiple fund recipients.[14]

6.15 In his written submission, Mr McNaught noted that currently the majority of employers still predominantly process their SG transactions using paper and cheque.[15] Similarly, Ms Butera noted in the hearing on 2 September 2002 that at June 2002, the

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10 *Committee Hansard*, 11 September 2002, p. 202.

11 *Committee Hansard*, 11 September 2002, p. 205.

12 *Committee Hansard*, 2 September 2002, p. 57.

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

14 *Submission* 45, Connect Internet Solutions Pty Ltd, p. 5.

15 *Submission* 45, Connect Internet Solutions Pty Ltd, p. 3.

percentage of Cbus employers who made SG contributions for their employees via electronic commerce was only 6.28 per cent.[16]

6.16 However, Mr McNaught raised a concern that the development of electronic services in the superannuation industry may not occur satisfactorily in a laissez-faire environment as providers rush to capture a share of the industry market, creating tens if not hundreds of transfer channels. Accordingly, he argued that the government should develop in conjunction with the private sector a common electronic trading platform for the transfer of superannuation funds:[17]

> Failure by the Government to address processing needs attached to the introduction of choice of fund will result in a confused market response that inevitably will add time and cost burdens to employers and funds. Ultimately this will adversely influence the end cost of administration that superannuants will be made to bear.[18]

6.17 The Committee acknowledges this suggestion, although it also notes evidence from Mr Bissaker from IFSA that the industry is probably a year to 18 months from seamless movement of money and information between funds.[19]

6.18 Despite this projection, the Committee notes that electronic transfers are already a reality for some. In its submission, the Commonwealth Bank drew attention to a service called Commonwealth eSelect. According to the Bank, this service enables employers to authorise a single payment covering all individual employee payments to any complying superannuation fund in Australia. The Bank advised that today it is providing this service to 1,000 employers in respect of 32,000 employees.[20]

6.19 While noting that this service has assisted some employers, the Committee also notes that a survey of employers using the eSelect shows that 82 per cent also use the Commonwealth as their business bank and that 75 per cent use the Commonwealth as their default fund for employees. The survey provided detailed examples of employers where most or all employees became members of the Commonwealth fund following the move to eSelect. In the words of one employer: '90 per cent of our staff fell into the CBA'.[21] As noted by the survey authors (Ross Cameron and Associates) this supports the view that:

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16 *Committee Hansard*, 2 September 2002, p. 45.

17 *Submission* 45, Connect Internet Solutions Pty Ltd, p. 5.

18 *Submission* 45, Connect Internet Solutions Pty Ltd, p. 6.

19 *Committee Hansard*, 11 September 2002, p. 240.

20 *Submission* 33, CBA.

21 *Submission* 33, CBA, Attachment, p. 20.

> NetSuper also serves as a business acquisition tool, with many of the businesses surveyed appearing to switch their super to the Commonwealth, or more particularly, making the Commonwealth their new 'default' fund.[22]

Clearing houses

6.20 In evidence to the Committee on 2 September 2002, Mr Rosario from Westscheme indicated that Westscheme offered employers a clearing house under the WA choice regime, whereby Westscheme acts on behalf of the employer to re-direct SG contributions made by the employer to the fund of the employee's choice. Mr Rosario also indicated that many fund clearing-houses in WA require separate cheques for each employee, even though they may have a number of employees with the same employer in the fund.[23]

6.21 In evidence on 11 September 2002, Mr Thomas from the Treasury cited the development of clearing-houses as possibly limiting costs to employers.[24] In evidence on 19 September 2002, Mr Thomas indicated that Westscheme costs employers approximately $1.50 per employee per transfer to another fund.[25]

6.22 The Committee acknowledges this evidence, although it notes that even for a small business of 20 employees, $1.50 per employee per month translates into a cost of over $300 a year.[26]

Employer fines

6.23 Proposed sections 32T and 32U of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 outline offences which attract penalties for failure by employers to comply with the choice of fund regime. The maximum penalty is 60 penalty units ($6,600).[27]

6.24 In its written submission to the inquiry, Mercer noted that the penalties for breaches of the choice regime are extreme, and 'are far beyond that which would be considered reasonable in respect of the breaches such as failing to give a standard choice form to an employee within 28 days' and that 'the imposition of such penalties is draconian and unnecessary.'[28]

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22 *Submission* 33, CBA, Attachment, p. 11.

23 *Committee Hansard*, 2 September 2002, p. 58.

24 *Committee Hansard*, 11 September 2002, p. 285.

25 *Committee Hansard*, 19 September 2002, p. 315.

26 *Committee Hansard*, 19 September 2002, p. 315.

27 *Committee Hansard*, 19 September 2002, p. 335.

28 *Submission* 20, Mercer, p. 4.

6.25 In this regard, Mercer noted that for some employees, it may be difficult to determine whether they are covered by a federal or state award, and that this could result in potential unintentional breaches of the choice requirements.[29]

6.26 ACCI also argued that the Bill takes a quite inappropriate penal approach to employer compliance. It noted that failure by employers to comply with the choice regime is punishable by fines of up to 60 penalty units, whereas under the decade old SG legislation, the penalty for failure to comply is an additional 25 per cent payment over and above the SG payment:

> Under the scheme of the SG Legislation, introduced by the then Keating government, it was statutory policy that there would be no penalties imposed under the SG Legislation (SGL) where an employer failed to meet an industrial award-based obligation. SGL penalties would only apply where there was a failure to meet SGL obligations. The 2002 Choice Bill alters this framework in a fundamental way – applying for the first time SGL penalties for a failure to meet industrial award requirements (via the default fund provisions).[30]

6.27 In its written submission, IFSA also suggested that it is totally inappropriate that the Bill seeks to apply criminal penalties through superannuation law to industrial issues, and that such penal provisions such should remain within industrial law.[31] In evidence, Mr Bissaker from IFSA reiterated this position.[32]

6.28 Given these concerns, Ms Harris from the NFF argued in evidence to the Committee on 11 September 2002 that the penalty provisions of the Bill should be amended. She suggested that the ATO should be allowed to issue warning notices prior to the imposition of strict penalties, and that there should be a moratorium on the penalty provisions for at least 12 months after the introduction of choice.[33] Ms Harris acknowledged that without such an amendment, the NFF would have to reconsider its support for the Bill.[34]

6.29 The Committee raised the employer penalty provisions with officials from the Treasury in the hearing on 11 September 2002. Mr Thomas indicated that the penalty provisions were changed from those in the previous Bill – the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 1998 – because of the inflexibility of the previous regime. Under the previous Bill, the ATO would have been obliged to penalise individual employers regardless of whether they had made an innocent mistake. Mr Thomas argued that the new regime gives the ATO the

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

30 *Submission* 25, ACCI, p. 13.

31 *Submission* 36, IFSA, p. 4.

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

33 *Committee Hansard*, 11 September 2002, p. 196.

34 *Committee Hansard*, 11 September 2002, p. 205.

flexibility to negotiate practices with employers to ensure that they comply with the choice of fund regime. Accordingly, he suggested that the regime would result in substantially fewer penalties.[35]

6.30 In response, however, the Committee noted a worst-case scenario under which an employer had a large number of staff in respect of whom the employer was in breach. Should the ATO decide to take the employer to court, rather than pursuing education programs with the employer, the employer could be determined to be in breach with respect of each individual employee.[36] Accordingly, an employer with 10,000 employees in respect of whom the employer was in breach could potentially face a fine of $66 million.[37]

6.31 In response, Mr Boneham from the Treasury argued that such a fine would be highly unlikely. It would require the ATO to decide to pursue the matter on the basis that the employer refused to comply, and the courts would have to decide to impose the maximum penalty in respect of each and every worker. However, Mr Boneham noted that under the old regime, the penalty would have been a mandatory $1 million, with no discretion at all on the part of the ATO.[38]

Constitutionality

6.32 The Committee also notes that, in its written submission, CSA indicated its belief that proposed section 32T and 32U of the Bill imposing fines on employers are unconstitutional, on the basis that they go beyond the taxation power of the Commonwealth.[39]

6.33 In response to this issue, Mr Thomas from the Treasury indicated in evidence on 11 September 2002 that the Treasury is currently seeking further legal advice.[40] In further evidence to the Committee on 19 September 2002, Mr Thomas declined to indicate whether the Government had received that advice, on the basis that it is an internal government matter.[41]

Employer liability

6.34 As noted in Chapter One, the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 allows for unlimited choice of fund. This is in contrast to the previous Taxation Laws Amendment Bill (No 7) 1997.

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35 *Committee Hansard*, 11 September 2002, p. 283.

36 *Committee Hansard*, 11 September 2002, p. 284.

37 *Committee Hansard*, 19 September 2002, p. 336.

38 *Committee Hansard*, 19 September 2002, p. 335.

39 *Submission* 13, CSA, p. 4.

40 *Committee Hansard*, 11 September 2002, p. 286.

41 *Committee Hansard*, 19 September 202, p. 321.

6.35 In its written submission, the NFF noted that unlimited choice removes the onus from the employer in selecting funds for choice, thereby removing any potential legal liability from the employer. Under the limited choice model, an employer could select four or five funds to offer to his or her employees that subsequently perform poorly, possibly leaving him or her open to litigation. In the NFF's opinion, this advantage of unlimited choice clearly outweighed any potential additional administrative burden on employers from employees selecting a broad range of funds.[42]

6.36 However, in its written submission, the MTAA Superannuation Fund raised doubts whether even the proposed unlimited choice arrangements would ensure that employers are not subject to any legal recourse or liability from any choice of fund that is made by an employee. The Fund argued that it is unclear on constitutional grounds whether the Bill can exempt employers from their common law duty of care.[43] Similarly, in its written submission, Quadrant Superannuation noted that:

> The position of the employer from a liability perspective will be precarious at best and unsustainable at worst. The employment costs and obligations that already exist are onerous.[44]

6.37 In response to this issue, Mr Boneham from the Treasury indicated that proposed section 32ZA of the Bill provides that employers are not liable for damages if they abide by the provisions of the Bill.[45] Proposed section 32ZA states:

> An employer is not liable to compensate any person for damage arising from anything done by the employer in complying with this part.

6.38 The Committee notes that this proposed section protects employers where they offer choice, and pay to any chosen fund or a default fund if there is no choice. However, it does not protect them if they go outside the terms of the Bill. For example, employers would not be protected if they provided advice to employees about what fund they should invest in.[46]

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42 *Submission* 1, NFF, p. 10.

43 *Submission* 11, MTAA Super Fund, p. 13.

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

45 *Committee Hansard*, 19 September 2002, pp. 340-341.

46 *Committee Hansard*, 19 September 2002, p. 341.

Chapter Seven

Commission-based selling

Introduction

7.1 During the inquiry, various parties argued that implementation of the Bill in its current form would encourage commission-based selling of retail funds, and would, in turn, lead to higher costs and lower returns for not-for-profit funds.

7.2 This chapter examines:

- the relative merits of different forms of commission-based selling; and
- the impact of commission-based selling on fund costs and fund returns.

Commission-based selling

7.3 During the inquiry, various parties raised concern that the lack of financial literacy of many employees will leave them vulnerable to commission-based selling of retail funds by financial advisers. In its written submission, the MTAA Superannuation Fund submitted:

> In such an environment, we fear that many employers and employees, especially those in the small business sector, will be fair game for any unscrupulous agent or pseudo financial planner who might choose to treat this opportunity as a commission-induced or trailing fee-paying 'feeding frenzy'.[1]

7.4 Similarly, the Industry Funds Forum also expressed concern that implementation of choice could lead to a rise in the selling of higher-cost funds by commissioned agents:

> The underlying basis of such a system would not be improved value or performance for a member, but the financial rewards available to an agent who is able to sell a new or different fund to an employee, thereby earning a commission.[2]

7.5 Cbus argued that, with commission selling, choice would benefit financial planners at the expense of employees:

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1 *Submission* 11, MTAA Super Fund, p. 9.

2 *Submission* 30, Industry Funds Forum, p. 3.

