CHAPTER 6

OTHER IMPLEMENTATION ISSUES

Introduction

6.1 The 1998 inquiry into choice concluded that there was a strong case for setting minimum standards for default funds, since it seemed likely that significant numbers of superannuation accounts would default to such funds.[1]

6.2 Under the proposed choice of fund legislation, the employer will need to pay contributions into a default fund when an employee does not have a chosen fund and does not choose one when given a chance. The reasons some may be indifferent to exercising a right to choice include:

- low levels of literacy or numeracy where employees lack confidence or feel unable or unwilling to choose; and/or
- lack of interest in making a choice.

6.3 There may also be substantial numbers already in such funds who are satisfied with their current superannuation arrangements and will actively exercise a choice to remain.

6.4 In the two years since the 1998 report, expectations concerning the numbers who may use default funds have not changed. In evidence to the Committee at the 1999 roundtable, ASFA asserted that, given the experiences of investment choice to date, and other surveys related to consumer attitudes to superannuation, even with unlimited choice available to them, many consumers, possibly 50 to 70 per cent, will not wish to make an active choice.[2]

Default fund

6.5 A great deal of the discussion at the roundtable focussed on issues connected with default funds, including how and by whom the default fund would be chosen; provision of appropriate insurance cover; asset allocation and frequency of payment of contributions. These issues are discussed below.

6.6 In reflecting the evidence on these issues, the Committee was mindful of other implementation issues raised by participants relating to the confusion surrounding the different federal and state choice arrangements, the need for consistency between

---

1 *Choice of Fund*, p. 57.

2 Submission No. 15, p. 12 and Hansard, p. 76.

these regimes and ensuring that the cost burden associated with the implementation of choice was minimised.

Selection of the default fund

6.7 There was a range of views on the principles for selection of the default fund. The Industry Funds Forum and the AIST proposed that:

- For existing employees, the default should be their existing fund;
- For new employees, the default should be the award fund where one exists;
- Where there is no award, or an award does not cover certain employees, the fund to which the majority of employees in the workplace belong should be the default fund.[3]

6.8 The Australian Chamber of Commerce and Industry (ACCI) expressed a preference for selecting either the existing fund for current employees or the majority workplace fund for new employees because 'it is a neutral thing.' While acknowledging the existence of a fourth option - that the employer chooses the default fund – ACCI stressed that this would not be an option the organisation recommended to its members, principally because 'it raises questions of employer liability if there are gaps in insurance or whatever.'[4]

6.9 The ACCI's reason for opposing employer selection is:

> … it is not the employer's role to choose. What criteria would the employer use? They are not financial advisers, they do not have a financial adviser certificate. The idea of a small business or whatever choosing superannuation arrangements for their employees is stretching it a bit.[5]

6.10 These views were endorsed by the Australian Society of Certified Practising Accountants as being especially relevant to small and medium business.[6]

6.11 The weight of opinion appeared to be with maintaining the existing practice of the default fund being the relevant award fund where there is award coverage. The ACTU, ASFA, Jacques Martin Industry Funds Administration and the ACA expressed a preference for this option. The latter two organisations commented that many of the existing default funds nominated under awards are industry funds that have desirable features such as portability, low fee structures, industry wide transfer protocols and appropriate insurance arrangements.[7]

---

3 Hansard, pp. 15 and 19.

4 Hansard, p 15.

5 Hansard, p. 19.

6 Hansard, p. 22.

7 Hansard, p. 14.

6.12 The ACTU pointed to other advantages in selecting the award fund:

> …the award funds are specified generally either as a result of agreement between the parties in the industry or a decision of the Industrial Relations Commission that has taken into account the nature of the industry…. the insurance arrangements that apply to award specified funds are generally designed to meet the needs of a particular industry.[8]

6.13 However, ASFA recommended that, in the event that no employment based award existed, and the employee had not made a choice in the specified period of time, the default fund may be nominated by the employer.[9]

