

Chapter Twelve

Conclusions and Recommendations

Parties to the inquiry

12.1 The Committee notes general support for the principle of portability of superannuation, on the basis that superannuation fund members should have the ability to manage their superannuation.

12.2 However, only two parties to the inquiry outside of Government, namely IFSA and the ABA, supported the specific terms of the gazetted regulations, dated 30 July 2003. IFSA and the ABA argued that consumers should have the right to select where their superannuation funds are invested, and that the best governance standards occur when consumers are informed and freely choose which financial services provider they will trust with their funds.

12.3 The Committee also notes the evidence of Treasury that many funds already provide portability without any significant problems, and that all the new regulations are really doing is extending that same right to a further group of superannuation fund members.

12.4 The great majority of parties to the inquiry opposed the specific terms of the draft or gazetted regulations, or the implementation of the regulations in the current environment. The Committee notes that a broad range of issues was raised. These are examined below.

Roll overs/transfers out of active accounts

12.5 The principal concern expressed by parties making submissions to the inquiry in response to the draft regulations was that they would mandate the right of superannuation fund members to roll over/transfer their superannuation savings out of an active fund (ie one still receiving employer sponsored SG contributions) into an inactive fund. It was argued that this would effectively constitute *de facto* choice of fund, or choice of fund by the back door.

12.6 The Committee notes that this concern still partly holds under the gazetted regulations. The gazetted regulations limit the number of roll overs/transfers out of an active or inactive account to one a year. Nevertheless, such a roll over/transfer out of an active account still effectively amounts to choice of fund. To implement such a measure would pre-empt the legislative intent of the parliament, which has previously rejected choice of fund legislation.

12.7 The Committee believes that the gazetted regulations should be amended to exclude portability out of an active account.

12.8 The Committee believes that an appropriate minimum standard measure of whether an account is active or inactive would be whether the fund received any contributions in the last 12 months. This would be sufficient time to pick up most cyclical or casual jobs. Clearly this would not apply if the employee had changed employment and was receiving mandated SG payment in another fund.

Portability, choice and parliamentary scrutiny

12.9 Many parties to the inquiry argued that the portability regulations should not operate independently of choice legislation. It was noted to the Committee that the Government has previously directly associated portability with choice.

12.10 The Committee believes that it would have been preferable to consider the portability regulations alongside choice of fund legislation. Indeed the Committee made this point in its previous report on choice tabled in November 2002, entitled *Provisions of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002*. However, the Committee accepts that portability and choice can stand alone where there is not portability out of an active account.

12.11 The Committee notes that the Government intends to introduce a revised choice bill in the spring sittings of Parliament. This was announced by the Assistant Treasurer, Senator Coonan, in a media release on 25 May 2003.

Superannuation account numbers

12.12 In the March quarter 2003, Australia's 9 million fund members held between them 25.5 million superannuation accounts – an average of 2.8 accounts per member. The Committee recognises the desirability of consolidating some of these accounts.

12.13 However, a number of parties to the inquiry argued that roll overs/transfers out of active superannuation accounts, as permitted under the gazetted regulations, would simply lead to a proliferation of superannuation accounts, rather than the anticipated consolidation of accounts.

12.14 The Committee accepts that the ability of fund members to roll over/transfer out of an active account into a new account would simply increase account numbers and churning. This holds true despite the change in the gazetted regulations to restrict roll overs/transfers out of active accounts to one a year.

12.15 At the same time, however, although it was not broadly canvassed by parties to the inquiry, the Committee accepts that the gazetted regulations provide an opportunity to some fund members to consolidate inactive fund accounts where at present they may be prevented from doing so.

Financial disclosure standards in Australia

12.16 The Committee believes that adequate and consistent financial disclosure by superannuation funds, including the provision of information such as a member's withdrawal benefit, investment strategies, rates of return, fees, charges and expenses, is essential if portability is to be introduced successfully in Australia.

12.17 Disclosure requirements for superannuation funds are now provided under the Corporations Act, as amended by the FSR Act, which commenced on 11 March 2002 (subject to certain transitional arrangements).

12.18 During the inquiry, a number of parties argued that portability should be delayed until the effectiveness of the FSR Act can be gauged. By contrast, other parties argued that the new FSR Act represents world's best consumer protection and should be given an opportunity to prove its effectiveness.

