# The introduction of choice of superannuation fund – results to date

**Ross Clare, Principal Researcher**
**ASFA Research Centre**
**Association of Superannuation Funds of Australia**

February 2006

**Federal Secretariat**

**Level 19**
**Piccadilly Tower**
**133 Castlereagh St**
**Sydney NSW 2000**

**PO Box 1485**
**Sydney NSW 2001**
**Tel: (02) 9264 9300**
**Fax: (02) 9264 8824**

**The Association of Superannuation Funds of Australia Limited** ABN 29 002 786 290 ACN 002 786 290
**ASFA Website: www.superannuation.asn.au**

# Executive Summary

This paper explores the extent to which employees have exercised choice to date, and the likely future impact of current and proposed legislative and administrative arrangements. It draws heavily on detailed data from an October 2005 ANOP survey commissioned by ASFA, but also makes use of a wide variety of other data.

*Forecasts made prior to introduction of choice*

The more measured and considered projections of the incidence of choice of superannuation fund put its likely incidence at a figure of less than 10% of fund members, and then over some time. Considerably higher forecasts of the exercise of choice of fund, with figures ranging between 16% and 47%, were obtained (by some) by surveying sub-groups of the population with a higher expressed or actual preparedness to exercise choice and/or interpreting member expressed intentions of exercising choice as "likely" or "quite likely" as indicators that choice would be exercised.

*Current distributions of member accounts for those in employment*

Employees are most likely to nominate a retail fund (either a group or personal arrangement) as their current main superannuation fund, but the proportion nominating an industry fund (at just over 30%) is similar. A substantial proportion of the population nominate a public sector fund, with the proportion for this sector more or less in line with the proportion of employees in the public sector.

The 'gap' between the proportion nominating a retail fund as their main fund and those nominating an industry fund appears to have narrowed in the last few years. This is due to both a strengthening of the industry fund share of the market and increased awareness by some members of the fund they are in.

Compared to the other fund sectors, industry funds tend to have a higher proportion of women, younger people, part-time workers, the lower paid, and clerical/sales and blue collar workers. However, there is still a fair degree of diversity in the membership of other types of funds, and industry funds themselves do have members across the complete range of age, income and occupation.

*Ability to choose own fund prior to choice legislation*

While overall around one in four respondents to an ANOP survey in October 2004 indicated that they personally chose the fund they were in, in the retail fund sector the figure was nearly one in two. On the other hand, industry funds had 12% of members indicating they personally chose to be in such funds, with industry funds also having around 3% of their membership drawn from the self employed.

Survey figures tend to suggest a rate of switching funds of about 7% or 8% a year, even without any legislated right to choice of fund. Much of this is due to job changes and fund closures by employers in the run-up to APRA licensing of funds.

*Incidence of choice after 1 July 2005*

The 2005 ANOP survey results provide an early indication of the exercise of choice of fund. Out of those surveyed, during the first three months of the operation of choice of fund legislation 7% changed funds. However, only 4% of the sample chose a new fund as a conscious act of choice, as 2% of respondents went to a new fund because it came with a new job, and 1% changed because of closure of the old employer fund.

Most of the conscious acts of choice of a fund happened without employment change, with almost all of those changing jobs going with the new default. The incidence of choice of a Self Managed Superannuation Fund was relatively low in the period concerned. Under 0.5% of the sample selected a SMSF.

*Likely future exercise of choice of fund*

In broad terms, on top of the 4% of respondents who have already actively exercised choice of fund (rather than moving because of a change of job or the like), another 4% or 5% are likely to change funds in the next twelve months. This adds up to 8% or 9% of fund members, which is remarkably in line with the February 2005 ASFA Research Centre forecast of 8% of fund members exercising choice over the first 12 months or so.

The percentages of respondents indicating that they are "very likely" or "likely" to change funds was down markedly between October 2004 and October 2005. While one reason for that is that those most likely to exercise choice have already exercised choice, the falls in the percentages are much bigger than can be explained by such behaviour. Fund members in many funds have now gone through a cycle of contemplating change, and a larger proportion of members are now more "rusted on" their fund than they were before**.** This is a positive result indicating both increased awareness/engagement and an increased loyalty to current funds.

The survey data indicate that retail fund members continue to be the most likely to shift funds. Some of these moves may be to other retail funds and some might be industry funds, and there may be a preparedness or intention by at least a few to set up a Self Managed Superannuation Fund.

Putting all the various figures together, a reasonable assessment might be that going forward the incidence of those in employment joining a new superannuation fund is likely to be in the order of 11% or 12% a year. This figure is likely to drift down rather than up over time, as the stock of corporate funds being closed by employer sponsors is diminishing. As well, over time more employees are likely to keep their old superannuation fund when they start a new job.

The incidence of choice of fund legislation linked selections of superannuation funds appears likely to be of the order of 6% a year in terms of a count of the number of fund members.

*Effect of new industrial relations legislation*

The Commonwealth Government's WorkChoices legislation is likely to have a significant impact on choice of fund, particularly after 1 July 2008 when various transitional arrangements preserving the previous State based industrial provisions expire and default funds are no longer specified by Commonwealth awards. However, initially the maximum number of employees being provided with choice might not exceed 200,000 and could well be less, with the number actually exercising choice only a small fraction of that.

All up, some 6.3 million employees might have Commonwealth legislated choice of fund by 1 July 2008, compared to around 5.2 million in July 2005.

*Winners and losers from choice*

As a number of observers have noted, it is difficult to find evidence of any type of fund being a loser from choice of fund or a fund executive claiming that their fund has suffered.

Industry funds appear to be trading well following the introduction of choice of fund, contrary to the expectations of at least some commentators. While it is difficult to net out the effects of strong investment returns and closure of corporate funds that both occurred over the same period as the introduction of choice, industry funds have gained substantial numbers of both new members and contributing employers.

Data for retail funds are even more difficult to interpret, but they too also appear to be generally prospering following the introduction of choice of fund. A number of retail funds have had substantial inflows of new members and/or contributions to existing accounts. However, at least one survey has suggested that there have been net flows of members from some retail funds, or at least for some products. That said, this may have more to do with the normal cut and thrust of competition within the retail sector, together with consolidation of inactive accounts and rationalisation of product lines within the retail sector than an actual loss of overall business in terms of assets under management. Assorted data indicate that retail products which are competitive in the market and/or are used for successor fund arrangements are doing quite well either regardless of or because of choice of fund.

To date interest in SMSFs appears to have tailed off, with the expressed intentions made a year or so ago by a substantial number of retail and other fund members not turning into reality. When investment returns from managed investments decline, as they will, there may be increased interest in SMSFs, but countering this is increased regulatory activity in regard to advisers involved with SMSFs, and increased community awareness of the time and cost involved in running a SMSF.

*Incidence of mis-selling*

The evidence on aggregate flows of members between funds and on reasons for moving from one fund to another tends to suggest that in the main choice decisions have been both rational and relatively untainted by any selling process.

However, it is likely that some mis-selling is happening and will continue, particularly if some financial advisers are not well supervised by the group they are affiliated to, or if non-licensed advisers influence decisions by fund members.

To date reported instances of mis-selling appear to be relatively isolated cases driven by individual advisers of some sort rather than the result of any coordinated marketing campaign. The cases to date also have involved member choices not linked to legislated choice of superannuation fund.

# The introduction of choice of superannuation fund

Legislation by the Commonwealth providing for choice of superannuation fund for the majority of Australian employees receiving the benefit of Superannuation Guarantee contributions from employers has now been in operation since 1 July 2005. **This paper explores the extent to which employees have exercised choice to date, and the likely future impact of current and proposed legislative and administrative arrangements.** In undertaking this exercise use is made of survey results, the experience of clearing houses for superannuation contributions made by employers, and analysis of the possible reach of proposed legislative provisions.

The paper also revisits some projections and forecasts about the incidence of choice made prior to its actual introduction. This is always an interesting exercise, especially if your own projections have held up fairly well compared to others.

The paper also explores the likely operation of choice of fund following the introduction of Commonwealth industrial relations arrangements removing corporations from the jurisdiction of State industrial relations legislation and removing superannuation as an allowable matter from federal awards. Both the mechanics of choice of fund for those affected together with estimates of the number of employees affected are explored.

## 1. Initial forecasts of the impact of choice of superannuation fund

Prior to the implementation of legislated choice of superannuation fund there were some interesting forecasts made of the likely number of fund members exercising choice. Generally these forecasts were based on surveys of the general population or a sub-set of that population. There was considerable diversity in published forecasts, reflecting differences in the populations sampled and, more importantly, differences in how questions about choice of fund were cast and how responses were interpreted.

