

## CHAPTER 6:

### CHOICE OF FUND

*Freedom of choice in superannuation is very much a two-edged sword.<sup>1</sup>*

#### The call for choice

6.1 The question of choice of fund was raised by a number of individuals as a solution to the difficulties they had experienced in maintaining the integrity of their own superannuation. These individuals had a history of broken workforce participation and small superannuation accounts.<sup>2</sup> Others had significant personal superannuation and small amounts of employer sponsored superannuation split between two accounts.<sup>3</sup>

6.2 Ms Andrea Malone submitted that her ability to accumulate superannuation savings has been hindered by account keeping fees, cashing out of small amounts, and intra and interstate moves. The result was that she had membership of some four different superannuation schemes. As part of her submission she proposed:

that any compulsory schemes should be established on a national basis and the worker should have the choice of joining a scheme and remaining with it as she moves from job to job. It is quite inappropriate to place the onus on individual workers to keep track of all the sundry schemes to which they are forced to belong.<sup>4</sup>

6.3 The Committee accepts that the circumstances described by Ms Malone, which have been called the 'small amounts problem', could have been alleviated by her being able to choose one fund and have all contributions paid to it.

6.4 The 'small amounts problems' of Ms Malone and others<sup>5</sup> could also have been alleviated if mechanisms were in place that would have prevented the erosion of those amounts and enabled the accounts to be consolidated easily.

<sup>1</sup> Stevens R, Evidence, p 168

<sup>2</sup> For example, see SW Sub Nos 8, 12, 22, 51

<sup>3</sup> For example, Hunter R, SW Sub No 34

<sup>4</sup> SW Sub No 12

<sup>5</sup> For example Shellham E, SW Sub No 84

This problem has been largely overcome by the approach that has been adopted with the member protection rules for amounts under \$1 000 and the transfer protocol. The Committee has recommended in Chapter 7 that all accumulation funds be required to participate in the transfer protocol if they accept compulsory contributions.

6.5 Notwithstanding the mechanisms that have been put in place to address the 'small amounts problem', choice of fund remains a highly sensitive issue within the superannuation industry<sup>6</sup> and between the major political parties.

6.6 The Committee looked briefly at the issue of member choice of fund in Chapter 2 of its Fourteenth Report, *Super Regs II*.

6.7 The entitlement to choose a superannuation fund depends on the individual's circumstances of employment. For example, a self-employed person may establish their own fund or choose from a variety of public offer funds. They are free to change superannuation funds at will, subject of course to entry and exit fees, which can be quite an inhibiting factor.

6.8 The Superannuation Guarantee scheme does not provide such opportunities for employees. It requires the employer to make superannuation contributions on behalf of employees to complying regulated superannuation funds. It may be the employer who chooses the particular fund into which the contributions are paid. Otherwise, limits on which fund can be selected are often imposed by awards.

6.9 In *Super Regs II* the Committee reported that most States have enacted legislation affecting State awards to allow employee choice of fund, provided the employer agrees. The Committee did not receive evidence in this inquiry on how such provisions have been utilised.

6.10 The question of fund choice elicited some vigorous responses in this inquiry. A wide range of issues were identified as relevant to a proper exposition of the question.

6.11 The issues identified in the inquiry as relevant in any consideration of the choice of fund issue are:

- the ability of consumers to make a informed choice, particularly the consequences of different vesting rules;
  - the actual power of an employee to exercise choice;
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<sup>6</sup> Alexander Consulting, SW Sub No 69

- effective portability;
- effective protection of small balances;
- the impact on employers;
- a sense of ownership on the part of superannuation account holders;
- competition;
- the extent to which a fund meets the needs of the individual's circumstances; and
- the appropriateness of the investment strategy of the nominated fund to the individual.