6.14 IFSA differed from those who saw no future role for the employer in the selection of a default fund. The Association saw no need to change the current system, where the default fund is chosen by the employer under the current award, even in a choice environment:

> Effectively you have the default fund being chosen by the employer under the current award system, and that seems to us to be effectively, systemically, working across the board.[10]

6.15 Also, in the exceptional case where, for example, the existing default fund becomes defunct, or loses its complying status, IFSA recommended that the employer retain the right to change the default fund.[11]

6.16 This view was contested by, among others, the Australian Consumers' Association which stressed its preference for 'employee' rather than 'employer' choice:

> The other issue is to do with this notion of employer choice. I can understand from the point of view of an employer that it would be best to keep open flexible options. However, from the point of view of the member, it could well be that the corporate incentive is slightly different to the individual incentive. When we have powerful possible bundlings of other financial services at a corporate level which could make it attractive to switch an entire class or category of workers towards a different default fund, that may not necessarily offer the best possible options over the long term. We think it is pretty crucial, although we should talk about the need for flexibility, that choice be driven by people as opposed to companies.[12]

---

8 Hansard, p. 15.

9 Submission No. 15, p. 12.

10 Hansard, p. 16.

11 Hansard, p. 17.

12 Hansard, p. 18.

Insurance

6.17 Many superannuation funds, particularly industry funds, include death and disability cover as part of the superannuation arrangements. While there is no requirement that insurance be provided as part of superannuation, it is nonetheless a very common practice. Further, it is apparently regarded as a very desirable feature by both employees and employers, particularly in high risk occupations where cover is either prohibitively expensive or unobtainable. Concerns were expressed at the roundtable that fund members, especially in default funds, may not have access to appropriate insurance cover in the choice environment.

Continuity of cover

6.18 Currently, many employees in industry funds receive insurance cover as part of the membership of the fund. The large memberships of these funds mean that death and disability cover can be provided at reasonable cost because the economies of scale make it cheaper to buy in the insurance through superannuation. The 1998 inquiry noted that insurers are often prepared to offer immediate cover when an employee commences work, where there is certainty that the employee's contributions will be directed to a particular fund, for example under an award arrangement.[13]

6.19 Choice, particularly unlimited choice, injects an element of uncertainty into the situation, since there is no guarantee that contributions will flow to a particular fund. This may effect the previous automatic provision of cover.

6.20 The Financial Services Consumer Policy Centre (FSCPC) indicated that choice had the potential to seriously affect the general availability of affordable insurance cover:

> We basically think that superannuation choice has the potential to undermine affordable access to life insurance. Indeed, fragmentation may result in funds and insurers lacking the critical mass to enable them to take the risks involved in mass insurance to safeguard against the likelihood of employees losing coverage.[14]

6.21 The Centre also expressed concern about the problem of 'gap insurance'. The proposed legislation allows a total of up to 56 days for the employer to offer, and the employee to accept, a choice of fund. It is possible that new employees may unwittingly be left without insurance cover in this period. The Centre recommended that the employer arrange to continue payments to the employee's existing fund so that continuity of insurance was maintained. [15]

---

13 *Choice of Fund*, p. 60.

14 Hansard, pp. 23-24.

15 Hansard, p. 24.

6.22 In evidence to the Committee, the Superannuation Complaints Tribunal advised that one third of all the existing complaints to the Tribunal concerned a dispute with the insurer about whether the deceased or disabled person was an insured member at the time of death or injury.[16]

6.23 Consequently, employees exercising fund choice may, if not adequately advised, be unaware of whether they will be insured under their chosen fund, or of the level or nature of that cover.

