CHAPTER 2:

MEMBER CHOICE

Beneficiary investment choice must be within the investment strategy laid down by the trustee for the fund as a whole.

Introduction

2.1 This chapter examines the issue of members' right to choose funds and the effect of SIS legislation upon funds which offer their beneficiaries choice in how their superannuation money is invested. It also examines the feasibility of mandating the right of beneficiaries to choose investments.

MEMBER CHOICE

2.2 Member choice has two key strands:

- choice of fund membership; and
- members and beneficiaries of funds choosing investment strategies offered by trustees.

Choice of funds

2.3 If a voluntary member of a public offer fund is dissatisfied with the performance of the fund, regardless of the investment strategies on offer, that member is free to move his/her money to another fund, which would necessarily be another public offer fund.

2.4 That freedom of fund choice is not fully available to all members of standard employer-sponsored funds, usually industry funds, frequently because of the conditions imposed by a governing award.

State awards - choice of funds

2.5 However, the committee notes that most states (New South Wales, Victoria, Tasmania and Western Australia) have enacted legislation affecting state awards which allows superannuation payments to be paid into a fund of the employee's choice, provided the employer agrees. South Australia does not have such legislation but was apparently discussing changes similar to those enacted in New South Wales.[3] The extent to which fund members have taken advantage of these opportunities is unknown to the committee.

Federal awards - choice of funds

2.6 The Department of Industrial Relations (DIR) has previously provided the committee with the results of a survey of major state and federal awards (those covering over 10,000 employees).[4] At the time of the DIR survey, ten major federal awards had been identified in the Australian Bureau of Statistics Award Coverage Survey. Only two of these ten awards did not provide any choice of fund. Of the rest, two allowed the individual employee the choice of funds nominated under the award. Membership of funds in the remaining six awards were generally decided by agreement of the union members or following discussions between employers and unions. (See Table 1.)

2.7 The test case decision handed down on 7 September 1994 by the Australian Industrial Relations Commission (AIRC) about what provision, if any, awards of the AIRC should contain with respect to employee contributions, left the choice of fund provisions intact.[5]

2.8 The recent introduction of enterprise bargaining may have been expected to introduce an extra element of choice for a substantial number of workers. However, the DIR recently advised the committee that as at 13 September 1994, superannuation provisions have been a feature in only 428 of the 2,461 enterprise agreements made, with 332 of those agreements dealing with the issue of choice of fund.[6] Of those 332 agreements, 235 (71%) provided no choice of fund:

- 205 provisions specify one fund only;

---

3 *Superfunds*, 'The brave new world of industry super', by Beth Quinlivan, April 1994, p 18

4 Submission No 81 to the committee's original inquiry, sent 1 May 1992

5 Australian Industrial Relations Commission Superannuation Test Case, Melbourne, 7 September 1994, Print No L5100

6 SGCREV Sub No 94

Table 1

AWARD	NO OF EMPLOYEES COVERED	FUND CHOICE	METHOD OF FUND SELECTION
Transport Workers (Superannuation) Award	25,200	One fund	N/A
Insurance Industry Superannuation Award	18,800	One fund	N/A
Printing Industry Superannuation Award 1988	33,800	Two funds: PISF or ARF	Employee
Hotels Resorts and Hospitality Industry Award	24,300	Two funds: HOST-PLUS or existing fund	Employer application - joint working party. To AIRC if no agreement
Textile Industry Award	19,400	Two funds: ARF or existing scheme	Agreed by union members
Timber Industry Award	18,400	Two funds: TISS or existing scheme	Agreed by union members
Motels Award 1989	16,200	Two funds: HOST-PLUS or existing fund	Employer application - joint working party in case of existing scheme. To AIRC if no agreement.
Metal Industry (Superannuation) Award	185,100	Choice of STA, ARF, Tasplan or other (possibly non-industry)	Agreement between employer, employees and union; employer choice in some cases
Vehicle Industry - Repair Services and Retail	60,000	Multiple	Employee choice
National Building and Construction Industry Award	18,800	Multiple	Disputes over choice referred to AIRC.

Source: Adapted from 'Survey of Major Awards - Superannuation Provisions' prepared and supplied by Mr Grant Doxey, Director, Employment Conditions Section, Department of Industrial Relations

- 84 agreements provide a choice of two or more funds for superannuation contributions;
- 30 agreements specified the fund in relation to Superannuation Guarantee (SG) contributions; and
- 13 superannuation provisions did not limit payments to any specific fund.

It is possible that the reduced number of employees in any given enterprise agreement, vis-a-vis an award agreement, resulted in restricted choice to facilitate employers' administration of their superannuation obligations.

