

Australian Administration Services submission to the Senate Select Committee on Superannuation—Draft *Superannuation Industry (Supervision) Regulations (Portability)*

Introduction

Australian Administration Services (AAS) welcomes the opportunity to comment on the draft Superannuation Industry (Supervision) Regulations on portability of benefits.

As one of Australia’s leading superannuation administrators, the effects of the proposed regulations are of key importance to AAS and our clients.

The portability regulations are integrally linked with the proposed Choice of Fund legislation. Combined, members would have a complete ability to choose the fund or funds for all of their superannuation entitlements, past and future. We cannot emphasise enough how important it is for the portability regulations to be linked to the passing of the Choice of Fund Bill. If separately introduced, the draft regulations are likely to increase fees and expenses with very limited benefits.

We support the aim of consolidating individuals’ superannuation benefits and allowing individuals to choose the best superannuation funds for their investments.

Many superannuation fund members will benefit from consolidating their accounts: the compounding effect of paying fees to multiple superannuation funds can have a significant effect on a members final retirement benefit. Consolidation of members’ accounts will also increase equity by reducing the overall level of cross-subsidies arising from the member protection standards.

However, as described in the body of our submission, we query whether the draft portability regulations will assist in removing the problem of individuals holding multiple superannuation accounts. Portability already exists for most fund members on changing employment; the main change from the draft Regulations would be to allow members to move existing superannuation benefits between funds while remaining with their current employer.

In addition, we have a number of concerns in relation to the ability of many superannuation account holders to make an informed choice. These concerns relate to two main areas:

- that retail superannuation providers with large marketing budgets will be the greatest beneficiaries of a portability regime, with non-profit funds potentially the largest losers; and
- that many financial planners are reluctant to recommend non-profit superannuation funds, such as industry funds, which do not pay commissions.

We note that the direct effect of the Choice of Fund Bill would fall mainly on employers and members, whereas the direct effect of the Portability Regulations would fall mainly on members and funds.

There are also potential effects on insurance as a result of portability and choice of fund. These could include an increase in premiums and a reduction in terms and conditions.

We would be pleased to provide more details or discuss our submission further on request.

About Australian Administration Services

Australian Administration Services Pty Ltd (AAS) provides professional core administration and related customer service to superannuation funds and redundancy trusts. We specialise in services to industry superannuation funds.

AAS is a fully owned subsidiary of KAZ Group Limited, the leading Australian specialist provider of information technology and business process outsourcing services.

Through 700 employees, based in six states, we provide superannuation administration and customer services to about 47% of our target market. Our services are provided to:

- 36 funds and subfunds;
- 300 individual trustees and fund executives
- 3.4 million members
- 165,000 employers.

AAS is ISO 9002 certified as a Quality Endorsed Company.

General comments

1. Background

“Portability of superannuation benefits” was defined in the Government’s September 2002 Consultation Paper, *Portability of Superannuation Benefits—Enhancing the Right of Members to Move Existing Benefits Between Superannuation Entities* as follows:

“Portability of superannuation benefits is the ability of a member to transfer existing benefits from one superannuation fund, approved deposit fund (ADF) or Retirement Savings Account (RSA) to another fund, ADF, RSA or exempt public sector superannuation scheme (EPSSS).”

Draft Superannuation Industry (Supervision) Regulations to introduce portability of superannuation benefits were first released for public consultation by the Commonwealth Department of Treasury on 27 May 2003. Submissions were due by 10 June 2003, a very short consultation period for very controversial changes to the superannuation system.

In general, the draft Regulations allow superannuation fund members to instruct their current superannuation funds to transfer all or part of their benefits to any other fund they nominate, at any time. The original fund must do so as soon as practicable and in any case within 90 days.

We note that our clients would find, in general, a service level of 90 days as well outside acceptable standards. However, we also recognise the potential benefits this may produce by imposing a minimum standard. We also note that if an employer paid their mandated contributions quarterly, it would be desirable to make a single benefit payment.

The draft Regulations do not require transfer of benefits being paid as pensions (other than allocated pensions), benefits from unfunded public sector superannuation schemes or self-managed superannuation funds, or defined benefit funds.

The Government originally planned to gazette finalised regulations in June 2003, with a commencement date of 1 July 2004. (reference: Assistant Treasurer's media release C040/03—25 May 2003)

The draft Regulations were referred to the Senate Select Committee on Superannuation on 17 June 2003 with a report due on 21 August 2003.

We note that, at the time of preparing this submission, the Treasury had not released any revisions to the original draft of the Regulations.

