Submission to the

Super System Review

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Executive Summary

National Seniors Australia (NSA) believes that examination of the operation of Australia's superannuation system is timely.

We strongly endorse the Panel's view that the back room operations of Australia's superannuation industry must be brought into the 21st Century and that the industry should focus, much more clearly, on individual fund members and their needs[1].

These lessons were driven home very powerfully by the bitter experiences of older fund members in the wake of the global financial crisis. With a relatively high average exposure to shares (see page 30), Australian funds – and those older members – were hit very hard by the stock market crash of 2008. The global financial crisis brought into sharp focus:

- the industry's short term approach to performance;
- its high levels of exposure;
- the limited accountability of trustees;
- discordance in fees and charges; and
- lengthy and complex disclosure documents.

We firmly believe that addressing these issues will go a long way towards restoring consumer confidence that the superannuation industry, itself, badly needs. The industry must now show that it is operating for the benefit of superannuants, not service providers.

We have consulted extensively with our members and the broader seniors' community to enable the consumer and ultimate beneficiary of the superannuation system to contribute directly to the development of this submission. In developing this submission, we have also been acutely aware of the need for regulatory and legislative stability in superannuation arrangements and of the negative impact that 'moving goalposts' has on confidence and development.

This submission addresses all phases of the Review and reflects the views of NSA members as expressed through extensive consultations, including a superannuation survey, in three sections:

1. Maximising Choice
2. Better Protecting and Serving Members
3. Self Managed Superannuation Funds

Our recommendations are explained in detail in this paper.

[1] *Superstream: A proposal to bring the back office of super into the 21st century*, Phase Two – Preliminary Report, 22 March 2010.

Summary of Recommendations

A: Maximising Choice

1. Take steps to allow all workers the opportunity to choose a super fund.
2. Ban incentives to employers or employee groups to choose particular funds as a default fund.
3. Support a requirement for employers to remit super contributions concurrently with payment of salaries and wages.
4. Calculate the Superannuation Guarantee on the basis of assessable employment income plus salary-sacrificed amounts.
5. Continue the development of a specific disclosure regime for superannuation funds (as commenced by the Financial Services Working Group on 5 February 2008).
6. Introduce mandatory fee categorisation to enable superannuants to better understand the fees applied to their account and to better compare fees across different options and funds.
7. Have the Australian Prudential Regulation Authority collect and publish independent comparative data on fund and investment option performance.
8. Work with consumer and industry representatives to develop an agreed standard on the labelling of investment options, in order to improve comparability.
9. Establish a ‘one-stop shop’ Government–run website dedicated to superannuation.
10. Streamline the process for rolling-over funds in order to minimise paper-based communication, time delays and costs to members and funds.
11. Reduce the 30 day time limit applying to fund transfers to 14 days (that is presently the industry’s best practice).
12. Prohibit exit fees (where they exceed the administrative cost of transfer) and provide the Superannuation Tribunal with the necessary powers to enforce this prohibition.
13. Make the costs involved in securing financial advice about superannuation tax-deductible.

B: Better Protecting and Serving Members

14. Consider the introduction of a fee cap for all default funds.
15. Abolish ongoing advice fees (including inbuilt sales commissions) for all default funds.
16. Require default funds to keep members who cease making contributions in the fund unless the member gives their explicit consent to being transferred to another fund.

17. Require trustees to more effectively structure default investment options on the basis of age so that balances are automatically adjusted from growth to more defensive assets as the member gets closer to retirement.

18. Encourage fund trustees to ensure that (where possible) investment decisions are personalised to the specific needs of members, such as taking into account their likely retirement horizons.

19. Consider the introduction of a fee cap for all Eligible Rollover Funds.

20. Prohibit Eligible Rollover Funds from adopting aggressive investment strategies.

21. Limit the number of Eligible Rollover Funds in order to create downward pressure on fees and improved processes for matching members.

22. Expand the currently limited use of Tax File Numbers in superannuation (in close consultation with community and industry stakeholders).

23. Implement a time limit for funds to switch investment options on the instruction of a member. This limit should be based on current industry best practice.

24. Implement the recommendations of the Ripoli Inquiry as they relate to licensing and the introduction of fiduciary duty for financial services licence holders.

25. Increase awareness of the Superannuation Complaints Tribunal (the proposal for a Government-run website dedicated to superannuation could assist here).

26. Create a single point of entry for complaints related to superannuation (in the Superannuation Complaints Tribunal) and expand its current narrow focus.

27. Reduce the period in which Trustees must respond to a complaint from 90 days to 45 days, in line with that applying to other financial service industries.

C: Self Managed Superannuation Funds

28. Maintain a nominal supervisory levy ($150) until a transparent and reasonable indexation process is put in place to determine future increases in the levy.

29. Develop and implement a complaints handling process for self managed superannuation funds.

30. Continue to permit existing investment strategies and decisions for self managed superannuation funds,

Introduction

An examination of the operation of Australia's superannuation system is long overdue after more than two decades of compulsory superannuation and several major reform packages. It is also timely.

The Global Financial Crisis brought into sharp focus:

- the industry's short term approach to performance;
- its high levels of exposure;
- the limited accountability of trustees;
- discordance in fees and charges; and
- lengthy and complex disclosure documents.

More broadly, the global financial crisis has driven home the realisation that consumer-led competition has not and for some time will not achieve all the objectives expected of it. Five years on from the introduction of the choice of super still fewer than 1 in 10 Australian workers are actively choosing a fund, while less than 4 per cent are switching funds each year[2]

Accordingly, Australian policymakers are now faced with two principal objectives:

1. Continuing to pursue consumer driven competition; and

2. Determining where government intervention is needed to give an immediate boost to business practice, and ultimately improve outcomes for consumers.