High Court judgment

2.9 On 1 July 1993, the High Court held that, special circumstances aside, an award cannot require employer superannuation contributions which are made in respect of employees who are not members of a union to be paid into a specified fund.[7] This judgment of the High Court may facilitate some members having a greater choice in nominating their superannuation fund.

Beneficiary investment choice (BIC)

The legislation

2.10 The SIS legislation prescribes the circumstances in which a trustee may be given directions, thereby allowing the beneficiaries of a fund to choose an investment strategy or a combination of strategies offered by the trustee. However, such choices, known as beneficiary investment choices (BIC), **are only possible at the discretion of the trustee.**

2.11 Subsection 52(4) of the SIS Act states that:

> An investment strategy is taken to be in accordance with paragraph (2)(f) [concerning the covenant requiring trustees to formulate and give effect to an investment strategy] even if it provides for a specified beneficiary or a specified class of beneficiaries to give directions to the trustee, where:

---

7 *Re Financial Sector Union of Australia; Ex Parte Financial Clinic (Vic) Pty Ltd and Others*, 178 CLR 352

(a) the directions relate to the strategy to be followed by the trustee in relation to the investment of a particular asset or assets of the entity; and

(b) the directions are given in circumstances covered by regulations made for the purposes of this paragraph.

2.12 The regulation made for the purposes of paragraph 52(4)(b) of the Act is SIS regulation 4.02:

REGULATION 4.02 COVENANTS IN GOVERNING RULES OF A SUPERANNUATION ENTITY - BENEFICIARY INVESTMENT CHOICE

4.02(1) [Circumstances in which directions may be given] For the purposes of paragraph 52(4)(b) of the Act, the circumstances in which a direction of the kind referred in that paragraph (other than a subsequent direction of that kind) may be given are:

(a) in the case of a direction by a specified beneficiary who is, or a class of specified beneficiaries each of whom is, a standard employer-sponsored member - the circumstances stated in subregulations (2) and (3); and

(b) in any other case - the circumstances stated in subregulation (2).

4.02(2) [Choice of investment strategies] For the purposes of paragraphs (1)(a) and (b), the following circumstances are stated, namely that:

(a) the trustee gives to the beneficiary, or to each member of the class of beneficiaries, a choice of 2 or more investment strategies from which the beneficiary, may choose a strategy, or combination of strategies; and

(b) the beneficiary, or each member of the class of beneficiaries, is given:

  (i) the investment objectives of each of the strategies mentioned in paragraph (a); and

  (ii) all information the trustee reasonably believes a person would reasonably need for the purpose of understanding the effect of, and any risk involved in, each of those strategies; and

(c) the beneficiary, or each member of the class of beneficiaries, is fully informed of the range of directions that can be given and the circumstances in which they can be changed; and

(d) the direction is given after compliance with the above paragraphs, and the direction specifies:

(i) which of the strategies or which combination of strategies referred to in paragraph (a) is to be followed in relation to investments of the beneficiary's or class of beneficiaries' interest in the fund; and

(ii) where applicable, matters related to the choice referred to in that paragraph.

...

2.13 **This type of choice which is allowed by the legislation can and should be distinguished from the kind of member-directed investment choice where the trustee *is required* to implement any investment or investment strategy for a member at the direction of that member. The legislation is concerned with existing investment strategy options which a trustee can offer fund members.**

The main concerns about BIC

2.14 The evidence taken by the committee indicated that there is broad support for BIC. However, a number of concerns were expressed about the manner in which BIC would operate under the SIS regime. These concerns merit serious consideration by trustees and the regulator, the ISC.

2.15 Some evidence suggested that BIC be a requirement rather than an option for some or all superannuation funds, either on moral/ethical grounds, or as a means of ensuring that members achieve optimal returns on their superannuation savings investments (under BIC, investment decisions could take into account such factors as the member's age, marital status, gender and financial commitments), or to discourage the establishment of excluded funds which would not be bound by the constraints on BIC in the legislation.[8] Others expressed concern that SIS regulation 4.02 undermined the basis upon which a number of master funds operate, namely: the right of investors to select and formulate investments that are appropriate to their own preferences and circumstances.[9]

Beneficiaries with limited choice

2.16 The committee considers that the lack of choice available to standard employer-sponsored (compulsory) members of some funds warrants closer examination than has occurred in its previous inquiries into the regulation of superannuation. In contrast, the committee has fewer concerns in this regard about voluntary members of public offer funds (including master trusts) who could become members as an act of personal choice and who, in many cases, are offered the opportunity to select a preferred investment strategy.