It is also possible that some of the results and projections were written up with an eye to being reported in the media, and hence were inclined to take a more newsworthy approach. In this context, **many of the forecasts of the takeup of choice made prior to 1 July 2005 pointed to high levels of usage of the choice provisions by employees. On the other hand, some forecasters (the ASFA Research Centre included) applied a considerable discount to stated intentions by fund members and derived much lower forecasts of the exercise of choice of fund.**

*The interesting and/or very large projections of choice being exercised*

In November 2004 **ACNielsen, a professional polling organisation, reported that a survey of over 2,600 superannuation customers indicated that Self Managed Superannuation Funds were to become the fund of choice for up to 16% of fund members**. While the calculation was not done by ACNielsen, this would imply the creation of up to 1.5 million SMSFs, which is quite a big number. 33% of respondents indicated that they “might” consider changing their current fund, with a further 17% “likely” or “extremely likely” to switch. It was also reported that of those who might or who were likely to switch, along with the 16% choosing SMSFs, 12% indicated a preference for retail funds, 9% for industry funds, 7% for Retirement Savings Accounts, 6% for corporate funds, and 5% for public sector funds. The survey report did not explore the mechanics of how persons who were not already members of corporate and public sector funds would go about choosing to be in such funds.

By July 2005 ACNielsen had found from its 1,500 online respondents that awareness of superannuation choice had increased by 48 percentage points to 93%. 51% were unlikely or would not change their current superannuation fund, while 28% said they "might" consider changing funds, down five percentage points. Of potential destination funds, 22% said they might switch to an industry fund, with support of other types of fund fairly steady.

In January 2005 *Personal Investor* magazine conducted an on-line survey of its readers in regard to choice of fund and other issues. There were around 1,650 respondents to the survey, mostly male, married, well-educated and toward the upper end of the income and wealth distribution in Australia, with 27% already indicating that they were in a Self Managed Superannuation Fund. Out of this self-selected and self evidently not entirely typical sample, 11% indicated that they were very likely to consider changing funds in the next two years, with a further 11% indicating that they were "fairly likely" to.

**Roy Morgan Research reported in mid 2005 that 15.6% of superannuation fund customers were "likely to switch" their superannuation fund manager, "implying that huge amounts of money will soon be changing hands"**. However, Roy Morgan Research also noted that "excitement does not seem to be matching the survey results".

**Alan Kohler in a qualitative assessment which formed part of a July 2005 presentation to a seminar is reported as declaring that industry funds would be unlikely to gain customers under the new law, and employees with a choice would be more likely to move out of their industry fund.** He also saw a more competitive future where the fees of industry fund managers would have to rise due to a need to advertise and inform their existing and prospective members. Also, he was reported as saying that eventually the industry fund managers would be sold to the large providers (principally the banks) as the whole superannuation industry became more commercialised.

**FuturePlus Financial Services were reported in May 2005 as indicating that they had found that 47% of people aged 25 to 34 believed they were likely to change funds over the next 12 to 18 months**. However, a spokesperson for FuturePlus did indicate that not too much should be read into the results, other than that younger people have a higher propensity to change.

*Projections on the run and moving*

Mercer Wealth Solutions in April 2005 reported the result of a survey of 558 fund members from 144 organisations, presumably drawn from employers Mercer had contact with. **David Anderson of Mercer indicated that 24% of employees would consider switching funds in the next two years**. One in ten claimed that they were very likely to change funds if they had the opportunity, with a further 14% claiming to be somewhat likely to change funds. The incidence of reported preparedness or likelihood to change was greatest amongst males (26% of males, 19% of females), those dissatisfied with their current fund, those with multiple superannuation accounts (26% of those with multiple accounts, 17% of those with one account), and those with higher account balances (32% of those with $100,000 in super likely to change).

By September 2005 Mercers had reinterpreted the data, with the new version being that **in February and June 2005 some 16% of members surveyed fell into the "at risk" category, being those members who had stated their intention to switch, are not satisfied with their current fund, and held multiple superannuation accounts making consolidation a viable proposition.** By September 2005 this proportion had fallen to 12%, with Mercers speculating that this might be the start of a slow and steady decline among the "at risk" group as they actually begin switching. However, at the same time there was an increase in the number of members reporting that they were unlikely to change funds, with the proportion in this category doubling from 24% in February 2005 to 48% in September 2005. This might suggest that behaviour in practice is different to what people indicate when asked an abstract question some months before choice of fund was implemented.

*ASFA projections*

**The ASFA Research Centre in a February 2005 paper put forward some of the lowest forecasts of the percentage of employees expected to exercise choice. It was estimated that around about 8% of fund members would be able to and would want to exercise choice of fund. This was forecast to lead to gross flows between fund sectors of about 6% of fund members, with these flows taking some years to occur fully.**

The percentage of assets on the move was forecast to be likely to be higher, given that those with higher account balances appear to be the most inclined to move. The analysis suggested that over time some 7.5% of total superannuation assets would move following the introduction of legislated choice of fund. Retail funds in particular were seen as being at risk of losing members as a result of choice of fund, with members wanting more control switching to use of Self Managed Superannuation Funds, with price conscious members considering use of industry funds. On the other hand, retail funds were seen as likely recipients of considerable bulk transfers of members following the closure of corporate funds in the run-up to the deadline for all funds to have an APRA licence.

It should be noted that these assessments were not based on simply adding up the percentage of respondents surveyed who indicated that they were very likely to choose another fund, or were likely to choose another fund. As a rough rule of thumb, the experience of market researchers is that most of the individuals who indicate that they are "very likely" to do something will actually do that thing, while only a very small proportion of those responding "quite likely" will move from intention to action. Accordingly, in this exercise it was considered that using the total for "very likely" might be a reasonable proxy for the weighted combination of the two categories in regard to those actually likely to change funds. The exclusion of the supposed "quite likely" changers of fund from the figures sets these projections apart from most others made at around the same time.

The ASFA Research Centre estimates also took into account the then extent of constraints on choice, such as the impact of awards and industrial agreements and the unavailability of choice to members of defined benefit and/or unfunded superannuation schemes.

The ASFA Research Centre projections received quite extensive media and other attention when they were released in February 2005, generally on a non-critical basis.

*Summary of projections and expectations*

**In summary, the more measured and considered projections of the incidence of choice of superannuation fund put its likely incidence at a figure of less than 10% of fund members, and then over some time. Considerably higher forecasts of the exercise of choice of fund were obtained (by some) by surveying sub-groups of the population with a higher expressed or actual preparedness to exercise choice and/or interpreting prompted member expressed intentions of exercising choice as "likely" or "quite likely" as indicators that choice would actually be exercised.**

The next sections of this paper look at the available evidence on the extent to which choice has been exercised in the months following the choice of fund legislation becoming effective.

# 2. ANOP survey results on the extent of choice of fund in practice

ANOP Research Services was commissioned by ASFA to conduct a national survey of the workforce about attitudes to superannuation and choice of fund following the introduction of choice on 1 July 2005. The national survey consisted of a telephone survey conducted in September-October 2005 of 504 Australians aged 25 to 64 years in regular full-time or part-time work (10 hours per week). Accordingly the bulk of the respondents were benefiting from compulsory employer contributions. Similar surveys also were conducted in earlier years by ANOP for ASFA, with these providing some baseline data on intentions in regard to choice. While the main results of the survey were published in November 2005 (and are available from the ASFA website), this paper provides further details.

The 2005 survey covered those in paid employment, not just employees. It is likely that up to 10% of those surveyed were self employed or were the owner/manager of an incorporated business. While a significant proportion of this group was subject to the SG arrangements because many of the businesses were incorporated, by definition such owner managers already had choice of fund.

**The primary aim of the research was to gauge awareness of, and attitudes to, choice of fund together with the incidence and likelihood of changing superannuation funds.** For instance, the survey investigated a range of drivers of choice or retention, such as satisfaction with current fund, and perceptions of the relative level of returns and fees, on the likelihood of changing funds and on the incidence of having already changed funds. The research also provides a valuable snapshot of the demographics of membership of various categories of funds and the split of employees between various types of funds. This demography helps to explain the likely outcomes for different types of fund from the introduction of legislated choice of fund.

The classification of responses into different fund sectors was based on respondents being asked to name their current main superannuation fund. Only 5% of the sample did not know the name of their main fund. Pleasingly, the vast bulk of respondents were able to name their fund with sufficient clarity for it to be identified and classified, although there were some interesting phonetic modifications in the giving and recording of fund names. Member knowledge of at least the name of the fund they are in is now quite high, with the percentage well up on recognition levels recorded in surveys five or ten years ago. Even as recently as July 2002 another ANOP survey for ASFA indicated that 11% of respondents did not know the name of their superannuation fund.

The ASFA Research Centre then classified each respondent into fund sectors (that is, retail, industry, public sector, corporate or self managed fund). This gives more accurate allocation of responses to sectors given that many members may not be clear as to what type of fund they are in. In particular, there often can be confusion on the part of fund members in regard to whether a personal account with a retail fund is a Self Managed Superannuation Fund or not.