> Instead of contributing funds towards the retirement savings of individuals, choice of fund will lead to Australia's superannuation system being used to contribute to the retirement of financial advisers.[3]

7.6 In its written submission, the ACTU cited a recent article by Tom Collins entitled *Industry Repair should be First Priority*, in which he was particularly critical of the commission-based remuneration system for financial planners. He argued that commission-based selling encourages so-called 'churning', whereby employees are constantly moved from one fund to another, to the benefit of the financial planners.[4]

7.7 In response to these concerns regarding commission-based selling and 'churning', the FPA cited in its written submission section 947D of the *Financial Services Reform Act 2001*, which it argued ensures a high level of disclosure when planners advise their client to change their investments. In addition, the FPA noted that the FPA's Code of Ethics and Rules of Professional Conduct, to which members of the FPA must adhere, states at Rule 118:

> A member (of the FPA) shall not move a client or cause a client to move from an investment to another investment without explaining to the client, in terms the client is likely to understand, the reasons for the move. The Member must demonstrate that the move is appropriate for the client.[5]

7.8 In the hearing on 11 September 2002, Senator Sherry raised with Mr Breakspear from the FPA the applicability of section 947D of the *Financial Services Reform Act 2001*. He noted that financial advisers are remunerated partly on the basis of commissions they receive from funds which they recommend, which may prevent them from being objective in their assessment of suitable funds for employees.[6]

7.9 In response, Mr Breakspear argued that section 947D of the *Financial Services Reform Act 2001* requires financial advisers to set out in writing advice to clients, indicating the basis on which they recommendation an employee change or not change funds. They must also indicate any benefit or commission they would receive from a change of fund. By law, if they make a recommendation based on their own financial gain rather than the client's financial gain, they are liable to prosecution by ASIC.[7]

7.10 Mr Rosser from the Treasury also made this point in the hearing on 11 September 2002. He indicated that even where a financial adviser provides advice to a client who is financially illiterate, and therefore vulnerable to commission-based

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

4 Cited in *Submission* 5, ACTU, p. 5.

5 *Submission* 37, FPA, pp. 4-5.

6 *Committee Hansard*, 11 September 2002, p. 218.

7 *Committee Hansard*, 11 September 2002, pp. 218-219.

selling, the financial adviser would nonetheless be required to comply with their legal requirement to provide financial advice in the best interests of their client.[8]

7.11 The Committee also notes that in evidence, Mr Breakspear acknowledged that approximately 95 per cent of financial advisers do not recommend industry funds in their advice to clients. Partly this is because many are not public offer funds. However, Mr Breakspear also acknowledged that most industry funds do not offer a commission to financial advisers for bringing new members to the fund. Mr Breakspear defended this situation, however, on the basis that financial advisers that operate on a commission basis rather than an up-front fee basis, would be unable to continue to offer advice if they included industry funds in their portfolio of funds from which they make recommendations.[9]

7.12 Responding to Mr Breakspear's evidence, Industry Fund Services advised the Committee that:

> The simple fact of the matter is that financial planning organisations almost invariably never recommend non-commission paying superannuation funds, and a retirement income system which combines compulsory superannuation contributions with unfettered commission-based selling is a recipe for disaster.[10]

7.13 Cbus expressed similar concern, stating in its submission that:

> The Superannuation Guarantee currently requires employers to contribute 9% of the gross ordinary time earnings of an employee into a complying superannuation fund. There is a question as to whether it is legitimate for commission to be debited from the funds that employees must compulsorily preserve until retirement.[11]

7.14 Various parties also advocated a ban on commission-based selling during the inquiry. For example, in its written submission, the MTAA Superannuation Fund argued that until Australians demonstrate an ability to make informed and educated choices, a ban should be imposed on commission-based selling of superannuation products in respect of mandated SG payments.[12]

7.15 Similar arguments were expressed in hearings. For example, Mr Silk from the Industry Funds Forum argued in the hearing on 11 September 2002 that SG

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8 *Committee Hansard*, 11 September 2002, p. 295.

9 *Committee Hansard*, 11 September 2002, p. 221.

10 *Submission* 44, Industry Fund Services, p.2.

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

12 *Submission* 11, MTAA Super Fund, p. 8.

contributions are mandated by legislation, and that there is no basis for individuals to enrich themselves at the expense of members' retirement savings.[13]

7.16 The Committee also considered in hearings the issue of third-line forcing, whereby superannuation providers offer 'deals' in which superannuation is packaged with a range of other products, effectively locking an employee into a superannuation fund which is not in their best interest.

7.17 In his response to this issue on behalf of the ABA, Mr Loveridge argued in evidence on 11 September 2002 that Australian banks would not consider using third-line forcing as a strategic initiative. At the same time, however, Mr Bell noted that 'bundling' products and services is legal under the *Trade Practices Act 1974* where an individual is fully aware of it.[14]

Trailing commissions

7.18 During the inquiry, various parties advocated a ban on trailing commissions. For example, in evidence on 3 September 2002, Ms Dyson from AIST indicated that AIST opposed trailing commissions by financial advisers, in favour of an up-front fee, disclosed at the time the client goes in for service. She also suggested that the up-front fee should be a cash amount rather than a percentage charge. Similarly, Dr Pragnell from ASFA acknowledged the possibility of abuses by commission agents using ongoing commission fees, and supported a limit being placed on commission fees in favour of an up-front fee.[15]

7.19 In response to these arguments for a ban on trailing commissions, Mr Murphy from the Association of Financial Advisers argued that trailing commissions constitute an essential part of his business:

> It (the trailing commission) provides me with the infrastructure and support to be able to give benefits to the members of the funds.[16]

7.20 At the same time however, Mr Murphy argued that 'the consumer does not care' about the level of fees – on the basis that the client gets what they pay for: 'If they want cheap, we give them the Yellow Pages and the phone book'.[17]

7.21 The Committee also raised a ban on trailing commissions with Mr Hristodoulidis from the FPA in the hearing on 11 September 2002. He also opposed a ban on trailing commissions on the basis that they are disclosed up front, and that payment should go with a service:

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13 *Committee Hansard*, 11 September 2002, p. 267.

14 *Committee Hansard*, 11 September 2002, p. 262.

15 *Committee Hansard*, 3 September 2002, pp. 145-146.

16 *Committee Hansard*, 2 September 2002, p. 33.

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

> Where service is being delivered by the financial adviser, that is an ongoing relationship, and they should be available to assist the client with their affairs. Then payment should follow service.[18]

7.22 In this regard, Mr Breakspear from the FPA indicated that normally, financial advisers would review a client's funds on either a six-monthly or yearly basis, depending on the size of the fund, and provide the client with a written report of their situation. In addition, there may be events throughout the year that require contact between the adviser and the client.[19]

7.23 Finally, in evidence on 11 September 2002, Mr Gilbert from IFSA also supported the charging of trailing commissions where such fees are disclosed in accordance with the provisions of the *Financial Services Reform Act 2001*.[20]

The international experience

7.24 During the inquiry, various parties cited the example of super funds in the UK in the mid-1980s, when defined benefit schemes were opened up to competition from retail funds. The result was that life agents 'encouraged' people to leave their defined benefit schemes and transfer into personal pension products with higher fees and commissions, thereby adversely influencing their retirement savings.

7.25 The CSA referred the Committee to the Report of the Sandler Review of Medium to Long-term Retail Savings in the UK, which found that widespread commission-based selling of medium to long-term retail savings products in the UK had operated to the detriment of consumers. As a result, the UK regulator was forced to intervene in the interests of fund members.[21]

7.26 The ACA advised the Committee that the estimated cost of compensation for the mis-selling of life insurance after the deregulation of that market in the UK in the late 1980s was £11.5 billion to 1.1 (m)illion consumers in what has been described as 'the largest consumer compensation exercise undertaken anywhere in the world'.[22]

7.27 The Committee raised these issues with Mr Boneham from the Treasury during the hearing on 11 September 2002. He argued that the disclosure regime in the UK during the mid-1980s was not as robust as the regime operating in Australia under the *Financial Services Reform Act 2001*, and that accordingly it was not valid to extrapolate the UK experience to Australia.[23]

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18 *Committee Hansard*, 11 September 2002, p. 226.

19 *Committee Hansard*, 11 September 2002, p. 227.

20 *Committee Hansard*, 11 September 2002, pp. 241-242.

21 Cited in *Submission* 13, CSA, p. 7.

22 *Submission* 53, p. 2.

23 *Committee Hansard*, 11 September 2002, p. 294.

Not-for-profit fund costs

7.28 In evidence to the Committee on 3 September 2002, Ms Rubinstein from the ACTU argued that retail funds are run for the benefit of shareholders, and have to recoup costs, whereas not-for-profit funds are run solely for the benefit of fund members, and thus can keep costs to a minimum.[24] However, several parties argued during the inquiry that under a choice environment, not-for-profit funds might nevertheless face higher administrative and marketing costs.

Administration costs

7.29 During the inquiry, various parties argued that not-for-profit funds currently have lower administrative costs than retail funds. For example, in its written submission, the MTAA Superannuation Fund noted that since the fund's establishment in the mid-to-late 1980s, it has reduced its weekly administration fees from an average of $4 per week per member to around $1 per week today. This has not changed in the last eight years, despite inflation of approximately 30 per cent.[25] Cbus also currently maintains a $1 a week administration fee.[26]

7.30 The MTAA Superannuation Fund further cited recent studies by Dr Hazel Bateman from the UNSW, Access Economics and Rainmaker Information Services that average administration charged in not-for-profit industry and corporate funds are up to half those of funds that operate in the marketplace for profit.[27]

7.31 The ACTU also cited in its written submission a study of November 2001 from the ASFA entitled 'Are Administrative and Investment Costs on the Australian Superannuation Industry too High?', which found that retail master trusts average at least twice the cost of industry, public and corporate funds.[28]

7.32 Given the low costs of not-for-profit funds, various parties argued in their written submissions that choice of fund will force not-for-profit funds to increase outlays on administration. For example, Corporate Super argued in its written submission that administration fees may rise as a result of strains placed on funding due to the lack of predicability of membership. This could particularly apply to defined benefit funds, as the mix of ages and service of members becomes less predictable.[29]

7.33 Similar concerns were raised in hearings. For example, in evidence to the Committee on 2 September 2002, Ms Butera from Cbus questioned whether the fund

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24 *Committee Hansard*, 3 September 2002, p. 126.

25 *Submission* 11, MTAA Super Fund, p. 6.

26 *Committee Hansard*, 2 September 2002, p. 50.

27 *Submission* 11, MTAA Super Fund, p. 7.

28 *Submission* 5, ACTU, pp. 4-5.

29 *Submission* 13, CSA, p. 5.

would be able to maintain a $1 weekly charge should choice of fund be introduced.[30] In addition, Mr Ward from Mercer argued in evidence to the Committee on 2 September 2002:

> For industry funds the expenses will increase because, as you say, they are competing against a wider marketplace with paid salesmen or commission salesmen out there. At the moment industry funds are not really competing against those other funds but they would be under a choice environment. On the other hand, though, there may be some reductions in cost in those bank and life office funds as they do start to try and compete.[31]

Marketing costs

7.34 Various parties also argued that the introduction of choice of fund under the current Bill would force not-for-profit funds to increase outlays on marketing. For example, Cbus noted in its written submission:

> In a choice of funds environment, market visibility is essential for Cbus to protect its position against larger, multinational fund managers.[32]

7.35 Dr Anderson from ASFA also made this point in evidence to the Committee on 3 September 2002. She indicated that not-for-profit funds have minimum expense bases, but that choice of fund would require not-for-profit funds to spend extra revenue promoting their product.[33]

7.36 The MTAA Superannuation Fund also cited in its written submission the proposed introduction of choice of fund in 1998. The MTAA Superannuation Fund argued that at the time, several household brand life offices and banks launched saturation, mass media, advertising campaigns, timed and predicated on what was expected to be the imminent introduction of choice of fund.[34]

7.37 The Committee also notes the evidence of Mr Rosario from Westscheme that following the introduction of choice in WA on 1 July 1998, there is no evidence that fees and charges went down. Nevertheless, Westscheme itself has effected reductions in fees through economies of scale from having more members and greater funds under management.[35]

7.38 In response to these concerns, however, Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW, claimed that, based on anecdotal evidence that comes from watching television, industry funds currently

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30 *Committee Hansard*, 2 September 2002, p. 50.

31 *Committee Hansard*, 2 September 2002, p. 102.

32 *Submission* 16, Cbus, p. 12.

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

34 *Submission* 11, MTAA Super Fund, p. 12.

35 *Committee Hansard*, 2 September 2002, p. 64.

engage in more marketing activity than retail funds.[36] However, the Committee notes that there is also a great deal of advertising on television in relation to superannuation products by retail funds.