We still believe that increased choice and competition are the most effective and enduring ways of improving outcomes. However consumers need practical help if they are to make good choices and get the best results. Complex material on statutory rights alone will not be enough.

Effective choice also requires practical steps such as:-

- Standardisation and simplification of comparable data;
- Improved financial literacy; and
- Access to affordable and impartial advice.

However the necessary government interventions are also important. So we must also highlight the areas where markets have not - and for quite some time will not - provide the outcomes consumers rightly want. Our central purpose in this is to meet the urgent need to better serve and protect the interests both of our members and the general public. We particularly wish to protect those who have placed their faith in the default system. We also want to see trustees Improve their governance of funds and better performance by third parties. A more robust complaints mechanism is also among other key areas which urgently require government intervention.

[2] J.Fear & G.Pace. *Choosing Not to Choose, Making superannuation work by default*. 2008.

We firmly believe that addressing these issues will go a long way towards restoring consumer confidence that the superannuation industry, itself, badly needs. The industry must now show that it is operating for the benefit of superannuants, not service providers.

In developing this submission, we have also been acutely aware, of the need for regulatory and legislative stability in superannuation arrangements and of the negative impact that 'moving goalposts' has on confidence and development.

About National Seniors Australia

National Seniors Australia is the largest organisation representing Australians aged 50 and over to government and business. Some 280,000 Australians aged 50 and over have already chosen to join us for the personal benefits we offer and the positive difference we make to the lives of Australians 50 and over.

Consultation

In developing this submission National Seniors Australia (NSA) consulted extensively with its members and the broader seniors' community. Consultation included the establishment of a panel of members with expertise in superannuation and the broader financial services industry, as well as an online member survey. Feedback from the panel and results from the survey informed the recommendations contained in this submission. A summary of the survey results is provided at Appendix 1.

Maximising Choice

The choice of fund policy (introduced in 2005) was hailed as a major victory for consumers and a catalyst for competition. The stark reality, however, is that five years on from its introduction, still fewer than 1 in 10 Australian workers are actively choosing a fund, while less than 4 per cent are switching funds each year[3]. We believe that the choice of fund policy was a necessary and significant first step, but by itself it will not generate sufficient improvements in levels of choice and competition. Additional government and industry measures are needed.

NSA is strongly supportive of the Panel's proposal to develop a governance model from a member, as opposed to a product or industry perspective. The Australian superannuation system is based on the principles of personal responsibility and self-sufficiency. In accordance with these, we believe workers should not be denied the opportunity to choose a super fund, if they wish to do so. It is our understanding that currently 'an employee is not entitled to choose their superannuation fund if an employer is already paying contributions for them under or in accordance with: a state award; a state industrial agreement; a federal industrial agreement; or an award or agreement that stipulates a fund that contributions are to be paid to[4].

Take steps to allow all workers the opportunity to choose a super fund.

In the Members' Interests

It is our view that the current 'one-size fits all' governance model has largely failed to protect the interests of members who have, for whatever reason, not made an active choice about their superannuation fund. The charging of ongoing advice fees and commissions by some default funds, despite members in these funds being unlikely to have received that advice or been aware that advice fees were being charged, is a clear illustration of the failure of the current governance model operating in practice.

Nine in ten employees are in default funds. Almost half of superannuation contributions under management by retail and industry funds are in default funds. We believe that individual choice needs to be promoted vigorously and employer choice of default funds phased out, We also believe it is important that fund trustees are only able to market their funds on the basis of benefits available to members, not employers

Ban incentives to employers or employee groups to choose particular funds as a default fund.

Employers are allowed generous latitude in the remittance of both Superannuation Guarantee contributions and contributions under salary-sacrifice arrangements. The former can be delayed for one month after they were deducted from employees' salaries and wages, while the timing of remittance of salary-sacrifice contributions is entirely up to employers.

[3] *Choosing Not to Choose, Making superannuation work by default*, Josh Fear, The Australia Institute, Geraldine Pace, Industry Super Network, November 2008
[4] Available at: http://www.ato.gov.au/super/content.asp?doc=/content/89672.htm&page=2

Given the changes in the way payrolls are managed since the introduction of compulsory superannuation there is no longer a practical reason for these delays. We believe super contributions should be paid at the same time as wages and salaries are paid to ensure members see super as part of their remuneration. This would help to promote member engagement with super. It would also ensure that these contributions generate investment returns for the member rather than the employer.

Support a requirement for employers to remit super contributions concurrently with payment of salaries and wages.

Salary-sacrificing into super is a way of boosting retirement savings and taking personal responsibility. This is an attractive option for people who find that later in their working lives their income has grown, they have discharged obligations such as mortgages and children's school fees, and they are seeking to boost their savings for their retirement. At present though, the way the Superannuation Guarantee is calculated in these situations appear to benefit the employer rather than the employee.

For example, a person aged over 50 with an annual assessable income from employment of $100,000 expects a Superannuation Guarantee of $9,000. If they salary-sacrifice the maximum amount allowable of $41,000 per annum they may end up with an annual Superannuation Guarantee of $4,500 as the employer's Superannuation Guarantee is required to be made only on the reduced salary amount. This is not only $4,500 less than expected, but is also money lost to the employee.

Calculate the Superannuation Guarantee on the basis of assessable employment income plus salary-sacrificed amounts.

However, even if these concerns about employer responsibilities and practices were addressed, serious concerns would remain with the proposed 'choice architecture' model as outlined in the Panel's Phase One Preliminary Report (*Clearer Super Choices: Matching Governance Solutions*).

A broad concern is that while the model would strengthen protections for default (universal) members it makes no attempt to facilitate movement from 'universal' to 'choice'.