## 2.1 Profile of Fund Sectors

Table 2.1 provides selected details of funds and the demographic characteristics of the members of the various types of funds as at October 2005.

**Employees are most likely to nominate a retail fund of some sort as their current main superannuation fund, but the proportion nominating an industry fund is similar. A substantial proportion of the sample nominated a public sector fund, with the proportion for this sector more or less in line with the proportion of employees in the public sector.** However, the proportion is down from the 23% recorded in July 2003.

**The gap between the proportion nominating a retail fund as their main fund and those nominating an industry fund appears to have narrowed in the last few years.** The proportion nominating a retail fund is largely unchanged over the last three years, while the proportion nominating an industry fund has grown from 19% to 32%. **The recorded results would reflect both market developments, and more individuals recognising an industry fund as their main fund as a result of increased awareness of superannuation and growth in average account balances in industry funds.** As noted above, employees now do generally seem to be aware of the fund to which their employer contributes.

The proportion of employees in corporate funds as indicated by the survey is still substantial at around 5%, but this is down a few percentage points from the level recorded three years previously in an ANOP survey for ASFA. This figure is likely to decline further with the closure of corporate funds following the introduction of more onerous licensing conditions by APRA and review by companies of what their core business activities.

The proportion of respondents nominating a Self Managed Superannuation Fund as their main fund continues to grow, up by 2 percentage points in the last two years. An even higher percentage of respondents in the current survey volunteered that they were in a SMSF, but analysis of the name of fund provided by some such respondents indicated that a significant number of respondents confused an individual account through a wrap or master trust with a SMSF. The classifications used in this analysis are based on what the fund named actually is, rather than the perception of the member. The bulk of the Self Managed Superannuation Funds that were identified were used by the self employed, or by owner managers of small businesses.

**Table 2.1: Profile of Fund Membership, October 2005(a)**

| **Current fund sector membership** | **Total** | **Retail Fund** | **Industry Fund** | **Public Sector** | **Corporate Fund** | **SMSF** |
|---|---|---|---|---|---|---|
| | % | % | % | % | % | % |
| **Fund membership** | 100 | 34 | 32 | 16 | 5 | 4 |
| **Gender** | | | | | | |
| Men | 56 | 64 | 46 | 46 | 75 | 67 |
| Women | 44 | 36 | 54 | 54 | 25 | 33 |
| **Age** | | | | | | |
| 25-34 | 28 | 34 | 30 | 18 | 23 | 14 |
| 35-44 | 30 | 26 | 29 | 38 | 29 | 26 |
| 45-54 | 28 | 29 | 27 | 29 | 26 | 34 |
| 55-64 | 15 | 11 | 14 | 15 | 22 | 26 |
| **Work** | | | | | | |
| Full-time | 75 | 81 | 68 | 74 | 96 | 74 |
| Part-time | 25 | 19 | 32 | 26 | 4 | 26 |
| **H'hold Income** | | | | | | |
| Under $40,000 | 19 | 17 | 29 | 6 | 11 | |
| $40-$59,000 | 21 | 24 | 20 | 23 | 12 | 4 |
| $60-$79,000 | 16 | 13 | 18 | 19 | 26 | 13 |
| $80-$99,000 | 14 | 13 | 11 | 17 | 13 | 30 |
| $100,000 plus | 23 | 26 | 16 | 27 | 34 | 36 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Occupation** | | | | | | |
| Prof/Mgrs | 28 | 29 | 20 | 43 | 16 | 36 |
| Cleric/Sales | 24 | 30 | 20 | 19 | 19 | 25 |
| Assoc Prof | 27 | 24 | 34 | 24 | 29 | 21 |
| Blue Collar | 20 | 17 | 26 | 12 | 28 | 13 |
| **Company Size** | | | | | | |
| 1-20 | 37 | 49 | 37 | 6 | 4 | 70 |
| 21-499 | 27 | 30 | 32 | 20 | 8 | 21 |
| 500+ | 34 | 21 | 27 | 72 | 88 | 9 |

(a) Results exclude the respondents unable or unwilling to identify their fund, or whose fund type is unable to be identified from the information provided. Unlike latter tables in this section, the results total to 100% within columns rather than across rows in order to allow demographic profiling of the members of each sector.

Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

**Industry funds tend to have a higher proportion of women, younger people, part-time workers, the lower paid, and clerical/sales and blue collar workers. This will come as no surprise to most industry funds and to other industry observers. However, there is still a fair degree of diversity in the membership of other types of funds, and industry funds themselves do have members across the complete range of age, income and occupation.**

In contrast, corporate funds tend to have a heavy preponderance of males and full-time workers amongst their members, with some, but not certainly all, members on relatively high salaries. However, overall corporate fund membership demographic characteristics appear to be moving closer to those for other sectors with the closure of certain corporate funds. The remaining corporate funds tend to be larger, and have higher proportions of blue collar and women workers amongst their members.

Retail funds tend to have a very strong market share amongst small businesses, with industry funds also increasing their penetration of this market sector. Public sector and corporate funds not surprisingly tend to have relatively large employers contributing on behalf of their members. Public sector fund members also tend to be more highly paid, less likely to work part-time and to be in professional or management positions.

While the respondent base for the survey results was not large for SMSFs, the demography of membership reported is more or less as expected. Their members tend to be in professional or management positions, and on relatively high incomes, although there are exceptions to this. Tradespeople as well as office based professionals have SMSFs.

It is interesting to note that there is growing convergence between the different types of funds in regard to their membership composition, at least in regard to members receiving the benefit of employer contributions. In particular, with their respective expansions in coverage, the profile of retail fund members is becoming more like industry funds, and the profile of industry fund members is becoming more like retail funds.

## 2.2. How were superannuation funds chosen prior to the introduction of legislated choice of fund?

For many members, choosing the fund to receive employer contributions did not commence with the choice of fund legislation. Individuals making voluntary personal contributions also have always had choice of fund.

ASFA Research Centre estimates based on Australian Bureau of Statistics data suggest that out of the 9.5 million in the Australian labour force, around 1 million self employed individuals and owner managers of businesses already had (by definition) choice of fund for employer and other tax deductible contributions, with another 1.9 million or more employees having choice of fund because their employer agreed or because of other existing State legislation and State public sector employment practices. However, reflecting the demographics of the membership of various types of fund, and the types of industries and employers each fund sector deals with, there were significant differences in the incidence of employees personally choosing the fund they are in. Whether or not a member is happy with the fund chosen for them by an employer also has a lot to do with whether they are likely to exercise a right to choice.

*ANOP survey results*

Table 2.2 provides an indication of the incidence of employee and employer choice of fund prior to the commencement of the choice of fund legislation. **While overall around one in four respondents in October 2004 indicated that they personally chose the fund they were in, for the retail fund sector the figure was nearly one in two.** This reflected the fact that many retail fund members are employees in small firms where there are no award, industrial agreement or legislative constraints on where contributions are made. As well, if there are only a few employees in a firm, the employer may have been willing to take into account the views of each employee as to where their superannuation should be paid. This will have particularly been the case where the employee was a manager and/or major shareholder in the small business, and especially in regard to contributions made in regard to the owner/manager.

Similarly there were (and are) many cases where employer contributions to industry funds are made in accordance with the direction of employees, rather than being a function of award provisions or an employer decision. Consistent with this, **industry funds had, as at October 2004, 12% of members indicating they personally chose to be in such funds, with industry funds having around 3% of their membership drawn from the self employed.** However, both the operation of industrial awards and agreements and the willingness of many industry fund members to leave the superannuation decision to their employer would be responsible for the relatively high figure of 85% of industry fund members being in a fund chosen or provided by their employer. In the case of public sector and corporate funds that percentage was close to 100%, reflecting the fact that employers who set up a superannuation fund generally will not provide choice of fund unless they have to.

