



16 December 2009

By email: info@supersystemreview.gov.au

Super System Review
GPO Box 9827
Melbourne VIC 3001

Dear Sir/Madam

Submission to Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System – Phase Two: Operation and Efficiency

The Consumer Action Law Centre (**Consumer Action**) welcomes the opportunity to comment on the Issues Paper entitled *Phase Two: Operation and Efficiency* (the **Issues Paper**), released as part of the Federal Government's review of Australia's superannuation system, the *Super System Review* (the **Review**).

We strongly support the review of Australia's superannuation system and consider that the Review is raising pertinent questions about important issues. We do not have the capacity to respond to all of the questions in the Issues Paper, thus we have limited our comments in this submission to two issues. The first is our support for a national default fund. The second is our recommendation that the processes and regulation around the early release of super be examined and improved. Our comments are detailed more fully below.

About Consumer Action

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action provides free legal advice and representation to vulnerable and disadvantaged consumers across Victoria, and is the largest specialist consumer legal practice in Australia. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Since September 2009 we have also operated a new service, MoneyHelp, a not-for-profit financial counselling service funded by the Victorian Government to provide free, confidential and independent financial advice to Victorians facing or experiencing job loss or reduced working hours to help them manage their money and debt.

National default superannuation fund

Consumer Action supports the introduction of a national default superannuation fund, as discussed in section 6.2.2 of the Issues Paper.

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The ability of members to facilitate better outcomes in the superannuation market through driving competition between funds seems to be limited by traditional demand-side problems such as information and cost problems, including complexity, search costs, exit fees and other switching costs.¹ Some of these are discussed in the Issues Paper.

However, we also consider that the actual behaviour of consumers in markets, beyond traditional information and cost problems, needs to be considered in designing a better superannuation system. Classical economics assumes that markets are filled with perfectly rational consumers who will try to make choices that maximise their self-interest and fulfil their pre-determined preferences using all the relevant information available, but it is now understood that actual consumer behaviour in markets can often differ markedly from this assumption.²

Behavioural economics examines actual consumer behaviour in markets and identifies systematic biases and departures from the perfectly rational consumer that is assumed by classical economics.³ These systematic biases include the tendency of individuals to use heuristics, or simple rules of thumb, rather than weighing up all options in making decisions; a default bias that sees individuals tending to procrastinate and remain with whatever option is first offered or taken up rather than make an active choice to change; a related endowment effect or status quo bias that sees individuals reluctant to sell or give up something they already own even if they would not newly take up this item if now offered it for the first time; and choice overload, in that when people are overwhelmed with choice they tend to decide not to make a choice at all, either walking away from a decision altogether, making the choice using an arbitrary method or delegating the choice to someone else, for example the product or service provider.

Behavioural economics has significant implications for policy, allowing these systematic biases or departures to be considered in determining both whether a policy intervention is necessary and how to design proposed policy responses to maximise their efficacy. By contrast, the effects of failing to consider behavioural principles have already been seen in Australia, for example in the current over-reliance on disclosure regimes in the Australian financial services market, including superannuation. Not only are consumers highly unlikely to actually read complex and detailed disclosure documentation, other forms of disclosure, such as the disclosure of a conflict of interest by an adviser, can have the opposite effect to that intended. For example, one study found that rather than making consumers more cautious, disclosure of a conflict of interest raised their trust regarding the adviser.⁴ Another study showed that mortgage

¹ See, eg, Waterson M, *The Role of Consumers in Competition and Competition Policy*, University of Warwick Economic Research paper no.607, 2001; Klemperer P, 'Competition when Consumers have switching Costs: An Overview with Applications to Industrial Organization, Macroeconomics, and International Trade', *Review of Economic Studies* 62: 515–539, 1995; Waddams C, Giulietti M and Waterson M, 'Consumer Choice and Industrial Policy: a study of UK Energy Markets', *The Economic Journal* 115: 949-968, 2005.

² Productivity Commission, *Review of Australia's Consumer Policy Framework - Productivity Commission Inquiry Report: Volume 2 – Chapters and Appendixes*, No. 45, 30 April 2008, pp 373-388.

