

CORPORATE SUPER ASSOCIATION

SUBMISSION

TO THE AUSTRALIAN SENATE SELECT COMMITTEE ON SUPERANNUATION

Re

SUPERANNUATION LEGISLATION AMENDMENT (CHOICE OF SUPERANNUATION FUNDS) BILL 2002

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1. Background

The Corporate Super Association

The Corporate Super Association is Australia's representative body for major Not For Profit corporate superannuation funds and their corporate sponsors.

The assets of Association members amount to approximately \$60 billion, representing about 85% of total corporate superannuation sector assets in Australia and some 750,000 individual employee fund members. The dominant position of the Association in the corporate Not For Profit superannuation sector is indicated by the fact that Association member funds total only 2% by number of the total number of funds in the sector, but hold 75% of the assets.

Abbreviations used in this submission

The Association	The Corporate Super Association
SIS Act, SIS legislation	Superannuation Industry (Supervision) Act 1993, and related legislation
FSR	Financial Services Reform Act 2001 and consequent amendments to the Corporations Act 2001
The Issues Paper	Issues Paper, <i>Options for Improving the Safety of Superannuation</i> , issued by Joe Hockey, then Minister for Financial Services and Regulation, on 2 October 2001.
SGAA; SG minimum benefits	Superannuation Guarantee (Administration) Act 1992; minimum support required under that Act

Context of submission

The Superannuation Legislation Amendment (Choice Of Superannuation Funds) Bill 2002 was referred to the Senate Select Committee on 21 August 2002. Submissions on the Bill have been called for by 30 August 2002.

2. Summary of the Association's position

This is an initial Submission and the Association looks forward to the opportunity of expanding on key points at the forthcoming Senate Select Committee Hearings.

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In principle, we support the concept of providing employees with greater involvement in determining the direction of their superannuation savings, particularly if they are well educated and informed about the options available.

Our concerns are broadly as follows:

- We believe that certain aspects of the legislation, as currently proposed, may be unconstitutional.
- The legislation, as currently proposed, has the potential to expose some employers to double liability.
- The legislation may permit employers to abandon award support currently provided in addition to their minimum SG obligations.
- We are concerned about the increased costs which will fall on funds:
 - i. in managing additional entries and exits resulting from the exercise of choice;
 - ii. in adapting funding to cater for lack of predictability in membership levels, and in particular adapting investment strategies to a less stable membership.
- The proposals will have the effect of shifting the focus of superannuation from a collective investment to a retail investment, with individuals making their own choices. This process is likely to result in sub-optimal outcomes for both costs and investment returns. We are also concerned about the potential destabilising effect on long term investment strategies caused by short-term competitive pressures.
- Choice brings with it competition. There is a tension between the advantages of competition and its costs in terms of marketing (which are passed on to the consumer). In this arena, Not For Profit trustees are at a disadvantage, as it is not part of their role to market their funds, they do not have the resources to do so, and furthermore, the legislation regulating the marketing of products (and of interests in superannuation funds) operates to favour those who are operating for profit.
- We believe that so long as it remains advantageous to advisers to encourage investors to enter new products (as a result of high entry fees and commissions) this will work to the detriment of retirement savings, which will be eroded by fees.
- Clarification is required as to the application of the FSR regime to corporate funds and their employer sponsors, so that they can inform employees about the features of any in-house fund without breaching legislation.
- We have concerns regarding the adequacy of the pool of funding set aside for the public education campaign to prepare employees for Choice.
- Overseas experience with Choice of Fund needs to be considered.

A serious long term outcome of the changes is likely to be that employers currently sponsoring their employees in in-house Not For Profit funds will reduce support levels, and ultimately close their in-house funds. This will reduce the level of overall support and the pool of retirement savings for Australians.

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We would welcome any developments which would:

- Make it easier for our funds to inform their members without running the risk of breaching legislation;
- Increase significantly the budget allocation for training the public about superannuation and choice;
- Reduce the incentives for advisers to encourage employees to chop and change between products (e.g. by capping entry fees);
- Exempt from the legislation employers who are currently providing benefits which exceed the minimum SG requirements.