It should be noted that a considerable proportion of respondents reporting that their employer chose the fund would actually have had a right to choose a fund other than the default suggested by the employer. For instance, while only 3% of public servants reported that they chose their own fund, in one public sector fund alone (First State Super) some 300,000 NSW public servants already had the right to exercise choice of fund. Many such employees would not have necessarily known that they already had a right to choose another fund and/or were happy for the employer to choose a default fund.

| **Table 2.2: How Superannuation Fund Was Chosen As At October 2004** | | | | |
|---|---|---|---|---|
| **Q: Was this super fund provided by your employer – or did you chose it, or did someone else chose it for you?** | | | | |
| **Choice of current fund:** | **Chosen, provided by employer %** | **Personally chosen %** | **Someone else chose %** | **Unsure %** |
| **TOTAL** | 73 | 23 | 3 | 1 |
| **Fund Sector** | | | | |
| Retail | 46 | 47 | 6 | 1 |
| Industry | 85 | 12 | 2 | 1 |
| Public Sector | 97 | 3 | - | - |
| Corporate^ | 100 | - | - | - |
| SMSF^ | 4 | 96 | - | - |
| **Gender** | | | | |
| Men | 70 | 26 | 4 | - |
| Women | 77 | 20 | 2 | 1 |

^ Caution: Small base size
Source: ANOP 2004 National Survey of 25-64 Year Olds in the Workforce

*Roy Morgan Research results*

**The ANOP survey results are also consistent with recently released data from a new quarterly survey conducted by Roy Morgan Research.** That survey, conducted between July and September 2005, asked respondents whether they had switched funds during the previous 12 months. Because the survey was conducted very close to the introduction of choice of fund (with some fund members interviewed in July unlikely to have even received the initial letter from employers offering choice) it provides more of a perspective on the incidence of choice and incidence of changing funds generally, rather than the impact of the choice of fund legislation.

**According to media reports (AFR, 9 January 2006 at page 36), the results indicate that 6% of members switched funds in the year to September 2005, with 5.8% of members in employer based funds moving and 7% of those in personal-retail funds moving.**

Many of the switches of fund associated with employees were associated with individuals switching employers. This was particularly common for those aged 18 to 34, who commonly change jobs and consequently superannuation fund. The second most common reason for switching was that the employer had changed superannuation provider. The third ranked reason for switching was to consolidate accounts. It should be noted that while consolidating accounts was less common than the other events specified, the amounts involved could be quite large relative to, say, the future contribution flow from a young employee in a casual job.

The figures also indicate that industry funds and public sector funds had a net inflow of members over the period concerned. Given that public sector funds do not accept contributions other than in regard to public sector employees, this set of figures highlights the role played by employment changes rather than exercise of choice.

**Also consistent with the ANOP survey (see Section 4 below), the Roy Morgan Research results indicated that industry and public sector funds had higher rates of member satisfaction and lower levels of expressed intention to change funds in the next 12 months. The survey indicated that 7.7% of fund members overall indicated that they were likely to switch funds, with figures of 7.5% for industry fund members and 4.4% for public sector fund members.**

While interpretation of the various figures is not without some ambiguities, **the survey figures tend to suggest a rate of switching funds of about 7% or 8% a year, even without any legislated right to choice of fund. Much of this is due to job changes and fund closures by employers in the run-up to APRA licensing of funds.** If there has been an initial clump of changes of fund following introduction of the choice of fund legislation, then the figures suggest that no more than around 1% or 2% exercised such choice in the first few months of the operation of the new provisions. More detail on this is available from the ANOP survey, and this is set out in the next section.

## 2.3. What has been the impact of the choice of fund legislation to date?

While it is early days yet for the operation of the choice of fund legislation, there are some indicators available as to its impact in terms of the percentage of fund members exercising choice and/or changing funds.

Some care is needed, both in asking fund members about the exercise of choice, and in interpreting responses. For instance, changing your superannuation fund is not necessarily an indication of the exercise of voluntary member choice as enabled by the legislation. In this context, many individuals in the past have become a member of another fund because of a change in employment, or because their employer has closed a fund or changed the default arrangements for superannuation contributions. As well, the exercise of choice can lead to an individual staying in the same fund following change of employment, rather than using the default fund chosen by the new employer. Exercise of choice also can occur at any time, with some fund members likely to exercise choice at some time in the future when they get round to it, or when they are provoked by a development such as a decline in investment returns.

Putting all these complications to one side, **the 2005 ANOP survey results provide an early indication of the exercise of choice of fund. Out of those surveyed, during the first three months of the operation of choice of fund legislation 7% changed funds (Table 2.3). However, only 4% of the sample chose a new fund as a conscious act of choice, as 2% of respondents went to a new fund because it came with a new job, and 1% changed because of closure of the old employer fund.** It also should be noted that the incidence of changing figures relate to the fund sector the member was in after changing funds. A relatively high figure for a sector can indicate either a relatively high rate of entry to that sector from other sectors and/or a relatively high rate of churn between funds in the sector.

**Table 2.3: Incidence of Changing Funds**

| | | FUND SECTOR, OCT '05 | | | |
|---|---|---|---|---|---|
| WHETHER CHANGED LAST 3 MONTHS: | **OCT '05 %** | **Retail %** | **Industry %** | **Public Sector %** | **Corp-orate** %** |
| Yes, Have changed funds | **7** | 7 | 11 | 3 | - |
| No, Haven't changed | **93** | 93 | 89 | 97 | 100 |

Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

**Most of the conscious acts of choice of a fund happened without employment change, with almost all of those changing jobs going with the new default.** Nearly half of the 11% of those currently in industry funds who had changed funds had done so because of job change. This is consistent with industry funds being more commonly used for casual workers, and in industries and professions (such as retail and hospitality) with relatively high employee turnover. **In the future choice of fund legislation might increasingly be used by individuals to keep their old fund when they change jobs, but so far the incidence of choice of fund in such circumstances appears to be limited.** Accordingly job turnover of, say, 10% a year might only lead to the incidence of choice of fund of around 1% of employees per year. Of course, there are other drivers of choice of fund, but choice of fund is in no way a complete solution to the problem of multiple accounts and lost members. To date and for the foreseeable future it seems likely to be only a very partial solution.

**The incidence of choice of a Self Managed Superannuation Fund was relatively low in the period concerned. Under 0.5% of the sample selected a SMSF.** In terms of fund destinations more generally, industry funds were marginally more popular choices than retail, but both types of fund were chosen by just under 2% of the sample. In terms of the direction of members moving from one fund to another, moving from one retail fund to another was not uncommon, as was from a retail fund to an industry fund. There were not many recorded cases of members moving from an industry fund to a retail fund. Consistent with this pattern of movements, respondents to the survey generally did not identify financial planners as playing a role in the movement from one fund to another.

Dominant reasons for a new fund, apart from a change in job, were fees, consolidation of accounts, and pursuit of better investment returns, in that order.

While some caution is needed in interpreting these results due to the relatively small number of recorded movements from one fund to another, they are relatively consistent with the pattern of prospective movements identified in the 2004 ANOP survey, and with the quantitative projections in my February 2005 research paper on the implications of the choice of fund legislation. However, **the drift to SMSFs at this stage appears to be lower than was anticipated prior to the introduction of choice of fund. In this regard, higher investment returns of large funds on top of increased constraints on those selling this option, together with more community awareness of the obligations attached to running your own SMSF appear to be**

**keeping the numbers of new SMSFs down for the moment.** This is consistent with Australian Taxation Office figures showing that the rate of establishment of new SMSFs is now around 2,000 a month, compared to around 3,000 a month a year or two ago. The current net increase in SMSFs is around 1,700 a month, reflecting the closure of some SMSFs. Reasons for closing them can range from not really ever having been operational in the first place, to death of member, to it all getting a bit too much for the member/trustee.

## 3. Clearing house experience with choice of fund

A relatively recent development in the superannuation sector has been the development of clearing houses. These have been established by either funds or third part providers, who might have a background in payroll or other payment services, to distribute superannuation payments to a variety of superannuation funds. In some cases this activity will be undertaken at no charge to employers provided that they make use of a designated superannuation fund as the default fund for their employees. In other cases, the clearing house services are provided on a purely commercial basis with pricing based on the number and type of transactions undertaken for an employer.

These services were provided in the market prior to the passage of choice of fund legislation, but they have taken on a new impetus with the introduction of choice of fund. As well, their experience is very informative in regard to the operation of choice of fund as they can directly record the number of instances of choice of fund that have been exercised by an employee they process contributions for, rather than bundling such cases in with instances where a new fund is joined because of a change in employment.

The experience to date of clearing house operators in regard to choice has not been widely divergent. Only a relatively small proportion of transactions have resulted from the exercise of choice**. For instance, in the case of Investment Link, one of the largest clearing houses, during the period 1 July 2005 to 31 October 2005 only 17,910 employees (which was 2% of the over 920,000 fund members that the organisation arranges payments for) exercised choice of fund. This involved some 6% of the 26,500 employers using the service. In other words, some 94% of employers using the service did not experience any exercises of choice during the period concerned although an awful lot of choice forms were handed out.**

While Investment Link expects the percentage of employees exercising choice to grow (possibly to an annual member impact approaching 10%), the numbers to date are suggestive of the eventual proportion of employees exercising choice to be well under 10% of the total number of employees for whom contributions are made by way of the clearing house.

On the basis of these numbers the overall exercise of choice on an annual basis amongst employees generally could be under 5%, as large public sector employers and corporations with their own superannuation funds and no or very limited choice of fund typically do not make use of clearing houses. The population of employers currently making use of clearing houses most likely has a higher incidence of having to offer choice of fund than employers more generally, because applicability of choice of fund is one of the reasons an employer will sign up with a clearing house.