6.24 ASFA advised that transparent insurance arrangements would be necessary in a choice environment:

> In terms of insurance, the bulk of people at the moment expect that their superannuation covers insurance… The automatic cover… becomes a critical step. If we move into a choice environment and some of the other options which are perhaps being marketed at cheaper rates, and the cover of insurance is not transparent, people unwittingly move into that, and they have caught themselves in a real trap.[17]

6.25 The Australian Bankers' Association also endorsed the need for transparency:

> …part of (the insurance) issue is a disclosure issue about the need for employers to clearly indicate to employees the nature of death and disability cover. We should keep that in mind.[18]

Cross-subsidies in industry funds

6.26 Phillips Fox Actuaries & Consultants identified the inherent cross-subsidies which are currently a feature of industry funds as a serious issue under choice. The company advised that, if large numbers of low-risk members move to other funds offering lower cost structures:

> Some of their members may not be insurable because they are in dangerous industries. There is a tendency for the younger members to subsidise the older, for females to subsidise the males and for clerical to subsidise manual. Any system that has inherent cross-subsidies is going to come under threat in an environment where people can opt out.[19]

6.27 A representative from W M Mercer Pty Ltd agreed with this, adding:

---

16 Submission No. 8, p. 1.

17 Hansard, p. 20.

18 Hansard, p. 29.

19 Hansard, p. 21.

> We have a big concern about the insurance aspects and the default fund being the repository of bad risks. As soon as premiums start going up in those funds, the better risks will opt out and go into another fund.[20]

6.28 The IFF advised that, although obtaining cover is not a problem at this stage:

> The models to date that have been proposed by the government have all included, as an element of concern for insurers, that the industry funds might become the repository of bad insurance risks. The insurers have said to us that if that is the case, then we will need to review our entire insurance arrangements because they are not priced on that basis… Some of the insurers have expressed to some of the funds that they might need to withdraw from the market if industry funds …become the repository of bad insurance risks.[21]

Cost of insurance cover

6.29 Several participants noted that the cost of insurance cover is already tending to increase and this trend may escalate with the advent of choice. Jacques Martin Industry Funds Administration attributed this to the fact that:

> …most insurers priced the product wrongly when compulsory superannuation first arrived—they under costed….So there is a movement amongst insurers to get their pricing right. That is driving costs up, obviously, but in a choice of fund environment, we think also that the insurers are very aware that people will anti-select. They will move around because of insurance options…[22]

6.30 Westscheme Superannuation Fund related its experience of insurance under the choice scheme introduced in Western Australia:

> In the first half of (1998), we were looking at changing our insurer. We went to the market looking for renewal of the terms that we were then on. We found that the insurer that we were with was extremely cautious about the offer that we had had from 1993 up to that stage. They had increased the premium and they were certainly looking for further increases for the same amount of cover, and they were looking at changes in terms and conditions which, in effect, reflected an increased cost of insurance to be borne by the members.
>
> We found that a number of other insurers, having looked at what we wanted to cover, then said that in the context of choice of fund they were unsure what the experience would actually be. So I think they were reflecting this

---

20 Hansard, p. 15.

21 Hansard, pp. 14-15

22 Hansard, p. 28.

> issue—that our experience might be more adverse with people selecting against us and bringing people into Westscheme as a default fund. [23]

6.31 ASFA advised the Committee of a further problem in the insurance market, namely that the availability of group insurance is contracting. ASFA explained:

> …in 1997 I think there were 12 major insurers in Australia providing that form of group cover. By 1998, it had dropped down to eight insurers, so it shows that that market is, in fact, becoming more shallow.[24]

Level of insurance cover

6.32 The participants reflected a wide range of views on whether there should be a mandated minimum level of insurance cover and what that level should be. It was indicated that it could be difficult to set a minimum because of the range of variables that exist.