2. Lack of explanatory statement

We note the draft Regulations were released without a draft explanatory statement. As a result, the intent of some of the draft Regulations is unclear.

3. Portability already exists on leaving employment

Most superannuation fund members already have the ability to move their superannuation benefits between funds when they leave employment¹. In fact, for many employer-sponsored funds, they are required to do so. In addition, members of retail superannuation funds and self-managed superannuation funds can move their benefits between funds at any time.

As a result, the effect of the draft Regulations for most superannuation fund members would be that they could move their *existing* superannuation benefits between funds *while remaining in employment*.

4. Relation to Choice of Fund Bill

The Government intends to implement its policy of superannuation choice using two measures:

- (i) giving members choice of fund for *existing* superannuation benefits by the draft Regulations (“portability”) and

¹ The notable exception to this rule is that members of certain unfunded public sector schemes where benefits must be retained in the fund, or transferred to one of a very restricted list of other unfunded public sector schemes, until retirement age. We have not considered the effect on these members in our submission.

- (ii) giving members choice of fund for *new* superannuation contributions by the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002² (“choice of fund”).

Both measures are intended to commence from 1 July 2004.

We cannot emphasise strongly enough how important it is that the gazettal of the portability draft Regulations be linked to passing of the Choice of Fund Bill. If these measures are separated, the result would be an increase in fees and expenses, with very limited benefits.

If the portability draft Regulations were gazetted without passing the Choice of Fund Bill, it would increase the incidence of members having benefits in multiple funds (with related duplication of costs), rather than decrease it. For example, after a member transferred current benefits from an employer-sponsored fund to another fund, new contributions would continue to be paid to the employer-sponsored fund.

In addition, there would be the possibility of a member transferring contributions between funds on a monthly basis, as soon as they are received from the member’s employer, although benefit payment fees are likely to limit the extent of this occurring. This possibility would circumvent the intended effect of awards and Australian Workplace Agreements.

We note in passing that the direct effect of the Choice of Fund Bill would fall mainly on employers and members, whereas the direct effect of the Portability Regulations would fall mainly on members and funds.

5. *Lost accounts*

The Assistant Treasurer, Senator Coonan, has stated (media release C040/03—25 May 2003):

“Portability will allow Australians to transfer benefits from their current superannuation fund to a fund of their choice. This will allow members to consolidate their superannuation benefits into one fund if they so wish. Maintaining superannuation benefits in multiple funds can significantly erode an employee’s retirement benefit and lead to lost superannuation accounts.”

We disagree with Senator Coonan’s inference that the proposed regulations will affect the issue of lost superannuation accounts. As noted in point 3 above, most members already have portability of their benefits once they leave employment. The Australian Taxation Office maintains a Lost Members Register. Individuals can check the register at no cost by contacting the ATO. Superannuation funds can check the register for their members, subject to certain controls, using the SuperMatch facility.

Members tend to have benefits in multiple funds because they *do not take advantage of the existing facility to transfer benefits* rather than because of a lack of portability. (Of

² This Bill was considered by the Senate Select Committee on Superannuation last year and is currently awaiting debate in the House of Representatives.

course, some members have benefits in multiple funds because of a deliberate decision to spread their risk or to avoid benefit payment fees.)

6. *Potential impact on fees*

In the media release quoted in point 5 above, Senator Coonan stated:

“Portability will also benefit Australians by creating greater competition in the superannuation industry, placing downward pressure on fees and charges.”

We are not convinced that the claimed “downward pressure” on fees and charges from Portability and Choice of Fund will necessarily lead to higher benefits for superannuation fund members for a number of reasons.

- (i) Any competitive pressure would be offset to a degree by extra costs of marketing and advertising (see section 7 below). In the past, marketing for non-profit funds was often limited to promotional work to employers and to assisting existing members obtain the greatest benefit from the funds. In an environment of Portability and Choice of Fund, marketing will become a greater expense.
- (ii) There is already a significant regulation cost for funds, which is likely to increase with the current Financial Services Reform requirements and the forthcoming Safety in Superannuation requirements.
- (iii) While transfer costs for portability will often be reflected in entry and/or benefit payment (exit) fees on a user pays principle, all fund members will bear a portion of the one-off cost to update disclosure materials. This comes at a time when most funds will recently have reprinted their main disclosure documents as Product Disclosure Statements under the new Financial Services Reform regime.
- (iv) If portability is introduced without Choice of Fund, duplication of administration fees will increase. Benefit payment fees may also be increased to recoup the additional administration required for a partial payment (see point 8 below).
- (v) Employers and employer associations will be less likely to subsidise the running of superannuation funds.