12.19 The Committee also notes that ASIC has recently released its new model for product disclosure statements. ASIC's model aims to address issues such as:

- The use of common terms;
- Standardised descriptions;
- Disclosure of the purpose of particular fees;
- Improved disclosure of adviser remuneration; and
- Transparency of fees.¹

12.20 The Committee notes, however, evidence that further refinement of product disclosure statements is required by ASIC to address issues such as expressing fees in dollar terms, disclosure of so-called 'soft-dollar perks', and the impact that fees and charges will have on the future returns of a fund.

12.21 The Committee believes that the financial disclosure environment in Australia will continue to improve with the full implementation of the FSR Act and further refinement of the Product Disclosure Statements by ASIC.

12.22 The Committee also notes that in the gazetted regulations, the Government introduced regulation 6.34(2) which requires that, prior to making a roll over/transfer, a trustee must be satisfied that the member is aware of his or her right to receive additional information on the effect of the roll over/transfer (eg. impact of fees or insurance cover) and is satisfied that the member does not require such information.

12.23 The provisions of regulation 6.34(2) came under considerable scrutiny during the inquiry. It was suggested that:

1 ASIC Media Release, 'ASIC Releases Fee Disclosure Model', 5 August 2003.

- a) It is unclear how this mechanism is meant to work, and that it may potentially become a 'rubber stamp exercise'.
- b) It may expose trustees and employers to subsequent legal action where a member makes a poor investment decision and later tries to sue the trustee or employer.

12.24 Accordingly, the Committee believes that regulation 6.34(2) of the Superannuation Industry (Supervision) Amendment Regulations 2003 (No.4) should be revisited to clarify its proposed operation and to protect trustees and employers from any retrospective legal action.

Financial education standards in Australia

12.25 The Committee notes that as with financial disclosure standards, various parties to the inquiry expressed concern about financial education standards in Australia. In particular, it was suggested that fund members lack sufficient education to be able to compare superannuation products in order to make an informed choice about portability of superannuation.

12.26 The Committee acknowledges this problem. In the Committee's opinion, there are no short-term solutions to the general lack of education in the Australian population in relation to superannuation and retirement savings. Any change is likely to be generational, beginning with the inclusion of financial education in the curriculum in schools. However, more immediately, financial education needs to be provided in universities, workplaces and by funds themselves.

12.27 The Committee notes that in its September 2002 consultation paper, Treasury indicated that it would conduct an education campaign prior to the commencement of the portability regulations. The campaign would be designed to meet the information needs of both fund trustees and fund members.

12.28 In this regard, the Committee notes that the \$28.7 million allocated by the Government over four years in the 2002-2003 Budget is to fund an education campaign targeting both choice of fund and portability.

12.29 The Committee acknowledges that such an education campaign cannot possibly reach every individual in Australia. Nevertheless, the Committee notes that many superannuants seek outside education and advice on financial matters, and anticipates that this will only increase in the future with the conduct of an appropriate education campaign.

Life insurance arrangements

12.30 The Committee notes that the gazetted regulations, which allow trustees to require members to leave a balance of up to \$5,000 behind in a fund, effectively address the concern that individuals would not have sufficient funds in their superannuation account to maintain their insurance coverage.

The superannuation surcharge

12.31 The Committee was presented with strong evidence that the portability regulations, especially the implementation of partial fund roll overs/transfers, would involve major difficulties for funds trustees and financial service providers administering the superannuation surcharge. In particular, it was argued that the portability regulations would introduce major difficulties in:

- a) Determining how much of a rolled over/transferred amount related to surchargeable contributions for the current year. For example, if a partial roll over/transfer is made, the difficulty would be to determine how much of the surchargeable contributions for that year related to the partial withdrawal, and how much related to previous years.
- b) Handling surcharge assessments. It was argued that there will be considerable disagreement as to whether a fund is still 'the holder of the contributions' for surcharge assessment purposes, as a surcharge assessment may relate to contributions made in an earlier year which has already been paid out of the fund.

12.32 In response to these issues, the Committee was reassured by evidence from officers of the ATO that the new regulations would not involve any significant further difficulties, although there may potentially be more roll overs/transfers, involving greater costs.

12.33 That said, the Committee accepts that this is a very difficult issue, and that the impact on some trustees and financial service providers of meeting superannuation surcharge issues may be disproportionate to that on others. The Committee believes that the Government should consult further with the industry on this matter.

Multiple/partial roll over/transfer costs

12.34 During the inquiry, a number of parties raised concern about the impact that unlimited and partial roll overs/transfers, as proposed in the draft regulations, would have on the administration and hence costs of funds. It was suggested that members could begin to treat superannuation interests like a bank account.