Not-for-profit fund returns

7.39 In its written submission to the inquiry, the MTAA Superannuation Fund argued that not-for-profit funds had achieved superior investment returns for their members in 2001-2002 when compared to retail funds. In 2001-2002, two not-for-profit industry funds (MTAA Superannuation Fund and REST) achieved returns of two per cent and 3½ per cent for their members when other funds returned negative results. The MTAA advised that:

> These results have not occurred by some fluke of good fortune. Not-for-profit industry funds, through their own efforts as well as the work of such innovative companies as Industry Fund Services, amongst others, have consistently delivered time and time again quality products for their members as well as superior investment returns on the assets under management – all for a far lesser cost than those charged by many 'for profit' retail funds.[37]

7.40 However, various parties argued during the inquiry that not-for-profit funds may not be able to achieve such good results in the future if choice of fund is introduced under the current Bill. As stated by the CSA:

> The FSR legislation lays the ground rules in terms which are tailored to the situations of these For Profit providers. Employers and Not For Profit trustees, on the other hand, are at a disadvantage. They may in fact be very competitive, but do not actually want to compete – this is not their objective. They are trying to meet their obligations to their employees, or to fulfil their obligations in operating a fund for the benefit of members. They do not have a budget for marketing to members, and hence are at a financial disadvantage.

7.41 The MTAA Superannuation Fund suggested in its written submission two reasons why choice of fund may lead to reduced returns from not-for-profit funds. First, 'churning' between funds may require funds to retain more liquid assets so as to be able to meet their liquidity obligations. Such asset classes, essentially cash and fixed interest, generally under perform growth assets over the mid to long-term. [38]

7.42 Second, the MTAA Superannuation Fund argued that in a highly competitive market, funds would be less inclined to invest in asset classes that have long lead times before producing positive returns, and which also happen to offer the most support to Australia's broader economic development (eg infrastructure,

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36 *Committee Hansard*, 2 September 2002, p. 27.

37 *Submission* 11, MTAA Super Fund, p. 7.

38 *Submission* 11, MTAA Super Fund, p. 12.

developmental capital, and members' home loans). Instead, they are likely to invest in the types of asset classes that may produce early high returns, but may be speculative.[39]

7.43 The Committee notes, however, the statement by the NFF in its written submission that the NFF 'hopes that it [choice] will lead to a potential growth of investment within rural and regional Australia.'[40] In the hearing on 11 September 2002, Ms Harris expanded on this claim, suggesting that with choice, there may be a greater pool of superannuation funds, and potentially more funds directed towards rural and regional Australia.[41]

39 *Submission* 11, MTAA Super Fund, p. 12.

40 *Submission* 1, NFF, p. 3.

41 *Committee Hansard*, 11 September 2002, p. 211.

Chapter Eight

Fees and Charges

Introduction

8.1 Superannuation and life insurance products vary greatly in terms of what they offer to members. The nature and size of a fund can also influence the level of fees and charges which apply, with larger funds possibly being able to take advantage of economies of scale with regard to fixed costs. This chapter examines the:

- impact of fees and charges on fund balances and retirement incomes;
- suggestions to address entry and exit fees; and
- proposals to monitor fees and charges.

The impact of fees and charges

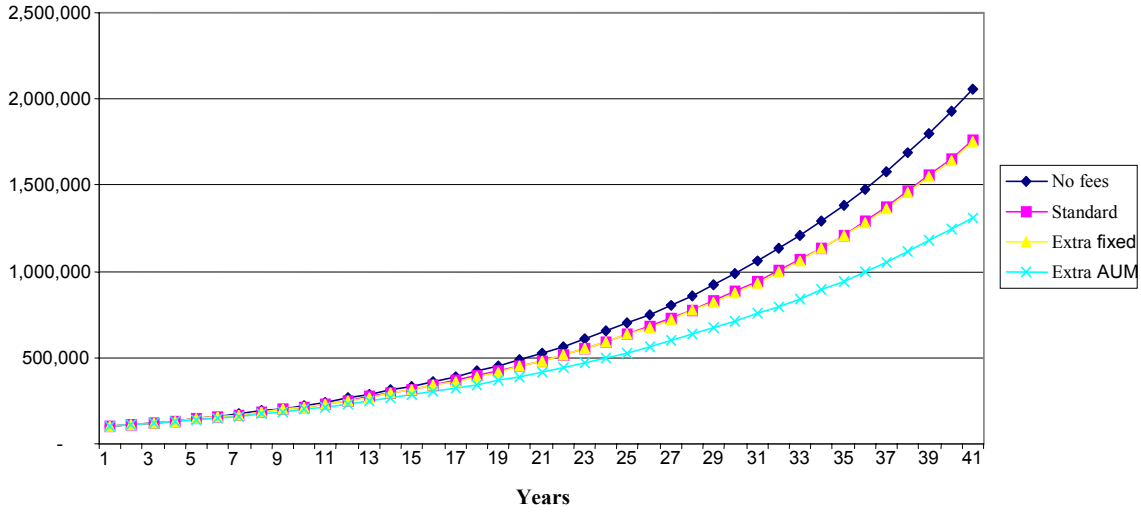
8.2 During the inquiry, several witnesses noted that even small differences in fund fees and charges can have a substantial impact in terms of fund returns and retirement incomes over a 40 year period. Mr Gallagher from the Treasury acknowledged this point in evidence to the Committee on 11 September 2002.[1] In fact, Treasury's assumptions about the adequacy of retirement incomes use an assumed fee of 1 or 1.2 per cent, which the Committee notes is significantly lower that many retail funds offer.[2]

8.3 The Committee cites below a graph provided by Sunsuper on the effect of fees on the balance of a fund over 40 years, based on an initial balance of $100,000:

1 *Committee Hansard*, 11 September 2002, p. 305.

2 See Department of the Treasury, evidence to the Committee's inquiry into superannuation and standards of living in retirement - Submission No 142.

Chart 1: Effect of Fees – Accumulation over 40 Years



Source: Submission 39, Sunsuper, p. 3.

Assumptions:
Interest of 6 per cent after tax before fees
Inflation of 3 per cent per annum
15 per cent tax on contributions
Initial annual contribution of $5,000
Standard fees - $1 per week and 0.5 per cent per annum asset fee
Extra fixed is extra $1 per week. Extra fee for assets under management (AUM) is 1 per cent per annum.

8.4 The graph shows that over a 40 year period, based on an initial balance of $100,000 and the assumptions listed above, an extra management fee of one per cent per annum would reduce the fund balance in its 40th year from $1,759,000 to $1,314,000, a difference of $445,000.

8.5 Given the impact that higher costs and lower returns have on fund balances over a 40 year period, the ACTU argued that the introduction of choice of fund via the current Bill would lead to lower retirement incomes in Australia:

> Increasing retail selling opportunities for large financial institutions in the management of legally mandated superannuation contributions will not be in the interests of maximising the retirement incomes of fund members. International and local experience shows that the result of this process is likely to be to force up costs and weaken performance, to the long-term detriment of fund members and the whole Australian community.[3]

8.6 Similarly, Quadrant Superannuation expressed concerns that even where individual employees stay in not-for-profit funds that are currently performing well,

3 *Submission* 5, ACTU, p. 4.

they may ultimately face higher costs and lower returns should the current Bill be implemented.[4]

8.7 In this regard, Senator Sherry expressed concern in the hearing on 11 September 2002 that if fund returns decline and costs rise under choice, the community will ultimately have to provide additional support to retirees through the social security system.[5]

Entry and exit fees

8.8 Various suggestions were made during the inquiry to address the issues of fund entry and exit fees, with some parties advocating a cap on entry or exit fees, while others proposed a prohibition on all such fees.

8.9 For example, during hearings, Senator Sherry raised the Labor Party's proposal for an overall cap on ongoing fees and charges – such as investment management and fund administrative fees – set at 1.2 per cent of a fund's balance, which is currently the industry norm, together with the prohibition of entry and exit fees above a small processing charge.[6]

8.10 In response, IFSA opposed a cap on fees in its written submission, on the basis that a competitive and transparent market is the most appropriate means of placing downward pressure on fees. It cited an IFSA commissioned report entitled *Superannuation Fees and Competition* showing a high level of price and product competition within the market. By contrast, IFSA suggested that placing caps on fees and charges could lead to:

- creeping up of prices to the ceiling price;
- withdrawal of advice and education on retirement incomes from the workplace;
- barriers to entry for new players in the market; and
- exit from the market of product providers.[7]

8.11 These arguments were repeated in hearings. For example, in his evidence to the Committee, Mr Rosario from Westscheme noted that capping fees may have the inverse impact of stopping people from being able to get information on investment choices, or being free to choose their managers – thereby in effect not maximising their superannuation benefit.[8] Similarly, Mr Ward from Mercers stated in evidence on 2 September 2002:

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

5 *Committee Hansard*, 11 September 2002, p. 305.

6 See for example *Committee Hansard*, 11 September 2002, p. 242.

7 *Submission* 36, IFSA, pp. 4-5.

8 *Committee Hansard*, 2 September 2002, p. 65.

> I would be concerned about a cap on fees and charges overall because I think if you put a cap on it it stops initiative and it stops a fund developing new and additional services. They cannot afford to because they are limited by the cap.[9]

8.12 Similarly, Mr Gilbert from IFSA also argued against a cap on fees and charges at 1.2 per cent of a fund's balance, on the basis that it could lead to a creeping up of prices to hit the 1.2 per cent ceiling. In addition, those funds that were already above the 1.2 per cent ceiling could cease to operate, thereby reducing investment options in the market place and inhibiting choice.[10] Mr Thomas from the Treasury expressed the same view.[11]

8.13 In response, Mr Silk from the Industry Funds Forum argued that a cap on fees would not necessarily lead to a migration to the cap. He suggested that in an efficient market, a higher cap on fees should have no impact on those parties that are currently charging less than the proposed cap. [12]

8.14 In their submissions to the inquiry, parties such as Cbus and AIST argued for a prohibition on entry and exit fees associated with the Choice Bill, other than charging the employee an amount to cover the administration of entry and exit.[13] Cbus cited in particular the example of a member of MLC Master Key Gold Star, who would have incurred a withdrawal fee of $3,297.69, or 100.7 per cent of the account's balance, if they had rolled out of the fund.[14] In addition, Cbus cited the following table of exit penalties of which it is aware:

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9 *Committee Hansard*, 2 September 2002, p. 103.

10 *Committee Hansard*, 11 September 2002, p. 242.

11 *Committee Hansard*, 11 September 2002, p. 302.

12 *Committee Hansard*, 11 September 2002, p. 268.

13 *Submission* 16, Cbus, p. 8. See also *Submission* 29, AIST, p. 1.

14 *Submission* 40, Cbus, p. 1.

Table 1: Exit Penalties from Various Superannuation Funds (Sorted by Penalty as a Percentage of Account Balance)

Fund	Policy Type	Exit Fee ($)	Account Balance ($)	Penalty as a % of Acc Bal
AXA	Personal Superannuation	5,623.79	10,927.96	51.5
FAI	Personal Superannuation	1,227.06	2,537.26	48.4
AXA	Personal Superannuation	5,940.77	18,578.82	32.0
Tower	Personal Superannuation	1,451.29	4,824.77	30.1
AXA	Personal Superannuation	376.27	1,710.32	22.0
AXA	Retirement Security Plan	2,974.12	15,581.14	19.1
AXA	Personal Superannuation	4,859.84	27,639.60	17.6
Norwich	Unbundled Ordinary Policy	2,226.26	12,674.76	17.6
AXA	Retirement Security Plan	1,642.89	10,578.09	15.5
AXA	PruPlan	1,189.90	8,263.04	14.4
MLC	PruPlan	1,189.90	8,263.04	14.4
RSA	Investment Savings Plan	1,939.02	13,943.28	13.9
AXA	Retirement Security Plan	4,982.45	41,369.36	12.0
AXA	Personal Superannuation	1,545.10	16,977.81	9.1
AXA	Personal Superannuation	2,541.59	29,609.42	8.6
AXA	Retirement Security Plan	3,632.53	45,005.68	8.1
AXA	Retirement Security Plan	2,078.97	27,261.52	7.6
Norwich	Personal Superannuation	1,910.98	25,922.57	7.4
AMP	Whole of Life	775.54	12,333.10	6.3
Total		**48,108.27**	**334,001.54**	**14.4**

Source: Submission 40, Cbus, p 4.