### *Informed choice*

6.12 The Industry Funds Forum (IFF) and the Sex Discrimination Commissioner both expressed concern that employees might make decisions that adversely affect their retirement income. For example, Ms Walpole said of women who have broken work histories and choose a defined benefit fund:

Unless women are aware of the impact of discriminatory vesting rules, this could be a very costly "choice" for them.<sup>7</sup>

6.13 Ms Malone highlighted the problem when she advised the Committee:

I am neither uneducated, nor uninterested in my superannuation but I am at a loss to know how to get the information I need to make informed decisions, what to do about the small amounts of money presently floating around in various unknown funds, how to "roll over" the separate amounts (or even what "roll over" means!) or how I should plan for, and incorporate, this compulsory system into a future which will inevitably involve constantly changing employment.<sup>8</sup>

6.14 The Committee concurs with the IFF submission that any moves toward member choice of fund need to be on the basis that the choice is:

- informed - through consistent disclosure of all costs and features of funds in accessible language, and

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<sup>7</sup> SW Sub No 89, Vesting provisions are examined in Chapter 7

<sup>8</sup> SW Sub No 12

- universal - the choice option needs to be offered to all employees.

6.15 Some members of the Committee supported choice on the basis that it would be collective so as to avoid the prospect of each employee in a workplace having a different nominated fund. Some Senators also expressed concern for those workers who cannot access membership to an industry fund and the portability that accompanies that membership. This is particularly important for casual and part-time workers. In that context, the Opposition Senators would like to see a far greater degree of choice so as to accommodate such workers.<sup>9</sup>

#### *Appropriate investment strategies*

6.16 The investment strategy of a particular industry fund may not be appropriate for a particular employee and current legislation does not provide for mandatory investment choice. The SIS legislation prescribes the circumstances where a trustee may be given directions relating to investment strategy, but such choices, known as member or beneficiary investment choice (BIC), are only possible at the discretion of the trustee.<sup>10</sup>

6.17 At different stages in an individual employee's life, different aspects of superannuation will be more important. For example, benefit levels in relation to family protection may be the highest priority in early years, while in the later years there will be more interest in retirement planning. Mr Robert Musgrave of LUPAC was concerned that not only was there no choice of fund, but there was no freedom of choice in the structure of benefits.<sup>11</sup>

6.18 It is therefore important that all funds ensure that their members have access to an investment strategy that is appropriate for them. The Committee recommended in a previous report that all standard employer-sponsored funds with fifty or more members be required to offer member investment choice.<sup>12</sup> The Committee is of the view that in an environment of limited choice of fund, access to appropriate investment strategies is imperative.

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<sup>9</sup> SW Sub No 77C

<sup>10</sup> *Super Regs II*, p 8

<sup>11</sup> Evidence, p 372

<sup>12</sup> *Super Regs II*, 1994, p 31

*Administrative complexity*

6.19 The issue of administrative complexity was put to the Committee.<sup>13</sup> It was argued that the cost of choice of fund could be 'quite significant for a lot of small businesses'<sup>14</sup> and that it would increase the administration required by employers to meet their superannuation requirements. However, evidence of systems that would facilitate the payment of superannuation contributions under a regime of employee choice for both small and large employers was presented.<sup>15</sup> These systems include:

For large employers:

- deskbank - a service through which a company electronically pays contributions to multiple funds, and
- diskette - a computer disk and single cheque is provided to bank for processing through banking system to superannuation accounts.

For small employers:

- list pay - list of employees, funds bank account and member account numbers and single cheque provided to bank for processing through banking system to superannuation accounts, and
- direct deposit - deposit book for each employee's fund. Employer pays by cheque to bank.<sup>16</sup>

6.20 The Committee also heard from Australia Post who submitted that they are equipped with the necessary technology to process banking and other financial transactions on-line. This technology could also provide for the collection, processing and disbursement of payments to superannuation funds. Such a service would be especially valuable to those small businesses without computer technology. These businesses would be able to simply provide Australia Post with one cheque and payment details.<sup>17</sup>