2.17 As noted previously, the voluntary members of public offer funds retain the option of transferring their accrued entitlements to other funds if they are dissatisfied with a fund's performance, even though exit fees may be substantial. Such an option may not be available to members of some funds where their membership of a fund is compulsory as a consequence of:

(i) conditions of an award negotiated with the Industrial Relations Commission; or

(ii) the employer's choice of fund into which compulsory superannuation contributions will be paid under the *Superannuation Guarantee (Administration) Act 1992*; or

(iii) agreed conditions of employment.

---

8 Howard Pender, Australian Ethical Investment Trust, and Caroline Le Couteur, August Financial Management Limited; Evidence, pp 11-22 and SISREG Sub No 15

Jock Rankin and Judith Towler, Financial Planning Association, Evidence, pp 37-59 and SISREG Sub No 11

Sly & Weigall, Lawyers, SISREG Sub No 13

9 J K Tidswell, SISREG Sub No 3; R E Nixon, Freedom of Choice, SISREG Sub No 4; Don Blyth, Trustee Corporations Association, SISREG Sub No 6

2.18 However, as noted in paragraph 2.5, recently enacted state legislation enables limited mobility for some fund members.

Fund members at risk

2.19 Several factors, especially when taken together, appear to prejudice beneficiaries whose membership of funds is compulsory (standard employer-sponsored members). These factors are:

(i) the general shift from defined benefit funds to accumulation funds, following the introduction of award superannuation and the SG legislation, moved the investment risk in the pre-retirement stage of a beneficiary's career from the employer to the beneficiary;[10]

(ii) employers choose the fund to which the compulsory SG contributions are paid; and

(iii) trustees are protected from liability for poor investment performance where investments have been made in accordance with an investment strategy formulated under the relevant covenant in the SIS Act.[11]

It can be argued that the outcome of these factors operating together is that most standard employer-sponsored members are required to bear the investment risk without having the power to effect the investment outcome. But countering this line of reasoning is the view that the majority of beneficiaries are not in a position to make prudent judgments on superannuation investments. These two arguments need to be carefully assessed.

---

10 (i) Financial Planning Association, SISREG Sub No 11

(ii) From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

(iii) David M. Knox, 'A Critique of the Direction of Current Superannuation Developments Using a Simulation Approach'; Colloquium of Superannuation Researchers, University of Melbourne, 8-9 July 1993

11 (i) Financial Planning Association, SISREG Sub No 11
(ii) Subsection 55(5) of the SIS Act 1993

Defined benefit funds

2.20 The Life Insurance Federation of Australia (LIFA) submitted that BIC was inappropriate in the case of defined benefit funds because benefits are not directly related to investment earnings.[12] While this argument has some merit, it could not be extended to all defined benefit funds, as some of these funds have benefits which are supplemented by member generated accumulation components. In respect of this component of a member's superannuation plan, there is a role for an element of member choice.

Advantages of BIC

2.21 The advantages of BIC were perceived to be that:

(i) it allows members to personalise their superannuation investments;

(ii) it allows members to complement their existing superannuation and non-superannuation investments;

(iii) it gives members what they want;

(iv) it would alter the current level of fiduciary responsibilities and obligations of trustees; and

(v) it avoids possible inequities in accumulation schemes by not having to use smoothing and reserving.[13]

Drawbacks of BIC

2.22 However, BIC has some possible drawbacks, namely, the perception that:

(i) overly conservative choices would be made by beneficiaries;

(ii) member benefits would no longer be protected by informed investment decisions made by investment professionals;

---

12 Supplement to SISREG Sub No 17

13 Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

(iii) generally members are not sufficiently sophisticated to make informed long term investment decisions;

(iv) BIC would interfere with trustees responsibility to protect their members superannuation savings;

(v) increased difficulty of administration would result; and

(vi) the added cost of introducing BIC could not be justified.[14]

Costs

2.23 LIFA estimated that the cost to a fund of introducing BIC into an existing accumulation scheme could be about 10 cents per member per month, plus a $20 charge for switching between options. This estimate took into account costs involving:

- trust deed amendments, processing of BIC requests, and various disclosure requirements;
- the development and implementation of the investment strategies; and
- advice to members.[15]

The estimate assumed that:

(i) the charge would be applied to all members of a fund rather than those who use the service;

(ii) there was no computer enhancement;

(iii) there was no personalised advice;

(iv) the choice was only available on joining and then annually; and

---

14 Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

15 SISREG Sub No 17, supplementary

(v) there would be a choice of four investment options for existing balances and/or future contributions.

LIFA estimates did not take into account certain investment costs such as buy/sell expenses.[16]

2.24 Where a 'user pays' principle is introduced, the cost per user would be higher. One estimate is that the cost of installing member choice was about $70 to $80 per head, but with little extra cost thereafter.[17] Jacques Martin estimated that based on the US experience (see below), administration costs, if spread across all members, will rise by between 25 to 50 per cent for simple investment choice arrangements.[18] For more complex arrangements, the costs could double.