8.15 Cbus' call for a prohibition on entry and exit fees was reiterated in hearings by Ms Dyson from AIST,[15] by Mr Silk from the Industry Funds Forum,[16] and Mr Hajaj, appearing on behalf of the Financial Services Consumer Policy Centre at the UNSW. Mr Hajaj observed that currently, consumers are experiencing appalling returns, which suggests that fund managers do not do much besides following what the stock market dictates.[17]

8.16 However, various other parties opposed a cap on entry and exit fees. For example, in its written submission, SOS agreed that entry and exit fees effectively stymie choice, but argued that prescribing a cap on fees could deny members access to certain asset classes of their choice.[18]

8.17 In evidence on 11 September 2002, Mr Hristodoulidis from the FPA also opposed a cap on entry and exit fees, on the basis that they will be determined by

15 *Committee Hansard*, 3 September 2002, p. 172.

16 *Committee Hansard*, 11 September 2002, p. 269.

17 *Committee Hansard*, 2 September 2002, p. 26.

18 *Submission* 4, SOS, p. 1.

competitive pressures, provided there is adequate education.[19] Mr Gilbert from IFSA[20] and Mr Bell from the ABA[21] presented similar arguments.

8.18 The Committee also notes that it received evidence from some parties claiming that a majority of funds now do not charge entry and exit fees. For example, in the hearing on 2 September 2002, the Committee received evidence from Mr Murphy from the Association of Financial Advisers that he has not seen a fund in the last 10 years that has come on to the market with exit fees. He argued that standard practice is to charge entry fees only.[22] Similarly, Mr Gilbert stated that new funds coming on to the market only have entry fees, and not exit fees.[23] In response to this claim, Senator Sherry cited a number of product disclosure statements from current superannuation funds that do charge exit fees.[24] The Committee also notes the evidence of Mr Thomas from Treasury that exit fees are still a feature of certain products.[25]

8.19 In response to this issue, the Committee raised with Mr Thomas from the Treasury during the hearing on 11 September 2002 the possibility of including a cap on entry and exit fees in the Choice Bill. Mr Thomas suggested that a cap would be more appropriately dealt with in the *Financial Services Reform Act 2001* than in the current Bill.[26]

8.20 The Committee also notes that in its consultation paper on portability, *Portability of Superannuation Benefits*, the Government leaves open the option of regulating fees and charges at a later date:

> … the Government must take into consideration the possibility that some funds could use exit fees as a means of countering the introduction of portability. It is for this reason that the Government will reserve the right to regulate exit fees. The Government would only consider regulating exit fees if there was evidence that exit fee arrangements were being structured for the purposes of preventing portability from operating as intended.[27]

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19 *Committee Hansard*, 11 September 2002, p. 226.

20 *Committee Hansard*, 11 September 2002, p. 240.

21 *Committee Hansard*, 11 September 2002, p. 264.

22 *Committee Hansard*, 2 September 2002, p. 37.

23 *Committee Hansard*, 11 September 2002, p. 241.

24 *Committee Hansard*, 11 September 2002, p. 241.

25 *Committee Hansard*, 19 September 2002, p. 310.

26 *Committee Hansard*, 11 September 2002, pp. 297-298.

27 *Portability of Superannuation Benefits: Enhancing the Right of Members to Move Existing Benefits between Superannuation Entities*, Consultation Paper, released by the Minister for Revenue and Assistant Treasurer, Senator the Hon Helen Coonan, 19 September 2002, p 16.

Monitoring fees and charges

8.21 A number of witnesses to the inquiry indicated that it would be useful for the Government to monitor fees and charges following the introduction of choice of fund. The Committee notes that the Government has stated its intention to do so. Mr Thomas of the Treasury advised the Committee that the Government will select an 'appropriate agency' to undertake the monitoring, although it is unlikely to begin until closer to 1 July 2004.[28]

8.22 The Committee also notes the recommendation of AIST in its written submission that the Australian Competition and Consumer Commission (ACCC) should oversee fees and charges, perhaps following the Government's review period.[29]

28 *Committee Hansard*, 11 September 2002, p. 302-303, *Committee Hansard*, 19 September 2002, p. 324-325.

29 *Submission* 29, AIST, p. 2.

Chapter Nine

Conclusions and Recommendations

Views on the Bill

9.1 The Committee notes that, during its inquiry, a broad range of views was expressed on the Choice Bill. A number of parties, notably consumer groups and organisations representing specialist financial product providers, strongly supported choice of fund and the Bill because it would give individuals greater ownership and control over their superannuation funds which would, in turn, foster greater competition and efficiency in the industry.

9.2 However, the majority of parties supported the principle of choice of fund, but argued that the Government would still need to address a number of issues prior to the implementation of choice. This position was adopted by a number of superannuation funds and associations, together with professional financial and human resource organisations, peak employer groups and superannuation lobby groups.

9.3 Only a small number of parties opposed the Bill because, in their view, it would increase retail selling opportunities for large financial institutions, thereby forcing up costs and weakening returns for fund members, to the long-term detriment of employees.

9.4 The Committee notes that, while there is support for the principle of choice, the proposed framework has certain limitations. The Committee also notes that the proposed Bill differs from earlier attempts by the Government to introduce choice, and that the measures proposed in the current Bill are, in some respects, improvements on the earlier bills. The Committee notes that the majority of submissions were from parties in the superannuation and financial services industry generally, rather than from individuals seeking choice.

9.5 However, as argued by a number of parties during the inquiry, the Committee believes that the current Bill and supporting measures before the Senate can be improved and that this would lead to a more successful implementation of choice of fund in Australia. The Committee summarises below the issues raised during the inquiry, and notes areas in which it has concerns.

Disclosure standards

9.6 Evidence to the inquiry suggests that, in order to make an informed choice about where to invest SG monies, individuals need funds to disclose adequate and comparable information about such matters as fees, charges, commissions, and rates of return. Product Disclosure Statements and reports of fund returns are important aspects of an effective disclosure regime which evidence to the inquiry suggests is an essential precondition for the implementation of choice.

9.7 The Committee notes that concerns in relation to adequacy of the disclosure regime applying to the Ongoing Management Charge (OMC) were raised during the inquiry. In particular, it was noted that the OMC did not measure total fees and charges, notably entry and exit fees, which have a crucial impact on the costs of moving between funds and the impact of that on the final benefit that is paid to employees. In addition, the OMC did not provide fund members with a means of comparing costs between funds that was fully supported by the financial services industry.

9.8 The Committee also notes that a number of regulations under the *Financial Services Reform Act 2001* were disallowed in the Senate on 16 September 2002 on the basis that the Ongoing Management Charge (OMC) was inadequate as a disclosure regime.

9.9 The Committee concurs with the recommendations of the Ramsay report that there should be separate disclosure of administration and investment fees, as this would enhance the disclosure regime for consumers.

9.10 The Committee also concurs with the views expressed by Superpartners, namely that, in addition to the OMC, financial disclosure regulations should require full financial disclosure of fees and charges on accounts, contributions, rollovers and benefits/exits, as it is fees and charges that largely determine members' financial benefits rather than the OMC.

9.11 The Committee believes that the disclosure regime covering superannuation funds and RSAs should allow employees to compare funds based on the projected final benefit, which includes the effect of fund fees and charges on the end benefit, rather than the overall cost of the fees and charges. Accordingly, the Committee also concurs with the view of Superpartners that there may be merit in the Government introducing a set of standardised assumptions for fund managers to use to project final benefits, thereby providing a means by which individual employees can compare funds.

9.12 In this regard, the Committee notes that Treasury is currently involved in working with ASFA on ASFA's current study into product disclosure and its template product disclosure statement. The Committee notes that the study is not yet concluded, but should be concluded by November 2002.

9.13 The Committee also notes the views of the former Assistant Treasurer, Senator the Hon Rod Kemp, who is on the public record as stating :

> Let me be absolutely clear that the government recognises the importance of an appropriate disclosure regime and an effective information campaign to support the move to choice.[1]

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1 Cited in the Financial Services Consumer Policy Centre, *The Key to Superannuation Choice: A Discussion Paper*, May 1999, p. 22.

9.14 The Committee notes that the current disclosure provisions could be enhanced to better support the implementation of choice. The Committee considers that a standardised disclosure regime, which has been comprehension tested, would improve the effectiveness of the current disclosure arrangements and with it the effectiveness of the consumer protection regime.

9.15 The Committee also notes that ASIC has a key role in the regulatory framework. As previously noted, ASIC has released a report on 26 September 2002 entitled 'Disclosure of Fees and Charges in Managed Investments: Review of Current Australian Requirements and Options for Reform', which makes a number of recommendations for improving the disclosure of fees and charges to enable comparison between funds. The Committee commends the report as contributing to an informed debate on improving disclosure requirements.

9.16 The Committee also considers that there would be merit in the Government examining the disclosure regime for fund returns in order to ensure consistency in approach and to increase the comparability of reporting fund returns in benefit statements. In this regard, the Committee welcomes the release of a discussion paper and draft guide by ASIC on 'The Use of Past Performance in Investment Advertising'.

9.17 Although the calculation of fund returns was not raised in great detail during the inquiry, the Committee notes that there is a range of means by which to calculate fund returns. For instance, they may be calculated pre or post fees and charges, or pre and post tax. Alternatively, they may be calculated over different periods of the year. Accordingly, the Committee welcomes the papers prepared by ASIC, and encourages interested parties to make a submission to ASIC on the draft guide by 15 November 2002.

Education standards

9.18 The Committee notes that during the inquiry, various parties raised concerns that many employees lack sufficient financial education to make an informed choice in a choice of funds environment, particularly when it comes to reading and understanding product disclosure statements.

9.19 However, the Committee also notes that the implementation of choice is proposed to be accompanied by an extensive education and implementation program involving the expenditure of $28.7 million over four years (with some $14 million earmarked for communication and education, and $14.5 million for administration and infrastructure). Although many parties argued for a greater financial commitment to education, the Committee notes the impossibility of reaching every individual through government sponsored education. The Committee anticipates that many employees will seek further outside education and advice as choice becomes available, which they will have to pay for themselves.

9.20 The Committee also notes in response to concerns regarding the targeting of the education program that the ATO has begun designing the education campaign, and will be taking advice from various consultants on elements of the campaign including

research, evaluation and monitoring. It is anticipated that the campaign would include marketing and education activities using TV, radio, press advertising and the like. In addition, $2 million has been allocated to the ATO for a consumer information centre.

Portability, the default fund and insurance

Portability and consolidation

9.21 During the inquiry, various parties argued that employees should be able to transfer their existing superannuation fund balances as at 1 July 2004, and not just their future SG contributions after 1 July 2004, to the fund of their choice. In this regard, it was argued that implementation of choice of fund should be accompanied by implementation of a portability protocol to avoid difficulties in transferring superannuation savings from one fund to another.

9.22 To progress the issue of portability, the Committee notes that the Government has released a consultation paper, *Portability of Superannuation Benefits: Enhancing the Rights of Members to Move Existing Benefits Between Superannuation Entities,* and that it 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,* with a commencement date of 1 July 2004. The Committee also notes Treasury's advice that there are no heads of power available to implement portability through primary legislation.

9.23 The Committee welcomes this indication of the Government's intention on portability. The Committee is of the opinion that portability is a key issue in the development of an effective choice environment in Australia. It must be noted, however, that there are currently no barriers to portability for millions of fund members beyond the paperwork burden and the impost of exit fees.

9.24 The Committee also welcomes the Government's assurance that it will move quickly to implement portability.

9.25 The Committee notes that the ALP proposal for automatic consolidation, subject to a member election not to consolidate, would substantially reduce the problem of multiple accounts and lost members.

9.26 The Committee also notes that in considering the Choice Bill, it would have been useful to have access to the Government's proposed portability regulations rather than a consultation paper.

The default fund

9.27 The Committee notes that, under section 32K of the current Choice Bill, the default fund is proposed to be an employee's current fund. The Committee also notes that where an employee does not have a current fund (that is, the employee is a new employee), the default fund is the Commonwealth or Territory industrial award fund for the employee, or if there was no such award, the employer's selected 'majority

fund'. If neither is available, the default fund is proposed to be any eligible default fund selected by the employer.

