

choice



THE SUPER SECRET:

How multiple accounts cost consumers billions

A report into the growth and costs of multiple superannuation accounts.

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Executive Summary

Multiple superannuation accounts – a growing problem

Consumers are losing billions of dollars as a result of holding multiple superannuation accounts. Collectively, consumers pay more than \$1 billion each year in unnecessary fees on about 13 million unnecessary accounts. Consumers lose further millions through 'lost' superannuation associated with multiple accounts.

This report provides new research into the cost of having multiple superannuation accounts. It identifies the reasons why there are too many superannuation accounts, and why the number of superannuation accounts is likely to increase. It recommends solutions for action by government and the superannuation industry.

The problem is getting worse. In June 2005 there were nearly 28 million superannuation accounts in Australia — 2.6 for each member of the labour force. Using prevailing growth rates, we estimate there are currently more than 30 million accounts in Australia. Between 1995 and 2005 the number of accounts grew many times faster than growth in the labour market: during this period the workforce grew by 1 million but the number of accounts grew by 14 million. There are now many more superannuation accounts than people in Australia — men, women and children. Recent research suggests 4.3 million people — around 27% of adults and at least a third of the current labour force — have multiple superannuation accounts.

The high cost of multiple accounts

For the vast majority of consumers, multiple superannuation accounts are unnecessary and cause significant financial harm. 'One person — one account' should be the rule. There are valid reasons why a small number of people may need to have more than one account. But currently there are many more who have a second or subsequent unnecessary account. If the superannuation system was working for consumers there would be around 1.4 rather than 2.6 accounts per member of the labour force.

Our research shows that more than 13 million superannuation accounts are completely unnecessary — and so are the fees, paperwork and administrative costs associated with them. The annual aggregate loss through unnecessary fees paid on these accounts is in the range of \$1.2 to \$2 billion per annum.

The prevalence of multiple accounts also means that consumers are more likely to lose track of their superannuation, and superannuation funds to lose contact with their members. A significant number of multiple superannuation accounts containing an estimated \$8.2 billion in consumers' money are recorded on the Lost Members Register. More than \$5 billion is held in low return, high fee Eligible Rollover Funds (ERFs) managed by superannuation funds. There are no incentives for funds to locate the missing account holders (indeed they profit from holding funds in ERFs), and many consumers are never reunited with their 'lost' funds.

The average consumer with multiple superannuation accounts will lose tens of thousands of dollars from their retirement benefit. In addition, government welfare expenditure will also increase — some retirees will require and be eligible for government pensions where they would have been self sufficient without the losses caused by multiple accounts.

Barriers to account consolidation

Both research and individual complaints suggest that consumers are having a hard time dealing with the current processes for consolidating small accounts. The key barriers to account consolidation include:

- onerous administrative requirements to consolidate funds,
- poor communication and inadequate assistance to fund members,
- the absence of an industry wide protocol on consolidation,
- inadequate consumer education,
- high exit fees, and
- difficulties obtaining simple financial advice about consolidation.

Many of the barriers to account consolidation flow directly from current and past industry practices. Some barriers exist because they make life easier for superannuation funds by transferring the effort and risk of dealing with multiple accounts to consumers. Government has failed to provide the regulatory incentives required to respond to this market failure.

Who benefits, who loses?

Superannuation funds benefit from the current defective system, to the detriment of consumers and government. They are paid more than \$1 billion in fees from the 13 million unnecessary accounts and gain further revenue from administering low return, high fee ERFs.

The changing nature of work contributes to the increasing number of superannuation accounts. Consumers who have broken work patterns or a series of casual jobs are more likely to have multiple low balance accounts which are easily 'lost' or left behind. Some vulnerable consumers with poor financial literacy skills and low superannuation balances are further disadvantaged because they are disproportionately affected by the losses caused by multiple accounts.

A new approach to reform

To date there has been little effective action by industry. Although superannuation industry associations are aware of the multiple accounts problem, individual funds have little economic incentive to promote or assist account consolidation. The industry has failed to adapt its practices to respond to the realities consumers face in the current work environment. It must bear most of the blame for the enormous unnecessary transfer of money from consumers to the industry.

Choice of superannuation fund legislation, which came into force in July 2005, *may* help by slowing the growth in new account creation or assisting consumers to consolidate existing accounts. However, choice of fund alone will not significantly reduce the number of superannuation accounts.

