File Number: 200723

Consumer Policy Framework Inquiry
Productivity Commission
PO Box 80, Belconnen, ACT 2616, Australia
Email: consumer@pc.gov.au

21 May 2007

ASFA SUBMISSION TO PRODUCTIVITY COMMISSION REVIEW OF AUSTRALIA'S CONSUMER POLICY FRAMEWORK

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to make this submission to the Productivity Commission Review of Australia's Consumer Policy Framework.

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, that include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

1. UNIQUE FEATURES OF SUPERANNUATION

There is now over $1 trillion in assets in Australian superannuation funds. For many Australian families, superannuation constitutes the second-biggest asset after the family home.

Though superannuation is a financial product, it is unique in a number of ways. These unique features must be considered when formulating the consumer protection associated with superannuation.

Role of the Trustee

A unique feature of superannuation is the role of trust law and the statutory obligations on trustees, as codified in the *Superannuation Industry (Supervision) Act 1993* (SIS). These obligations go beyond a mere contractual arrangement and oblige the trustee to act in the best interest of members.

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300
F + 61 2 9264 8824

outside Sydney
1800 812 798
outside Sydney
1800 812 798

Compulsion and Role in Retirement Income System

A unique feature of superannuation in Australia is compulsion. The Superannuation Guarantee (SG) requires most employers to pay an amount equal to 9 per cent of an employee's ordinary time earnings to a superannuation fund. This provides for wide coverage of superannuation and ensures its role as a fundamental component of our retirement income system.

However, compulsion brings with it certain challenges. One such challenge is the lack of financial literacy of many who become superannuation fund members as a result of their employment. For many of these members, superannuation will be the only sophisticated financial product they will ever hold.

Further compounding this challenge is that most Australians are in accumulation funds. As a result, it is individual members, not employers or the government, who bear the associated costs and investment risks.

Long Term Nature

Another unique feature of superannuation is its long-term nature. Superannuation is part of Australia's retirement income system. Superannuation monies are "preserved" and cannot be accessed until the member retires from the workforce, reaches a particular age or satisfies another condition of release.

For young consumers, the final benefit of superannuation may appear "remote" and therefore of minimal interest. Further, continual changes to the taxation and regulation of superannuation have led many to be wary of investing in super in case they are adversely affected by future changes.

2. CONSUMER PROTECTION REGULATION OF SUPERANNUATION

As noted above the unique features of superannuation must be considered when formulating an appropriate consumer policy response. Role of the trustee, role of superannuation within retirement income policy, compulsion, and the long term nature of superannuation require responses to the regulation of superannuation that may be somewhat different to those of other "retail" financial products.

These unique features require a regulatory system that has:

- **Strong and Proactive Regulation to Protect Consumers**– A regulatory system that ensures member's interests are adequately protected, superannuation funds are well governed, and assets properly invested and secure for the provision of future retirement income.

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

- **Simple and Understandable Disclosure for Consumers**– Compulsion and preservation help ensure superannuation's role in the provision of retirement income. However this has meant many superannuation fund members are disengaged from their super and / or financially unsophisticated. In a choice environment, it is therefore important that disclosure to members is simple and understandable.
- **Efficient and Cost Effective Regulation** – As most superannuation fund members are in accumulation funds, it is those members who ultimately bear the cost of regulation. Regulation must therefore be efficient and cost effective.

3. STRONG AND PROACTIVE REGULATION TO PROTECT CONSUMERS

3.1 Superannuation guarantee

An important consumer protection policy is the Superannuation Guarantee. By requiring employers to pay an amount equal to 9 per cent of an employee's ordinary time earnings to a superannuation fund, it ensure wide coverage of superannuation and guarantees superannuation as a fundamental component of our retirement income system. Strong enforcement of employer obligations by the Australian Taxation Office (ATO) is critical to the SG's success.

There are a number of improvements to the SG that would benefit consumers. At the moment the SG is required to be paid at least quarterly. ASFA supports employers being required to pay contributions monthly and for employers being required to notify employees that contributions have been made. This recommendation is an important part of a strategy to ensure better compliance in the payment of SG entitlements by all employers and in so doing ensuring that other related entitlements (e.g. death and disability insurance) are also payable.

Now that mandated contributions have reached 9% of salary, and because the introduction of choice and portability have removed the concerns raised about finding a suitable fund to accept smaller contributions, ASFA supports the removal of the provision that excludes SG to those earning under $450 per month from a single employer. This will particularly assist those in casual and part-time work (predominately women).