We are particularly concerned about the presumption that because a superannuant has not chosen a fund they must have a low level of financial literacy and that if they have made an active choice they must have a high level of literacy. We also believe it is incorrect to assume that members who have not exercised a choice about their fund will remain disengaged.

We agree with the proposition that universal funds should not be allowed to charge ongoing advice fees (including commissions), though we believe that competition between funds catering for default members should be encouraged in order to provide the best possible level of service to members.

The notion that reporting requirements for universal funds be minimal, while being comprehensive for choice funds is also a cause for concern. This approach would work against the development of personalised reporting, which is the policy objective that would

most benefit consumers. Representations to NSA consistently state a preference for more personalised reporting.

For example, the preference of some members is to check the performance of their fund online, without the need for written correspondence (other than an annual statement). Alternatively, others members (particularly older members who lack internet access) may prefer more regular written reporting, such as a quarterly update.

More broadly, the reporting approach outlined in the choice architecture proposal could further entrench member disengagement as universal fund members would have less contact with their fund, while choice fund members may be overwhelmed by the level and detail of reporting.

The notion that 'choice' funds should have a potentially unlimited menu of options for investment wrongly presumes that all superannuants who have made a choice have a high level of financial literacy, and has the potential to turn people away from choice funds towards universal funds.

> *Case Study 1 – "(Fund name removed) offers a myriad of diverse funds. The choice is mind boggling. Why should it be so complex… and why is it virtually impossible to have a 'financial advisor' respond to my query about the costs involved in switching between the Fund's product ranges!" (NSA Member 2/2/10)*

The reporting approach outlined in the choice architecture proposal could further entrench member disengagement as universal fund members would have less contact with their fund, while choice fund members may be overwhelmed by the level and detail of reporting. Representations to NSA confirm this, with members reporting that the high volume of investment options is creating confusion amongst superannuants and is fast becoming a barrier to choice.

Information Provision

NSA believes one fundamental area which has so far been overlooked is the provision of basic comparable information.

Ordinary superannuants (those without specific knowledge of superannuation or financial expertise) do not have access to information that would enable them to make a comparable assessment of which fund or option best suits their needs. In particular, there is currently no consistency in the way funds report:

- the level of fees and charges;
- investment returns (particularly over the longer term);
- levels of ethical investment; and
- basic governance (such as whether the Board is elected).

There are also areas where there is greater opportunity for the provision of more consistent reporting. These have been outlined in greater detail below.

Disclosure – Room for improvement

Representations to NSA consistently state a preference for more personalised reporting. For example, the preference of some members is to check the performance of their fund online, without the need for written correspondence (other than an annual statement). Alternatively, others members (particularly older members who lack internet access) may have a preference for more regular written reporting, such as a quarterly update.

The principles-based nature of the Product Disclosure Statements (PDS) regime has largely encouraged issuers to produce lengthy and complex PDSs.

Superannuation funds have been no different, and this has undoubtedly contributed to consumer disengagement. The 2007 PJC Report into the structure and operation of the superannuation industry found that PDSs produced by superannuation funds may be legally compliant, but are also long, complex, difficult to compare and more broadly, do not serve the purpose of communicating effectively with consumers[5].

The reality is that consumers want standardised and shorter PDS. Consumers find these easier to read and understand. These statements also help people to make useful comparisons between superannuation products. There are also considerable gains to be made by funds in adopting a personalised reporting approach through reduced administrative costs. The Review's Second Issues Paper (*Operation and Efficiency)* contained estimates that administrative costs equate to about 0.4 per cent of fees under management[6].

Accordingly, recent Federal Government initiatives to improve PDSs for superannuation funds should be applauded. NSA believes that shorter statements, as well a more prescriptive and targeted approach to disclosure will make it easier for consumers to read, understand and compare superannuation products, while also reducing costs and water wastage for funds.

Continue the development of a specific disclosure regime for superannuation funds (as commenced by the Financial Services Working Group on 5 February 2008).

Fees & Charges - The case for uniform categorisation

Consumers also have generally a low level of understanding when it comes of the particular fees and charges applied to their accounts. Almost half (45%) of respondents to our superannuation survey reported they had a limited or very poor understanding of the various fees and charges that their fund applies to their account(s) each year. Once again this problem was more common among women (51%), singles (52%) and those with low super balances. In fact, 59% of those with balances of less than $200k had a limited or poor understanding of the fee structures affecting them.

Respondents, though, overwhelmingly supported the idea of condensing fees and charges into a small number of set categories that could be used by all funds. Indeed, 95% of respondents said it would improve their understanding of fees and enable them to make

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[5] PJC. *Report on the structure and operation of the superannuation industry*. 2007. Canberra

[6] Australian Government. Review into the governance, efficiency, structure and operation of Australia's superannuation system. Issues Paper Phase Two. 2009

useful comparisons between funds. This figure included 65% who felt it would be 'very helpful'.

Introduce mandatory fee categorisation to enable superannuants to better understand the fees applied to their account and to better compare fees across different options and funds

Investment Performance & Other Comparative Data

A significant proportion of superannuants remain unaware of the relative performance of their fund. Almost 1 in 3 respondents (29%) said they were not aware how their fund had performed in the last 10 years. This kind of awareness was lowest for those with smaller super balances. Indeed, 46% of those with balances of $100,000 or less were unaware how their fund had performed. Yet only 19% of those with balances of $500,000 or more, and only 7% of those with balances of $1 million or more, were not aware of their funds performance.

The introduction of the choice in super reforms in 2005 led to increased consumer and industry demand for information on the investment performance of funds. This has since led to a growth in commercial agencies which collect data and rate funds and securities. However, the vast majority of superannuants (aged 50 and over) are either unaware of commercial ratings agencies or choose not to use them. Only 25% of respondents had visited a ratings agency website

Our research also identified a degree of consumer concern over a perceived lack of transparency and accountability among these agencies. Our survey found that only 30% (1 in 3) of respondents had a high level of trust in the accuracy of ratings provided by commercial agencies.