Recent welcome Commonwealth Government announcements, including greater use of tax file numbers and a shorter time frame to transfer super from one fund to another, address some of the barriers to account consolidation. CHOICE particularly welcomes the proposed greater role for the ATO in helping deal with 'lost' accounts. While these changes will not be enough by themselves to reduce the number of superannuation accounts to an acceptable level, they provide a good basis for building an effective solution.

This report recommends nine key actions. They are designed to:

- reduce the number of unnecessary new superannuation accounts; and
- make it far simpler to consolidate existing multiple accounts.

The problems caused by multiple superannuation accounts can be solved, but to do so will require concerted government action, together with active cooperation from the superannuation industry. Fixing the problem will also produce benefits to government in avoiding the costs of increased pension expenditure. To do nothing will cost consumers too much in lost retirement savings.

Recommendations

Recommendation 1

The Commonwealth government should establish a Superannuation Accounts Office within the Australian Taxation Office (ATO). This builds on the expanded role that the government already plans for the ATO in dealing with 'lost' accounts, but it would extend to all multiple accounts. The Superannuation Accounts Office should be responsible for assisting consumers and superannuation funds to consolidate accounts. It should have the power to investigate and resolve disputes about account transfers. It should work to ensure that the superannuation industry meets targets for the reduction in the number of accounts.

Recommendation 2

The Commonwealth Government should introduce legislation to establish a new 'real time' electronic superannuation transfer system.

Recommendation 3

The proposed electronic transfer system should rely on tax file numbers as the unique identifier.

Recommendation 4

The Commonwealth Government should establish a Central Consolidation Fund. This fund should take over the role currently played by ERFs (Eligible Rollover Funds) in the management of 'lost' superannuation accounts.

Recommendation 5

The Commonwealth Government should introduce legislation to provide that a superannuation fund has a maximum of 30 days to implement a requested transfer *starting from the date on which the transfer request was lodged by a member* rather than from when the fund has gathered together all required information. The Superannuation Accounts Office should audit fund compliance.

Recommendation 6

Legislation or ASIC guidance should make it easier for funds and financial advisers to provide basic and targeted financial advice about account consolidation.

Recommendation 7

Steps should be taken to improve the information available about superannuation to support more effective policy development. These should include giving the SAO or APRA responsibility for collecting more comprehensive data on superannuation accounts including data on account type (active, inactive, 'lost') and the employment and migration status of the account holder.

Recommendation 8

The SAO should review the level of exit fees on superannuation funds. The SAO should be given the power to lower exit fees to a set level so that they reflect administration costs and don't inhibit the transfer and consolidation of superannuation.

Recommendation 9

After 3 years the Commonwealth should ask the Australian National Audit Office or another suitable agency to review progress against the goals of reducing the growth in new accounts and increasing account consolidation.

Introduction

Since 1992/1993 it has been compulsory for employers to pay part of each employee's remuneration in the form of superannuation payments. Until 30 June 2005 the employer was entitled to choose the fund into which they paid their employees' superannuation. As a result, employees were often forced to set up a new superannuation account each time they changed employer. Various factors meant that many employees did not consolidate their existing account(s) into the new one, and so the problem of multiple accounts was born.

In June 2005 there were 27.88 million superannuation accounts in Australia — 2.64 for each of the 10.55 million members of the labour force. While figures for 2006 are not yet available, at prevailing growth rates Australia would now have more than 30 million accounts. The number of superannuation accounts is growing at a much faster rate than increases in the labour force. If this growth rate continues there will be around 3.5 accounts per person in 2010 and 5.7 in 2020.

Research suggests 4.3 million people — around 27% of adults and at least a third of the current labour force¹ — have multiple superannuation accounts. For the vast majority of these consumers multiple superannuation accounts are unnecessary and cause significant financial harm.

We estimate that Australia needs only around 1.4 accounts per member of the labour force (see part 3 below). More than 13 million existing accounts are completely unnecessary, as are the fees and charges, paperwork and administrative costs associated with them.

Our purpose in publishing this report is to stimulate action to fix this problem. We estimate that fixing the problem will mean more than a billion dollars each year in fees currently benefiting funds to the detriment of consumers, will rightly stay in consumers' superannuation accounts. The average affected consumer will have tens of thousands of dollars more in their retirement nest egg.

The multiple superannuation accounts problem can be solved, but it will require concerted government action together with active cooperation from the superannuation industry. We welcome the government's recent reforms in this area, but argue that substantially more will be required to effectively address the multiple accounts problem. This report describes the magnitude of the problem, explores the causes and the impact on individual consumers, and explains how it can be fixed through straightforward government and industry action.