9.28 The Committee notes that a majority of parties giving evidence to the inquiry supported the selection of award funds as the primary default fund where employees have no current fund, on the basis that award funds have been selected by the AIRC for being well-run and offering good returns. However, the Committee also notes that various parties expressed concern that the secondary default fund, the 'majority fund', may change regularly as workplaces change and new workers elect to join different funds.

9.29 The Committee notes that at least in the initial years of a choice regime, a majority of employees will continue to have SG contributions made to the default fund by their employers. The Committee also notes suggestions that maintaining the status quo in relation to default funds would overcome many of the concerns raised in relation to the default provisions of the Bill.

9.30 The Committee notes concerns that the 'majority fund' may change over time for individual workplaces, placing additional administrative costs on employers, and possibly additional fees and charges on employees. Accordingly, the Committee believes that the default fund provisions require reconsideration and simplification.

9.31 The Committee recognises that confusion might arise for an employer determining the default fund where more than one fund is provided in the award. The Committee notes that proposed section 32K(6) indicates that where there is more than one award fund specified, the employer must select one of those funds for the employee, but provides no guidance on what criteria should be applied in the selection of that fund. This lack of clarity in the Bill has the potential to place an onerous responsibility on the employer if the fund selected proves to be a poor performing fund.

9.32 The Committee also notes confusion surrounding proposed sub-section 32K(5)(b) that precludes the selection of a fund prescribed in an award as the default fund if that award also provides an employee with a choice of fund. The Committee accepts that this may not be the intention of this sub-section but does not find the explanation from Treasury, at paragraph 4.30, to be satisfactory. The Committee believes that this sub-section should be amended to allow award funds to be default funds in such circumstances and to permit the employer to choose from those nominated in the award. Such an amendment would be consistent with the intention of the legislation.

9.33 The Committee also notes in relation to the 56-day compliance period that employers may be required to make a quarterly SG payment to a default fund before the 56-day period has elapsed. This raises the issue whether that contribution can be retrieved later if the employee subsequently makes a choice of fund. The Committee is concerned to ensure that all SG contributions are made. However, the Committee understands that that this matter is likely to be addressed when the Government's portability proposals are finalised.

Death and invalidity insurance

9.34 Employees in industry and corporate funds generally receive comprehensive life and disability insurance as part of their membership of the funds. However, the Committee notes that 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.

9.35 The Committee also notes that, in response to this concern, it was argued that under a choice environment, a market will develop to offer insurance to fund members where funds are unable to offer universal coverage, and employees will select funds which offer death or disability coverage if they want them. The Government is also proposing to enter into consultation with the industry following the passage of the Choice Bill to examine the possibility of prescribing a minimum default fund insurance level.

9.36 Noting that some employees may not wish to take out death and disability insurance, the Committee wishes to ensure the continuation of low-cost insurance coverage for those who want it without the need for medical assessment. The Committee is particularly concerned by this issue, and the possibility that many new employees may not be covered by death and disability insurance on their commencement of employment under a choice environment. To ensure coverage, the Committee believes that default funds should be required to guarantee minimum level of coverage from the date of employment, and that this should be stated up-front in the Bill, and not be the subject of consultation after the passage of the Bill. The Committee suggests around $50,000, or a figure within the range of $30,00 to $70,000, as an appropriate level or range at which to set a basic level of death insurance.

Other implementation issues

Defined benefit schemes

9.37 The Committee understands that the Government's intention is that defined benefit funds should fall under the provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002, with the exception of unfunded schemes. However, the Committee understands that employers do not have to offer choice where the employee has reached his or her accrued maximum benefit, or where the scheme is in surplus. This is dependent, however, on obtaining from an actuary a certificate stating that the employer is not required to make contributions for the quarter, and that the assets of the scheme are equal to or greater that 110 per cent of the scheme's liabilities.

9.38 The Committee notes that a certificate from an actuary must be obtained on essentially an annual basis and that, potentially, this may add significantly to the fund's costs. The Committee understands that these costs would ultimately be born by the members of the fund through higher fees and charges to recoup costs. The

Committee also understands that Treasury intends to work with the Institute of Actuaries to develop appropriate guidelines, once choice has been implemented.

9.39 The Committee also notes that where a defined benefit fund member does have a choice, and elects to move to an accumulation fund, there are difficulties in determining the balance that gets transferred. This is because it is impossible to determine the benefits of defined benefit schemes, such as retirement income, until the point where a member leaves a scheme. Accordingly, it is very difficult to advise a member of a defined benefit scheme who is thinking of moving to an accumulation fund of the advantages and disadvantages of such a move.

9.40 Although the Committee notes that most defined benefit funds are offered by large corporate employers and that choice is satisfied where a fund is nominated in a Workplace or Certified Agreement, the Committee still believes that inclusion of defined benefit schemes under the provisions of the Bill raises too many problems. Accordingly, the Committee believes that the employer sponsors of defined benefit funds should be exempt from the provisions of the Bill, provided the schemes are fully funded and where the employer contribution is in excess of the 9 per cent SG rate. In this regard, an excess contribution should take into account the employer paying administration and/or insurance costs. The Committee also notes that the Bill mentions the Commonwealth PSS and CSS schemes as excluded from the provisions of the Bill, but does not mention the relevant state defined benefit schemes.

9.41 The Chair also raised in hearings the drafting of proposed section 32G(3), which is designed to prevent individual employees from switching from a defined benefit scheme to another scheme without formally acknowledging their understanding that they are doing so. In response, Treasury officials indicated that section 32G(3) must be read in the context of the proposed Division 4 of the Bill, under which employees in defined benefit schemes may make a choice under proposed section 32F using a standard choice form instead.

9.42 The Committee understands this argument, but nevertheless believes that the Treasury should revisit the drafting of this section to make its meaning more transparent.

9.43 The Committee does not accept that there should be any ambiguity in the drafting of the proposed Bill. While judges may use the Explanatory Memorandum (EM) as an extrinsic aid in hearing cases, it is the Committee's view that the Bill should be unambiguous and not rely on supporting documentation such as the EM or ATO documents.

AWAs and certified agreements

9.44 The Committee notes that during the inquiry, some parties supported recognition of superannuation provisions in AWAs and certified agreements as satisfying choice. However, the Committee also notes that many other parties argued that choice should be left exclusively to the industrial sphere, on the basis that it is inconsistent that AWAs and certified agreements override the choice of fund

requirements, yet existing awards, which are also a product of the industrial relations process, do not.

9.45 By contrast, other parties argued that superannuation should be removed from industrial matters (awards) entirely. It was argued that currently, employers have to contend with a dual regulatory regime - one stream of regulatory obligation (the SG legislation) that is neutral as to choice of fund, and the other (industrial awards) that is prescriptive as to fund selection.

9.46 The Committee supports the current provisions of the Bill because AWAs and certified agreements may include superannuation arrangements reached between employers and employees. Recognising such arrangements for the purposes of choice enables employers to collectively meet their obligations, thus leading to greater efficiency when giving effect to choice.

Other issues

9.47 The Committee notes that other implementation issues – collection of arrears, the standard choice form, and the commencement date of the proposed Bill – were also raised during the inquiry.

9.48 The Committee is satisfied with the provisions of the proposed Bill in respect of most of these issues. However, the Committee considers that there could be a more streamlined approach to arrears collection.

9.49 While not directly related to choice, an additional implementation issue raised by Sunsuper relates to the potential for different earnings bases to indirectly introduce additional complexities, such as wage bargaining.[2] The Committee notes this view and considers that the issue of the possible effect of different earnings bases on superannuation contributions should be kept under review. In this context, it should be noted that the former Select Committee on Superannuation and Financial Services made two recommendations in its April 2001 report on enforcement of the superannuation charge in relation to earnings bases, which the Government has noted.[3] These included the abolition of the pre-21 August 1991 notional earnings bases.[4]

9.50 The Committee also notes that the issue of not providing automatic death benefits to same sex couples was a key issue in the defeat of the previous Bill. The Committee draws the Government's attention to the report of the former Select

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2 *Submission* 8, Sunsuper, p.1.

3 In the Government response to the report, tabled on 20 June 2002, the Government noted the recommendations and indicated that it would consult with industry to establish whether it is feasible to move to a simplified earnings base provision over a period of time.

4 Senate Select Committee on Superannuation and Financial Services, *Enforcement of the Superannuation Guarantee Charge*, April 2001, Recommendations 15 and 16, p. 110.

Committee on Superannuation and Financial Services on the superannuation entitlements of same sex couples.[5]

Employers

Employer costs

9.51 The Committee notes that some evidence to the inquiry was critical of the expected additional administrative costs on employers, estimated at $27 million in the first year, with additional ongoing costs of $18 million per annum. A number of parties questioned these figures, presenting their own estimates of costs based on the cost of educating employees, processing standard choice forms and the cost of contributing to more funds.

9.52 The Committee also notes that superannuation commentators such as Gabriel Szondy, a financial services partner with PricewaterhouseCoopers, have pointed out that choice of funds will force employers who have outsourced their super funds to deal with super again and may negate some of the objectives of outsourcing.

9.53 The Committee acknowledges these concerns. The Committee notes that e-commerce and clearing-houses, including some that are already operating, will offer some cost savings to employers. However, employers using such facilities will still incur additional costs compared to the status quo, which will be substantially higher than those estimated in the EM to the Bill. Of particular concern is the impact on small business, which does not have payroll departments or similar structures to deal with this additional burden.

9.54 Noting that, in the short term employer costs may increase, while in the longer term costs may decrease because of account consolidation and e-commerce, the Committee considers that the appropriate regulator should report on the impact of choice on costs to employers for the next three years.

Employer fines

9.55 The Committee notes that, during the inquiry, various parties argued that the strict liability penalty regime proposed in the Bill is excessive, and that the penalty regime should remain within the provisions of industrial law.

9.56 The Committee also notes the advice from Treasury that the proposed arrangements were more flexible than those proposed under the previous Bill. Under that Bill, the ATO would have been obliged to penalise individual employers even when they had made an innocent mistake.

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5 Senate Select Committee on Superannuation and Financial Services, *Report on the provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000*, April 2000.

9.57 The Committee acknowledges that the Bill provides the ATO with greater flexibility in regard to enforcement of choice, but believes that the penalty regime appears somewhat excessive and should be reconsidered by the Government.

9.58 The Committee notes that, although such a fine might be unlikely, an employer with 10,000 employees could potentially face a total penalty of $66 million under the proposed regime. At the very least, the Committee considers that the Bill should be amended to provide for the issuing of warnings, or to have a moratorium on the first year of operation of the penalty regime of the proposed Bill to allow employers more time to become familiar with the provisions.

9.59 The Committee also notes evidence suggesting that the penalty regime may be unconstitutional, on the basis that the proposed employer fines go beyond the taxation power of the Commonwealth. The Committee understands that Treasury has sought legal advice whether the fines go beyond the taxation power of the Commonwealth. The Committee considers that resolving the constitutionality issue is a matter of priority.

Commission-based selling

9.60 The Committee notes the concerns expressed by some parties to the inquiry that the lack of financial literacy of many employees will leave them vulnerable to commission-based selling of retail funds by financial advisers. Some of these parties recommended a ban on commission-based selling.

9.61 The Committee also notes that others submitted that section 947D of the *Financial Services Reform Act 2001* seeks to prevent solely commission-based selling, on the basis that financial advisers are legally required to provide a Statement of Advice which considers the client's objectives, financial situation and needs and which identifies any actual or potential charges, loss of benefits or consequences of taking the advice. While the potential remains for serious conflicts of interest on the part of advisers, who may not always recommend funds that do not pay commissions, paying up-front fees in preference to commissions is more likely to encourage a level playing field.

9.62 The Committee also notes that a number of parties also proposed a ban on trailing commissions charged by financial advisers, in favour of an up-front fee, disclosed at the time the client seeks assistance. In response, other parties, notably the representatives of financial planners and retail funds, supported trailing commissions, arguing that where an individual receives an ongoing financial service from an adviser, the adviser needs to be able to recoup costs.

9.63 The Committee acknowledges this argument, and believes that it is difficult to substantiate a case for trailing commissions for a compulsory product like SG contributions. Where there is a non-mandatory product, the Committee acknowledges that commissions may be appropriate, provided they are disclosed up-front, and that the client is made aware of the impact of the commission on the end benefit payable by the fund.