2.25 While these estimates are approximate, the committee considers that the introduction of BIC into a fund need not be accompanied by substantial costs, particularly if, in the case of industry funds, simple choices are made available.

2.26 The following case study indicates to the committee that if BIC were to be integrated into a new fund's administrative systems from the outset, albeit in its simplest form, it may not add appreciably to the financial burden imposed on a fund and its members.[19]

2.27 Queensland Coal and Oil Shale Mining Industry Superannuation Fund (QCOS) (see paragraph 2.33 below), an industry fund which introduced BIC after the fund was established, found that BIC generated extra costs associated with providing information to members as part of a communication program designed to both inform and educate members of

---

16 SISREG Sub No 17, supplementary

17 Estimate attributed to Robert Birnbaum of J P Morgan in Barrie Dunstan's column in the *Financial Review* on 27 July 1994; article titled 'Super fund investment choice still a long way off'

18 SISREG Sub No 32

19 Information supplied by State Street - SISREG Sub No 35

Case Study:

The Australian Superannuation Savings Employment Trust (ASSET), is an industry fund which has been offering simple BIC since it was established (see Appendix E). The trustees charge members of the fund about 85 cents per person per week in administrative fees, which appears to be in a competitive price range for industry funds. As BIC was an integral part of the services administered for the fund, it is not possible to clearly quantify the cost of providing that option. However, it seems that the administrative costs charged to the members of that fund would not be appreciably less if members did not have the option.

the fund into investment choice.[20] Despite this, the fund was proceeding with the program, which was comprehensive in its scope (detailed further at paragraph 2.66 below).

Choosing choice

2.28 The committee considers that in principle it is appropriate for **both** choice of fund and BIC to be available to all members of superannuation funds as it believes this would:

(i) promote competition between funds;

(ii) enhance consumer understanding of superannuation; and

(iii) empower individual members of funds to influence their superannuation arrangements and provide them with an increased sense of ownership of their superannuation balances, thereby assisting them in achieving the objectives of self provision in the Government's retirement incomes policy.

2.29 The committee considers that the advantages to beneficiaries would easily outweigh the disadvantages provided that beneficiaries were more fully

20 Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

informed and educated to the range and nature of investment opportunities available. These advantages could be enhanced if members were also given some practical information as to how the various investment options could be used to optimise their superannuation entitlements given their individual circumstances and preferences.

2.30 The obvious advantages of BIC increasingly will be embraced by the community and be reflected in market forces which will further its cause. As homogenous investment strategies will be perceived by many members to be inadequate for their individual needs, it is expected that members, and possibly their representatives, who in some funds, act on their behalf, will demand greater choice in the manner in which their money is invested. Similarly, trustees and investment managers of funds would be expected to perceive that they should offer their members choices which would more closely suit their needs.

The current market

2.31 The committee is encouraged to learn that some industry funds are already offering BIC. As noted in the case study, one such fund, ASSET, offers BIC in a simple form, by way of a choice of two portfolios (see Appendix E).[21] One portfolio is market linked, with its attendant risks and designed as a long term investment because of the likely fluctuations in the year to year returns, while the other, designed for older members closer to retirement, consists mainly of capital guaranteed funds or capital stable investment arrangements.

2.32 The committee's attention was drawn to certain terminology used by the industry to describe different types of investment, for example: capital stable, capital guaranteed, and capital secure. Although these terms have very specific meanings within the industry, the distinctions between them are often lost on consumers. The current market can be bewildering for superannuants. The committee therefore calls on industry to ensure that their clients are clearly apprised of these distinctions before they enter investment arrangements. The committee also calls on the regulator, the ISC, to monitor compliance with the requirement that the trustee provide

---

21 ASSET employer kit

all the information that a person requires to understand their choice of investment strategy.

2.33 As noted at paragraph 2.27, QCOS also provides BIC.[22] In October 1993, QCOS introduced BIC to members who make voluntary contributions. Of the 10,400 members of the fund, 5,406 are voluntary contributors, of whom 1,113 (21%) elected to make a choice:

> Of those who participated, just over a third chose a mix of investments recommended by trustees according to the age of the member and two-thirds decided to mix and match their own choices from pools of capital guaranteed, balanced and 100 per cent equities. Those who did nothing had their voluntary contributions placed in the capital guaranteed pool, while the mandatory funds which made up the majority were managed in accordance with a member-age schedule.[23]

2.34 One of the largest industry fund administrators is also in the process of promoting BIC for the funds it administers.[24] The committee commends those funds which have taken, and are taking, this very important initiative.