3. Detailed information

Constitutional issues

Taxation Act imposing fines

Proposed sections 32T and 32U would impose fines on employers who make contributions which do not comply with the Choice of Fund requirements. The proposed sections would form part of an Act which deals with taxation, and hence have the potential to be unconstitutional.

Taxation Act excluding liability

Proposed section 32ZA would seek to exempt employers from any liability arising if compliance with choice legislation results in breach of any other law. We would have no objection to such an outcome, but believe that such exclusion of liability cannot be achieved as it would be unconstitutional for an Act dealing with taxation to do this.

We have similar difficulties with section 32Z which states that a Commonwealth or Territory industrial award is not enforceable to the extent that an employee's contributions are made in compliance with the Choice of Fund legislation to a chosen fund or a default fund.

Employers exposed to double liability

We believe that there is a risk that certain employees currently supported in funds whose deeds do not permit reduction of benefits may be able to obtain double support from the employer, by choosing a separate fund from the current employer-sponsored fund and then insisting on the maintenance of support in the current fund as well.


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Possible solutions could include:

- the ability for employers in such a situation to reject the choice by the employee, or
- the legislation permitting the employee to exercise choice under these circumstances only if the employee leaves the employer's fund with the employer's consent.

Potential reduction in employer support levels

The legislation may permit some employers to abandon additional award support currently provided. This could have serious implications for the adequacy of retirement savings and could also lead to industrial relations problems.

Reduction in support may arise because of the operation of proposed section 32Z, which relieves employers from obligations under Commonwealth or Territory industrial awards where an employee's contributions are made in compliance with the Choice of Fund legislation to a chosen  or a default fund.

We believe that the proposed protection provided by section 32Z is necessary, in order to avoid difficulties where an employee chooses a fund other than that specified in an applicable award. However, we believe that the potential problem of reduced overall support could be alleviated by giving employers incentives to provide support which exceeds the minimum SG levels.

Increased costs for funds

We are concerned about the increased costs which will fall on funds as a result of the Choice legislation. These increases will result from:

- managing an increased number of entries and exits;
- potential strains placed on funding due to lack of predictability of membership. This will apply particularly to defined benefit funds. The mix of ages and length of service of members become less predictable. Further, we understand that there is a risk of adverse selection against a defined benefit fund. There is a particularly strong incentive for members with impaired health (and potential claims for disability benefits) and for members with the highest potential salary growth (and hence the most to gain from defined benefits) to remain in the fund; and
- an inability to take the same long term investment approach as is currently adopted by corporate funds when their membership is stable and predictable, resulting in an average reduction in investment returns.

Change from collective to individual investment approach

The effect of permitting full individual choice of fund has to be very carefully managed to ensure that sub-optimal results are not achieved. In its most effective form, superannuation is a collective investment whereby risks are pooled and offset, costs are shared and have minimum

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profit content for external parties. The proposals are likely to have the effect of shifting the focus of superannuation from collective investment pools, to an approach where individuals make their choices from an array of retail offerings. This process, whilst providing greater choice and responsibility to the individual, reduces wholesale savings on services and investments, increases fees on individual transactions, and in general is likely to result in sub-optimal outcomes for both costs and investment returns.

We are also concerned about the potential destabilising effect on long term investment strategies caused by short-term competitive pressures. Where there is a facility for individuals to move from one fund to another on a regular basis, and where there is a body of advisers who have every incentive to encourage this behaviour, (see further below), competition between funds is likely to focus on recent investment performance. Competition on this basis is highly unsuitable when one considers that superannuation savings have a long time horizon.

There is thus a tension between the efficiency achieved by competition and the additional costs resulting from individual choices.