12.35 As indicated in Chapter One, these concerns have been partially redressed in the gazetted regulations through a move to minimise roll overs/transfers to one a year. Nevertheless, it is clear that funds face additional costs under the regulations.

12.36 In relation to partial roll over/transfer, the Committee believes that where the cost to the fund is fully recoverable through an appropriate exit fee, there should be no restriction on partial roll overs/transfers. The advantage of partial roll overs/transfers is that they give members the opportunity to manage risk by diversifying their accounts.

Exit fees

12.37 The Committee notes that the issue of exit fees continues to be very controversial, with considerable disagreement amongst parties as to the nature, level and applicability of exit fees.

12.38 On the one hand, the Committee was presented with evidence by IFF and Cbus that high exit fees are widespread in the superannuation industry and constitute a significant barrier to portability out of an account.

12.39 On the other hand, IFSA, the FPA and the ABA presented evidence that high exit fees are confined to superannuation products that were offered during the 1980s by the life insurance industry, and that such products now constitute less than 5 per cent of all retail and master trust funds under management.

12.40 Given this disagreement about the real impediment to portability that exit fees provide, there remains considerable debate whether a cap or even ban should be placed on exit fees.

12.41 A large number of parties supported a cap on exit fees at a fixed dollar amount, set at a level sufficient to cover actual administrative expenses to a fund from a roll over/transfer. Such a cap would need to be prospective rather than retrospective.

12.42 In response to this argument for a fee cap, IFSA suggested that regulation of exit fees would be counter productive from a competition, choice and consumer design perspective. If a cap was placed on fees, IFSA argued that fees would tend to rise to match the level of the cap.

12.43 The Committee believes that future exit fees should be limited to the reasonable administrative cost and redemption cost of a roll over/transfer. The Committee notes that in its September 2002 consultation paper, the Government left open the option of regulating exit fees.

12.44 Although not raised during the conduct of the inquiry, the Committee also believes that the Government should investigate whether there should be a greater role for the Superannuation Complaints Tribunal in dealing with complaints about fees and charges. Currently, the tribunal cannot generally deal with a complaint that fees and charges are too high, although it may be able to deal with a complaint that fees and charges were not disclosed or that misrepresentations were made about the existence or level of fees and charges.

Fund investments and liquidity

12.45 The Committee notes concern that higher levels of churning between funds under the portability regulations would require funds to retain more liquid assets so as to be able to meet their liquidity obligations under the SIS Act. In turn, forcing funds to maintain more liquid assets would lead to lower long-term average returns.

12.46 In response, it was argued by IFSA that long-term investments are readily available and redeemable on the stock market, and that portability would have little or no impact on fund returns.

12.47 The Committee does not regard the impact of the portability regulations on fund liquidity and investment returns as a reason to delay the introduction of the regulations. However, the Committee acknowledges that more frequent roll overs/transfers could have a modest impact on fund liquidity and hence returns.

12.48 The Committee endorses the evidence of APRA that trustees will need to review fund liquidity and their risk profile from 1 July 2004.

Commission-based selling

12.49 The Committee notes concerns that the portability regulations could increase the likelihood of fund members being persuaded by financial advisers to move their savings around either once or repeatedly, the principal advantage of which would accrue to the advisers in the form of commissions. To prevent this, various parties recommended a ban on commission-based roll overs/transfers of mandated employer superannuation contributions.

12.50 In response to these concerns, the FPA noted that Section 947D of the new FSR Act makes it clear that the Government will not tolerate churning of fund members by financial advisers. The Committee is also encouraged by the FPA's new Professional Partner Program aimed at 'raising the bar' in relation to professional standards in the financial planning community.

12.51 The Committee has some concerns in regard to commission-based selling where it impacts on compulsory SG funds. In its previous report entitled *Planning for Retirement*, the Committee indicated its opinion that the mechanisms for remunerating financial planners need reform to implement a more direct relationship between the amount of work performed and the fee charged. The Committee further recommended that the Productivity Commission investigate the remuneration arrangements for financial planners.

12.52 The Committee believes that commission-based selling should be re-examined by the Government following the outcome of the Productivity Commission investigation.

Not-for-profit funds

12.53 The Committee notes the concerns expressed by the Corporate Super Association, AAS and SOS that the portability regulations would lead to a one-way flow of funds out of not-for-profit employer-sponsored superannuation funds into retail funds. This is because retail funds can promote themselves to the public and invite membership whereas not-for-profit funds do not seek roll overs/transfers from the general public.