2.35 The simple alternatives offered by ASSET are one end of the spectrum of possibilities which BIC opens to members. At the other end of the spectrum, a sophisticated range of BIC offerings is in the process of being formulated by AMP for public offer employer-sponsored funds - these are the traditional funds where employer contributions are supplemented by employee co-contributions.[25] The AMP plan includes an array of investment options ranging from very conservative capital guaranteed investments, such as short term Australian fixed interest securities, to investments with high levels of exposure to Australian and international

---

22 Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

23 Greg Bright, Case Study Two: 'Costs rise with choice of investment' in article titled 'It's a whole new ball game', *Super Review*, August 1994

24 Barrie Dunstan, 'AMP prepares for super push', *Australian Financial Review*, 25 August 1994

25 Information supplied by AMP on 19 August 1994

shares, in which the investor accepts a high level of volatility in return for the prospect of a high level of real returns associated with long term share investment.

Attitudes to superannuation which inhibit BIC

2.36 A combination of market forces and changing community expectations may not, on their own, be sufficient to entrench BIC throughout the superannuation industry. BIC, in the absence of steps to educate the community about its benefits, could prove to be:

> a way of guaranteeing members the total right to be wrong.[26]

2.37 Another factor suggested as inhibiting the introduction of BIC is that:

> there was no demonstrated demand for it, except for the top few per cent of people in superannuation.[27]

2.38 The BIC dilemma could well be explained by the widespread confusion which still surrounds the whole issue of superannuation. The Sweeney Report, which was commissioned by the Department of Social Security, published survey data indicating that about 50 per cent of Australians were confused about superannuation and that most did not know how much superannuation they needed to provide for a comfortable retirement.[28] An important message emerging from this report was that a very significant number of people would consider contributing more if they

---

26 Comment by Garry Weaven, executive chairman of Industry Funds Services Pty Ltd, reported by Barrie Dunstan, in 'Member choice a super danger', *Financial Review*, 21 July 1994

27 Comment by Garry Weaven, executive chairman of Industry Funds Services Pty Ltd, reported by Barrie Dunstan, in 'Member choice a super danger' *Financial Review*

28 Kalisch and Patterson of the Department of Social Security, 'Australia's Retirement Incomes System: Interactions and Attitudes' presented at the First Annual Colloquium of Superannuation Researchers at the University of Melbourne on 8-9 July 1993

understood more about superannuation. Higher levels of contributions would undoubtedly encourage a higher level of participation in choosing investments most appropriate to individual needs.

The pace of change

2.39 The pace of change in this area of superannuation activity will be influenced by the extent of trustee and beneficiary education. In its sixth report, the committee recommended that the ISC and key superannuation industry groups representing the interests of consumers and providers, combine to develop and implement a five year superannuation consumer education strategy for implementation in early 1994.[29]

2.40 The committee understands that following the Treasurer's Statement of 28 June 1994, a consumer education campaign is to be managed by the Australian Taxation Office, working closely with the ISC, various other government agencies and through a Public Education Focus Group which includes these and a number of other interest groups, including some private sector industry groups.[30] Although BIC was only a very small part of this education strategy, the ISC has recently produced a Superannuation Circular stating its position on this issue.[31] But it is important to note in this regard that ISC Superannuation Circulars are more for consumption by trustees than for fund members.

2.41 It is the committee's expectation, therefore, that BIC should be an integral component of the superannuation education plan of both the ISC and the superannuation industry.

---

29 Recommendation 3.10 of the Sixth Report of the Senate Select Committee on Superannuation titled *Super - Fees, Charges and Commissions*

30 Michael Monaghan, ATO, Evidence, 23 September 1994, pp 611-612

31 Superannuation Group, *Superannuation Circular No II.D.1, 'Investment Strategies and Beneficiary Investment Choice'*, September 1994

Recommendation 2.1

The committee recommends that in developing its comprehensive public education campaign on the consumer elements of superannuation, the Government make BIC a component of the forthcoming ATO/ISC campaign.

Beneficiaries who already have the right to choose

2.42 Although BIC has long been a feature of personal superannuation policies and has recently become a major selling point with a number of master funds, several submissions were received expressing concern that SIS regulations 4.02 and 4.09 would restrict the ability of such funds to enable their members to selectively tailor their investment strategies.[32] Included in these concerns was that these regulations will not allow investment strategies to be implemented unless they are formulated before being offered to all members through a prospectus.[33]

2.43 Freedom of Choice Funds Management Limited submitted that subregulation 4.09(2), which requires the trustee of a superannuation entity to formulate and give effect to an investment strategy that has regard to all the circumstances of the entity, is the reverse of their current practice which is to accept the strategy and place the investments as selected.[34] Freedom of Choice maintains that it is not possible for it to formulate and promulgate through its prospectus a range of strategies to suit every new applicant.