So far as destination funds are concerned, Investment Link paid contributions to some 1,700 funds as a result of choice of fund, with over 500 of these being Self Managed Superannuation Funds. Retail and industry funds received similar numbers of choice nominations, with these large funds benefiting from the bulk of choices made.

While the figure of 500 SMSFs being chosen might on the face of it seem high, this amounts to less than 3% of the choice elections made, with this figure not very different to the market share of such funds in regard to the overall number of employees in SMSFs. Overall less than 0.1% of the employees that Investment Link processed contributions for chose a SMSF. In the cases where a choice was made, most of the SMSFs receiving contributions were established rather than recently formed entities.

Of the non-SMSF group of funds which were chosen, many of these were divisions of large retail and other funds. Most contributions went to established retail brands (AMP, CBA, ING, AXA and ASGARD) and major industry funds, such as REST, ARF, STA, Host-Plus and Sunsuper. Industry funds filled five of the top ten choice destinations. Some new players, such as VirginSuper and MaxSuper show up in the destination lists, but more like in the top 50 rather than top 10.

# 4. Future prospects for exercise of choice

The ANOP survey results also provide some indication of the percentage of fund members who are likely to change superannuation fund in the future. However, care is needed in interpreting the expressed intentions of individuals, as intention often does not transform into action. As a rough rule of thumb, the experience of market researchers is that most of the individuals who indicate that they are very likely to do something will actually do that thing, while only a very small proportion of those responding "quite likely" will move from intention to action.

Table 4.1 provides October 2005 survey results for stated intention to change superannuation fund, with some October 2004 results also included (in brackets). **In broad terms, on top of the 4% of respondents who have already actively exercised choice of fund (rather than moving because of a change of job or the like), another 4% or 5% are likely to change funds in the next twelve months. This adds up to 8% or 9% of fund members, which is remarkably in line with the February 2005 ASFA Research Centre forecast of 8% of fund members exercising choice over the first 12 months or so.**

The percentages of respondents indicating that they are "very likely" or "likely" to change funds went down markedly between October 2004 and October 2005. While one reason for that may be that those most likely to exercise choice have already exercised choice, the falls in the percentages are much bigger than can be explained by such behaviour. **Fund members in many funds have now gone through a cycle of contemplating change, and a larger proportion of members are now more "rusted onto" their fund than they were before.** For instance, there are now 55% of respondents "not at all likely" and 23% of respondents "not very likely" to change funds. A variety of factors contribute to this attachment to a current fund. Inertia plays a role, with around 3 in 10 stating that they cannot be bothered shifting funds, or something to that effect. A further 1 in 10 know that they cannot shift because of a workplace agreement or other exception to choice. **However, around half of those**

**stating that they are unlikely to change funds provide more positive reasons for this, including loyalty or positive commitment to the fund.**

**Table 4.1: Incidence of Likelihood of Changing Funds**

| HOW LIKELY TO CHANGE NEXT 12 MTHS | | FUND SECTOR, OCT '05 | | | |
|---|---|---|---|---|---|
| | **OCT '05 %** | **Retail %** | **Industry %** | **Public Sector %** | **Corp-orate** %** |
| Very likely | **5** | 8 (13) | 4 (11) | 2 (3) | 7 (7) |
| Quite likely | **7** | 11 (16) | 6 (20) | 4 (13) | 8 (28) |
| Not very likely | **23** | 26 | 21 | 12 | 23 |
| Not likely at all | **55** | 43 | 55 | 77 | 62 |
| Unsure. Other | **3** | 5 | 3 | 2 | - |
| Total likely | **12** | 19 | 10 | 6 | 15 |
| Total not likely | **78** | 69 | 76 | 89 | 85 |

Figures in brackets are the percentages of equivalent responses in the October 2004 survey.
Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

**The survey data indicate that retail fund members continue to be the most likely to shift funds, although the proportions indicating that the are "very likely" or "quite likely" to shift are down from a year earlier. Some of these moves may be to other retail funds and some might be industry funds, and there may be a preparedness or intention by at least a few to set up a Self Managed Superannuation Fund.**

The percentage of industry fund members who are intending to change funds, or are contemplating this, is relatively low at 4% of respondents. Even with this number it is not clear whether the fund members concerned generally want to change funds, or whether they are anticipating changing jobs with an associated expectation of a change in superannuation fund.

Public sector fund members appear to be effectively bolted onto their funds. This reflects the fact that such funds often offer very good benefits for members. It might also reflect the understanding of the members of such funds that they might not be allowed to switch funds, either currently and prospectively.

That 7% of corporate fund members (albeit drawn from a relatively limited sample) are expecting to change funds may have something to do with member expectations of the closure of corporate funds or an impending change in job, rather than their contemplated exercise of a legislative right to choice of fund. Anecdotal evidence from one corporate fund indicates that only 10 out of 4,000 employees have exercised their right to choice to date, and this sort of experience is likely to be repeated with other corporate funds.

More generally, the survey results show that many of those indicating that they are likely to change funds are considering this on the basis of rather broad considerations, such as reviewing options, or being open to change. Wanting to consolidate accounts is the next most mentioned factor leading to a change of fund, followed by changing jobs, wanting better returns, and wanting lower fees, in that order.

**As shown by Table 4.2, "happiness with fund" is strongly correlated with stated intentions in regard to changing funds, or rather, not changing funds. Retail funds have a lower proportion of members than other types of funds stating that they are unlikely to change, but at 69% the proportion unlikely to change is still substantial. The survey also indicated that retail fund members stating they were unlikely to change provided reasons more related to inertia than positive loyalty to the fund.**

**Table 4.2: Reasons of Members For Being Unlikely to Change Funds**

| | | FUND SECTOR, OCT '05 | | | |
|---|---|---|---|---|---|
| | **OCT '05 %** | **Retail %** | **Industry %** | **Public Sector %** | **Corp-orate** %** |
| **Unlikely to change** | **78** | 69 | 76 | 89 | 85 |
| MAIN REASON: | ∇ | ∇ | ∇ | ∇ | ∇ |
| 1. **Happy with current fund.** Suits my needs | **35** | 27 | 42 | 40 | 31 |
| FOLLOWED BY: | | | | | |
| 2. **Couldn't be bothered.** Too much trouble | **6** | 7 | 6 | 5 | 8 |
| 3. **Satisfied with returns.** Good results, growth | **6** | 5 | 4 | 14 | 4 |
| 4. **Not interested.** Haven't considered it | **6** | 8 | 4 | 4 | - |
| 5. **Don't have choice.** Choice doesn't apply to me | **5** | 2 | 3 | 18 | - |
| 6. **All funds are the same.** Offer same returns, benefits | **4** | 7 | 5 | - | - |
| 7. **Retiring soon.** Too late | **4** | 3 | 2 | 7 | 7 |
| 8. **Stick with employer's fund.** Provided by company | **3** | 3 | 2 | 1 | 20 |
| 9. **Lack knowledge about super.** Don't know enough | **3** | 4 | 2 | 4 | 4 |
| At 1-2% level: . Have SMSF . Only if change jobs . Habit, familiarity . Small investment only . Have consolidated . Cost of changing | | | | | |
| - Main responses to open-ended question - | | | | | |
| SUMMARY: | **%** | **%** | **%** | **%** | **%** |
| • **Satisfied with current fund. ("Loyal").** Happy. Good returns | **42** | 31 | 47 | 51 | 35 |
| • **No compelling reason. ("Inertia").** Couldn't be bothered. Not interested. All the same. Retiring soon. Lack knowledge. Habit | **27** | 32 | 23 | 20 | 19 |
| • **Employment-related.** No choice. Stick with employer's fund. Only if change jobs | **10** | 7 | 6 | 22 | 28 |

** Caution: small sample size

Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

In summary, the survey results show that public sector and corporate funds are likely to have high levels of retention of members, both because of loyalty to the respective funds, and because many members do not effectively have a choice. On the other hand, employment related reasons do not loom large for members of retail and industry funds, suggesting that provisions in awards and agreements are not really constraining the availability of choice.

**In the retail sector there have always been substantial competitive pressures, with a large proportion of retail members personally choosing to be in the fund they are in, and also able to choose another fund when they want to.** The retail sector is accustomed to the ebb and flow of contributions in response to developments in both perceived and actual levels of investment performance, cost and service delivery. While not without their ambiguities and uncertainties, the ANOP survey results also suggests that retail fund members might be the group most susceptible to exercising choice in the future. This might involve switching from one retail fund to another, or for some it might involve choice of an industry fund or Self Managed Superannuation Fund.

Tables 4.3 and 4.4 provide further details on drivers of choice and retention.