Structure of this report

Part 1 of the report provides information about the number of superannuation accounts and describes recent and projected trends in the growth in the number of accounts.

Part 2 considers the factors that have contributed to the explosive growth in superannuation accounts and the factors that work towards and against account consolidation.

In **Part 3** we estimate the number of superannuation accounts that are really needed, and discuss the enormous individual and aggregate costs to consumers, government and the economy that flow from having too many superannuation accounts.

Part 4 identifies the particular problems arising from the use of Eligible Rollover Funds to manage 'lost' superannuation and inactive accounts.

Part 5 identifies who wins and who loses from the current system.

Part 6 outlines how the problems caused by multiple superannuation accounts can be fixed. It sets out the history of ineffective government and industry responses and makes nine key recommendations for change.

¹ Institute of Chartered Accountants of Australia (ICAA)(2006) from its survey of 1200 people in March 2006. Between 3 and 4 million of those adults are retired or have never been in the labour force and so will have no super account, and so the proportion of employees who have multiple accounts will exceed one third.

A note on sources and the availability of data

The Australian Prudential Regulation Authority (APRA) and the Australian Taxation Office (ATO) collect data on superannuation. APRA collects data on account numbers annually. ATO collects data on 'lost' super. However, there is little publicly available information about the number and location of superannuation accounts on the basis of their account status (that is, the number and proportion of active, inactive or 'lost' accounts and so on). There is also very little information available about the type of consumers who have multiple accounts (gender, age, whether accounts are held by current or former members of the labour force, or whether accounts are held by people who reside in Australia or overseas, and the number of accounts held by each).

As a result, it is not currently possible to answer all the questions that need to be addressed in considering the multiple accounts problem.

Similarly, the quality of data held about accounts notified to the ATO's Lost Members Register is poor. This limits the ability of the ATO to help match consumers with their money, and also hinders analysis of the problem.

In the report we recommend improvements to data collection and analysis.

Unless otherwise stated, statistics in this report refer to the year to 30 June 2005, or the figure that applied on 30 June 2005.

About CHOICE

CHOICE improves the lives of consumers by taking on the issues that matter to them.

CHOICE is a not-for-profit organisation which has been campaigning on behalf of consumers since we were founded as the Australian Consumers' Association in 1959. With over 190,000 subscribers to CHOICE magazines and CHOICE Online we are the largest consumer organisation in Australia. Our aim is to arm consumers with the information to make confident choices and to advocate for change when consumers are getting a raw deal.

CHOICE is fiercely independent: we do not receive ongoing funding from any commercial, government or other organisation. We earn the money to buy all the products we test and support our campaigns through the sale of our own products and services.

Our policy voice is widely recognised. As an independent non-government organisation we can advocate for consumers without fear or favour. Our advocacy work responds to consumer priorities based on the benefit or detriment consumers will face and research into consumers' experiences and opinions.

We campaign on key issues for consumers in food, health, financial services, product safety and communications. We also stand up for consumers in broader policy debates on consumer protection law, the quality of enforcement agencies and consumer information and education.

CHOICE conducts research, publishes policy reports and online information, gives presentations and keeps the media informed of our policy views. We provide representatives for many industry and government committees and independent bodies considering matters of concern to consumers.

To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns or subscribe to CHOICE Campaigns Update at www.choice.com.au/ccu.

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Part 1: The rapid growth in superannuation accounts