---

32 J.K. Tidswell, SISREG Sub No 3

R.E. Nixon, Freedom of Choice Fund Management Limited,SISREG Sub No 4

Don Blyth, Trustee Corporations Association, SISREG Sub No 6

33 R.E. Nixon, Freedom of Choice Fund Management Limited, SISREG Sub No 4

J.K. Tidswell, SISREG Sub No 3

34 SISREG Sub No 4

2.44 Another problem raised by Freedom of Choice was an extension of this perceived constraint, that is: a member who decides to replace one investment with another investment is prevented from doing so because under the SIS regulations the participant cannot direct the trustee to replace investments unless it is an investment strategy which has already been formulated by the trustee.[35]

2.45 Tidswell Benefit Consultants and Fund Administrators and the Trustee Corporations Association of Australia raised similar concerns.[36] Freedom of Choice and Tidswell both submitted that many of their subplans would be likely to leave the master trust and establish their own excluded superannuation funds, which are not bound by SIS regulation 4.09, and which would therefore regain direct control over their investment options.

2.46 The Australian Government Actuary commented on this issue:

> ...our experience is that the members of [master trusts with subplans of less than five members] definitely do need prudential protection from the ISC. It has been suggested that the effect of the legislation may be a swing from these master trusts to excluded funds...Some of these very free choice master trusts may break up into their constituent subfunds...In a prudential sense, this is probably a positive move because the separate subfunds will then be separately audited and have separately identified assets, which will deal with one of the major prudential problems that we have detected so far...[37]

2.47 Notwithstanding this line of reasoning, the committee is not troubled by the mode of operation of master trusts which actively formulate individual investment strategies in consultation with members of their subplans, as long as these are consistent with all the circumstances of the fund, particularly with the overall investment strategy formulated for the fund as a whole. The essential ingredient in this process is that the trustee accepts responsibility for the final design and selection of investments. The committee does, however, have concerns that the software used by some

---

35 SISREG Sub No 4

36 SISREG Sub Nos 3 and 4

37 Evidence, p 105

master trusts has been inadequate for the task, generating unacceptable delays in administrative processing.

2.48 Although the members of funds most likely to participate in designing and implementing investment strategies would be generally those with substantial investments in superannuation, the committee does not consider that this option should be denied to less affluent fund members. This will become increasingly important as the accrued entitlements of members of funds grow under the SG regime.

Recommendation 2.2

The committee recommends that the ISC review the SIS regulations to ensure that the formulation of an individual investment strategy by a trustee in consultation with a fund beneficiary will not be a breach of operating standards, provided this strategy is consistent with the overall investment strategy that the trustee has formulated for the fund as a whole.

Should a beneficiary be given the right to choose investment strategies?

2.49 Mr Howard Pender, of the Australian Ethical Investment Trust, and Ms Caroline Le Couteur of August Financial Management Limited, submitted, in effect, that standard employer-sponsored members of a fund, who are compelled to join their industry fund or corporate sub-plan, and who have moral or ethical objections to the manner in which a trustee of a fund invested a member's contributions, should be able to exercise some right of choice as to where their money is directed.[38] Such a direction would, amongst other things, be subject to the trustee being satisfied that the proposed investment strategy was suitable for superannuation purposes.

2.50 Ms Judith Towler and Mr Jock Rankin of the Financial Planning Association (FPA) were also in favour of members having the choice of fund and the choice of an investment strategy within funds.[39] The FPA's submission was that individuals would be better off if allowed to make a choice based on their needs, personal circumstances and risk tolerance, with that choice being made within the context of competent and unbiased financial advice.

2.51 In examining the issue of whether or not BIC should be mandated, the committee considered that such a course of action would be premature, if done immediately, for the following reasons:

(i) a concern that one of the cornerstones of SIS, namely, the concept of a single entity, the trustee, taking full responsibility for running the fund, may be undermined;

(ii) at this stage, there appears to be only a small demand for BIC by members of superannuation funds; and

(iii) enhanced community education about superannuation is needed before a mandatory BIC regime is implemented.

---

38 Evidence, p 21

39 Evidence, p 45
SISREG Sub No 11

These concerns are discussed in further detail below.

2.52 The committee gained the impression that BIC, while frequently discussed, was not a matter upon which some key superannuation groups have formulated firm policy positions.[40] The absence of publicly stated positions by some of these industry players underscores the impression that although BIC has been allowed under trust law for some considerable time, it is in conceptual and practical terms, in its embryonic stages of development.