12.54 The Committee recognises the concerns of not-for profit funds, but does not believe that the solution to this problem is to prevent portability. Rather, as indicated in the Committee's previous report entitled *Planning for Retirement*, the imperative is to ensure that financial planners provide independent and unbiased advice by removing any commercial advantage from the provision of that advice.

Defined benefit schemes

12.55 The Committee notes the issue raised by Watson Wyatt that it is quite common for a defined benefit fund in Australia to have a benefit design that provides:

- a) On resignation prior to the attainment of a specified period of service or age, a benefit that is accumulative in nature (eg. a benefit that is the sum of a member account and a company account, or a benefit that is expressed as a multiple of member account); or
- b) On attainment of the specified period of service or age, a benefit that is defined benefit in nature (eg. a benefit based on a certain factor multiplied by years of service multiplied by average salary).

12.56 Watson Wyatt submitted that such an interest should be classified as a defined benefit component for the purposes of regulation 6.30(2)(c), thus excluding such benefits from the provisions of the Superannuation Industry (Supervision) Amendment Regulations 2003.

12.57 The Committee believes that the Government should examine this issue to determine whether any further modifications to regulation 6.30(2)(c) of the Superannuation Industry (Supervision) Amendment Regulations 2003 is warranted.

Unfunded Public Sector Superannuation Schemes

12.58 The Committee notes the concerns of the Government Employees Superannuation Board of Western Australia in relation to the definition of unfunded public sector superannuation schemes in the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997*. Put simply, the 1997 regulations refer to two repealed Western Australian Acts.

12.59 The Committee believes that the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997* should be amended to reflect current legislative circumstances in WA. The Government should also take steps to consolidate the terms used to refer to superannuation schemes administered under Commonwealth, State or Territory Law.

The Queensland Local Government Superannuation Scheme

12.60 The Committee notes that the Queensland Local Government Super is in a unique position through its proposed exclusion from federal choice of superannuation

legislation (should it be enacted), while potentially being simultaneously subject to the portability regime.

12.61 The Committee believes that the Queensland Local Government Super, and any other funds in a similar position, should be excluded from the provisions of the Superannuation Industry (Supervision) Amendment Regulations 2003.

A roll over/transfer protocol

12.62 The Committee notes considerable support for the development and inclusion in the regulations of a roll over/transfer protocol to help facilitate roll overs/transfers. ASFA suggested the possible inclusion in the regulations of an additional sub-regulation detailing the type of information required, such as:

- a) The ABN of the destined fund;
- b) The amount to be rolled over/transferred out of the fund; and
- c) Either the SPIN of the destination fund/product or the member's account number of that fund.²

12.63 The Committee supports the development and inclusion in the regulations of a roll over/transfer protocol. That said, the Committee notes that a roll over/transfer protocol has been a matter that the industry has looked at for many years, but which has proved very difficult to implement for some funds.

The timing of roll overs/transfers

12.64 The Committee notes arguments that the 90 day roll over/transfer period under regulation 6.34(3) of the Superannuation Industry (Supervision) Amendment Regulations 2003 is excessively generous, and that a shorter roll over/transfer period could be enforced. However, the Committee believes that while a 90 day roll over/transfer would generally be considered as outside normal standards, it nevertheless represents an acceptable minimum standard.

Suspension or variation of roll overs/transfer

12.65 The Committee believes that the Government should investigate whether there needs to be:

- a) Definition of the terms 'reasonable grounds' and 'significant adverse effect' under regulation 6.36 of the Superannuation Industry (Supervision) Amendment Regulations 2003.
- b) A time limit, for example within 30 days of receiving a request for a roll over/transfer, on the ability of a trustee to apply to APRA for

2 *Submission 2, ASFA, p. 6.*

relief under regulation 6.37. This would avoid any conflict that may arise between the requirement to roll over/transfer an amount and seeking and gaining relief due to an inability to pay.

12.66 The Committee also endorses the concerns of the Law Council of Australia that:

- a) Regulation 6.34(3) does not allow for ‘variation’ or ‘suspension’ of a transfer under regulations 6.36 and 6.37.
- b) A trustee may make an application to APRA under regulation 6.37 for suspension of a transfer under regulation 6.34(3), but APRA may not make a decision within 90 days, placing the trustee in breach of the regulation.