**Table 4.3: Importance of Factors When Choosing a Superannuation Fund Amongst Those Changed or Likely to Change Fund**

| | IMPORTANCE | | |
|---|---|---|---|
| **Importance in choice of fund:** | **Very %** | **Quite %** | **Not+ %** |
| TOP 2 FACTORS: | | | |
| 1. Financial performance of fund | 76 | 20 | 3 |
| 2. Fees & charges | 72 | 21 | 6 |
| FOLLOWED BY: | | | |
| 3. Financial advice available | 44 | 33 | 22 |
| 4. Fund's reputation | 42 | 42 | 16 |
| 5. Range of investment options | 41 | 38 | 19 |
| 6. Helpfulness of call centre, website & member communications | 39 | 31 | 28 |
| 7. Insurance coverage offered | 36 | 40 | 20 |

%s add to less than 100% because of small % unsure

+Rated 'Not very important' or 'Not important at all'

Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

**Table 4.4: Importance of Factors When Deciding to Stay with Fund - Among the 81% Unlikely to Change or Unsure**

| Importance in decision to stay: | IMPORTANCE Very % | Quite % | Not+ % |
|---|---|---|---|
| TOP 2 FACTORS: | | | |
| 1. Financial performance of fund | 66 | 25 | 7 |
| 2. Fees & charges | 56 | 30 | 12 |
| FOLLOWED BY: | | | |
| 3. Fund's reputation | 44 | 36 | 17 |
| 4. Financial advice available | 36 | 35 | 26 |
| 5. Range of investment options | 33 | 39 | 26 |
| 6. Helpfulness of call centre, website & member communications | 32 | 36 | 27 |
| 7. Insurance coverage offered | 32 | 35 | 29 |

%s add to less than 100% because of small % unsure

+Rated 'Not very important' or 'Not important at all'

Source: ANOP 2005 National Survey of 25-64 Year Olds in the Workforce

Putting all these figures together, **a reasonable assessment might be that the furture incidence of those in employment joining a new superannuation fund is likely to be in the order of 11% or 12% a year**. This figure is likely to drift down rather than up over time, as the stock of corporate funds being closed by employer sponsors is diminishing. As well, over time more employees are likely to keep their old superannuation fund when they start a new job. This overall figure for the percentage of employees changing funds may not be that much different from the aggregate figure prior to introduction of the choice legislation. However, there will be more employees choosing a different fund while still in the same job, and fewer employees ending up in a different fund when they change jobs.

**The incidence of choice of fund legislation linked selections of superannuation funds appears likely to be of the order of 6% a year in terms of a count of the number of fund members.** The percentage of contributions and fund balances on the move could be a little more than this as it is typically those with higher account balances that are interested, willing and able to exercise choice.

These figures could increase as a result of new industrial relations legislation and related choice of fund provisions, and also if (or rather when) there is a downturn in investment returns from balanced managed funds, including superannuation funds. The next sections address these issues.

# 5. Impact of new industrial relations legislation on choice

The Workplace Relations Amendment (WorkChoices) Bill 2005 was passed by Parliament on 7 December 2005. The bulk of the legislation will take effect on a date to be proclaimed, which is expected to be in March 2006. The legislation also contains a number of transitional provisions, many of which come to an end in 2008. This legislation has implications for the operation of the choice of fund legislation as it proposes to create what is in the main a single national industrial relations system. This has clear implications for the operation of the choice of fund legislation, which currently exempts employers who are subject to certain State awards and agreements dealing with superannuation from offering choice of fund to employees.

The WorkChoices legislation covers all employees of trading and financial corporations ("constitutional" corporations), and also all employees in the Territories, Victoria, and waterside, maritime, and flight crew employers and employees.

**In essence, the legislation displaces the operation of State and Territory industrial laws in regard to the employees it covers, and it also makes substantial changes to the arrangements applying to employees who have always been covered by Commonwealth industrial laws and regulations. However, the legislation converts existing State industrial awards, instruments, and terms of employment into new preserved Commonwealth instruments.**

The legislation also limits what can be an allowable matter under Federal awards. Superannuation is not one of the core matters that will remain. However, under another transitional arrangement superannuation provisions remain in Federal awards until 30 June 2008.

Exactly how all of this will interact with the choice of fund legislation is not yet entirely clear, not least because ASFA understands that amendments are to be made to the choice of fund legislation in light of the WorkChoices changes and in order to implement the commitment of the Commonwealth Government to extend choice to employees of corporations who are covered by State awards from 1 July 2006. These changes are required reasonably urgently and ASFA expects the amendments to be made real soon, as otherwise employers could in certain circumstances face double jeopardy. This would involve having to offer choice under the choice of fund legislation while at the same time being required by a new preserved Commonwealth instrument based on the previous State arrangements to pay contributions to a specified fund.

While, as noted above, it is still not entirely clear how the various provisions will work, a reasonable assessment is as follows:

- Superannuation funds specified in Federal awards will continue to be default funds for choice of fund purposes until 1 July 2008, when all reference to superannuation will be removed from Federal awards. After that date employers subject to such awards will be able to decide for themselves what will be the default fund, but it is unlikely that many such employers will actually change the default merely because they then will be able to. Federal awards also will be able to continue until 1 July 2008 to specify other superannuation related matters, such as frequency of payments and the requirement for an employer to sign up as an employer sponsor of a named fund.
- Superannuation funds specified in State awards are likely to be at the very least default funds when the provisions of State awards become for employees of constitutional corporations and other covered employers new preserved Commonwealth industrial instruments. More specifically these will be called a NAPSA, a notional agreement preserving a State

award, an acronym which should easily roll of the tongue of employees and employers. The Assistant Treasurer has stated on a number of occasions the intention of the Commonwealth to allow, as from 1 July 2006, employees who have superannuation contributions paid under or in accordance with a State award to have choice of fund. Clarifying legislation may be required in any event as preserved State award provisions provided by a notional Commonwealth industrial instrument do not sit neatly with the already convoluted choice of fund legislative provisions currently in place. Without amendments, employers could be faced with having to offer choice from March 2006 (when WorkChoices provisions are proclaimed) but also having to comply with the provisions of the previous State award when it becomes a NAPSA.

- Where superannuation was paid under or in accordance with a State industrial agreement (rather than a State award), it is likely that when the terms become part of a Commonwealth industrial instrument that the employees covered will remain exempt from choice (again subject to clarifying amendments).
- The incidence of superannuation being dealt with in new individual and collective agreements within the Commonwealth framework replacing previous State awards and collective agreements is unclear at this stage.

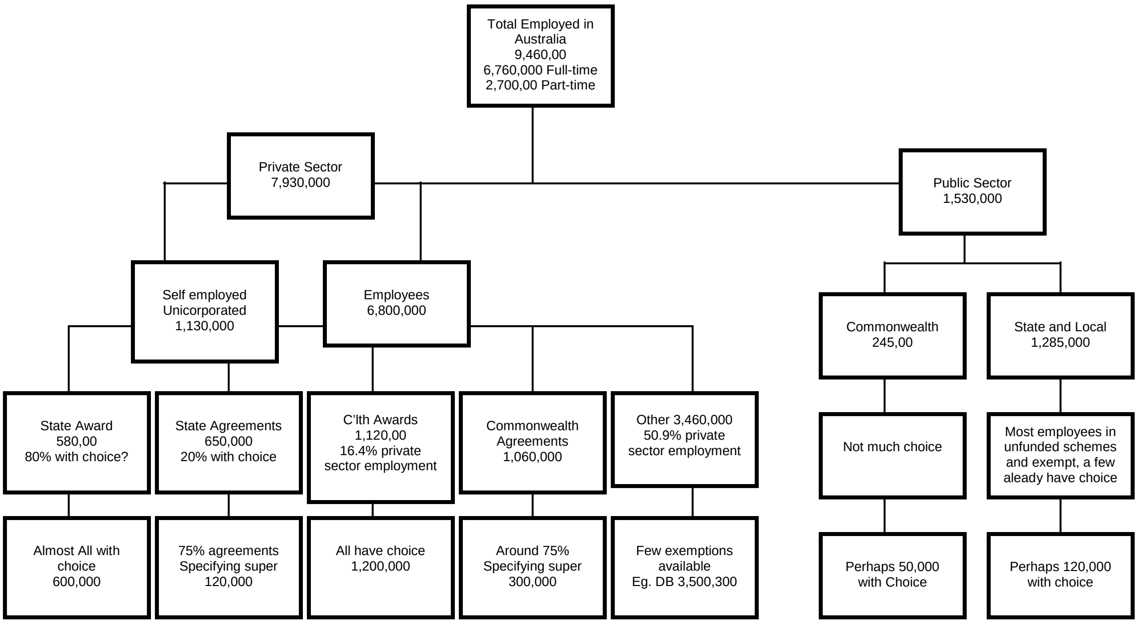
The Office of Workplace Services (a new Commonwealth agency) will have responsibility for enforcement matters, including presumably the payment of superannuation as required by existing industrial agreements that fall within Commonwealth jurisdiction and the payments required by the new industrial instruments that transfer obligations from awards and industrial agreements established under State legislation.