The trustee as the sole entity responsible for running a superannuation fund

2.53 This key element to the SIS legislation and its attendant prudential safeguards was recommended by the committee in its first report, *Safeguarding Super.* The committee maintains that trustees should not be forced to, or be able to, avoid responsibility of designing an investment strategy and, ultimately, selecting particular investments. Should this occur, there would be a severe risk of undermining the whole purpose of the SIS legislation, namely, to attain prudential control and security of superannuation assets. This risk would be heightened if individual BIC were to be mandated, and a trustee required to accept an investment strategy or a particular investment preference of any individual member or group of members, regardless of whether or not that investment or investment strategy was certified by an accredited financial adviser as being suitable for superannuation. The basic role of a trustee includes the right to make, and to take full responsibility for, the fundamental evaluation of whether an investment or an investment strategy is suitable for superannuation.

2.54 Nevertheless, the danger to a trustee's responsibility and independence would clearly stem not from BIC per se, regardless of whether

---

40 For example, Australian Institute of Superannuation Trustees; Association of Superannuation Funds of Australia; and the Australian Consumers Association did not give oral evidence on this issue. Of these three organisations, only ASFA forwarded a submission which took a position on this issue, maintaining that it should be '...up to funds as to whether to offer investment choice to members... Member choice should not be compulsory in the current environment.' - SISREG Sub No 28

or not it is mandatory, but from investments and investment strategies being forced upon a trustee.

Demand for BIC

2.55 The results of the symposium held by J.P. Morgan with industry representatives on 19 July 1994 seemed to indicate that BIC would inevitably become a more entrenched feature of the industry.[41] In addition, a survey conducted by Towers Perrin of 139 superannuation funds, revealed that 15 per cent of the funds surveyed already offered BIC, and that a further 50 per cent of the funds surveyed are planning to, or will consider, offering members a choice of investment.[42] Of the remaining 35 per cent of funds that did not intend to offer BIC to their members, over two thirds indicated that pressure from members would make them reconsider their decision not to offer BIC. A smaller but significant proportion indicated that market pressure and a decrease in costs associated with establishing BIC would make them reconsider. Appendix F includes some of the results of the Towers Perrin survey.

2.56 These findings were also reflected at the J.P. Morgan symposium where, although less than one third of the industry representatives at the symposium stated that their funds currently offered BIC, and only about half stated that their funds intended to offer BIC within two years, over two thirds agreed that fund members should have a say in what choices the fund should offer. In addition, nearly three quarters of these representatives agreed that BIC would increase voluntary contributions to the fund while nearly half considered that BIC would increase participation in the fund. Furthermore, nearly two thirds agreed that members of funds are interested in how investment alternatives affect their retirement income.

---

41 J.P. Morgan Industry Funds Symposium, Interactive Session Results - Sydney, 19 July 1994

42 Towers Perrin, *Topics*, 'Results of survey on member investment choice', May 1994

The US experience

2.57 In evaluating what appears to be a lack of demand for BIC on the part of members of funds at large, the committee examined the origin of BIC in the USA, where it has become a popular feature of retirement savings plans. Mr Robert Birnbaum, of J.P. Morgan, maintained that the first factor that arose in the US was the shift from defined benefit funds to defined contribution funds (accumulation funds) which were less expensive to fund and operate than traditional pension plans.[43] In addition, employers wished to avoid liability for poor performance. Finally, as their accounts grew, employees, who bore the investment risk in defined contribution plans, demanded control over investments involving their funds.

2.58 The extent of member choice in the US is immense. According to statistics quoted by Mr Birnbaum, by 1993 there were nearly US$1.2 trillion invested in defined contribution plans which incorporate member choice, drawing level with the amount invested in defined benefit plans. Mr Birnbaum stated that:

> The growth in the US pension industry over primary savings has really been in the member choice area. It's anticipated by the turn of the century that member choice will be the dominant form of retirement savings in the US...[member choice] plans are enormously popular and enormously visible. People receive statements, they think of it as their money, they see money flowing in both from their own salaries and the company contribution. They see investment growth. They know if they leave their company these things are portable: they can take their money with them. They are very popular benefits. If you look in classified advertisements in newspapers for jobs in the United States, you will very frequently see these plans as the key benefits for attracting employees.[44]

---

43 From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

44 From an edited transcript of a presentation by Robert Birnbaum, of J.P. Morgan, on 19 July 1994 at the J.P. Morgan Industry Funds Symposium in Sydney, provided by the Australian Institute of Superannuation Trustees Inc

In Australia

2.59 A salient feature of superannuation plans in the US is that, in the main, membership is voluntary. This, of course, contrasts with the compulsory nature of much fund membership in Australia, generated as it has been by award superannuation and SG contributions, and employment contract arrangements.

2.60 Within Australia, a substantial portion of fund membership is within the large industry funds which are a product of the award superannuation developments of the 1980s. By and large, these funds are defined contribution plans, the members of which, as noted previously, bear the investment risk in relation to the contributions made on their behalf by their employers.