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<sup>13</sup> Women in Horticulture, SW Sub No 5

<sup>14</sup> Evidence, p 583

<sup>15</sup> Iemi L, SW Sub No 91

<sup>16</sup> SW Sub No 77 (A number of ARISA members withdrew from the ARISA submission: see SW Sub Nos 77A-77H)

<sup>17</sup> SW Sub No 67

## Access to the Australian Taxation Office and other national schemes

6.21 The concept of a government scheme into which any employee could choose to have their superannuation contributions paid was suggested in a number of submissions.<sup>18</sup>

6.22 The Committee first considered the new ATO arrangements with regard to small balances and whether some extension of this scheme was warranted. It was submitted that 'there should be a mechanism for automatic transfer of small amounts and contributions to the Australian Taxation Office (ATO), rather than leaving it to the discretion of employers'. It was further suggested that the ATO should pay interest of at least four per cent on small balances.<sup>19</sup>

6.23 Ms Allison McClelland, of the Australian Council of Social Service (ACOSS), said her organisation believed employees should be able to transfer their 'small contributions' to the ATO if they wished and not be dependent on the employer deciding on their behalf. She believed this was a denial of freedom of choice which would not be regarded as fair in other markets. A minimal rate of return of four per cent was suggested, given the use of that figure by the Department of Social Security as a 'deeming rate'.<sup>20</sup>

6.24 In one of the proposals that employees should be able to choose a public administered national superannuation fund (NSF), it was said of member choice:

At present if any choice is available it is only among funds in the private sector. We suggest that for superannuation members to have real choice, that is, a choice that emphasises security, that choice should be between a publicly or privately managed superannuation fund.<sup>21</sup>

6.25 It was suggested that a NSF would have other advantages. Being broadly based it would be a 'repository and accumulation fund' for those funds that cannot be managed economically by the private sector. There would be no need for involvement of the ATO in member protection and small amounts. Services such as housing finance could be made available to a wider section of the community through an NSF than would be the case in the private sector. Investment strategies of an NSF could incorporate broader social objectives

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<sup>18</sup> Examples see SW Sub Nos 18, 24, 64

<sup>19</sup> ACOSS, SW Sub No 62

<sup>20</sup> Evidence, p 81

<sup>21</sup> Gallery N & G, SW Sub No 771

such as funding infrastructure and venture capital. An NSF could be a benchmark for measuring the performance of private funds and provide model operating and disclosure standards.<sup>22</sup>

6.26 The Cabinet Office of NSW identified the 'development of a central superannuation fund available to all, but targeting low income earners and having a small administration fee' as an initiative that would take account of the differences between male and female earnings and savings patterns.<sup>23</sup>

6.27 It was argued by Natalie and Gerry Gallery that 'by establishing an NSF, the Government will demonstrate that it is effectively discharging its responsibility to provide Australians with an efficient long-term retirement income system that is secure, accessible and equitable'.<sup>24</sup>

### *SHAR and choice*

6.28 The Committee notes that a person with amounts in the SHAR system effectively has some choice. Such individuals may nominate where the money in their SHAR account is to be paid.<sup>25</sup>

6.29 The Committee supports the choice provided to these small account holders. It considers that small account holders whose employers do not facilitate this avenue of choice may feel disadvantaged.

### **Conclusions**

6.30 The concepts of freedom and choice are important in a democratic society. They attract costs as well as benefits however, and in order to strike the proper balances a creative tension is often present from which solutions may emerge. In markets such as superannuation which are always imperfect, it is often necessary to offer protection to individuals, as well as maintaining their freedom to choose within those same markets.

6.31 Members of the Committee hold strongly different views on the issue of employee choice of fund. These reflect the different philosophies of the political parties.

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<sup>22</sup> ibid

<sup>23</sup> SW Sub No 41

<sup>24</sup> SW Sub No 771

<sup>25</sup> Australian Taxation Office, SW Sub No 65