1.1 Growth in account numbers

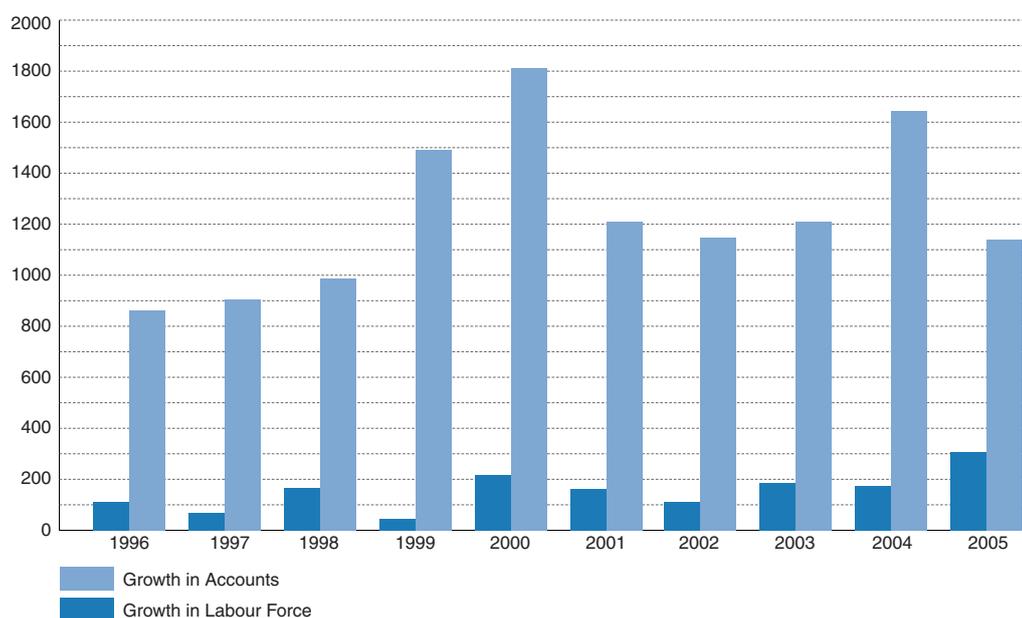
Superannuation accounts are generally held by people who are in the labour force or have recently left it. In June 2005 there were 27.88 million superannuation accounts in Australia. At that time there were 10.55 million people in the labour force². While figures are not yet available it is highly likely that today there are more than 30 million accounts.

The number of superannuation accounts has grown rapidly compared to the number of workers.

- There are now around 2.64 superannuation accounts for every person in the labour force³.
- There are 17.33 million more accounts than persons in the labour force.
- Research in March 2006 suggests 4.3 million Australian consumers have multiple superannuation accounts⁴ — 27% of the adult population and more than a third of the workforce.

From 1996 to 2005 the number of accounts grew *many times* faster than growth in the labour force. The labour force grew by 1.5 million, while the number of accounts grew by 12.4 million: see Figure 1.

Figure 1: Annual growth in superannuation accounts and labour force 1996 to 2005 ('000s)



Sources: Account numbers from APRA Annual Statistical Bulletin (various); Growth in labour force ABS time series 6202.0

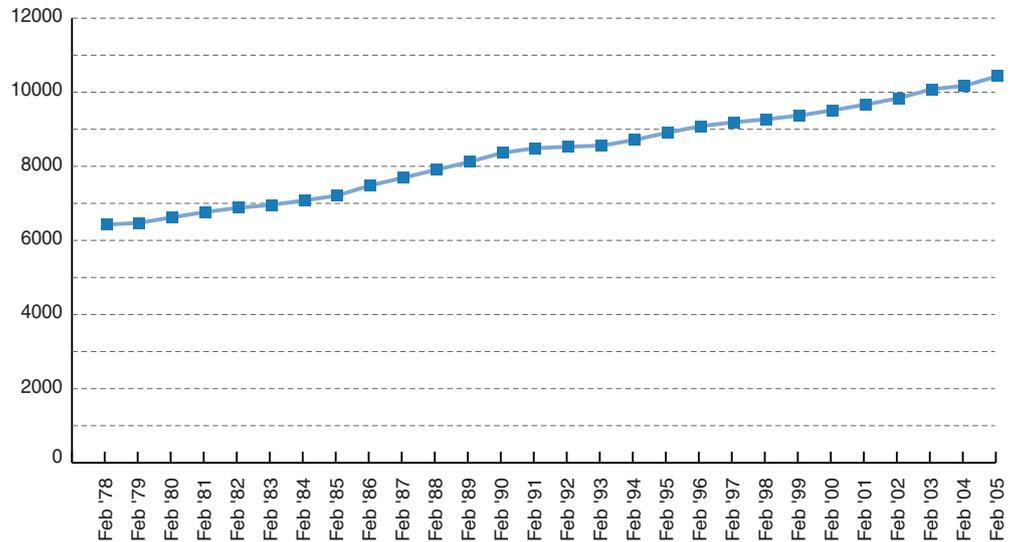
2 Australian Bureau of Statistics (ABS) (2005) *Labour Force, Australia* Cat no. 6202.0 (Time Series) at June 2005.

3 That is 27.88 million accounts / 10.55 million members of the labour force. Note that when we refer to the current account numbers we are using the latest available APRA figures to June 2005. The actual current figure for total accounts is certainly much higher.

4 ICAA (2006).

Over the same period, the number of accounts per member of the labour force has steadily increased. Figure 2 shows that on average there were 1.72 accounts per member of the labour force in 1995, rising to 2.64 by 2005.