³ For a list of biases in consumer behaviour, see: OECD Committee on Consumer Policy, *Roundtable on Demand-side Economics for Consumer Policy: Summary Report*, 20 April 2006, Appendix II. Behavioural Biases, p 3; also Productivity Commission, as above, pp 380-381.

⁴ See Cain D M, Loewenstein G and Moore D A, 'The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest', *Journal of Legal Studies* 34: 1 – 25, 2005.

broker compensation disclosure can actually confuse consumers and lead them to make worse decisions than they would have had no disclosure been provided.⁵

We consider that a well-designed default superannuation fund has the benefit of making use of, rather than fighting against, systemic biases that affect how consumers make decisions, particularly around consumer preferences to avoid making complex decisions and to stick with the status quo. For this reason, we also believe that a default fund would help to address several of the other concerns discussed by the Issues Paper, including how to minimise lost member accounts, the rolling over of members into more expensive Eligible Rollover Funds (ERFs), attempts to improve information disclosure to members to encourage them to drive better outcomes and the lack of competition generally due to inactive decision-making by members.

In this regard, we support the case for the introduction of a national default superannuation fund made by The Australia Institute in its paper, *The case for a universal default superannuation fund*.⁶

As the Issues Paper notes, choice overload has been explored in the superannuation context, where it has been argued that when consumers are faced with multiple options, this can increase the likelihood of greater confusion and complexity and make a decision difficult.⁷ The Australia Institute's paper reports that, while the introduction of choice of superannuation fund for consumers was intended to lead consumers to drive an increase competition resulting in lower fees and increased investment returns, as little as 10% of Australian consumers have actively chosen their superannuation fund. Moreover, when consumers are offered multiple investment choices within their chosen fund, up to 80% of members do not consider this option, thereby simply remaining with the default investment option.⁸

The paper by The Australia Institute also notes the lack of success that the choice of fund policy has had in reducing the number of multiple superannuation accounts per consumer, with 32 million superannuation accounts currently in existence – almost triple the amount of people in the workforce – and around 13 million unnecessary super accounts accumulating around \$1 billion in fees each year.⁹ The Issues paper also notes this problem in section 7.1. These figures come from research generated by the consumer organisation CHOICE, which has also pointed out that a lot of these inactive or lost superannuation funds are then rolled over into ERFs, which charge high fees for lower returns. A national default fund could be used to hold these account funds, instead of them being rolled over into ERFs.

A recent paper estimates that the introduction of a national default superannuation fund could potentially save superannuation members more than \$20 billion per year and possibly double the

⁵ See Lacko J M and Pappalardo J K, 'The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment', *Bureau of Economics Staff Report*, Washington DC: Federal Trade Commission, February 2004.

⁶ Ingles D and Fear J, *The case for a universal default superannuation fund*, The Australia Institute, Policy Brief No. 3, September 2009.

⁷ Mottola G R and Utkus S P, *Can there be too much choice in a retirement savings plan?*, Vanguard Centre for Retirement Research, June 2003.

⁸ Ingles D and Fear J, above n6, pp 2-3.

⁹ As above, p 5.

retirement wealth accumulated by a member over their working life.¹⁰ This paper also argued that a default fund would provide a simple and easy to understand alternative for all consumers and would provide a performance benchmark to promote competitiveness and efficiency in the superannuation market.

We therefore support the proposals for a national default fund put forward by The Australia Institute, which include that the fund should:

- keep fees low by contracting out administration and employing a passive approach to investment;
- be able to be adopted by any employee at any time as the fund of choice
- be used to consolidate lost and/or inactive accounts
- act as a repository when members are moving their employment and do not wish to transfer their accounts to a new fund;
- employ an age-based weighting towards equities in the investment options used for members; and
- be government-backed.¹¹