Competition and marketing

Choice brings with it competition. Competition brings with it the need for trustees to inform potential fund members of the relative advantages of the fund they operate (or at least of the disadvantages of leaving it). For those providing financial products in the market, the expense of providing this information is met from a marketing budget, and is part of the operating process for the for profit financial group. The FSR legislation lays the ground rules in terms which are tailored to the situations of these For Profit providers. Employers and Not For Profit trustees, on the other hand, are at a disadvantage. They may in fact be very competitive, but do not actually want to compete – this is not their objective. They are trying to meet their obligations to their employees, or to fulfil their obligations in operating a fund for the benefit of members. They do not have a budget for marketing to members, and hence are at a financial disadvantage. Further, as indicated above, the legislation governing the marketing of products (and of interests in superannuation funds) operates to favour those who are operating for profit.

Erosion of savings by entry commissions

We believe the continued existence of high entry fees and commissions will work to the detriment of retirement savings, which will be eroded by fees. It is inappropriate that the adviser fee structure for a long term savings vehicle should provide incentives to encourage investors to chop and change between products.

Licensing and information provision

We are keen that the uncertainty regarding the obligation for Not For Profit fund trustees to hold an ASIC licence in respect of providing “advice” should be clarified as quickly as possible. We have sought clarification from ASIC on this issue. The uncertainty revolves around interpretation

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of the word “advice” as distinct from “information”. It is important that those of our members who wish to inform their members about the characteristics of their fund should be able to do so without having to suffer the expense of seeking an ASIC licence of the type needed by those who are actively marketing financial products.

Concerns regarding the level of funding for Choice education

We have concerns regarding the adequacy of the pool of funding set aside for the public education campaign to prepare employees for Choice. It is of paramount importance that choice should be exercised by individuals who are fully informed about the characteristics of superannuation as a long term investment. We note that there is a substantial body of belief that superannuation should be treated much in the same way as a bank deposit or other short term investment: see, for example, the assertion in the Issues Paper that “superannuation is essentially a managed investment with special characteristics.....” (opening of section 1.2), and the continuing presumption in that document that superannuation shares the characteristics of bank deposits and managed investments. We believe that if individuals are to exercise choice, they must be better informed about investment as a whole and about the characteristics of long term investment pools and stock market cycles and fluctuations.

Overseas experience

We note with concern the experience in the UK where individual choice of fund has been in operation for some time. We refer to reports on this topic commissioned by the UK Treasury, the Report of the Sandler Review of Medium and Long-Term Retail Savings in the UK: found at http://www.hm-treasury.gov.uk/documents/financial_services/savings/fin_sav_sand.cfm; and the Pickering Report: <http://www.dwp.gov.uk/publications/dwp/2002/pickering/report.pdf>. These reports indicate that the impact of widespread retail commission based sales of medium to long term savings products has operated to the detriment of the consumer.

Essential outcomes for Not For Profit employer sponsored superannuation


Our major concern is that the long term outcome of the changes is likely to be that employers currently sponsoring their employees in in-house Not For Profit funds will reduce support levels, and ultimately close their in-house funds. This will reduce the level of overall support and the pool of retirement savings for Australians.

This is already a very real possibility given the current escalation in fund costs and the difficulty of compliance with FSR and other legislation. The Choice of Fund legislation, and the difficulties mentioned above for Not For Profit funds in complying with it, will add to the difficulties.

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4. Recommendations

We believe that it is important that

- in a Choice environment, our funds should be able to inform their members about their characteristics without running the risk of breaching legislation. Hence, we are seeking clarification of FSR rules on licensing and “advice”;
- incentives for advisers to encourage employees to chop and change between products should be removed or minimised (by capping fees and limiting or banning commissions);
- the budget allocation for public information on superannuation and investment should be increased; and
- exemption from the Choice legislation should be granted to employers who are currently providing benefits which exceed the minimum SG requirements. If such exemption is not granted, the trend will be for such employers to abandon any support which exceeds the statutory minimum. This will have significant long term consequences for the adequacy of ement income provision in Australia.

5. Conclusion

We support the principle of providing employees with greater involvement, education and responsibility in determining the direction of their superannuation savings, provided that it is possible to address the concerns outlined above.