6.33 The IFF noted that the basic level of cover varied considerably from industry to industry, depending on the relative degrees of danger in particular occupations:

> …where there is likely in particular to be (Total and Permanent Disability) and to a lesser extent death exposure, then the amount you get is simply not comparable with what you might have in a fund that largely comprises white collar workers. It might be a ratio of five to one, for example. [25]

6.34 AMP Financial Services noted that industry funds once had a basic level of cover priced at $1 per week but now offered a greater variety of options. The company advised that the need for death and disability cover had to be balanced against ultimate retirement savings, adding that the balance also needs to take account of individual needs at a particular stage:

> I think you have to be a little bit careful because of the needs of the individual, if we are looking at choice as being the individual choosing the options that best suit their needs. For a person who is aged 35 who has five children and has a high need for a reasonable level of insurance cover, at that point in time it might not be unreasonable for a higher percentage of their SG to be absorbed into (insurance).[26]

6.35 The ACA noted that the target audience also had to be taken into account when considering a basic level of cover:

> If you are looking at the self-funding of retirement benefits, then disability cover, whether it is by insurance or otherwise, effectively puts people in a

---

23 Hansard, pp. 22-23.

24 Hansard, p. 25.

25 Hansard, p. 27.

26 Hansard, p. 27.

> position to self-fund their retirement. There are problems, particularly in the accumulation schemes where there is insurance based disability cover, in providing adequate retirement income or adequate insurance to match what people would have accrued had they continued working until normal requirement. In typical examples of industry funds, the base levels of cover do not get anywhere near that for most people.[27]

6.36 It was evident that while some favoured a mandated level, others did not. IFSA indicated that it did not consider that such constraints were necessary:

> At the end of the day, we would be quite disappointed to see some minimum mandated level or style of insurance, because we do think that the market is already starting to show evidence of addressing these issues.[28]

6.37 The Financial Services Consumer Policy Centre did not share this viewpoint:

> As opposed to so many of the organisations which represent industry, we are not as sanguine about the ability of the free market to regulate itself in such a manner as to actually provide the right cover. We believe that it is a task of government to codify and to put in place—into awards or whatever the relevant area is—the relevant default and life insurance provisions.[29]

6.38 However, W M Mercer Pty Ltd took up IFSA's reference to employer-provided insurance as a possible solution to the insurance conundrum, provided that tax implications could be addressed:

> One of the solutions which we have not really mentioned today on insurance is for employers—and many employers would be happy to do this—to take out a bulk insurance contract on all of their employees, perhaps outside the superannuation environment. What many employers do not want is to find that one of their employees is not covered for insurance because they chose the wrong fund or deliberately chose not to be covered. The employer is going to feel some sort of moral obligation to that employee. He will consider making ex gratia payments to the widow and so on. To avoid that, some form of bulk employer sponsored insurance could be very useful.
>
> However, one of the problems we have there is the current tax system and the complexities of tax on that sort of insurance arrangement outside superannuation, where we have potential for FBT, CGT and a whole range of taxes applicable on that sort of product. If the government could simplify those arrangements, we could have a feasible alternative.[30]

---

27 Hansard, pp.27- 28.

28 Hansard, p. 17.

29 Hansard, p. 24.

30 Hansard, p. 72.

Asset allocation

6.39 Participants noted that current default funds, many of which are industry funds, provide internal investment choice covering a range of options. However, several groups indicated their preference that minimum standards under choice should include provisions for appropriate asset allocation standards for default funds.

6.40 Drawing attention to the probability that the majority of members in default funds would be those who were unlikely to have the relevant financial expertise, education level or desire to personally make the correct investment choices to maximise their retirement savings,[31] ASFA, ACA and the IFF recommended that a default fund should be a balanced fund including long term capital growth. The FSCPC also nominated this as one of the essential features of any default fund.[32]

6.41 However, IFSA contended that difficulties might arise in mandating particular investment choices, in particular, defining asset classes:

> … we look at issues like asset allocation and fees on default funds, and we say that those issues should be separated from the discussions of choice. We do not try to mandate asset allocation in default funds today, and we know from the APRA statistics that, … while there are isolated examples of people ending up in cash arrangements, the actual overall systemic figures show that we do not have a lot of people sitting on cash.
>
> If we want to start thinking about mandating asset allocation inside default funds, we are going to have to start to think about how you legally define asset classes. In my experience that is an incredibly difficult thing to do. [33]

