Investment & Financial Services Association Ltd
ACN 080 744 163

22 July 2003

The Secretary
Senate Select Committee on
Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Mr Frappell

Reference:

Portability of Superannuation

The Investment and Financial Services Association represents Australia's leading investment managers and life insurance companies who are responsible for investing approximately $620 billion on behalf of over 9 million Australians.

IFSA supports the portability of superannuation benefits as a key consumer sovereignty measure. Superannuation is the private property of individuals saving for their retirement, and should be subject to only those constraints required to achieve retirement incomes policy objectives. Ability to choose, and change, among licensed superannuation providers is a basic consumer entitlement.

The draft regulations would provide an important improvement in the ability of Australians to place their superannuation in a fund of their choosing.

Currently, many Australians are not able to move their superannuation to another superannuation fund or superannuation provider unless they satisfy a trigger event or condition of release under the Superannuation Industry (Supervision) Act and Regulations (SIS). The draft regulations would extend the options available to these people.

Full and effective disclosure is a critical component of consumer sovereignty. IFSA continues to support effective fee disclosure in financial products, and believe the financial sector reform legislation will achieve effective disclosure. Disclosure reinforces consumer sovereignty, while some forms of regulation may actually militate against sovereignty. Regulation that inappropriately limits competition is particularly likely to erode consumer sovereignty.

Effective prudential regulation is also an important element of consumer sovereignty in superannuation. Individual consumers may not feel they have the capacity to assess the safety and capacity of superannuation providers, and so an effective licensing regime will improve consumers' confidence in making selections. IFSA

Level 24, 44 Market Street, Sydney NSW 2000 Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au Fax: 61 2 9299 3198

has supported the superannuation safety review, and continues to participate actively in the development of the new legislation.

Current portability of superannuation benefits

Retail superannuation

There are few, if any, limitations on the ability of individuals to transfer balances out of superannuation funds offered by IFSA member companies. Full portability of superannuation is already available to retail investors.

- Retail (personal) superannuation funds do not restrict the circumstances in which consumers can transfer their personal superannuation out of a fund. Customers can request part or full balance rollovers.
- The majority of corporate superannuation plans in retail (employer) master trust arrangements do not restrict the circumstances in which consumers can transfer funds. Part balance rollovers are widely available from these master trusts although minimum balances may be required to prevent triggering member protection.
- Some corporate superannuation plans in retail (employer) master trust arrangements may require a SIS trigger event (usually leaving the employer) before transferring benefits.
    - In some cases, employers prefer that a SIS trigger event occur before transfer.
    - In some cases, the SIS trigger event rule is part of the master trust's offering to employers.
    - In either case, the employer may be offering employees choice of superannuation fund, and those employees who prefer another fund, or a fund with no transfer limitations, would not be in this master trust.

Retail (personal) superannuation funds and retail (employer) master trusts do apply various business rules to remaining balances after a rollover.

- Personal superannuation accounts are offered subject to minimum balance requirements as disclosed in offer documents. Remaining balances below these minima may be closed.
- Corporate superannuation plans in retail (employer) master trusts may have varied business rules on minimum account balances

Where an account is to be closed after transfer because the account would be below a minimum balance requirement, retail funds have indicated they would prefer to send the remaining amount to the chosen destination funds, rather than to an eligible rollover fund.

Other superannuation funds

IFSA understands that some, perhaps many, corporate superannuation funds (funds offered by employers, as opposed to master trusts) require a SIS trigger event before transfer. This would usually be leaving the employer by resignation, retirement or retrenchment.

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IFSA understands that some multi-employer funds also require a SIS trigger event before transfer, and that some further restrictions may apply as well – such as those intended to retain an account unless the member has left the industry in which the fund operates. We understand that these requirements have decreased in recent years, particularly among the multi-sector, multi-employer funds.

Defined benefit funds generally do not allow portability of superannuation benefits, for reasons that are widely accepted. Unfunded defined benefit superannuation schemes routinely restrict portability of benefits, even after a member has left employment. In many cases, the design of the fund or scheme is such that a transfer amount could not be calculated – for instance, where an employee has not left employment. However, many members of defined benefit funds could be readily provided with a transfer value, and some members of hybrid schemes already have an accumulation-style balance amount yet cannot transfer that balance.

Barriers to portability

Direct barriers

As outlined above, the principal barrier to portability occurs where fund or scheme procedures require a SIS trigger event, a SIS condition of release, or some other condition, before a transfer is permitted. The draft regulations would overcome this barrier.

Exit fees

The terms of reference specifically mention exit fees. Importantly, exit fees do not directly prevent transfer of benefits, as some superannuation fund rules may do.

Exit fees on superannuation funds and products fall into four broad categories.