3.2 Security of superannuation

The supervision or regulation of superannuation needs to be strong and proactive to reflect the compulsory nature of super for most members and its role in the Government's retirement income policy.

ASFA supports fund governance frameworks by trustees who are responsible, and accountable, for the prudent management of the fund, including the assets held in trust, in the interest of the primary stakeholders of the fund: members and their dependants.

ASFA believes that prudential supervision to ensure the safety of superannuation should be based on a genuine assessment of risks and the adoption of an appropriate and measured

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

response to any problems identified. Addressing any problems requires the creation of appropriate and targeted guidance as well as the presence of a pro-active regulator prepared to take action when members' benefits are genuinely at risk. As well, any regulation aimed at improving the security of superannuation must be done on a cost / benefit basis – see Section 5 of this submission.

3.3 Superannuation Complaints Tribunal as EDR

When consumers have complaints, it is important that they have access to an external dispute resolution (EDR) mechanism. ASFA supports the Superannuation Complaints Tribunal (SCT) as the most appropriate EDR for superannuation funds.

ASFA's support for the SCT includes the need for the following standards / principles to be adhered to in order to ensure consumer confidence and integrity of the complaints mechanism for superannuation (including compulsory superannuation):

- it is independent;
- it is a statutory body;
- the decisions are appealable (to the Supreme Court);
- it provides written decisions; and
- the governance structures mitigate any potential conflict of interest.

3.4 Compensation for Loss in Event of Theft or Fraud

When a superannuation fund member suffers a loss as a result of theft or fraud committed by the trustee, it is important that they be adequately compensated for the loss.

ASFA supports a cost-effective and targeted approach to compensation for loss based on:

- Part 23 of the SIS Act (whereby the Minister levies the industry in event of theft or fraud);
- the Superannuation Complaints Tribunal; and
- trustee indemnity insurance cover.

ASFA does not support the establishment of a standing statutory scheme for potential compensation payouts for loss in the case of fraud or theft. Such a scheme raises concerns over issues of moral hazard and cost. ASFA does not support the extension of compensation to SMSFs where decisions were made by the individual trustee / member. It inappropriate that other funds (and their members) should bear the burden of such compensation.

Currently, compensation for loss is paid in event of theft or fraud under Part 23 of the SIS Act. ASFA supports consideration of a wider definition of reasons for compensation to be paid, whilst recognising that the underlying principle for payment of compensation must be based around protecting fund members from a trustee acting in a grossly unreasonable

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

manner in undertaking their fiduciary obligations and which members would have had no ability to foresee. In giving consideration to a widening of the definition, ASFA would be seeking to ensure that the broader industry is not funding the result of what is effectively a poor or imprudent choice of fund by an individual or employer.

4. SIMPLE AND UNDERSTANDABLE DISCLOSURE FOR CONSUMERS

4.1 The Lessons of Behavioural Finance Research

As noted above, compulsion and preservation help ensure the role of superannuation in the provision of retirement income. However many superannuation fund members are disengaged from their super and / or relatively unsophisticated in their financial literacy. In a choice environment, it is therefore important that disclosure to members is simple and understandable.

Disclosure should be grounded in how consumers actually make decisions rather than abstract notions of economics or law. Much of our thinking has been informed by behavioural finance research, including our own consumer comprehension testing.

Behavioural finance research of the two decades has reinserted individual psychology into economic decision-making. It has shifted away from the abstract notion of the economic actor as rational and utility maximising. Rather, behavioural finance examines how economic decisions are actually made – often relying on experimental settings.

Behavioural finance has discovered some important findings about how individuals make economic decisions. One is that individuals often rely upon "rules of thumb" when making decisions, so that complex decisions are simplified so that a decision can be made. Another finding is that how material is presented can impact on the decision. Lastly, there is the notion that individuals engage in economically irrational behaviour, often mispricing as a result of emotional decisions.

In our own various rounds of consumer comprehension testing, ASFA had similar findings. We found that individuals preferred documents that were short and simple.

We also found that individuals will ordinarily not read a disclosure document from cover to cover. The take-aways from our research has been that ideally disclosure documents should be short, simple, with important information near the front and navigation tools available so individuals can find the information they want quickly and easily.

One element that should be considered when developing consumer protection policy is to actually test the proposed policy prescription with real consumers. ASFA has found that consumer comprehension testing of sample disclosure documents is an invaluable tool in this regard.