It is also essential that a national default superannuation fund remain cost-effective with low administration fees and charges. The Issues Paper notes that in New Zealand, the established auto-enrol default superannuation fund, KiwiSaver, is subject to a certain level of government pressure on fee levels, with any fees charged to fund members required to be 'not unreasonable'.¹² This approach seeks to ensure that fund operating costs do not eat away at member retirement savings. The Australia Institute's paper also considers capping fees as an approach to ensuring fair fees for superannuation funds, default or otherwise, which we consider has merit. This might be easier if fees were subject to a standardised structure for their naming and levying, as the Issues Paper discusses in section 8.2.3. A similar approach has been followed in the UK in relation to mortgage exit fees, for example.¹³

Early release of superannuation benefits

The Issues Paper does not discuss the issue of early release of superannuation benefits. However, we recommend that changes could be made to the way in which early release operates to improve outcomes for members, particularly disadvantaged or vulnerable individuals.

According to the Superannuation Industry (Supervision) Regulations 1994 (the **Regulations**), the early release of an individual's superannuation benefit is permitted under certain circumstances, subject to the rules of the fund or Retirement Savings Account (**RSA**). A person can access their superannuation benefit before retirement age if they meet one of the grounds for early release,

¹⁰ Sy, W, *Toward a national default option for low cost superannuation*, Paper presented to the 16th Australian Colloquium of Superannuation Researchers 3-4 July 2008 at the University of New South Wales, Australian Prudential Regulation Authority, 30 June 2008.

¹¹ Ingles D and Fear J, above n6, pp 12-16.

¹² See O'Connell A, 'KiwiSaver: A Model Scheme?', *Social Policy Journal of New Zealand* 36:136, August 2009.

¹³ See Australian Securities and Investments Commission, *Review of mortgage entry and exit fees*, Report 125, April 2008, pp24-25.

which include severe financial hardship, compassionate grounds specified in the Regulations, permanent departure from Australia, permanent incapacity or terminal illness.

Two of the grounds for early withdrawal which are relevant to the more vulnerable of consumers are severe financial hardship and specified compassionate grounds. In short, the Regulations allows a person to access their superannuation under financial hardship if they are in receipt of a Commonwealth income support payment, and have been so, continuously, for the last 26 weeks; and if they satisfy the trustee/RSA provider that they are unable to meet reasonable and immediate family living expenses. (There are guidelines that Australian Prudential Regulation Authority (**APRA**) has produced to assist trustees in assessing claims, including a definition of ‘unable to meet reasonable and immediate family living expenses.’) If unable to claim early release under financial hardship, the most common means to access superannuation benefits is through specified compassionate grounds. Obtaining funds under these specified grounds requires application to APRA and the grounds are as follows:

- to pay for medical treatment or medical transport for the person or a dependant;
- to enable the person to make a payment on a loan to prevent foreclosure of a mortgage on the person’s principal place of residence or the exercise by the mortgagee of a power of sale over the person’s principal place of residence;
- to modify the person’s principal place of residence, or vehicle, to accommodate the special needs of the person, or a dependant, arising from severe disability;
- to pay for expenses associated with the person’s palliative care in the case of impending death or to pay for expenses associated with a dependant’s: palliative care in the case of impending death, death, funeral, or burial; or
- to meet expenses in other cases where the early release is consistent with one of the above grounds, as APRA determines.¹⁴

Superannuation benefits released to individuals under the age of 55 are taxed at the rate of 21.5% (which includes the 1.5% Medicare levy). This taxation removes any tax concessions on the superannuation benefits and is intended to act as a disincentive to accessing superannuation savings before retirement age. However, given that the nature of most claims for early release of benefits will be for severe financial hardship and compassionate grounds, the tax imposes an extra financial burden on people who are already in significant financial distress. It is difficult to determine whether this “withdrawal tax” on early release of superannuation actually does act as a disincentive to consumers. If a person meets the criteria for financial hardship or a specified compassionate ground for early release, it is likely that that they will be desperate enough for the funds to bear the tax.

For example, a 2007 report by the Consumer Law Centre of the Australian Capital Territory and the Australian National University (the **(CLC ACT Report)**) suggests that the large increase in applications to APRA for early release of superannuation benefits over recent years may be

¹⁴ Superannuation Industry (Supervision) Regulations 1994 Regulation 6.19A.

related to mortgage defaults.¹⁵ APRA provided data on the number of applications received and approved for early release of superannuation on compassionate grounds, which showed that there was a marked increase in applications received and approved between 2001 and 2006 as well as a marked increase in both the total amount of funds released and funds released per application.