We believe there is scope for the government to take a stronger role in the collection and publication of performance data. Our survey indicates strong support for direct government involvement in this area. An impressive 64% of respondents indicated they would have a greater level of trust in these ratings if they were developed and published by government. We believe there is also a clear need for standardisation in the calculation of performance ratings and an agreed standard on the labelling of investment options. The current lack of a uniform approach to the collection and publication of performance data exposes consumers to streams of confusing, differently based performance data, through fund advertising, ratings agencies and financial advisers.

As the Australian Prudential Regulation Authority (APRA) has been collecting and publishing data at an industry level since 1998, it is well placed to provide additional data at a more disaggregated level. We also note this would align APRA's institutional publication of superannuation data with the data the authority publishes on other industries it supervises.

Have the Australian Prudential Regulation Authority collect and publish independent comparative data on fund and investment option performance.

Standardisation in the comparability of data and in the labelling of investment options will provide reassurance to consumers that only investment options with the same risk versus

reward trade-offs are being compared, facilitating real choice and driving soundly based competition.

Work with consumer and industry representatives to develop an agreed standard on the labelling of investment options, in order to improve comparability.

A 'one-stop shop' website dedicated to superannuation

Aside from the provision of more general information on superannuation, we believe there is good reason to establish a 'one-stop shop' government-run website dedicated to superannuation. This website should provide:

- General information on super;
- Comparative performance data; and
- Information on contribution tax incentives.

As we have seen, there is clear scope for the APRA to collect and publish this performance data at both the institutional and investment option level. This would provide an independent reference point which consumers could utilise to check the claims made by financial advisors, and those contained in funds advertising.

We believe the proposed website would also assist in increasing awareness of incentives applying to superannuation contributions, such as the co-contribution scheme and the higher concessional contributions cap for those aged 50 and over. More broadly, a dedicated website would assist in improving understanding of superannuation and could help to improve financial literacy.

Establish a 'one-stop shop' Government-run website dedicated to superannuation.

Portability

Portability and choice of superannuation fund for investors has been extended in recent years through the standardisation of forms and proof of identity requirements, as well as the introduction of a 30 day time limit. Notwithstanding these measures, barriers to portability clearly remain and are serving as a disincentive to switch or consolidate funds.

Our members tell us that obstacles, such as obscure requirements for transferring funds, identification issues, and onerous processes – mostly including a heavy paperwork focus - are creating delays and increasing the likelihood of consumers giving up. The paperwork, in particular, is proving unnecessarily costly for members and funds.

> *Case Study 2 – "I went on to my fund's website to see how I could roll over my savings into an SMSF (self managed super fund). I went first onto their website to see if it could be done online – not available. I then looked for a form that I could download and print off – not available. So I rang up and arranged for a form to be posted out to me and was told I could expect it in 7 working days."*

We believe that portability would be greatly enhanced if there was a shift away from a paper-based system towards a more efficient real time process, which could be provided online and over the phone (for those without internet access). There is also scope for information

requirements to be further refined to be less time-consuming. However, this must be done with considerable caution and with regard to security considerations.

Streamline the process for rolling-over funds in order to minimise paper-based communication, time delays and costs to members and funds.

With a more efficient process for transferring funds in place, NSA considers that the current 30 day limit applying to the rollover of funds could be further reduced, and that a 14 day limit would be more appropriate. Several major funds already guarantee that they will transfer funds within 14 days.

Reduce the 30 day time limit applying to fund transfers to 14 days (that is presently the industry's best practice).

Members also complain about exit fees. This is particularly so with older financial products and low savings balances, which are often seen as barriers to consolidation. We urge the abolition of exit fees which bear no apparent relationship to the cost of leaving. This is one obvious way of enhancing portability. By their very nature, exit fees act as a disincentive to making an active choice about superannuation.

We note that the Parliamentary Joint Committee on Corporations and Financial Services *Report on the structure and operation of the superannuation industry* (2007) recommended that exit fees be prohibited where they exceed the administrative cost of transfer[7].

Prohibit exit fees (where they exceed the administrative cost of transfer) and provide the Superannuation Tribunal with the necessary powers to enforce this prohibition.

Financial Literacy & Advice

Thousands of Australians were shocked by the impact that the 2008 stock market crash had on their prospective superannuation pay-outs. This shows, above all, that most Australians were not aware of just how their retirement savings, in superannuation accounts, were being invested. More importantly, this illustrates the need for greater financial literacy levels and advice. Superannuants also need to better understand the long-term focus of their superannuation.

The establishment of a government-run website dedicated to superannuation, backed by a low key government advertising campaign, could promote the kind of financial literacy that is needed. Australia's superannuation funds – and financial advisers - also have important roles to play in public education on these vital matters. These issues require both reflection and action. The expenses fund members incur in seeking advice on these important matters are part of costs they must meet to secure their post retirement incomes. Accordingly NSA is calling for these expenses to be tax-deductible.

Make the costs involved in securing financial advice about superannuation tax-deductible

[7] Available at: aph.gov.au

Better Protecting and Serving Members

NSA believes that while continuing to pursue consumer driven competition, through the measures outlined in *Maximising Choice*, we also need to acknowledge that to date competition has not, and will not achieve all the objectives expected of it. Accordingly, policymakers need to consider what additional government intervention is necessary to deliver best practice, and improved outcomes for consumers.

The areas where markets have been less effective were clearly illustrated by the global financial crisis, which among other things brought into focus:

- a short-term approach to fund performance;
- the limited accountability of trustees;
- high exposure to equities;
- high fees and charges; and
- lengthy and complex disclosure.