9.64 In relation to commission-based selling, the Committee notes that various parties also cited the experiences of the UK and Chile following the deregulation of their superannuation industries. However, the Committee believes that Australia's regulatory regime is a lot stronger than that which applied in the UK and Chile at the time. The Committee believes that the improved licensing and regulatory regime in Australia reduces the possibility of such experiences occurring in Australia.

9.65 The Committee notes that the estimated cost of compensation for the mis-selling in the UK in the late 1980s is of the order of £11.5 billion. The Committee is keen to ensure that the lessons are learnt from the UK experience, in order to avoid such costly ramifications in Australia, given the compulsory nature of superannuation and therefore the much greater proportion of the population that is at risk.

9.66 The Committee also notes the evidence presented that choice of fund could potentially impact adversely on not-for-profit fund costs, which in turn could potentially lead to a reduction in returns for not-for-profit funds. However, the Committee understands that even people who pay an up front fee may continue to nominate an industry fund.

9.67 The Committee acknowledges these concerns, but believes that in a competitive market place, not-for-profit funds offering good returns at low cost should remain attractive to employees, and should be able to retain their membership.

Fees and charges

9.68 The Committee notes that the issue of fees and charges associated with superannuation funds was of concern to some witnesses because the fees and charges were seen to act as a potential disincentive to choice as they decrease the level of fund payouts and retirement incomes in Australia.

9.69 In this regard, the Committee recognises that even a small difference in fund costs and returns can translate into large differences in retirement incomes over a 40-year period. The Committee notes instances where exit fees have been greater than the balance of a fund, and are routinely around 15 per cent of a fund's balance.

9.70 In order to address the issue, the Committee notes that various parties providing evidence to the inquiry suggested either a cap on fees and charges or a prohibition on entry and exit fees.

9.71 In response, however, other parties opposed a cap on fees and charges. It was argued that a cap could lead to a creeping up of prices to hit the cap, could inhibit choice by pricing various products out of the market, and could lead to a withdrawal of advice and education on retirement incomes from the workplace.

9.72 The Committee recognises that compliance with the FSR regime may result in increased costs. However, the Committee believes that fees that funds charge should reflect the underlying cost of the service, with larger funds able to take advantage of economies of scale. The Committee accepts that a cap on fees and charges would not be without its practical problems. For example, to prescribe fees to apply to a diverse range of funds could result in increased cross-subsidisation between fund members.

Alternatively, it may lead funds to become more homogenous, and to a reduction in competition. However, in light of the effect of fees on final retirement savings and widespread evidence of significant fee differentials within the industry between funds offering similar products, more detailed consideration should be given to the likely costs and benefits of regulating fees and charges.

9.73 The Committee notes, however, that in its consultation paper on portability, the Government leaves open the option of regulating exit fees should they rise excessively under a choice environment. In addition, the Committee notes the advice from Treasury that the Government intends to monitor fees and charges before and after the introduction of choice of fund on 1 July 2004 through an 'appropriate agency'. The Committee strongly supports this initiative.

Consumer protection

9.74 The introduction of choice of superannuation funds brings with it a number of consumer protection issues which have been discussed in this report. They relate mainly to the need for consumer education, and a standardised disclosure regime which permits valid comparisons to be made about the impact of fees and charges on changing funds and end benefits. However the Committee considers that the consumer protection regime could be enhanced in a number of ways.

9.75 While the FSR regulations require 'appropriate advice' to be provided to consumers by financial planners, the Committee considers that further guidance is needed in the regulations as to the meaning of 'appropriate advice'. Based on the UK experience, there is a risk that the advice financial planners might give, particularly when it is associated with a trailing commission, not an up-front fee, might not be 'appropriate' or in the best interests of their clients.

9.76 The Committee is keen to ensure that consumers contemplating a choice of superannuation fund have access to guidance from an independent source. The Committee notes that, in the short term the ATO has been funded to provide the consumer education campaign for choice and that $2 million in seed funding has been allocated for a consumer information centre. However, if choice is implemented, the Committee considers that there is a case for the seed money to be allocated to ASIC which would be well placed to make more effective use of this funding. The Committee considers that ASIC has the expertise and capability in the area of consumer protection and that, while there is a role for community based consumer services, ASIC should have the primary and ongoing responsibility for all aspects of consumer education and protection in relation to choice.

9.77 For this reason, the Committee considers that it may be appropriate for a special independent financial advisory service to be established within ASIC so that consumers contemplating making a choice of superannuation fund can access independent guidance. Such a unit would need to have a free call number so that access to the service would be available to all consumers, regardless of income level.

9.78 In order to provide an enhanced consumer protection regime, the Committee also considers that it would be appropriate for ASIC to have a role in auditing the financial planning sector by monitoring the financial plans and Statements of Advice provided by financial planners to consumers, especially in relation to choice of fund issues.

Summary

9.79 The Committee supports the principle of choice, and the right of individuals to choose their own superannuation funds, with appropriate consumer protections. However, the Committee believes that the Bill would benefit from a number of improvements in providing for the successful implementation of choice. Accordingly the Committee believes that the Government should consider making appropriate amendments to the Bill, after examining the implementation issues raised during the inquiry, in particular:

- clarifying and simplifying the default fund provisions, while retaining the protection offered by Federal, State and Territory industrial awards, where applicable;
- considering the compliance burden on businesses;
- considering the impact of fees and charges;
- reconsidering the provisions applying to defined benefit funds, with a view to exempting defined benefit funds from the proposed legislation, providing the schemes are fully funded and the employer contribution is in excess of the nine per cent SG rate;
- ensuring that appropriate levels of death and invalidity insurance cover under the default provisions of the Bill are outlined in regulations;
- considering the impact of death benefits on fund members; and
- reconsidering the level and nature of employer fines, following receipt of advice on their constitutionality.

9.80 The Committee also notes that for choice of fund to be successfully introduced in Australia through the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002, in addition to the proposed education campaign, the Government would also need to consider the following issues not directly related to the provisions of the Bill:

- improving the existing consumer protection regime by enhancing the current disclosure provisions, including adopting a standardised disclosure regime, which has been consumer comprehension tested, and establishing a special financial advisory unit within ASIC to provide guidance to consumers contemplating the choice of a superannuation fund; and
- clarifying the proposed details of the arrangements for portability.

9.81 With these issues appropriately addressed, and appropriate amendments made, the Committee supports the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002.

Recommendations

9.82 All members of the Committee recommend that the Government examine the issues raised by the Committee in this report.

9.83 Government members of the Committee recommend that the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 be passed.

Senator John Watson
Committee Chair

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 choice[1]:

> 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 fours 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 current 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:

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[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

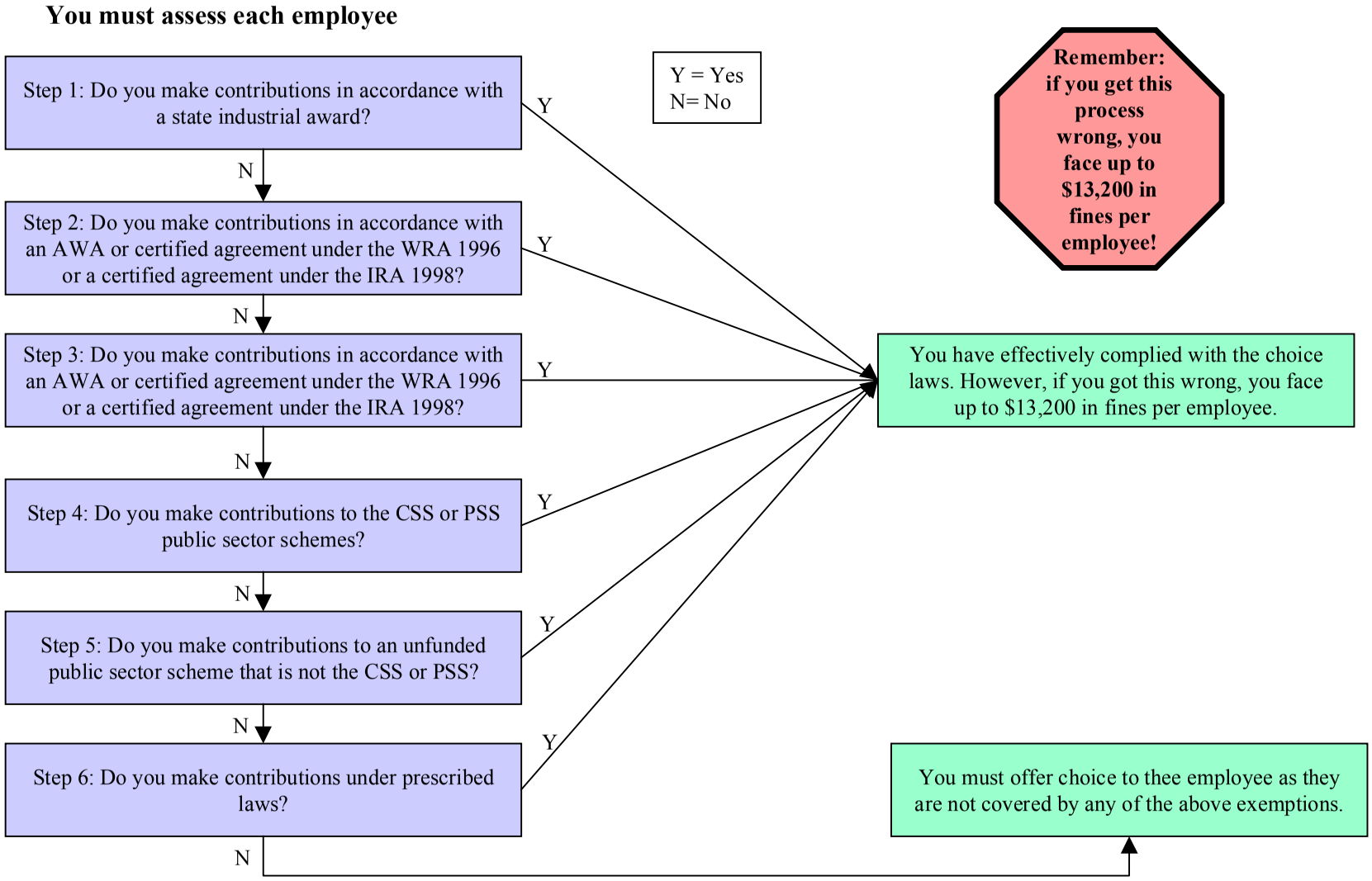
Senator Geoffrey Buckland

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?



The Liberal's Super Choice Maze for Business

Part B – How choice must be offered… page 1

Y = Yes
N= No

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

Formal choice process (FCP)

Step 7: You must provide a **standard choice form** if the employee is covered by the choice laws or if there is no individual written agreement in place. You must do this:

Definition

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

Step 8: Before 29 July 2004 for each employee employed on 1 July 2004

And

Step 9: Within 28 days of an employee first starting work (in the meantime, paying to the default fund)

And

Step 10: Within 28 days of an employee request for a SCF (only if request is more than 12 months since the last time you have the employees as SCF)

And

Step 11: Within 28 days of you becoming aware you can continue contributing to a chosen fund

And

Step 12: Within 28 days of you becoming aware you can't contribute to a default fund (for employees who have chosen)

And

Step 13: At any time you want

Once you have provided a SCF

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

Definition

Step 14: Has the employee responded in writing within 28 days?

N

Y

Step 15: Is the chosen fund an **eligible chosen fund (ECF)**?

N

Y

Not sure

Step 16: You can request the employee obtains a statement from the fund. If you have asked for this statement, has the employee provided it within 28 days?

Y

N

Step 17: Can you contribute to the ECF?