Figure 1 below sets out some revised figures on the number of employees who will hae a legislated right to choice of superannuation fund as of 1 July 2006 (the second row from the bottom) and 1 July 2008 (the bottom row**). The numbers for 2006 do not vary much from previous ASFA Research Centre estimates, as the transitional Commonwealth arrangements appear to largely preserve existing superannuation requirements within State agreements (as opposed to State awards). As well, not every State award now deals with superannuation, and there will be unincorporated employers who will remain subject to State industrial relations arrangements.**

**Depending on yet to be released choice of fund legislative amendments, some 200,000 employees formerly covered by State awards might gain choice in 2006. However, there are issues to be resolved, such as whether employees who have already been offered choice or who have actually exercised choice under State arrangements (such as in Western Australia) would have to be offered choice again under the Commonwealth arrangements.**

**However, come 1 July 2008 there are likely to be significantly more employees with a legislative right to choice.** This will in part be due to employment growth. It is also projected that more choice will be offered amongst employers currently making use of collective agreements. There also will be a drift from what were preserved State agreements to agreements under the new Commonwealth framework. Some growth in choice numbers is also projected for Commonwealth and State public servants. On the other hand, some unincorporated employers will remain under State awards which rule out choice. **All up, some 6.3 million employees might have Commonwealth legislated choice of fund by 1 July 2008, compared to around 5.2 million in July 2005.** Some 380,000 or so more employees will have choice because of the changes to industrial relations legislation, with the remaining 520,000 growth in the number of employees with choice due to employment growth and changes in the composition of type and terms of individual and collective agreements covering superannuation.

**Who will have exercised choice of fund?**




Bottom row of squares show figures for July 2008
Row above that is for July 2006

## 6. Winners and losers in terms of funds and membership numbers and asset levels

Developments to date have been more or less consistent with what analysts, including the ASFA Research Centre, were expecting to happen with choice of fund. However, there have been some subtle and not so subtle departures from these expectations.

**Industry funds appear to be trading well following the introduction of choice of fund, contrary to the expectations of at least some commentators who saw choice as a threat to their continuing operations.** While it is difficult to net out the effects of strong investment returns and closure of corporate funds that occurred over the same period as the introduction of choice, industry funds have gained substantial numbers of both new members and contributing employers.

The existence of net flows of new members to industry funds has been shown by the October 2005 ANOP survey, the July-September 2005 Roy Morgan Research survey, and fund data compiled by SuperRatings for the September quarter 2005.

InvestmentLink also reports that industry funds fill five of the top 10 choice destination funds. The Roy Morgan Research survey in particular shows strong net flows of members to industry funds.

**Data for retail funds are even more difficult to interpret, but they too also appear to be generally prospering following the introduction of choice of fund. A number of retail funds have had substantial inflows of new members and/or contributions to existing accounts. However, at least one survey (Roy Morgan Research) suggests that there have been net flows of members from some retail funds, or at least from some products. This ties in with the various ANOP surveys showing greater preparedness of retail fund members to switch funds.**

All that said, it should be acknowledged that the shifts between and from retail funds may have a lot to do with the normal cut and thrust of competition within the retail sector, together with consolidation of inactive accounts and rationalisation of product lines within the retail sector rather than an actual loss of overall business in terms of assets under management. Assorted data indicate that retail products which are competitive in the market and/or are used for successor fund arrangements are doing quite well regardless of, or because of, choice of fund.

For instance the SuperRatings figures show AMP's SignatureSuper product line experiencing growth in assets from $0.56 billion to $1.64 billion over the September quarter 2005, with the Mercer Superannuation Trust growing from $8.29 billion to $9.26 billion over the same period. It should be noted that the SuperRatings figures only cover employer sponsored superannuation arrangements.

A number of retail funds are experiencing increased flows into personal retail funds, apparently driven by employee choice of fund and desire to consolidate superannuation accounts. For instance, the Colonial First State personal superannuation product FirstChoice attracted net flows of $590 million in the September quarter 2005 with a large amount of employer contributions in those flows. This was on top of net inflow of $362 million for the FirstChoice corporate super master trust. The flow of employer contributions into certain personal retail superannuation products following exercise of choice also is apparent from examination of clearing house data on receiving funds.

**What the figures and surveys appear to be showing is that retail products which are competitive in the market are coping well with the increased level of competitiveness occurring since the introduction of employee choice of fund. This applies to both funds which have a primary focus on personal superannuation and to funds which are used for bulk corporate superannuation contributions and for successor fund arrangements.**

In any event, a reduction in overall member numbers would not necessarily be a problem for retail funds, particularly if the exits are from old legacy type superannuation products and/or involve relatively modest account balances. Retail funds have also tended to do well in winning successor fund transfers, with these tending to be more effective than member elections of choice of fund in achieving transfer of existing balances rather than just future contributions.

Going forward retail funds will face even greater competitive pressures as the stock of corporate funds interested in closure and transfer of members to a successor fund diminishes. Current expectations are that after 1 July 2006 there will be around 320 licensed trustees, responsible for around 450 superannuation funds. These figures may hold fairly steady, as any fund and associated employer sponsor willing to get through the licensing process almost certainly has a long term commitment to remaining in business.

**The various surveys also show that a proportion of retail fund members are sensitive to concerns about investment returns and about fees and costs, amongst other things. When investment returns decline, as they inevitably will, a certain proportion of retail fund members can be expected to look at alternatives.**

Given that any decline in investment returns will impact on all types of fund, this interest in alternatives might lead to increased interest in the establishment of Self Managed Superannuation Funds. **To date interest in SMSFs appears to have tailed off, with the expressed intentions made a year or so ago by a substantial number of retail and other fund members not turning into reality.** However, a downturn in investment returns might lead to at least some members pursuing the SMSF option on the basis of a perception of being able to outperform professional fund managers.

Some, such as Robert Brown writing in the February 2005 issue of *Charter* magazine, see an increasingly large proportion of new employees making a positive choice, with this often involving choice of a SMSF. He wrote of one company where 75% of new employees since 1 July 2005 have chosen a fund other than the default. The article acknowledged that this is an unusual case, and it would be interesting to know why the default was so unpopular.

On the other hand, there are now increased levels of awareness in the community of the monetary and other costs of running a SMSF, along with increased regulatory attention on advisers and others involved in the establishment of such funds. The net results of these factors is likely to be increased migration of retail fund members to SMSFs at some point in the future, but at a rate lower than originally was expected.

There have also been some new retail players who appear to be attempting to attract customers from both retail and industry funds. Both VirginSuper and MaxSuper have a business model based on relatively simple superannuation products which are directly distributed to members without the involvement of financial planners. Investment costs and charges are kept down by using true index return investment products where the investment manager is paid out of any return they achieve over and above the true index return. They also have member fees which are a percentage of the account balance, rather than the customary fixed dollar based fee plus a percentage. Practically all of the activities of these superannuation products, including the trusteeship, are contracted out. The only real exception is the promotion of the product, with the promoter taking any residual profits from the fixed percentage fee as the payment for their role and a commission on insurance payments made by members.

Both VirginSuper and MaxSuper are very price competitive with the larger industry funds in regard to lower balance accounts, but are less competitive when the annual dollar based fees of industry funds are diluted in the case of members with relatively high account balances. As well, many industry funds through their portfolio construction and manager selection have managed to outperform index returns in recent years. While only time will tell, this may remain the case in the future if their investment portfolio construction continues to be successful.

Relying on an asset based fee of a modest amount is a reasonably challenging business model if you are a for profit provider, as the margins are not large, and distribution depends on strength of brand and direct marketing. Unlike other retail superannuation products these new promoters of superannuation products make little or no use of financial planners in distribution (as no commissions are paid), and they generally are not used for any large scale corporate superannuation plans. They also do not have the benefit of being specified in any award or group industrial agreements. There is also something of a youth orientation in their marketing, which is not necessarily of assistance in attracting members with large balances in the run-up to retirement.

That said, these new funds have been effective in developing their brands, and are starting to turn up as destination funds on the lists of clearing houses and in surveys of the population. However, they may not yet be at the point where they are generating a profit for their promoters. Substantial assets under management would be needed to generate revenues to cover the cost of advertising and other expenses. For instance, if the promoter of such a fund were achieving a return after assorted administration and other expenses of around 0.3% of assets under management, then they would need around $670 million of assets under management to support promotional expenditure of $2 million, and $6.7 billion to support promotional expenditure of $20 million. The margin available to the promoter could of course be less than 0.3% of assets, but there would be commissions on insurance premiums as well contributing to revenue of the promoter.