More broadly, the crisis has called into question whether funds are truly operating in the best interests of their members. That is, whether the superannuation system is still operating for the benefit of superannuants by maximising retirement savings? Or, is it serving providers and fund managers instead? These are particularly important questions to answer, especially as the vast majority of fund members are passive on superannuation issues. They, effectively, place their faith in the system, expecting it to serve and protect their interests.

We outline in this section several areas in which we believe markets have failed and regulatory shaping is needed.

A Default Safety Net[8]

The global financial crisis has clearly challenged long-held assumptions and conventional wisdom regarding the design of the default option[9].

NSA believes this challenge has highlighted the need for a consumer safety-net in the form of minimum standards which superannuation funds should be required to meet before they can accept contributions on behalf of workers who do not choose a fund.

Longer term, a set of standards would also generate meaningful competition between funds to go above and beyond the minimum required, in order to be nominated by employers or included in industrial awards. In addition to flow on benefits from competition, a safety net would bring immediate benefits to consumers through lower fees and greater protections.

Importantly, this would provide a statutory safety net for superannuants until they decide to make an active choice. Better clarification of the conditions offered by funds would also

[8] The concept of a set of minimum standards has been previously presented in *Choosing not to choose,* a joint publication by The Australia Institute & Industry Super Network (2008).
[9] M.Drew. Submission to the Cooper Review. September 2009.

make it easier for employers to nominate a fund, and would provide re-assurance that their nomination is in the best interests of their employees.

NSA is proposing that the following standards (dealt with in greater detail below) be mandatory for funds to be nominated as an eligible default fund:

- A cap on fees and charges (say 1%);
- The prohibition of ongoing advice fees (including commissions);
- Enabling members to retain the fund as their default fund, unless they make an active choice to the contrary; and
- Structuring default investment options on the basis of age, while making all attempts to personalise investment decisions to take account of actual retirement horizons.

We do not support the notion of a single government-run national default fund. This will not increase competition and is unlikely to lift industry standards.

A fee cap

Many superannuants are worried by high fees and charges, especially when they are apparently not related to investment performance. This is causing considerable anxiety. Although Australia's superannuation funds suffered real losses of around 27 per cent in 2008, our members tell us that during and immediately after the global financial crisis fees and charges maintained their real value or in some cases increased.

Treasury projections suggest that fees currently take around 1.25 per cent from superannuation balances each year, representing around $2.75 billion across the industry. Superannuation account fees have a direct bearing on final retirement income.

Treasury also estimates that fees at two per cent of a member's account rather than one per cent could, over 30 years, reduce their final balance by up to 20 per cent[10]. Other research has found the impact of fees to be much higher - a 2009 Report by the Australia Institute found that fees of 1.35 per cent can wipe 27 per cent off a person's final super savings – about $130,000 for an average worker over their career[11].

Accordingly, NSA strongly supports moves which will facilitate the yield of cost downs, such as reduced fees and charges applied by superannuation funds to members' accounts. In the case of default funds, we consider a fee cap to be appropriate and note that a similar approach has already been implemented in New Zealand[12].

Importantly, a push for lower fees should not and need not focus solely on efficiency gains in administrative and member services (such as insurance) as this could lead funds to further scale back their already low levels of customer service. NSA believes there are far larger efficiency gains to be made in areas where fees are currently less transparent to consumers, such as investment management, as well as ongoing advice and commissions.

Consider the introduction of a fee cap for all default funds.

[10] The Hon Senator Nick Sherry. Speech to the Global Pensions Conference. Sydney. February 2009.
[11] *The case for a universal default option*. The Australia Institute. September 2009. Sydney
[12] This is advocated by The Australia Institute

Ongoing Advice Fees (& Commissions)

A 2008 Report by Rainmaker Information estimated that commissions from superannuation totalled $2.4 billion in 2007[13]. An estimated $860 million (or 36 per cent) of this amount was for commissions on compulsory superannuation contributions.

> <u>Case Study 3</u> – *"I decided to set up a 90 day term deposit, however at the end of 90 days the interest the account had accrued was zero! Fees and charges has taken all the interest. One of the "charges" was interesting....an 'ongoing advisory fee'. What advice is needed to operate a term deposit? I am much happier now that I have withdrawn all funds from (fund name removed) and deposited them in a bank where I will be assured of receiving a healthy amount of interest from a genuine term deposit." (NSA Member, 31/01/10)*

Given that the vast majority of superannuants are in default funds and as a result are unlikely to have requested advice, the amount paid in commissions provides serious grounds for concern.

Prohibiting these fees for default funds would ensure that only those superannuants who are receiving or benefiting from advice are being charged for it. Funds wanting to charge advice fees or commissions either in aggregate or for a particular option would need written approval from each member affected[14].

Abolish ongoing advice fees (including inbuilt sales commissions) for all default funds.

Retaining your default fund

We understand that some superannuation funds automatically transfer members to a different plan or to an external Eligible Rollover Fund (ERF) if no employer contributions are received over a certain time period.

Given the markedly higher average fees applying to ERFs (Rice Warner estimates average fees for ERFs are 2.49 per cent, compared to 1.21 per cent across all funds) the practice of transferring inactive members has the potential to significantly increase their fees and reduce their returns.

We consider this practice to be particularly disadvantageous to parents (most likely mothers) taking time out of the workforce, as well as those taking time out of the workforce later in life with the intention of returning after a period of years.

Require default funds to keep members who cease making contributions in the fund unless the member gives their explicit consent to being transferred to another fund.