7. *Marketing expenses and commissions*

The issue of marketing expenses is a significant concern. The majority of our clients are industry funds. As non-profit organisations, fees are charged to members at a level set to recoup expenses. Accordingly, these funds have considerably lower resources for marketing compared to large, retail providers.

It has been argued repeatedly that there is a general lack of financial literacy in the community, particularly in relation to superannuation, and that it is difficult for many superannuation fund members to make an informed choice.

This problem is exacerbated by the large number of younger superannuation fund members who see superannuation only as an issue for many years in the future. Even if financially literate, these people do not usually give sufficient time and consideration to making superannuation decisions. The compulsory nature of superannuation means that this can be a significant problem. For example, one large client has a membership of whom 65% are aged 35 or less.

There is a strong concern that retail superannuation providers with large marketing budgets will be the greatest beneficiaries of a portability regime, with non-profit funds the largest losers. This would not be of benefit to most fund members.

This concern is supported by the *ANZ Survey of Adult Financial Literacy in Australia—Final Report*, prepared for the ANZ Banking Group by Roy Morgan Research (May 2003) which stated that:

“The survey also highlighted limited awareness of fees, charges and taxes in relation to superannuation:

- *fifty-five per cent (55%) of fund members claimed to know little or nothing about the fees and charges that apply to superannuation; and*
- *only 54% of those with superannuation were aware that it is taxed at a lower rate than other investments.*

...

Around 30% of people either did not read their annual superannuation statement or read but did not understand them “very much” or “at all”. There was generally limited understanding of what constitutes an appropriate level of superannuation.”

In addition, there are concerns that many financial planners are reluctant to recommend non-profit superannuation funds, such as industry funds, which do not pay commissions. These concerns are supported by a recent report, “Survey on the quality of financial planning advice” prepared by Australian Securities and Investment Commission and the Australian Consumers Association (February 2003). This report stated

(i) Under the heading “Non-impartial advice”:

“A common observation by several judges was that clients’ interests did not appear to be the sole factor in the plan strategy or product selection. They characterised this practice as ‘commission-driven product selling, not impartial advice’ ... Recommendations frequently overlooked options that may be more cost-effective: ... low cost superannuation funds—never recommended; ...”

(ii) In more detailed comments on recommendations made in financial plans provided for clients, under the subheading “4.1(c) Suitability of investments—Cost”:

“Many plans did not recommend the lowest cost option available. As low cost options pay no commission, this raised some suspicions about the influence of commission on advice. For example, no adviser recommended switching to a non-profit, industry superannuation fund.”

8. Fee structure

A review of fee structures would be required to reflect the additional costs of this new type of benefit payment on portability. A member may generate either one final benefit payment or several partial benefit payments. Where a partial payment is made and the member continues in the fund, additional work is required to ensure, for example, member benefit protection rules are now not applied. Ongoing contributions also need to continue to be able to be made.

The above will require both administration systems and business processes to be altered. The cost for this transaction will be higher than that for a benefit payment which closes a member's account. Portability, in this regard, will increase the cost of superannuation administration.

We support the view that any fee for this transaction should reflect the actual costs of making or receiving the transaction. We do not support any device such as an artificially high fee, designed to impede portability.

9. Preservation

We note that the portability rules have the potential to allow members to avoid the preservation requirements by repeated transfers of amounts less than \$200 (which may be paid in cash). We believe that this is unlikely to lead to a major outflow of funds from the superannuation system due to the administration/benefit payment fees which apply to most superannuation funds. However, the Committee should be aware of the potential for abuse in this manner.

10. Investment Strategy and Reserving Policy

Some funds maintain a reserving policy, to help smooth investment returns over a period of some years. In such a fund a small number of members may actively use portability to gain an advantage over other members of the fund. This would occur when a return is increased by drawing down part of the investment reserves. In effect a member takes advantage of the higher return to calculate the benefit and uses portability to take what may then be viewed as an unfair share of the investment return.

Some funds set their investment strategy in the knowledge that they will use smoothing and so have a higher proportion of the fund's money invested in assets which over the longer term would be expected to provide higher overall returns. These funds may have to alter their investment strategy to hold higher levels of cash, to the detriment of ongoing members, as a result of portability requiring the fund to have members' long term retirement savings effectively "at call".

Where a fund does not use smoothing and according to its strategy has only a small holding of cash, portability may still require the fund to increase its level of cash holdings. This again may lead to a reduction in the long term benefits available to members.

Short term liquidity needs, due to portability, would work against the members' longer term interests.