2.61 About a third of the almost 4 million members of 80 or so industry funds which responded to a recent survey are classified as 'inactive' members.[45] This description generally refers to members in relation to whom no contributions have been received for 12 months or more.[46] This is an inhibiting factor which clearly militates against BIC at this stage. Until an effective mechanism is implemented to address the small amounts/inactive members problem, industry funds will find it difficult to have high levels of member participation or choice.

Educating members of superannuation funds

2.62 The low level of participation in industry funds, the ongoing confusion in the minds of the community concerning superannuation, and the complexity of investment decisions in exercising BIC, leads the committee to reiterate that extensive and effective community education needs to be given priority and fully implemented, regardless of whether or not BIC becomes mandated. The committee again notes in this context that greater knowledge of superannuation is likely to lead to significantly higher levels of voluntary contributions by fund members, and that a greater stake

---

45 Beth Quinlivan, 'The brave new world of industry super', *Superfunds*, April 1994

46 Ibid

in a fund, particularly a voluntary stake, often leads to greater participation.[47]

2.63 An interesting corollary of an education process leading to greater participation and therefore greater use of BIC opportunities, is that BIC plans themselves may provide educational opportunities because:

> they are visible, people care about them, they watch what happens to them and perhaps this is a chance to educate the...public around financial and economic issues.[48]

2.64 The committee is encouraged to learn that the process of trustee and beneficiary education seems to be gaining substantial momentum in a number of quarters.

2.65 In addition to the recent seminars conducted by J.P. Morgan on the subject of BIC for the benefit of the industry, ASFA intends conducting seminars, surveys and study groups on the issue of BIC.[49]

2.66 The QCOS experience in developing a communication program on BIC is a noteworthy example at the individual fund level. The QCOS program addresses the characteristics of each investment option available to members, the administration requirements for investment choice, and how their investment choice fits in with the fund's investment strategy in the context of superannuation.[50] The fund also distributes a booklet describing its investment strategy, holds meetings of members and their spouses, uses company and union representatives to provide information and issues a quarterly newsletter to all work sites for dissemination to members. In the future, the fund intends providing members with additional investment performance information and more detailed annual reports.

---

47 The Sweeney Report, mentioned in paragraph 2.38, refers

48 Robert Birnbaum, from edited transcript of presentation at the J.P. Morgan Industry Funds Symposium in Sydney on 19 July 1994

49 SISREG Sub No 27

50 Greg Bright, *Super Review*, August 1994, 'It's a whole new ball game'

2.67 Another insight into BIC at the fund level was provided by Mr Bob Putnam at the J.P. Morgan Industry Funds Symposium. The CSR Staff Superannuation Fund under Mr Putnam's leadership has been administering BIC since 1983.[51]

2.68 *The committee considers that standard employer-sponsored members of funds should ultimately have the right to choose between investment strategies. It is acknowledged that the introduction of BIC would add to operating costs of existing funds. It is essential that these operating costs should be explicitly identified.*

2.69 *As evidence to the committee (outlined at paragraphs 2.23 to 2.27) suggests that those costs can be reasonably contained, and as market pressure will push administrators into implementing BIC, existing standard employer-sponsored funds with fifty or more members should not be exempted from being required to provide BIC.*

2.70 The committee considers that smaller funds should be exempted from the administrative burden of mandatory BIC unless a future review determines that such an exemption is not an appropriate course of action.

2.71 The committee wishes to encourage a regime which will make BIC mandatory and anticipates that such a requirement could be phased in over, say, five years. This would allow the superannuation industry, with Government assistance, the opportunity to implement appropriate education strategies and sufficient lead time for trustees to reorganise the administrative/technological capacities of their funds.

2.72 The committee notes LIFA's evidence that, if the trustee of any industry fund wanted to offer a particular service involving BIC, then one or more of its (LIFA's) members would be able to accommodate that need.[52]

---

51 'Should your fund offer member investment choice?', presented by Bob Putnam, Manager Superannuation, CSR Limited, at the J.P. Morgan Industry Funds Symposium on 19 July 1994 in Melbourne

52 Evidence, p 91

Recommendation 2.3

The committee recommends that the trustees of all standard employer-sponsored funds with fifty or more members (except those defined benefit funds which have no member generated accumulation component) be required to offer beneficiary investment choice to their members in accordance with the provisions of SIS regulation 4.02.

The committee also recommends that this not be introduced before the community education campaign, being conducted by the superannuation industry in conjunction with the ISC and ATO, nor before fund trustees are able to reorganise, as necessary, the administrative/ technological capacities of their funds to ensure the smooth introduction of BIC.