[13] *Commissions Revenue Report*. Rainmaker Information. 2008.
[14] The is advocated for by the Industry Super Network

A life-cycle approach

One of the clearest illustrations of markets failing consumers, and of the subsequent need for regulatory intervention, was the over-exposure of Australian funds to the equities market during the global financial crisis.

In 2008, Australian superannuation funds had the highest allocation towards equities of any OECD country (with an average equity allocation of 57 per cent, compared to the OECD average of 36 per cent). This resulted in Australian funds reporting the second worst investment performance for private pensions across 30 ECD countries in 2008, at negative 27 per cent[15]. Most concerning was the fact that this high level of exposure and resultant fall in balances was not limited to those who had consciously invested in a high growth option, the vast majority of superannuants who were in default funds and balanced options were generally just as exposed.

Australians aged 50 and over were particularly hard hit. While some older workers switch to less risky investments as they near retirement, in Australia more than 60 per cent of people stick with the default investment options of their private plan, and equities typically makes up around two-thirds of this portfolio[16]. Being close to or already in retirement, they simply do not have the accumulation years remaining in order to make up losses.

We believe that regulatory intervention is needed to ensure that trustees more effectively structure default investment options on the basis of age so that as members pass various age thresholds, their balance is automatically adjusted along a so-called 'glide path' from growth to more defensive assets as the member gets closer to retirement. It is noted that this approach has already been implemented overseas (US and UK), and that some Australian funds have also implemented this practice.

However, NSA is also aware that the framing of a default option can improve, or hinder, long term investment outcomes, and that a ‘one-size fits all’ approach to investment may have the effect of disadvantaging default funds members.

As outlined in our report *Still Putting In*[17], an increasing number of older Australians are working beyond traditional retirement age. Research suggests this trend will continue as the baby boom generation reaches Age Pension age (65). Accordingly, this raises the issue of how adjustments can be made in order to protect those approaching retirement from future downturns, but at the same time not causing unnecessarily low returns that will never generate adequate retirement income balances.

NSA believes the only practical way to overcome this is for fund trustees to (where possible) personalise life cycle approaches to the needs and retirement horizons of members.

Require trustees to more effectively structure default investment options on the basis of age so that balances are automatically adjusted from growth to more defensive assets as the member gets closer to retirement.

[15] OECD. *Pensions At A Glance Report.* 2009.
[16] Ibid.
[17] *Still Putting In: Measuring the Economic and Social Contributions of Older Australians*, May 2009, National Seniors Productive Ageing Centre, Canberra

Encourage fund trustees to ensure that (where possible) investment decisions are personalised to the specific needs of members, such as taking into account their likely retirement horizons.

Eligible Rollover Funds

The fact that Eligible Rollover Fund (ERF) membership increased by over 66 per cent (to 5.909 million accounts) in the five years to 30 June 2008 (compared with a 27 per cent increase for mainstream super funds) is cause for concern[18].

While there is some merit in the suggestion that recent measures, such as tax penalties levied on no-TFN accounts from 1 July 2007, will stem future increases once they work through the system, NSA considers there is still scope for additional measures to assist with the management of lost and multiple accounts.

One area where market forces have failed is the level of fees applied to ERF accounts. One of the primary purposes of ERFs is to preserve the balance with minimal or no principal reduction due to management fees. In reality, research has shown that fees are excessive - Rice Warner research shows that ERFs were the highest cost superannuation sector in 2008 at an average rate of 2.49 per cent[19].

Given that investment strategies are typically very conservative, and effectively capital guaranteed in their risk profile, as well as the fact that ERFs do not provide additional services (such as insurance) - these comparatively high fees are concerning. We also suggest that the current protection that fees on a member's account cannot exceed the investment return allocated to the account does not go far enough.

NSA believes additional measures are needed to reduce the level of fees on ERFs, and that consideration should be given to a (percentage) cap. Measures which will encourage downward pressure on fees applied by ERFs through increased competition should also be considered.

Consider the introduction of a fee cap for all Eligible Rollover Funds.

Prohibit Eligible Rollover Funds from adopting aggressive investment strategies.

Limit the number of Eligible Rollover Funds in order to create downward pressure on fees and improved processes for matching members.

We believe that automatic consolidation of accounts via the use of Tax File Numbers (TFNs) would assist the management of lost and multiple accounts. We also note though that this would be a major step (given that the current use of TFNs in superannuation is very limited). Recognising the sensitivities that still surround the use of national identifiers, reform in the use of TFNs would need to be preceded by an extensive community consultation process.

Expand the currently limited use of Tax File Numbers in superannuation (in close consultation with community and industry stakeholders).

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[18] Australian Government. Review into the governance, efficiency, structure and operation of Australia's superannuation system. Issues Paper Phase Two. 2009

[19] Ibid.

Switching Investment Options

While a 30 day time limit applies to the transfer of funds to a different fund, there is currently no limit on the time it takes a fund to switch investment options on the instruction of a member. Members tell us that, in times of economic uncertainty, this can lead to considerable losses.

> Case Study 4 – *In early 2008 a NSA member instructed his fund to switch his investment option to one with a more conservative asset allocation. This was due to the member's concern about future downward trends in the equities market. It took the fund 42 days to act on this instruction, over which period the member estimates he lost over $12,000. (NSA Member, 12/07/09)*

The level of service provided to the member in the case study above clearly reflects the problems resulting from a lack of effective competition, as some funds have little incentive to improve the level of service provided to members. In the absence of competition there is clear scope for government intervention and in this regard NSA believes that a mandatory time period for switching investment options is appropriate.

Consumer support for a maximum time period in which funds must switch investment options is high – 83% of respondents to NSA's superannuation survey supported a mandatory time period for switching options. 92% of respondents also stated that a 5 (working day) period would be most reasonable, while 45% felt a 48 hour time period would be most reasonable.