Portability could result in funds closing their smoothed investment options. We submit that where a fund offers a smoothed investment option, it should be exempt from the portability regulations as is the case for defined benefit funds.

11. Rollovers and transfers [various proposed regulations]

The SIS Regulations currently use two terms with respect to moving benefits between two superannuation funds: "rolled over" and "transferred" (Regulation 5.01(1)).

The term “transferred” refers to benefits moved between funds when a “condition of release” (e.g. retirement, termination of employment) has *not* occurred. The term “rolled over” refers to all other eligible termination payments within the superannuation system.

The draft Regulations use the terms “roll over”, “rolled over” and “rollover” rather than “transfer” and its derivatives (which might have been expected).

We note that the intent of the draft Regulations is to allow movement of benefit entitlements between superannuation funds at any time, regardless of whether or not a condition of release has occurred. As a result, to minimise complexity, we submit that the legislation (SIS Act, Corporations Act and Family Law Act) should be reviewed with the aim of achieving a consistent use of the two terms “rolled over” and “transferred”, potentially leading to a single term.

If it is intended to retain a difference between the two terms, we would appreciate some clarification on the difference.

12. Member benefit protection [proposed Regulation 1.03B]

We note an inequity in relation to the proposed changes to the benefit protection standards (Part 5 of the SIS Regulations).

The member benefit protection standards aim to prevent small superannuation benefits from being eroded by fees and charges. In general (and with some exceptions), the standards provide that if a member’s withdrawal benefit is less than \$1,000, the fund must “protect” it by limiting fees and charges to a maximum of the investment earnings applied to the benefit in a year.

In effect, this is a compulsory cross-subsidy of members with small accounts by those with larger accounts. Compliance with the member benefit protection standards also results in a small increase to administration expenses.

Items 1-3 of the draft Regulations amend the definition of a “protected member”. The proposed new Regulation 1.03B(3) states:

“If the trustee of a regulated superannuation fund has rolled over an amount that is the whole or part of a member’s withdrawal benefit to another regulated superannuation fund or to an approved deposit fund, RSA or EPSSS in accordance with Division 6.5, the member is not a protected member of the fund from which the amount was rolled over.”

This means that if a member transfers money from one fund to a second fund in accordance with the proposed portability regulations, the remainder of the benefit will not be required to be protected in the original fund (although the trustee of a fund may decide to do so to minimise additional administration). However, the amount transferred to the new fund will still be subject to protection.

We submit that this has the potential to increase the costs and cross-subsidies of member benefit protection, particularly if a member transfers amounts smaller than \$1,000 to multiple funds. To avoid the potential of portability increasing the overall cost of member benefit protection, we suggest that the draft regulations be amended to introduce a minimum transfer amount.

Based on the insurance concerns set out in section 13 below, we also suggest that a minimum account balance be maintained where ongoing employer contributions will continue to be made.

We recommend that the member benefit protection requirements be completely reviewed in conjunction with the introduction of Portability and/or Choice of Fund.

13. Benefits funded by insurance [proposed division 6.5]

Insurance is a complex area in the already complex subject of superannuation. It is not clear what the effect of portability will be on the terms and conditions of the insurance policies held by most superannuation funds to provide death and/or disablement cover for their members.

We note that members of superannuation funds usually benefit from wholesale “group insurance” policies which offer particularly cost effective premiums and insurance cover without the need to undergo a medical examination or provide other evidence of health (for employer-sponsored members). This is certainly the case for our industry fund clients.

The above insurance basis may be undermined by portability and, in particular, with Choice of Fund as aspects of the insurance would move closer to a retail/individual basis. This would result in:

- members paying higher premiums;
- some members being required to take medical examinations;
- some members being declined insurance or only able to obtain limited insurance; and
- restrictions on, or even the loss of, other member benefits such as the Continuation Option which allows a member to obtain some insurance cover after leaving the service of the current employer, without the need to provide any medical evidence.

A member may not appreciate the insurance implications of Portability and Choice of Fund. Depending on a member’s personal circumstances:

- insurance may cease in the original fund but not be obtained in the new fund;
- a member who transfers a partial benefit may be required to pay premiums for a compulsory level of insurance in multiple funds, regardless of that member’s needs;
- a member wishing to retain the insured benefits in the original fund may have left an insufficient account balance to support this benefit, again resulting in a loss of benefits.

We submit that to protect members’ benefits, a member of a superannuation fund which expects to receive ongoing employer contributions should be required to retain a minimum account balance to ensure there is no loss of insured benefits.