

CORPORATE SUPER ASSOCIATION

SUBMISSION TO

THE SENATE SELECT COMMITTEE ON SUPERANNUATION

ON

DRAFT PORTABILITY REGULATIONS

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BACKGROUND

1.1 *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 \$55 billion, representing about 85% of total corporate superannuation sector assets in Australia and some 750,000 individual employee fund members.

1.2 *Abbreviations used in this submission*

The Association	The Corporate Super Association
The Draft Regulations	Draft Regulations under the SIS Act and the RSA Act, relating to portability of benefits, issued for public comment on 27 May 2003
The Paper	Consultation paper, <i>Portability of Superannuation Benefits</i> , prepared by the Department of the Treasury, Canberra, September 2002
RSA Act	Retirement Savings Accounts Act 1997
SIS Act, SIS legislation	Superannuation Industry (Supervision) Act 1993, and related legislation
ACA	Australian Consumers' Association

1.3 *Context of submission*

The Draft Regulations were issued on 27 May 2003. Treasury invited comments on the Draft Regulations from interested parties. Our Association provided a submission to Treasury dated 11 June 2003.

The Senate Select Committee is now conducting an inquiry into the Draft Regulations and has invited submissions from the public. Our submission to the Committee appears below.

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2 GENERAL COMMENTS

We support the principle that Australians should take responsibility for and become better informed about their personal and retirement savings.

We recognise that the portability proposals have the objective of increasing public awareness of and interest in the management of retirement savings, and we support this objective.

However, to introduce full portability of superannuation in the current context will not achieve the objectives. The move to portability is premature in the context of:

- current standards of public education about investment matters and superannuation generally;
- current public concern about the competency of advisers to provide sufficient information to an imperfectly educated public; and
- current public concerns about the level of information disclosure about fees and charges.

Further, the introduction of portability through regulations in advance of any parliamentary debate about choice of fund in general is inappropriate, as discussed below.

Further concerns arise in relation to the effect on investment returns of the enhanced level of liquid assets required in a fund where members' balances are effectively "at call".

In the context of Not For Profit superannuation provision, in which our members participate, we are also concerned that full portability may leave members worse off. This is a potential result where an individual exercises a choice to leave an efficient collective investment in favour of an individually chosen investment, thereby losing the benefits of scale. These benefits include enhanced negotiating power, pooled resources, reduced fee levels, and greater investment returns arising from the diversification of a collective investment pool.

In addition, members of any fund are at hazard of eroding their savings as a result of potential exit fees and other costs involved in changing funds. These other costs may include commissions paid to advisers and other interested parties both on entry to new funds and on an ongoing basis.

We believe that any transition to portability should occur in a context where:

- individual Australians are well-informed about their choices; and
- the issues associated with choice of fund and portability have been subject to full public debate and parliamentary process.

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3 CONCERNS

3.1 *Broad areas of concern*

3.1.1 Relationship to “Choice” legislation

We are concerned that the changes proposed to be accomplished via regulation represent in effect a broader and more major adoption of the “choice of fund” principle than does the proposed Choice of Super Fund legislation itself.

The broader application arises from the portability regulations as follows. Whilst the proposed Choice of Fund legislation would be limited in its application to prospective contributions, the portability regulations would enable members to make decisions about all their benefits accrued to date and, effectively, prospective contributions (which could be moved from the fund to which they were originally contributed to a “choice” fund on a regular basis, thus effectively achieving choice but in a more cumbersome and wasteful way). We suggest that, since the (effectively) narrower issue of choice of fund for prospective contributions is subject to such significant community debate, it would be an abuse of the regulation making power to introduce a broader form of choice without subjecting the proposals to full Parliamentary process.

3.1.2 Concerns regarding the objectivity of advisers and the risk of “churning”

We refer to the latest review of financial planners conducted by the Australian Consumers’ Association in conjunction with ASIC and published in the Jan/Feb 2003 issue of CHOICE magazine. The ACA’s findings suggested that a significant number of planners involved in the survey did not take sufficient account of their clients’ needs and objectives and made investment recommendations without apparent justification (seemingly to earn the planner commissions). *(Paraphrase of findings reported in ACA press release, accessed on Choice web-site, dated 11 February 2003).*

In an environment in which there is concern that a significant number of transactions risk being commission-driven, there is concern that fund members may be persuaded by such advisers to move their savings around either once or repeatedly, the principal advantage of such transactions accruing to the advisor in the form of commissions (to the detriment of individual savings).

3.1.3 Absence of limitation on frequency of withdrawal requests

As currently proposed, the regulations would not impose any restriction on the number of transfers each member would be permitted to request: hence multiple withdrawals could be made (in some cases on a regular basis after contribution by the employer). This would be costly in terms of administrative process and also, potentially, in terms of adviser fees and entry and exit fees.

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3.1.4 Absence of restrictions on fees

As currently drafted the regulations do not propose any statutory cap on exit fees or other fees relating to transfers under the proposed arrangements for portability. Given the current concern over fee levels, including member understanding and disclosure, it is undesirable to introduce a wide ranging scheme for ready transfer of benefits without setting limits to transfer fees.

3.1.5 Effect of exits on exiting members' benefits and/ or on fund costs

We understand that the absence of a cap on exit and other fees is intended to make it possible for funds to recover from members the costs arising from the choices they make. Inevitably, if benefits can be withdrawn on demand, a different and larger administration structure will be required in funds which are not currently experiencing exits on demand.