Based on our own testing and the broader behavioural finance, we should expect consumers to want disclosure documents that are relatively brief, easy to navigate and understand and

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

provide answers to their key questions. Ideally, new superannuation fund members should receive a relatively brief disclosure document that explains the basic features of the fund. If they want further information, it should either be available on request or on the fund's website.

4.2 Shorter and More Understandable Product Disclosure Statements

Unfortunately, the main disclosure documents for superannuation funds, the Product Disclosure Statements (PDSs), have become lengthy and complex documents, often difficult for members to comprehend.

PDSs should be consumer guides. They should be presented and written in a way that will assist a member make decisions. As noted above, proposed requirements should be tested with consumers to better ensure that efficacy.

As well, "incorporation by reference" of certain non-essential information may assist in keeping PDSs shorter and therefore more understandable for members. However, information that is critical to consumer decision-making should always be included within the PDS.

The internet represents a cost-effective mechanism for providing additional information to members. However, there remain variations between the membership of different superannuation funds and their accessibility to the internet. If the incorporated material were available through the fund's website, then the fund should also be prepared to provide hard copies of incorporated material upon request.

In the *Corporations and Financial Services Regulation Review: Draft Corporations Amendment Regulations and Commentary*, released for comment on 26 March 2007 by the Commonwealth Treasury, Proposal 1.15 would introduce an ability for PDSs to refer to other documents available from a website or on request. Though ASFA supports the general intent of this proposal, we have made specific recommendations to Government to ensure a workable "incorporation by reference" provision in the Corporations Act.

Ideally the incorporation by reference test should be relatively unambiguous and preferably refer to specific content requirements, such as information about insurance or investment options. Otherwise, the reforms may be under-utilised and not achieve the intended policy outcome.

ASFA intends to undertake future research on effective disclosure documentation and liase with ASIC and Treasury on the outcomes. ASFA is also continually supporting more effective disclosure through initiatives such as the ASFA Communication Awards and supporting the role of communication experts through specialist discussion groups.

4.3 Improving Financial Literacy

Improving the quality of disclosure documents is only one part of the equation. ASFA is also supportive of initiatives designed to promote and improve financial literacy within the

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

community. The Government's Financial Literacy Foundation was one such initiative that we anticipate will bring about such improvements. We believe that both Government and industry have roles in advancing such initiatives and that the most effective initiatives are those where Government and industry work together.

5. EFFICIENT AND COST EFFECTIVE REGULATION

5.1 Levies

Consumer protection regulation in financial services is paid for through a regulatory levy. ASIC and the SCT receive funding for their consumer protection role through a levy placed on financial service providers including superannuation funds. This is an important factor to keep in mind as often it is the superannuation fund member, who is effectively paying for the cost of regulation. The supervisory levies have risen considerably in recent years and have become a concern for superannuation funds seeking to maximise the retirement benefits of their members. The cost/benefit of the current and ever-increasing regulatory demands is not always evident.

Currently the Government, following consultation with industry, sets the levies.

To improve the operation of the levies, ASFA seeks:

a) a fair and more transparent distribution of costs amongst superannuation fund members and between superannuation funds and other regulated financial institutions;

b) provision of data and information to allow the industry to give informed comment on levy proposals;

c) an independent board to set levies and formal requirements for it to consult with industry on a timely basis: and

d) appropriate accountability for the use of levies.

5.2 Reducing Regulatory Duplication and Overlap

One of ASFA's main concerns has been regulatory duplication and overlap between ASIC and APRA. This is not necessarily an issue specifically touching consumer policy regulation, as ASIC has primary responsibility for consumer protection in financial services.

However, given the two regulators operating in similar areas, guarding against duplication and overlap is important. Regulation should be efficient and cost effective and avoid any unnecessary duplication or overlap of functions between regulators. Positive examples where the regulators have worked together in a pro-active fashion, such as unit pricing policy needs to be replicated where the prudential responsibilities of APRA and the consumer protection responsibilities of ASIC become blurred.

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798

If you have any questions or comments on this submission, please feel free to contact me, Brad Pragnell or Robert Hodge at the ASFA Secretariat on 02 9264 9300.

Yours sincerely,

Philippa Smith AM
CEO, ASFA

SECRETARIAT

Piccadilly Tower
Level 19
133 Castlereagh St
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T + 61 2 9264 9300

F + 61 2 9264 8824

outside Sydney
1800 812 798