At this stage Virgin Superannuation has not released information on assets under management, or the extent of any profit (or loss) on this line of business. However, the CEO of Virgin Money is quoted in a *Business Review Weekly* article published in January 2006 as not expecting Virgin Super to become profitable for a long time, and that funds under management were then small. Many of the fund's members do not have large balances, with 40% aged under 30 years and 75% aged under 40. On the other hand, it is a demographic group which with very few exceptions will have growing superannuation balances.

**In summary, as a number of observers have noted, it is difficult to find evidence of any type of fund being a loser from choice of fund or a fund executive claiming that their fund has suffered.** While there has been and will continue to be a significant flow from corporate funds of both members and assets, this generally is the intention of employer sponsors and managements of the funds concerned. Some industry funds have also decided to amalgamate with other industry funds, but in most cases the choice of fund legislation has only been a minor factor in such decisions. Other influences, such as the views of the employer organisation and union sponsors of the industry funds concerned, the requirement to obtain an APRA licence, and the desire to achieve a scale of operations which will deliver more efficient delivery of services to members appear to have dominated.

Public sector funds have been largely insulated from the effects of choice because of the various exemptions available for defined benefit funds, unfunded schemes and where the obligation for contributions to be made to a specific fund is set in legislation. Both asset levels and membership levels of public sector funds have tended to show strong growth in recent periods. This has included those public sector funds which have all or some of their members able to exercise choice.

However, when investment returns eventually decline at some unknowable point of time in the future and when the stock of corporate funds closing declines markedly after June 2006 life will be more challenging for the remaining superannuation funds. The personal divisions of retail funds in particular will then have to be able demonstrate to their customers the value delivered relative to the level of fees charged. Such funds, or divisions of funds, might in circumstances of generally reduced investment returns have to run harder to just stand still. That said, the great bulk of members of personal divisions of retail funds have always been in such funds because they have chosen to be there, either independently or in conjunction with advice provided by a financial planner. Legislated choice of fund will not have a lot to do with their success or failure.

Legislated choice may have opened up the potential flow of more employer contributions to personal divisions of retail funds, but it has also lead to increased levels of member consideration of alternatives. The proportion of members and assets in older, mostly closed to new members, retail products with substantial exit fees has declined, which reduces barriers to movement between funds. Retail funds currently have the largest market share, and hence have the most to lose. There is evidence that retail members are not necessarily "rusted on", with many, depending on the circumstances, interested in exploring alternatives both within and outside the retail sector.

## 7. Is there evidence of current or prospective mis-selling?

A continuing worry for the sector and policy makers is that the introduction of legislated choice of fund will lead to fund members being sold products which are not suitable and/or demonstrably worse than the funds they already are in. **While it is early days yet there is no evidence of mis-selling happening to any significant extent. The evidence on aggregate flows of members between funds and on reasons for moving from one fund to another tends to suggest that in the main choice decisions have been both rational and relatively untainted by any selling process.**

There are a number of reasons for this. Some relate to policy and legislative provisions in Australia which provide much greater protections than applied when substantial mis-selling occurred in jurisdictions such as the United Kingdom. Others relate to the natural protections in our system provided for most individuals with superannuation. It is not worth the time of anyone to mis-sell to most Australians given the current relative paucity of their existing balances and the modest level of future contributions. This is in contrast to the United Kingdom where a substantial proportion of employees had reasonably high accrued levels of benefits.

Like the bank robber who when asked why he robs banks answers because that is where the money is, any individual or firm intent on mis-selling will seek out those individuals with substantial superannuation balances. This rules out the bulk of individuals with superannuation, and many of those in Australia with a high level of accrued benefits are in unfunded public sector schemes where there is no portability of account balances. Community awareness of issues such as fees and charges and the costs and benefits of various types of superannuation arrangements also appears to have increased, with informed customers harder to mis-sell to.

**All that said, it is likely that some mis-selling is happening and will continue, particularly if some financial advisers are not well supervised by the group they are affiliated to, or if non-licensed advisers influence decisions by fund members.**

**However, to date most instances of mis-selling appear to be relatively isolated cases driven by individual advisers of some sort rather than the result of a coordinated marketing campaign. The reported cases to date also have involved member choices not linked to legislated choice of superannuation fund.**

For instance, ASIC took action against a Tasmanian financial planner for failing to provide a Statement of Advice to four clients before switching the clients' superannuation funds. The planner concerned pleaded guilty, and was placed on a good behaviour surety for 12 months with no criminal conviction recorded.

ASIC has also launched legal action against a Sydney financial planning firm that allegedly convinced teachers to swap from a public sector fund to a private fund. ASIC has filed proceedings in the NSW Supreme Court seeking a ruling for the firm concerned to stop giving advice to teachers and also to allow the teachers concerned to switch back to their old fund and to receive compensation for any money lost. Around 200 teachers are involved. The case will come before the Court on 24 February 2006.

As well, in June 2005 ASIC accepted an enforceable undertaking from Industry Fund Services Pty Ltd (IFS) in relation to its super choice advertising campaigns 'Compare the pair' and 'A lifetime of difference'. IFS, without accepting ASIC's views, undertook to refrain from:

- using projections of retirement payouts or future fund balances applying comparisons of current or past fees or average fees, unless these projections were properly qualified, and
- representing that the only relevant factor for comparisons of different super funds, in the context of projections of retirement payouts or future fund balances, is the fees charged by the operator of the fund.

On 27 May 2005, IFS suspended its advertising campaign, which involved both television and print media, pending the outcome of discussions with ASIC. It resumed its advertising making use of appropriate qualifications following the provision of the undertaking.

**ASIC has also been conducting surveillance of a range of financial advisers in order to determine whether and to what extent any advisers have acted other than in accordance with their legal obligations. The results of that surveillance, which may include enforcement action in regard to any breaches that were discovered, are expected to be released by March 2006.** ASIC appears to be paying particular attention to client files, and whether appropriate Statements of Advice were provided to those switching funds. ASIC expects Statements of Advice to provide information on the "from fund" as well as the "to fund" so that consumers can make informed decisions. Various information services have started up to assist planners with information on a subscription basis about "from funds".

There have also been some cases of mis-selling of SMSFs in order to gain early release of benefits, although in some cases this has been a joint conspiracy by the member and promoter. This generally has had more to do with portability of benefits than with the fund chosen to receive future employer contributions. The incidence of this practice also may be on the decline following enforcement action by the ATO and ASIC which has led to a parade of promoters of such arrangements before the courts, not infrequently the Southport Magistrates Court for some reason or another. The Magistrates concerned should be building up some expertise in dealing with such cases, and no doubt have a tariff of sentences not unlike the gradation of penalties for varying levels of blood alcohol over the prescribed limit.

## 8. Some remaining legislative and regulatory issues

There are what could politely be called "untidy" areas in relation to choice of fund, particularly in relation to the processing of contributions.

What has been noticeable in the early months of choice is the fact that some funds (and their administrators' processes) seem not to have fully worked through the fact that under choice, with the exception of default fund contributions, employers are merely directing contributions on the advice of the employee. Where the trust deed of a fund requires the employer to sign up before admitting the employee to membership, the fund's processes need to be able to identify quickly where membership is not possible and deal with those contributions in a timely manner. The choice legislation does provide an employer with a dispensation from having to comply with the selection of such a fund by an employee, but this is of not much assistance to members and funds when a payment bounces. Employers also may be frustrated by the subsequent difficulty in meeting their Superannuation Guarantee obligations and in dealing with the disappointed expectations of employees.

The wider use of clearing houses may add another layer of complexity, and processing time, to this process. It even appears that some clearing houses provide their name, not the employer's name, as being the contributor.

Solutions to this are likely to require action by a variety of players on a variety of fronts. It would appear that some employers could be stricter in requiring employees to provide written evidence that a fund can accept contributions in regard to an employee without the employer having to sign up or provide assorted details. Clearing houses and funds could also be quicker at reversing transactions once it becomes clear that a contribution cannot be processed because an employer will not or has not signed up as an employer sponsor. There also might be scope for possible legislative changes which make it simpler and quicker for an employee to become a public offer member of a fund (where the fund is a public offer fund) if they are already an employee sponsored member as the result of contributions made by a former employer.

The role and regulation of clearing houses might deserve further and co-ordinated consideration by the various regulators as well. To date, ASIC, APRA and the ATO have taken some interest in clearing house operations, but generally this interest has related to peripheral rather than core issues. For instance, the ATO has analysed when and in what circumstances contributions processed by a clearing house actually get to the stage of meeting Superannuation Guarantee obligations, and APRA has examined the issue of the sole purpose test and funds operating clearing houses. ASFA has written to the Government requesting more coordinated and over-arching consideration by the various regulators.