Y

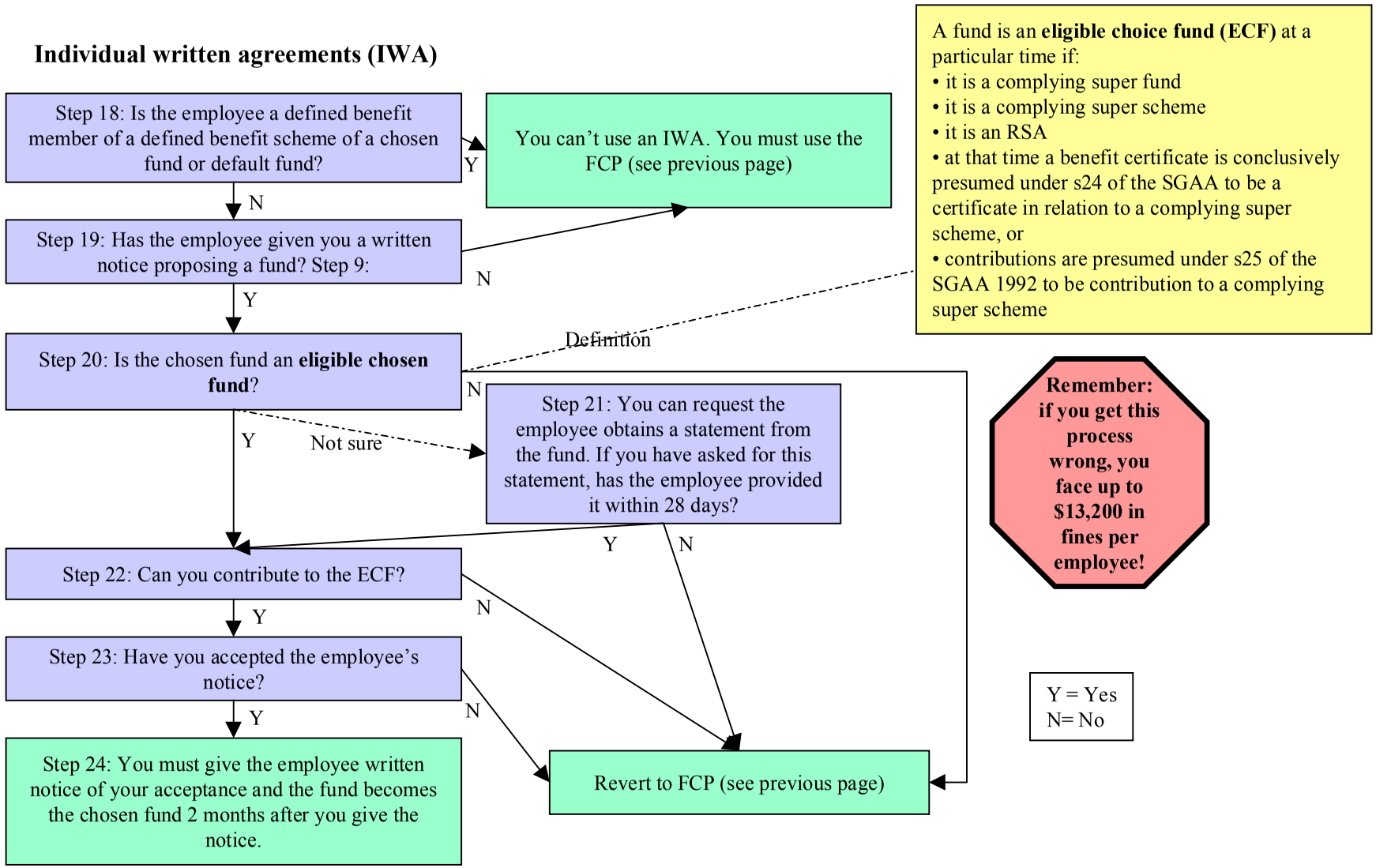
N

You must pay into the chosen fund. That may mean as many payments as you have employees. Note that funds may stop being a chosen fund – See Part C

You don't have to accept the choice. Pay super into a default fund

The Liberal's Super Choice Maze for Business

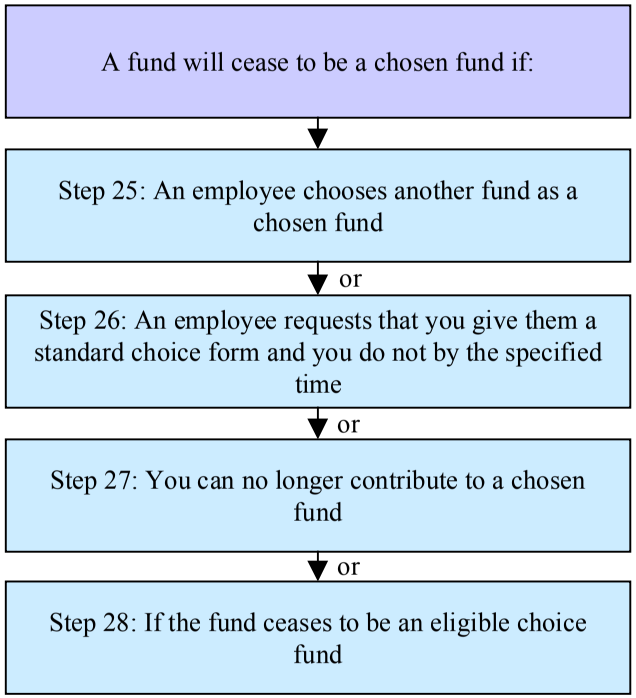
Part B – How choice must be offered… page 2



The Liberal's Super Choice Maze for Business

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?

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

When a fund is the default fund

Step 29: A fund must be an **eligible default fund**

Definition

A fund is an **eligible default fund** if:
- it is an eligible choice fund, and
- it meets the prescribed requirements in relation to offering insurance in respect of death

Y = Yes
N= No

Step 30: Is there a **selected Commonwealth or Territory industrial award fund** for the employee?

Y

Definition

A fund is a **Commonwealth or Territory industrial award fund** if:
- a Commonwealth or Territory industrial award requires you to make contributions to a fund, and
- the award does not provide the the employee may choose the fund, and
- contributions by you to that fund would satisfy the award, and
- the fund is an eligible default fund

If there is more than one industrial award fund, you may select which one you want to be the default fund.

N

Step 31: Is there a selected majority fund?

Y

Not sure

N

Step 32: Did you make contributions in the past 12 months for employees to only one fund?

Y

That fund is the default fund

N

Step 33: Did you make contributions in the past 12 months for employees to more than one fund?

Y

Step 34: Determine the fund to which the greatest number of employees' contributions were made

N

Step 35: Select any eligible default fund

Special rule: for employees which are employed on 1 July 2004, the default fund for the employees on 1 July 2004 is the last eligible default fund to which the employer contributed for the benefit of the employee before 1 July 2004.

Appendix 1

Submissions

Submission No.	Submittor	Issue
1	National Farmers Federation	Choice
2	Joe Hlubucek	Surcharge
3	Society of Superannuants	Surcharge
4	Society of Superannuants	Choice
5	ACTU	All
6	West Tamar Council	Co-contribution
7	Joseph Xerri	Surcharge
8	SunSuper	Choice
9	AIG (Australian Industry Group)	Choice
10	CPA Australia	All
11	MTAA Super Fund	Choice
12	Bob Stephens, Chris Engelhardt	Choice
13	Corporate Super Association	Choice
14	Quadrant Superannuation	Choice
15	Institute of Actuaries Australia	All
16	Cbus	Choice
17	ASFA	Choice
18	ASFA	Co-contribution
19	ASFA	Surcharge
20	Mercer Human Resource Consulting Pty Ltd	Choice
21	Mercer Human Resource Consulting Pty Ltd	Co-contribution

22	Mercer Human Resource Consulting Pty Ltd	Surcharge
23	Taxpayers Australia Inc	All
24	Association of Financial Advisers	Choice
25	Australian Chamber of Commerce and Industry (ACCI)	Choice
26	Superpartners	All
27	Australian Consumers Association & Financial Services Consumer Policy Centre (UNSW)	Choice
28	Superpartners (Supplementary)	Co-contribution
29	AIST	Choice
30	Industry Funds Forum Inc	All
31	Corporate Super Association (Supplementary)	Choice
32	Kearney Financial Services Pty Ltd	Co-contribution
33	Commonwealth Bank of Australia	Choice
34	Australian Bankers' Association	Choice
35	Australian Council of Social Service (ACOSS) and surcharge	Co-contribution
36	Investment & Financial Services Association Ltd (IFSA)	All
37	Financial Planning Association of Australia Limited	Choice
38	Australian Chamber of Commerce and Industry (ACCI) (Supplementary Submission)	Choice
39	Sunsuper Pty Ltd (Supplementary Submission)	Choice
40	Cbus (Supplementary Submission)	Choice
41	Australian Taxation Office	Co-contribution
42	Society of Superannuants (Supplementary Submission)	Surcharge
43	Confidential	
44	Industry Fund Services	Choice
45	Connect Internet Solutions Pty Ltd	Choice
46	National Farmers' Federation (Supplementary Submission)	Choice

47	National Farmers' Federation (Supplementary Submission)	Choice
48	Australian Taxation Office (Supplementary Submission)	Choice
49	IOOF Funds Management	Choice
50	Confidential	
51	Department of the Treasury	Choice
52	Austsafe Super	Choice
53	Australian Consumers' Assoication (Supplementary Submission)	Choice

Note: Submissions 1 to 43 tabled on 26 September 2002 with Report on Provisions of the Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 and Provisions of the Superannuation Legilsation Amendment Bill 2002.

Appendix 2

Public Hearings

Monday, 2 September 2002, Melbourne

Superpartners

Ms Fiona Galbraith, Manager Compliance

Australian Consumers' Association (ACA) and the Financial Services Consumer Policy Centre (FSCPC)

Ms Catherine Wolthuizen, Senior Policy Officer, Financial Services, ACA

Mr Khaldoun Hajaj, Researcher, FSCPC, UNSW

Association of Financial Advisers

Mr Michael Murphy, Chair, Public Affairs Committee

Cbus

Ms Maria Butera, National Marketing Manager

Mr Gordon Noble, Employer Coordinator

Westscheme

Mr Howard Rosario, Chief Executive

CPA Australia

Mr Murray Wyatt, Chair, Superannuation Centre of Excellence

Ms Noelle Kelleher, Superannuation Centre of Excellence

Mr Paul Drum, Senior Tax Counsel

Society of Superannuants (SOS)

Mr Peter Somerville, Treasurer

Mr Don Steel, Actuarial Adviser

Mercer Human Resource Consulting

Mr John Ward, Manager, Research and Information

Tuesday, 3 September 2002, Melbourne

Corporate Super Association

Mr Mark Cerche, Chairman

Mr Nicholas Brookes, Chief Executive

Ms Elizabeth Goddard, Head of Research

Australian Council of Trade Unions (ACTU)

Ms Linda Rubinstein, Senior Industrial Officer

Motor Trades Association of Australia (MTAA) Superannuation Fund

Mr Paul Watson, Executive Officer

Mr John Jones, National Manager, Marketing and Business Development

ASFA

Dr Michaela Anderson, Director, Policy and Research

Dr Brad Pragnell, Principal Policy Adviser

Taxpayers Australia and Superannuation Australia

Ms Barbara Smith, Technical Director

Australian Institute of Superannuation Trustees (AIST)

Ms Helen Dyson, Vice President

Australian Chamber of Commerce and Industry (ACCI)

Mr Peter Anderson, Director, Workplace Policy

Dr Steven Kates, Chief Economist

Wednesday 11 September 2002, Canberra

National Farmers' Association

Ms Denita Harris, Policy Manager and Industrial Relations Advocate

Financial Planning Association (FPA)

Mr Ken Breakspear, Chief Executive

Mr Con Hristodoulidis, Senior Manager Policy

Investment and Financial Services Association (IFSA)

Mr Richard Gilbert, Chief Executive Officer

Mr Bill Stanhope, Senior Policy Manager

Mr Brian Bissaker, Member, Economic Savings and Tax Board, IFSA

Australian Bankers' Association (ABA)

Mr David Bell, Chief Executive Officer

Ms Ardele Blignault, Director

Mr John Loveridge, Manager, Employer/Employee Benefits, Commonwealth Bank

Industry Funds Forum (IFF)

Mr Ian Silk, Convenor

Department of the Treasury and the Australian Taxation Office (ATO)

Mr Trevor Thomas, Manager, Superannuation, Retirement and Savings Division, Department of the Treasury

Mr Phil Gallagher, RIM Group, Department of the Treasury

Mr Christopher Timotheou, Analyst, Department of the Treasury

Mr Michael Rosser, Manager, Consumer Protection Unit, Department of the Treasury

Mr Brett Wilesmith, Analyst, Consumer Protection Unit, Department of the Treasury

Mr Patrick Boneham, Analyst, Superannuation, Retirement and Savings Division, Department of the Treasury

Mr Alan Mallory, Analyst, Department of the Treasury

Ms Vicki Wilkinson, Specialist Adviser, Financial Systems Division, Department of the Treasury

Mr Marcus Markovic, Assistant Commissioner, ATO

Mr Stephen Murtagh, Assistant Commissioner, ATO

Thursday 19 September 2002, Canberra

Department of the Treasury and the Australian Taxation Office (ATO)

Mr Roger Brake, General Manager, Superannuation, Retirement and Savings Division, Department of the Treasury

Mr Trevor Thomas, Manager, Superannuation, Retirement and Savings Division, Department of the Treasury

Mr Michael Rosser, Manager, Consumer Protection Unit, Financial System Division, Department of the Treasury

Mr Patrick Boneham, Analyst, Superannuation, Retirement and Savings Division, Department of the Treasury

Ms Vicki Wilkinson, Specialist Adviser, Financial System Division, Markets Group, Department of the Treasury

Mr Marcus Markovic, Assistant Commissioner, ATO

Mr Stephen Murtagh, Assistant Commissioner, ATO

Note: Proof transcripts were tabled on 26 September 2002 with Report on Provisions of Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 and Provisions of the Superannuation Legislation Amendment Bill 2002.