Implement a time limit for funds to switch investment options on the instruction of a member. This limit should be based on current industry best practice.

Trustee (& Third Party) Governance

Our members tell us that the standards of financial governance, found in the superannuation industry, do not match those in other finance sectors, such as banking.

During the Ripoli inquiry, it emerged that ASIC, the regulator of the financial products and services industry which manages the vast majority of superannuation money in Australia, was unsure whether holders of a financial services licence had a fiduciary duty towards their clients. The inquiry recommended that a fiduciary duty for licensees be created and that ASIC be given increased powers to take action against individuals "deemed to be operating at or near the fringes of the industry"[20].

We believe that these are sensible proposals. In particular, imposing a fiduciary duty on the people that advises super fund trustees, who already have a fiduciary duty towards fund members, is a logical measure. It cannot, by itself, make superannuation funds more efficient in terms of net investment returns, but it is a key component to ensuring good governance of the financial products and services industry, including super fund management.

[20] *Inquiry into financial products and services in Australia*, Parliamentary Joint Committee on Corporations and Financial Services, November 2009.

Implement the recommendations of the Ripoli inquiry as they relate to licensing and the introduction of fiduciary duty for financial services licence holders.

Effective Complaints Mechanisms

Transparent and robust complaints mechanisms are a fundamental component of any financial system, and the superannuation system is no exception. Unfortunately, awareness of the Superannuation Complaints Tribunal is very low - only 37 per cent of respondents to our superannuation survey were aware of the Tribunal. This was markedly lower amongst women (26% compared to 44% of men) and those with low super balances (only 18% of those with balances of less than $100,000).

Increase awareness of the Superannuation Complaints Tribunal (the proposal for a Government-run website dedicated to superannuation could assist here).

In addition, there was considerable dissatisfaction with the Tribunal's handling of complaints and a loss of faith in current complaints mechanisms. One in two (50%) of survey respondents who had made a complaint to the Tribunal, said they were unsatisfied with the Tribunal's handling of that complaint, including 40 per cent who reported being 'very unsatisfied'.

Create a single point of entry for complaints related to superannuation (in the Superannuation Complaints Tribunal), and expand its current narrow focus.

There is also justifiable dissatisfaction with the provision that a member has to give their fund 90 days to respond to a compliant before raising it with the Tribunal. According to the Tribunal's 2008/09 Annual Report, more than 28 per cent (around 1 in 3) of complaints received during that year were made without complainants going through their funds first. This suggests a high level of frustration with the 90-day rule and the way funds respond to member complaints. NSA believes that providing Trustees with a 45 period in which to resolve a complaint would be more appropriate, and is in-line with that applying to other financial services (such as banking).

There is also considerable scope to increase the powers of the Tribunal, in order for it to investigate and make a determination on a broad range of issues, such as where funds have exceeded the time limit for releasing funds, or have charged unreasonable fees (such as exit fees).

Reduce the period in which Trustees must respond to a complaint from 90 days to 45 days, in line with that applying to other financial service industries.

Self Managed Superannuation Funds

If the principles of personal responsibility and self-sufficiency underpinning the Australian superannuation system were rigorously applied, the policy aim would be to make self-managed super, the ultimate form of choice in superannuation, the norm.

There are no more than perhaps 15,000 members of these funds. Yet the contributions of their owners represent one-third of the total value in superannuation in Australia.

This, already important, sector of Australia's superannuation industry is growing rapidly. Changes in the regulatory environment can help it flourish.

Supervisory Levy

We note that the level of the supervisory levy appears to have been set arbitrarily at $150, in other words, without regard to a costed compliance monitoring plan covering self managed superannuation funds (SMSF). We also note that the panel's documents canvass a possible increase to $500. Unless there is evidence the ATO's compliance monitoring is failing as a result of under-funding, we believe there is no justification for this level of increase.

45% of respondents to our superannuation survey stated that the supervisory levy should be abolished, while 25% of respondents wanted a 'nominal' levy. This could be interpreted as an overwhelming rejection by SMSF members and trustees of the notion that SMSFs should cover the cost of regulatory compliance monitoring of SMSFs.

In the absence of price transparency, including a cost/benefit analysis of proposed compliance monitoring activity, NSA considers the view of the majority of respondents to its survey justified.

Maintain a nominal supervisory levy ($150) until a transparent and reasonable indexation process is put in place to determine future increases in the levy.

Complaints

While there is no evidence to suggest there is an urgent need to bring the management and performance of SMSFs under the umbrella of a complaints process, SMSF members have currently nowhere to turn to have a complaint dealt with other than the courts. We believe it to be reasonable to develop and implement a complaints handling process for SMSFs and merge entry to this process with the single point of entry approach.

This position is reinforced by the response to our superannuation survey - two-thirds of respondents (all of which are SMSF members or trustees) support a formal dispute resolution arrangement for SMSFs.

Develop and implement a complaints handling process for self managed superannuation funds.

Regulation of Investment Choice and Methodology

The panel's review documents canvass the desirability or otherwise of banning SMSFs investing in leveraged financial products and in art work and collectibles. Given the performance of retail, industry and self-managed funds during the global financial crisis and the lack of evidence that SMSF trustees as a group lack investment expertise, we think it would be discriminatory to ban SMSFs from certain investments or to prescribe, even loosely, how their funds should be invested, while retail and industry funds remain unaffected by these types of restrictions.

We see no reason to ban SMSFs from using leverage if using leverage is acceptable for retail and industry funds. Likewise, while investment in art works and collectibles is generally not practised by retail and industry funds, we suggest the (negligible) investment by SMSFs in art works and collectibles should be primarily viewed as a niche asset category where SMSFs can excel. Such investments should not be automatically assumed to be circumventions of the sole purpose test.