6.42 The Industry Funds Forum, while supporting asset allocation, did not agree with IFSA that it would be difficult to define asset classes. IFF also pointed out the adverse long term effects of cash options alone:

> The second point relates to whether a default fund should have a stipulated investment mix. We would support the views of the Financial Services Consumer Policy Centre to suggest that a balanced option, however defined—and I do not think it would be as difficult to define as perhaps others—should be the default model, because if cash is the default model everyone around this table would understand the long-term adverse implications of that for members.[34]

6.43 In addition, ASFA considered that the choice environment would necessitate stronger safeguards for default fund members, such as asset allocation:

31 Hansard, p. 23.

32 Hansard, p. 14.

33 Hansard, p. 16.

34 Hansard, p. 19.

> …because the choice environment will by itself necessitate those safeguards to be stronger than they are now. I think it will necessitate, in particular, certain minimum standards, particularly in relation to insurance and also to having either balanced or growth orientated standards being there in terms of the default schemes.[35]

6.44 The Australian Consumers' Association also saw a need to improve current arrangements for a choice environment. The ACA suggested a further refinement for an asset allocation system, while acknowledging that an increased level of sophistication in default finds would have cost implications:

> We agree that the current arrangements may well be a good framework for default mechanisms, although we do not necessarily agree that, simply because things are as they are, they could not be improved. We certainly share the broad policy objective that there should be a net gain in terms of choice in superannuation and, of course, we measure that not only from the opportunity cost of being in cash over too long—which could well not be a big problem—but also the risk of being exposed to risk at the wrong period of life.
>
> … in the United Kingdom…the concept of a tracker fund which matches risk with age in relation to default is an interesting one. We have a problem here: the more we rely on default funds by weight of market force, the more sophisticated they need to become to keep up with the more contestable models, and that is expensive in relation to switching mechanisms and the like. However, we are hopeful that the industry can cooperate to compete, particularly with respect to e-commerce standards—they should be open standards and very functional in relation to portability.[36]

Frequency of contributions

6.45 The Superannuation Guarantee (SG) came into effect on 1 July 1992. It was introduced to reduce reliance on the age pension as a means of funding retirement for individuals. The SG legislation requires employers to contribute a prescribed minimum level of superannuation for employees each financial year. The statutory contributions for any financial year are to be paid by 28 July in the next financial year. The ATO is responsible for ensuring that employers comply with their SG obligations in accordance with the SG legislation.[37]

6.46 The majority of evidence to the Committee indicated that it would be preferable for employers to make payments on a monthly basis if choice of fund is

---

35 Hansard, p. 20.

36 Hansard, pp. 17-18

37 ANAO, *Superannuation Guarantee, Australian Taxation Office,* Report No. 16, 1999-2000, pp. 11 and 23.

introduced. This view was put by industry funds, such as the AIST and the IFF, and by ASFA.[38]

6.47 In its submission, IFF pointed out that the reasons for this were:

- The spirit of the *Superannuation Industry (Supervision) Act 1993* requires trustees to take an active role in the collection of arrears and monthly contributions enable trustees to undertake this task more efficiently;
- Insurance coverage is currently based on a regular monthly payment of contributions by the employer; and
- A movement to monthly contributions payments means that employees receive a greater benefit from compound interest.[39]

6.48 An advocate for the ACA advised that there were two good reasons for more regular payments and that these related to identifying recalcitrant employers and ensuring continuity of insurance cover. The representative told the Committee:

> The first is the identification of recalcitrant employers who do not pay more regularly. I think there are problems with that at the moment in the collection mechanism through the Australian Taxation Office—the identification of employers who are not paying and then chasing them up and collecting the money. …Also, if an employer goes belly up halfway through a year and, if instead of six months worth of contributions, there is one month's worth of outstanding contributions because they have been paying up until that point, the loss is less for the employees. That is a major problem. I have seen many examples of workers who have been left out of pocket by thousands of dollars in unpaid superannuation contributions because employers have either never paid or paid only on an annual basis and the employer has gone belly up in the meantime.
>
> The other issue—which has, to some extent, been addressed previously—is insurance. Insurance is usually provided by way of premiums paid on a monthly basis. The cover for disability usually extends for 30 days or one month from the date of the last contribution. For death cover you can continue for up to six months. So if you have an employer who has not paid the contributions from which the premium is deducted to maintain the insurance cover and they have not paid it for a six-, nine- or 11-month period, there is a risk that the person will be uncovered. Again, I have seen many examples in private practice of employers who have not paid up to date and they have gone belly up or the employee has stopped work because of a disability and the insurer has said that they are not covered. Some of the larger funds and industry funds have arrangements with their insurers whereby they will maintain the cover if the contribution and the premium is

38 Submission No. 5, p. 2, Submission No. 1, p. 2, and Submission No. 15, p. 5.

39 Submission No. 1, p. 3.

> paid within a certain period of time, but that is not across the board and it is an issue that needs to be looked at.[40]

6.49 At the roundtable, ASFA acknowledged that quarterly payments 'would be a step forward' but the Association reinforced its view that monthly payments would address the insurance issue more effectively than quarterly payments.[41] The ACTU also expressed its support for monthly payments.[42]

6.50 Jacques Martin Industry Funds Administration also advised that, from the point of view of a fund administrator, monthly contributions were supported as this made it easier for administrators to identify when payments were missing.[43]

6.51 William M Mercer Pty Ltd added its support for monthly contributions, but emphasised that it should come in conjunction with a review of the penalties under the SG legislation. The company suggested that 'some greater flexibility in the penalty structure would be necessary if we moved to monthly contributions.'[44]

6.52 The Australian Society of Certified Practising Accountants indicated that it had yet to come up with a view on the frequency of SG contributions, but that the Society would probably favour quarterly over monthly contributions because of the administrative costs for small employers. The ASCPA also indicated that moving to quarterly payments would be more consistent with the move to quarterly GST instalments.[45]

6.53 In response to this suggestion, the IFF pointed out, that in its view, there appeared to be no relationship between payments that are made to government, and employee entitlements.[46]

6.54 The employer group, the Australian Chamber of Commerce and Industry, supported quarterly payments. The ACCI explained its position to the Committee as follows:

> … if you have a provision in the Act about frequency of payments quarterly … then that does remove a lot of the remaining purposes of awards in the superannuation area apart from notional earnings base, which is an extraordinarily important issue for cost reasons.[47]

---

40 Hansard, p. 54.

41 Hansard, p. 57.

42 Hansard, p. 55.

43 Hansard, p. 54.

44 Hansard, pp. 54-55.

45 Hansard, p. 55.

46 Hansard, p. 80.

47 Hansard, p. 56.

Summary

6.55 Witnesses drew attention to a number of other issues which need to be addressed as part of the proposal to introduce a choice regime. The need for consistency between federal and state regimes and the need to minimise the cost burden associated with the introduction of choice were raised.

6.56 In relation to other implementation issues, witnesses generally supported maintaining the existing practice of the default fund being the relevant award fund where there was award coverage. Where there was no award coverage, the favoured option was that the majority fund in the workplace should be the default fund.

6.57 The arrangements to ensure continuity of insurance cover in order to provide appropriate protection for employees; the need to address the problems of cross-subsidies and the questions of the cost and level of insurance cover, were also emphasised by witnesses. A number of witnesses also recommended that asset allocation be a minimum standard for default funds.

6.58 Almost all witnesses favoured monthly, or at least quarterly contributions by employers to employee superannuation funds, instead of the current annual contribution. Some witnesses pointed out that there were advantages, particularly for small business, to contribute quarterly to be more consistent with taxation requirements.