Appendix 3

Tabled Documents

Monday 2 September 2002

- *Senate Committee Discussion Points - 2nd Sep 02*, tabled by Mr Somerville, Society of Superannuants;
- *Case Study 1: Do not pay me that extra dollar*, tabled by Mr Ward, Mercer Human Resource Consulting; and
- *Case Study 2: How to pay more than 70% tax*, tabled by Mr Ward, Mercer Human Resource Consulting.

Tuesday 3 September 2002

- Article from *Money Management* magazine, August 22, 2002, entitled: Tom Collins, 'Industry repairs should be first priority', tabled by Ms Rubinstein, ACTU; and
- Issue 18, September 2002, *DIY Superannuation* journal, tabled by Ms Smith, Taxpayers Australia Inc.

Appendix 4

Main Provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

1.1 The Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002 amends the *Superannuation Guarantee (Administration) Act 1992*. Of particular note, the Bill amends Item 22 of Schedule 1 of the Act, through the insertion of a new Part 3A – Choice of fund requirements. This new Part 3A is structured in eight Divisions. The main provisions of these Divisions are outlined below (Division 1 is an overview).

Division 2 – Contributions that satisfy choice

1.2 Proposed section 32C lists the following contributions as complying with the choice of fund requirement:

- Contributions to a chosen fund;
- Contributions to a default fund where there is no chosen fund for the employer to contribute to;
- Contributions to unfunded public sector arrangements other than contributions for Commonwealth employees that are members of the Commonwealth Super Scheme (CSS) or Public Sector Superannuation (PSS);
- Contributions made to the CSS, PSS and contributions made under the *Superannuation (Productivity Benefit) Act 1988*;
- Contributions made under an Australian Workplace Agreement (AWA) or a certified agreement under the *Workplace Relations Act 1996*;
- Contributions made under relevant Victorian or prescribed Commonwealth, State or Territory legislation; and
- Contributions made after employees cease employment.

Division 3 – Funds that are eligible choice funds

1.3 Proposed section 32D lists the funds that will be deemed to be eligible choice funds:

- A complying superannuation fund or scheme at the time;
- An RSA; or
- A fund that is presumed to be a complying fund while further information is sought or a decision on complying status is pending.

Division 4 – Choosing a fund

1.4 Proposed section 32F provides that an employee can select a fund in accordance with the choice process set out in Division 6.

Division 5 – Default fund

1.5 Proposed section 32K sets out the default fund for an employee. For new employees or on-going employees whose default fund has ceased by virtue of the proposed section 32L, the default fund will be:

- The Commonwealth or Territory industry award fund for the employee; or
- If there is no Commonwealth or Territory industry award fund for the employee – the 'majority fund'; or
- If there is no Commonwealth or Territory industry award fund for the employee or 'majority fund' – any eligible fund chosen by the employer (proposed section 32K(2)).

1.6 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)).

Division 6 – Formal choice process

1.7 Proposed sections 32M and 32N set out the process to be followed in choosing a fund under section 32F. Under these sections, an 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, although such requests may only be made once every 12 months. An employer must also offer a choice within 28 days of becoming aware that they cannot contribute to a chosen or default fund.

1.8 Proposed section 32P requires that a standard choice form should contain the following information:

- A statement that the employee may choose any eligible choice fund;
- The date the form was given to the employee and the date by which the employee must make a choice; and
- Information required to be provided in accordance with Regulations, including details of the default fund and particular information for defined benefit fund members about their scheme.

1.9 Employees must advise their employer of their chosen fund, in writing, within 28 days of being given the standard choice form.

Division 7 – Non-compliance with the choice of fund requirement

1.10 Proposed sections 32T, 32U and 32V make it an offence for an employer not to provide an employee with a standard choice form, or to contribute to a fund or an RSA that is not in compliance with the choice of fund of the employee.

Division 8 – Miscellaneous

1.11 Proposed section 32ZA sets out that an employer will not be liable for anything done in complying with the choice of fund rules. This addresses employers' earlier concerns about potential liability for damages.

Appendix 5

List of Committee Reports

Reports of the Select Committee on Superannuation

(1991-1998)

- *Super System Survey* - A Background Paper on Retirement Income Arrangements in Twenty-one Countries (December 1991)
- Papers relating to the Byrnwood Ltd, WA Superannuation Scheme (March 1992) Interim Report on Fees, Charges and Commissions in the Life Insurance Industry (June 1992)
- First Report of the Senate Select Committee on Superannuation - *Safeguarding Super* - the Regulation of Superannuation (June 1992)
- Second Report of the Senate Select Committee on Superannuation - *Super Guarantee Bills* (June 1992)
- *Super Charges* - An Issues Paper on Fees, Commissions, Charges and Disclosure in the Superannuation Industry (August 1992)
- Third Report of the Senate Select Committee on Superannuation - *Super and the Financial System* (October 1992)
- *Proceedings of the Super Consumer Seminar*, 4 November 1992 (4 November 1992)
- Fourth Report of the Senate Select Committee on Superannuation - *Super - Fiscal and Social Links* (December 1992)
- Fifth Report of the Senate Select Committee on Superannuation - *Super Supervisory Levy* (May 1993)
- Sixth Report of the Senate Select Committee on Superannuation - *Super - Fees, Charges and Commissions* (June 1993)
- Seventh Report of the Senate Select Committee on Superannuation - *Super Inquiry Overview* (June 1993)
- Eighth Report of the Senate Select Committee on Superannuation - *Inquiry into the Queensland Professional Officers Association Superannuation Fund* (August 1993)

- Ninth Report of the Senate Select Committee on Superannuation - *Super Supervision Bills* (October 1993)
- Tenth Report of the Senate Select Committee on Superannuation - *Super Complaints Tribunal* (December 1993)
- Eleventh Report of the Senate Select Committee on Superannuation - *Privilege Matter Involving Mr Kevin Lindeberg and Mr Des O'Neill* (December 1993)
- A Preliminary Paper Prepared by the Senate Select Committee on Superannuation for the Minister for Social Security, *Options for Allocated Pensions Within the Retirement Incomes System* (March 1994)
- Twelfth Report of the Senate Select Committee on Superannuation - *Super for Housing* (May 1994)
- Thirteenth Report of the Senate Select Committee on Superannuation - *Super Regs I* (August 1994)
- Fourteenth Report of the Senate Select Committee on Superannuation - *Super Regs II* (November 1994)
- Fifteenth Report of the Senate Select Committee on Superannuation - *Super Guarantee - Its Track Record* (February 1995)
- Sixteenth Report of the Senate Select Committee on Superannuation - *Allocated Pensions* (June 1995)
- Seventeenth Report of the Senate Select Committee on Superannuation - *Super and Broken Work Patterns* (November 1995)
- Eighteenth Report of the Senate Select Committee on Superannuation - *Review of the Superannuation Complaints Tribunal* (April 1996)
- Nineteenth Report of the Senate Select Committee on Superannuation - *Reserve Bank Officers' Super Fund* (June 1996)
- Twentieth Report of the Senate Select Committee on Superannuation - *Provisions of the Social Security Legislation Amendment (Further Budget and Other Measures) Bill 1996 - Schedule 1* (November 1996)
- Twenty-first Report of the Senate Select Committee on Superannuation - *Investment of Australia's Superannuation Savings* (December 1996)
- Twenty-second Report of the Senate Select Committee on Superannuation - *Retirement Savings Accounts Legislation* (March 1997)
- Twenty-third Report of the Senate Select Committee on Superannuation - *Superannuation Surcharge Legislation* (March 1997)

- Twenty-fourth Report of the Senate Select Committee on Superannuation - *Schedules 1, 9 & 10 of Taxation Laws Amendment Bill (No. 3) 1997* (June 1997)

- Twenty-fifth Report of the Senate Select Committee on Superannuation - *The Parliamentary Contributory Superannuation Scheme & the Judges' Pension Scheme* (September 1997)

- Twenty-sixth Report of the Senate Select Committee on Superannuation - *Super - Restrictions on Early Access: Small Superannuation Accounts Amendment Bill 1997 and related terms of reference.* (September 1997)

- Twenty-seventh Report of the Senate Select Committee on Superannuation - *Superannuation Contributions Tax Amendment Bills.* (November 1997)

- *Super Taxing* - An information paper on the Taxation of Superannuation and related matters. (February 1998)

- Twenty-eighth Report of the Senate Select Committee on Superannuation – *Choice of Fund*. (March 1998)

- Twenty-ninth Report of the Senate Select Committee on Superannuation - *Superannuation Legislation (Commonwealth Employment) Repeal and Amendment Bill 1997, Commonwealth Superannuation Board Bill 1997, Superannuation Legislation (Commonwealth Employment - Saving and Transitional Provisions) Bill 1997.* (April 1998)

- Thirtieth Report of the Senate Select Committee on Superannuation - *Workplace Relations Amendment (Superannuation) Bill 1997*. (May 1998)

- Thirty-first Report of the Senate Select Committee on Superannuation - *Resolving Superannuation Complaints* - options for dispute resolution following the Federal Court decision in *Wilkinson v CARE*. (July 1998)

Reports of the Select Committee on Superannuation and Financial Services - 39th Parliament

(1999 - 2002)

- *Choice of Superannuation Funds (Consumer Protection) Bill 1999* (November 1999)
- *Superannuation Legislation Amendment Bill (No. 4) 1999* (November 1999)
- *Roundtable on Choice of Superannuation Funds* (March 2000)
- *Provisions of the Superannuation (Entitlements of Same Sex Couples) Bill 2000* (April 2000)
- *New Business Tax System (Miscellaneous) Bill No 2 2000* (June 2000)
- *Financial Sector Legislation Amendment Bill (No 1) 2000* (August 2000)
- *Interim report on the Family Law Legislation Amendment (Superannuation) Bill 2000* (November 2000)
- *Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (December 2000)
- *Family Law Legislation Amendment (Superannuation) Bill 2000* (March 2001)
- *The opportunities and constraints for Australia to become a centre for the provision of global financial services* (March 2001)
- *A 'reasonable and secure' retirement? The benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes* (April 2001)
- *Enforcement of the Superannuation Guarantee Charge* (April 2001)
- *Issues arising from the Committee's report on the Taxation Laws Amendment (Superannuation Contributions) Bill 2000* (May 2001)
- *Report on the Provisions of the Parliamentary (Choice of Superannuation) Bill 2001* (August 2001)
- *Prudential supervision and consumer protection for superannuation, banking and financial services - First Report* (August 2001)
- *Prudential supervision and consumer protection for superannuation, banking and financial services - Second Report - Some case studies* (August 2001)

- *Prudential supervision and consumer protection for superannuation, banking and financial services - Third Report - Auditing of Superannuation Funds* (September 2001)
- *Early Access to Superannuation Benefits* (January 2002)
- *Investing Superannuation Funds in Rural and Regional Australia - An Issues Paper* (February 2002)

Reports of the Select Committee on Superannuation - 40th Parliament (2002)

- *Taxation Laws Amendment (Superannuation) Bill (No. 2) 2002, and Superannuation Guarantee Charge Amendment Bill 2002* (June 2002)
- *Taxation Treatment of Overseas Superannuation Transfers* (July 2002)
- *Provisions of the Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 and Provisions of the Superannuation Legislation Amendment Bill 2002 (September 2002)*