Legal protection for trustees

12.67 The Committee endorses the concern of the Law Council of Australia that trustees should be provided with legal protection under the portability regulations to make it clear that if a roll over/transfer occurs in accordance with the regulations, the member bears the risk.

12.68 Accordingly, the Committee believes that the portability regulations should include a section giving specific legal protection to trustees, in accordance with the model outlined by the Law Council of Australia in paragraph 11.26.

Summary

12.69 The Committee supports the principle of portability, and the ability of individuals to consolidate their superannuation accounts. In particular, the Committee supports giving individuals the ability to consolidate an inactive superannuation account into either an active account or another inactive account. Such a measure, accompanied by a targeted education campaign following the introduction of portability, would achieve a reduction in superannuation account numbers in Australia.

12.70 However, the Committee believes that the portability regulations, by extending portability to active accounts, raise an issue which is better dealt with through choice of funds legislation on the grounds of efficiency and consumer protection. There may also be concerns where a person’s death benefit is significantly greater than the member’s account balance. The Committee is also concerned that portability out of active superannuation accounts could lead to an increase in superannuation account numbers in Australia due to the need to maintain multiple accounts.

12.71 Accordingly, the Committee believes that the Government should revise the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the

Retirement Savings Accounts Amendment Regulations 2003 (No. 2) to prohibit roll overs/transfers out of an active superannuation account into an inactive account.

12.72 The Committee notes that the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the Retirement Savings Accounts Amendment Regulations 2003 (No. 2) are not due to come into force until 1 July 2004.

Recommendation 1

The Committee recommends that the Government prior to 1 July 2004 revise the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the Retirement Savings Accounts Amendment Regulations 2003 (No. 2) to prohibit roll overs/transfers out of an active superannuation account.

12.73 The Committee also believes that when revising the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the Retirement Savings Accounts Amendment Regulations 2003 (No. 2), the Government should:

- Revise regulation 6.34(2) of the Superannuation Industry (Supervision) Amendment Regulations 2003 (No.4) relating to disclosure to clarify its proposed operation and to protect trustees and employers from any retrospective legal action;
- Revise regulation 6.30(2)(c) of the Superannuation Industry (Supervision) Amendment Regulations 2003 (No.4) to exclude defined benefit schemes from the provisions of the regulation where the member's current entitlement is in accumulation or partially vested form;
- Exclude Queensland Local Government Super (and any other funds in a similar position) from the operation of the Superannuation Industry (Supervision) Amendment Regulations 2003 (No.4) due to the particular nature of the scheme under state legislation;
- Include a roll over/transfer protocol, based on consultation with the industry, to help facilitate roll overs/transfers;
- Examine the timing, suspension and variation of roll overs/transfers under regulations 6.34, 6.36 and 6.37 of the Superannuation Industry (Supervision) Amendment Regulations 2003 (No.4); and
- Include a section giving specific legal protection to trustees, in accordance with the model outlined by the Law Council of Australia in paragraph 11.26.

Recommendation 2

The Committee recommends that when revising the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the Retirement Savings Accounts Amendment Regulations 2003 (No. 2), the Government should also address the issues raised in Paragraph 12.73.

12.74 The Committee also notes that the introduction of portability of superannuation in Australia would be further facilitated by:

- The commencement of the education campaign on choice and portability when the portability regulations come into effect using the \$28.7 million allocated by the Government over four years in the 2002-2003 Budget;
- Further refinement of product disclosure statements by ASIC;
- Limiting future exit fees to the reasonable administrative cost and redemption cost of a roll over/transfer;
- Further consultation with the industry on the handling of surchargeable contributions;
- An extension to the role for the Superannuation Complaints Tribunal in dealing with complaints about fees and charges; and
- Revising the *Superannuation Contributions Tax (Assessment and Collection) Regulations 1997* to reflect current legislative circumstances in WA and to consolidate the terms used to refer to superannuation schemes administered under Commonwealth, State or Territory Law.

Recommendation 3

The Committee recommends that the Government prepare for the introduction of portability and choice by addressing the issues raised in paragraph 12.74. In particular, the Committee believes that when the portability regulations come into effect, the Government should commence its education campaign using the \$28.7 million allocated by the Government over four years in the 2002-2003 Budget.

12.75 Labor and Democrat Senators note that they will move to disallow the Superannuation Industry (Supervision) Amendment Regulations 2003 (No. 4) and the Retirement Savings Accounts Amendment Regulations 2003 (No. 2) in the Senate if the Government does not support the recommendations in this report.

**Senator John Watson
Committee Chair**