Continue to permit existing investment strategies and decisions for self managed superannuation funds.

Appendix 1: Summary of results from NSA's superannuation survey 2010.

Between 5 and 26 March 2010, 855 NSA members participated in an online consumer survey on superannuation. Respondents were broadly representative of the three key ageing cohorts (50-65 years; 65-75 years; and over 75 years), as well as the major fund types (20% of respondents had their savings with a retail fund, 24% with an industry fund and 30% with a public sector fund). The remaining 22% of respondents had a self managed fund (SMSF).

Funds Performance[21]

- 69% of respondents were satisfied with the quality of their fund's level of customer service, which was consistent across all fund types. However, rates of satisfaction were markedly lower for those with smaller savings balances.
- Only half (50.1%) of all respondents felt that their fund did enough to keep them informed of what was happening to their savings during the global financial crisis (GFC), with minor differences across fund types (Public sector - 53%; Retail - 53%; and Industry – 46%).
- Those with low savings balances ($100,000 or less) were markedly less satisfied, with only 34% (1 in 3) believing their fund had done enough to keep them informed during the GFC.

Financial Literacy

- A significant minority of respondents don't read all the information that their fund sends them - 20% of respondents (1 in 5) don't read all the information that their fund sends them. This was higher for females (30% or 1 in 3), singles (33%) and those with low super balances (37% of those with balances of up to $100,000)
- A significant minority of respondents also reported that when their fund sends them information they don't fully understand what they are reading - 26% of all respondents have a limited understanding of the information their fund sends them. This was higher for females (40%) compared with males (19%); singles (40%) compared with couples (33%), and those with super balances of less than $100,000 (46%) compared with balances of $500,000+ (9%).

Fees & Charges

- Fees and charges were generally poorly understood - 45% of all respondents had a limited or very poor understanding of the various fees and charges that their fund applies to their account(s) each year

[21] For the purposes of this survey, performance goes beyond simply investment returns to include general levels of service provided to members.

- A poor understanding of fees and charges was notably higher for women (51% had a limited or poor understanding), singles (52% had a limited or poor understanding) and those with low super balances (59% of those with less than $200,000 had a limited or poor understanding)
- There was overwhelming support for the condensing of fees and charges into a small number of set categories that could be used by all funds – 95% of respondents felt it would improve their understanding of fees and enable them to make useful comparisons between funds (65% felt it would be 'very' helpful)

Financial Advice

- A high proportion of respondents had received financial advice regarding their retirement savings (85%). However, only 57% of those with super balances of $100,000 or less had received financial advice compared to 94% of those with balances of $500,000+.
- For those who had not received financial advice, 'not trusting the impartiality of financial advisors' was cited as the main justification (30% of respondents).

Accountability of Trustees & Third Parties

- Respondents were generally unfamiliar with the duties and responsibilities of super fund trustees – only 37% of respondents were familiar with the duties and responsibilities of super fund trustees
- Familiarity was markedly higher amongst men compared with women (44% of male respondents were familiar with the duties and responsibilities of super fund trustees compared to 28% of female respondents)
- Familiarity was also markedly higher amongst those with large super balances compared with low balances (47% of respondents with balances of $500,000+ were familiar with the duties and responsibilities of super fund trustees compared with only 28% of those with less than $200,000)

Superannuation Complaints Tribunal (the Tribunal)

- Awareness of the Superannuation Complaints Tribunal and its role was low – only 37% of all respondents were aware of the Tribunal.
- Awareness was markedly lower amongst females (only 26% of females were aware of the Tribunal compared to 44% of men), and those with low super balances (18% of those with balances of less than $100,000 were aware of the Tribunal compared with 61% of those with balances over $1 million)
- Of those who had made a complaint to the Tribunal a very high proportion were unsatisfied with the handling of the complaint – of all respondents who had raised a compliant 50% (1 in 2) were unsatisfied with its handling (including 40% who reported being very unsatisfied).

Fund Comparisons

- Awareness of fund investment performance was low – 29% of all respondents (nearly 1 in 3) were unaware of how their fund had performed in the last 10 years compared with over funds.

- Awareness of fund performance was lowest for those with smaller super balances – 46% of those with balances of $100,000 or less were unaware of how their fund had performed in the last 10 years compared with over funds. Comparatively, only 19% of those with balances of $500,000+ were unaware of their funds performance, and only 7% of those with balances of $1 million+.

- A very low proportion of respondents had visited a commercial agency website (such as Super Ratings) in order to compare fund performance – 75% of respondents had never visited a comparative website.

- Of those who had visited a commercial agency website (such as Super Ratings), only 30% (1 in 3) had a high level of trust in the accuracy of the performance ratings.

- Support for performance comparisons being undertaken by government was very strong – 64% respondents would have a greater level of trust in performance ratings if they were developed and published by a Government Agency, such as APRA

Portability

- Consumer support for a mandatory time period for switching investment options on the instruction of a member is high – 83% of respondents supported a mandatory time period for switching options. 92% of respondents also stated that a 5 (working day) period would be a reasonable time period, while 45% felt a 48 hour time period would be reasonable.

Self Managed Superannuation Funds (SMSFs)

- Respondents supported the introduction of two barriers of entry – minimum educational standards for SMSF trustees (61%), and a minimum start-up balance (55% for and 37% against).

- Respondents did not support the annual supervisory levy – 45% wanted it abolished outright, while 25% wanted a 'nominal' levy.

- Respondents recognised trustee loss of mental capacity as a problem for the SMSF sector. However, 45% of respondents said that mental capacity in SMSF trustees should be treated in the same way as mental incapacity is generally. 36% were not sure how SMSF's should deal with a loss of mental capacity, and only 5% of respondents were in favour of specific action.