- Recovery of administration and transaction costs. Completing a transfer of superannuation requires significant administration, to ensure that the transfer has been successful not only in moving monies, but also to ensure that the receiving fund is a complying fund, that it will accept the transfer, and that the transferring fund has sufficient information to ensure that any surcharge liability is effectively passed to the receiving fund. Transfers may also involve transaction costs on fund assets, including adjustments to tax provisions. This fee is usually a dollar-based, fixed fee.
- Deferred entry fees. The investor chooses not to pay an entry fee for advice, and instead to pay higher ongoing fees. The product provider pays the advice fee to the adviser up front, to pay for the advice given to the member. They represent no more than 5% of the member's balance. A reducing exit fee applies to recover the balance of the commission, should the investor leave the fund within a set period. The exit fee reduces to zero after a set period, for example five years, allowing the investor to amortise the cost of advice. A number of superannuation funds offer this option.
- Early termination fees in closed products. These fees were set in superannuation products offered through life insurance offices, and recovered up front costs incurred by the life office. They are often calculated on the first year's premium and reduce over a set period of, say, five years. The proportionate impact of these fees also reduces the longer a product is held

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because the first year's premium becomes a smaller and smaller proportion of the balance.

- Early termination of contract (traditional policies – whole of life, endowment or pure endowment). Traditional policies were structured on a long-term basis usually comprising an investment and, in earlier years, an insurance component. The contracts operated on the basis of a guaranteed maturity value at a date in the future. Up front costs were incurred meaning that in the first few years of operation, the surrender/cash value of the policy was nil, or significantly less that what had been paid in. Defaulting on the contractual terms would create a significant gap between what would have been paid, both as a guarantee and in bonuses, had the contract run to maturity. Provided that clients have met the conditions of the contract, most traditional super policies have probably been in force for so long that this position no longer applies. These contracts were formulated in a very different environment and, given their long-term structure, do not suit early withdrawal or partial cashing (although bonuses may generally be taken early). These contracts are no longer offered.

Termination or exit fees, which simply meet the administrative and transaction costs of a transfer, do not represent barriers to exit. These costs only arise as a consequence of the member's request for transfer - it would be inequitable to subsidise them from the remaining members of the fund.

Deferred entry fees are usually offered to investors in retail superannuation funds as an alternative to entry fees. Generally, fee structures are flexible and investors can choose the structure they prefer. These fee options are subject to disclosure requirements. Since fees reduce to zero over a period of up to five years, deferred entry fees do not represent a significant barrier to portability.

Superannuation products with early termination fees, or adjustments for early termination of contract, were commonly offered in the 1980's but the life insurance industry has moved away from offering such products. Most have been closed for more than ten years. These 'old style books' are being run down progressively and they are estimated to be less than 5% of funds under management of all retail funds and master trusts. As such, they do not represent a significant proportion of the retail superannuation market.

IFSA is a strong supporter of full and effective disclosure of all fees and costs in superannuation, and has worked closely with the Australian Securities and Investments Commission (ASIC) to develop a comparative fee template.

In summary, IFSA does not believe that exit fees represent a significant barrier to the portability of superannuation accounts. We do not believe a compelling case has been made to regulate exit fee levels. We do believe that regulation of exit fees would be counterproductive from a competition, choice and product design perspective. Capping of exit fees would be particularly counter-productive: we are firmly of the view that fees would tend to rise to match the level of the 'cap'.

It would be very disappointing indeed if a small proportion of closed products with early termination style exit fees were to stand in the way of opening superannuation to higher competition and greater consumer sovereignty.

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The draft regulations

IFSA has made a number of comments on the draft regulations directly to the Treasury during the earlier consultation processes. Our concerns have generally been met, particularly in the draft provisions concerning information from the transferring member.

We have suggested some minor changes to Treasury on these draft regulations.

- We suggest the trustee need only comply with one transfer request in a given year. In drafting terms, the obligation should only be mandatory if no request has been made in the preceding twelve months.
- We suggest that trustees be able to close a transferring account under the fund's business rules – in particular minimum balances – and send the remaining account balance to the destination fund with the bulk of the transfer. This would further assist account consolidation, and would more accurately reflect investors' preferences than would sending the remaining balance to an eligible rollover fund.

IFSA accepts the carve-outs for defined benefit and unfunded superannuation amounts. While it might be argued that all Australians should be able to choose the superannuation fund their retirement savings remain in, this would be difficult to calculate in some defined benefit arrangements.

Consumer protection measures

IFSA believes that consumer protection is best achieved though full and effective disclosure, and by effective conduct and prudential regulation.

IFSA has been active in developing uniform and effective fee disclosure measures. We believe the financial sector reform legislation has improved, and will continue to improve, disclosure to consumers, and that its licensing provisions will improve the quality of financial advice offered to consumers.

Given the processes to address both disclosure and prudential safety in superannuation are well underway, IFSA does not believe further measures in either field are required in portability provisions.

Thank you for the opportunity to comment.

Yours sincerely

Richard Gilbert
Chief Executive Officer

Level 24, 44 Market Street, Sydney NSW 2000 Ph: 61 2 9299 3022
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