We understand that the Review is not considering taxation issues specifically. However, the process for the early release of superannuation should be within the Review's scope. The current policy settings rely heavily on a large tax upon withdrawal to act against inappropriate early release of superannuation, however, we consider that this merely tends to punish further individuals who have already decided to access their superannuation early due to financial difficulties. Rather than use tax settings in this way, we recommend that the Review consider how the process for applying for and approving early release of superannuation could be improved to ensure early release is available quickly when it is appropriate, but be refused when it is not appropriate.

The CLC ACT Report was specifically concerned not with the taxation on early release at all, but on the inappropriate use of early release of superannuation to pay mortgage arrears when the consumer was still likely to default in the longer term and lose both their home and, now, their superannuation benefits. The CLC ACT Report states:

Where a consumer is experiencing short-term financial hardship, but in the longer term will be able to meet home loan repayments, accessing superannuation funds to meet mortgage arrears can be highly beneficial. However, where a loan is likely to fail because it is simply unaffordable, paying superannuation money to cover arrears delays the inevitable and potentially undermines the borrower's future financial security that superannuation is intended to assist.

Evidence from the Centre for Consumer Law's casework suggests that a growing number of clients have been encouraged to access their superannuation to pay mortgage arrears, rather than negotiating other outcomes. Under section 66 of the *Consumer Credit (Australian Capital Territory) Code 1996*, a consumer who is unable to meet obligations under their owner-occupier home loan because of circumstances such as illness or job loss, can request a hardship variation from their lender to reduce payments for a period of time. However, the experience reported by many of the CLC's clients has been that lenders suggest accessing superannuation to pay arrears in the first instance.¹⁶

We have similar concerns that early release should not be available if a mortgage is unaffordable for the consumer and using superannuation funds to pay arrears and prevent immediate foreclosure will not prevent ongoing default and, thus, foreclosure down the track. This merely transfers superannuation benefits to a lender for no real member benefit, which is certainly not the purpose of allowing for early release in such circumstances. We are also aware that some lenders have actively encouraged borrowers to apply for early release of superannuation to pay

¹⁵ The Consumer Action Law Centre of the ACT and the Centre for Commercial Law, The Australian National University, *"They still want to take our house": A further investigation into house repossessions in the ACT Supreme Court*, December 2007. Much of the report focuses on the level of people who have experienced mortgage foreclosure despite getting early access to their superannuation. It resulted in them losing both their house and retirement savings.

¹⁶ As above, p 26.

mortgage arrears, without concern as to whether the loan repayments are serviceable by the borrower.

The CLC ACT Report states that a significant question is whether the legislation guiding APRA in this area is sufficiently vigorous or adequate in an environment where lenders are pushing early access as a means of payment for consumers. The CLC ACT Report also points out that, more specifically, the criteria used by APRA in deciding whether or not to release funds to a member does not include any assessment of whether the member/borrower is likely to avoid defaulting in the future.¹⁷

Consumer Action recommends that the Review consider the regulation of early release of superannuation further. In our view, the high tax on release should be replaced by better and more detailed rules around when superannuation may be released and a more active role by APRA in determining when release will and will not be appropriate. We believe that the Review should also consider how the process for early release depending on different grounds could be better harmonised and made more consistent. For example, at present, release on the grounds of severe financial hardship is determined by the trustee or RSA provider, whereas APRA regulates early release on compassionate grounds. As the Issues Paper has not discussed these issues explicitly, we would agree that further consultation with various interested stakeholders would be appropriate.

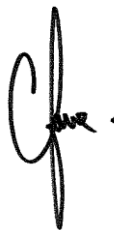
We again thank the Review Panel for the opportunity to provide comment on its review of Australia's superannuation system. Should you have any questions regarding this submission, please contact Nicole Rich at Consumer Action on (03) 9670 5088.

Yours sincerely

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¹⁷ As above, pp 28-29.