Regardless whether the fund or the member bears these costs at the time of the transaction, we wish to point out that ultimately the costs will reduce the accumulated retirement savings of Australians.

3.1.6 Potential effect on fund liquidity and investment returns

Access to accumulation benefits on demand would also change the investment structure for most existing non-retail funds, and would generally result in lower returns.

Trustees, in formulating fund investment strategies, are required, under section 52 of the SIS Act, to take account of matters which include:

- expected cash flow requirements; and
- the ability to discharge liabilities when they fall due.

As a very broad generalisation, the yield from less liquid investments tends to be higher over time than that from more liquid asset classes. Hence there is an incentive to minimise the more liquid investments to the extent that is considered prudent. A related issue is the generally higher return over the long term earned from equity interests as opposed to non-equity investments such as bonds and mortgages. As equity interests are subject to changes in value arising from economic conditions and other market factors, many consider equities best viewed as long term investments rather than liquid assets.

Currently most employer sponsored funds would base their investment strategies on a broad assumption that members will remain with the fund while the employment with the sponsor lasts. Statistics on the age and average service profile of the membership will enable the fund's trustees to estimate timing of benefit payments and hence to determine a long-term investment strategy based on anticipated liquidity requirements.

Ready portability of benefits would alter the liquidity requirements of a fund. In general, the anticipated period of membership would be expected to reduce. In addition, the timing of exits from the fund would be less predictable, hence a higher liquidity reserve would be needed. The

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average holding period for investments would reduce, and as a result of the shorter average holding period, the return on fund assets could on average be expected to decline. Hence, benefits available for members would also reduce. Thus the price of ready portability of benefits would be a reduction in the retirement savings of all accumulation scheme members.

The higher returns achieved by corporate funds, arising from reasons which include their current ability to take a longer view because of the greater stability of their membership, is illustrated in figures provided in a paper on superannuation funds' investment performance released by APRA in February 2003¹.

3.1.7 “One-way” effect for not for profit funds

The proposals favour retail funds, because such funds can promote themselves to the public and invite members. Not for Profit corporate funds, on the other hand, by their nature are established and operated under an arrangement between the trustee and the employer-sponsor and do not seek transfers in from the general public. The existence of standard employer-sponsored funds arises from the obligations of the employment relationship and the meeting of these obligations by responsible employers who take an ongoing interest in safeguarding their employees' retirement savings.

The result of the retail funds' ability to canvass for new members and the absence of such ability for standard employer-sponsored funds is that there will be a one-way flow from Not for Profit employer-sponsored superannuation to retail funds. Given the ongoing fees suffered by members of retail funds and the additional adviser costs of moving funds, the result will be lower retirement savings.

3.1.8 Need for guidance regarding circumstances in which APRA would exercise its power to restrict transfers

The proposed regulations indicate that APRA would have the power to prevent transfers from a fund where the result would prejudice benefits in the fund or impair equity between members. This power could be exercised by APRA on its own instigation or as a result of a request from a fund.

It is desirable that information and guidelines should be made available about the circumstances under which APRA would be likely to exercise its discretion whether unilaterally or at the request of a fund's trustee. This would assist funds in determining whether they would need to alter benefit design to avoid adverse selection of the types discussed at 3.2 below, or whether they could expect to receive an exemption from portability requirements because of specific circumstances.

¹ *The Investment Performance of Australian Superannuation Funds*, Anthony D. F. Coleman, Neil Esho and Michelle Wong, Working Paper 2003-02 Australian Prudential Regulation Authority, February 2003

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3.2 Specific situations

We remain concerned regarding the following situations:

- a) Under the terms of some trust deeds or other governing rules a capital guarantee may apply to an accumulation interest in a defined benefit fund. If it is open to a member to use the protection of a capital guarantee for a period when returns are uncertain, and then to move to another fund where the return is market based when market conditions improve, there is scope for adverse selection to be exercised against the fund offering the capital guarantee.
- b) Some funds seek to reduce fluctuations in crediting rates on accumulation balances from year to year by use of an investment reserve. The objectives are to promote fairness between members and/ or to promote the understanding that returns are stable over time.

There is a hazard that where accumulation balances become readily portable, members may time their departure from a fund at the point where reserves have been allocated, making a point of re-entering when reserves have climbed again. This would reduce equity between members or could result in membership fluctuations at critical times. Hence, funds would be forced to abandon the practice of reserving, and lose the potential advantages that reserving may bring.

We understand that in at least one major fund where a capital guarantee as described in (a) above is provided, the actuary has indicated that if the regulations are made as currently drafted, it will be necessary to approach APRA to have the fund's ability to roll over amounts suspended under draft Regulation 6.37. Failing such a suspension, the fund's rules will have to be changed to remove the capital guarantee, in order to meet the trustees' obligations to ensure that there is equity between members. Removal of the guarantee will be to the detriment of all members (but will preserve equity).

Similar concerns have been expressed about point (b) above.

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4 OTHER ISSUES

4.1 Existing arrangements for portability of accumulation balances

5 RECOMMENDATIONS

5.1 Capital guaranteed funds should be protected

We would recommend that portability be removed for accumulation balances which are subject to a capital guarantee or to smoothing of investment returns (whether or not these balances are linked to a defined benefit).

5.2 Deferral of portability proposals

We would support deferral of the proposed changes until there has been an opportunity for full public and Parliamentary consideration of the entire issue of Choice of Fund, and of the risks of poorly informed decision-making by individual Australians.