Figure 2: Accounts per member of the labour force ('000s)



Sources: Account Numbers from APRA Annual Statistical Bulletin (Various); Growth in labour force ABS time series 6202.0

1.2 Future growth in account numbers

If the current growth rate continues, the number of accounts per member of the labour force will rise significantly, adding further to unnecessary costs.

Since July 2005 a majority of the labour force has been entitled to choose their superannuation fund. It is likely that choice of fund will provide a necessary framework for account consolidation but on its own will not reduce the excessive growth in the number of super accounts (see section 2.3 below).

Table 1 shows the projected growth of superannuation accounts per member of the labour force at 30 June 2005 at the current rate of increase in account numbers and at half the current rate of increase. At current growth rates there would be more than 30 million accounts at the time of writing — September 2006 — and there will be around 39 million accounts in 2010 (3.52 per person), 74 million in 2020 (5.72 each) and a staggering 9.30 accounts per person in 2030.

Using the more conservative estimate of half the current growth rate we would still witness a significant growth in account numbers. By 2010 there would be 2.93 accounts per member of the labour force and 4.15 per person by 2030. We would reach 40 million accounts in 2017 with a workforce of around 12.6 million — 3.2 accounts each.

Table 1: Projected growth in the number of superannuation accounts

Projected growth at current rate				Projected growth at half the current rate			
Year	Accounts	Labour force	Accounts per member of the labour force	Year	Accounts	Labour force	Accounts per member of the labour force
2010	39,343	11,166	3.52	2010	32,669	11,166	2.93
2015	53,900	12,003	4.49	2015	38,332	12,003	3.19
2020	73,842	12,902	5.72	2020	44,978	12,902	3.49
2025	101,163	13,868	7.29	2025	52,776	13,868	3.81
2030	138,592	14,907	9.30	2030	61,925	14,907	4.15

Sources: Estimates based on Account Numbers from APRA Annual Statistical Bulletin (Various) and Growth in Labour Force ABS time series 6202.0

1.3 Where are the multiple superannuation accounts?

The short answer is that no one knows where all 27.8 million superannuation accounts are. What we do know, or can reliably estimate, is as follows (figures at 30 June 2005):

- nearly all of the 10.5 million members of the labour force had at least one active superannuation account⁵;
- there were 5.4 million accounts recorded on the ATO's Lost Members Register⁶;
- there were about 1.9 million defined benefit accounts⁷. Some of these are included in the 10.5 million accounts held as each member of the labour force's single or primary active account. Many of these will, however, be held as second accounts by people that have subsequently changed jobs and now have another account;
- there were a number of accounts held by people who were previously in the labour force but have not yet retired; these may be in the order of 1.5 million⁸;
- there are likely to be a number of accounts that have been transferred to Eligible Rollover Funds but which are not yet recorded on the Lost Members Register; and
- some accounts are held by people who no longer reside in Australia, including foreign nationals who held work visas. Many of these accounts will be included in the accounts recorded on the Lost Members Register but some will not⁹.

In summary, superannuation accounts can be divided into a number of broad categories. The number of accounts in each category other than the first is unknown. The categories are:

- an active account for each member of the labour force (about 10.5 million accounts);
- necessary second accounts (active or inactive) where the consumer holds the second account for one of a number of good reasons;
- the first account held by some people who are not currently in the labour force¹⁰; and
- unnecessary second and subsequent accounts.

This final category is the multiple accounts problem.

In section 3.1 below we estimate the numbers of accounts held in each of these categories.

The unnecessary second and subsequent accounts which make up the multiple accounts problem can be further divided into the following categories:

- second accounts where the fund and consumer remain in contact but there is no good reason for the consumer to have a separate account;
- inactive accounts where the consumer is not 'lost', but the money in a low balance account has been transferred to an Eligible Rollover Fund (ERF);
- inactive accounts where contact has been lost but the account is not yet reported as 'lost' to the Lost Members Register maintained by the ATO;
- lost superannuation which has been transferred to an ERF (the account may or may not have been reported to the Lost Members Register); and
- other accounts recorded as lost on the Lost Members Register (that is 'lost' accounts where the account balance has not been transferred to an ERF).

The superannuation accounts of overseas residents who held work visas but have not yet claimed back their superannuation will be included in one of the last three categories.

5 For example, employees regularly earning less than \$450 a month and some long term self-employed people might not have super accounts.

6 ATO (2005) Table 2.34.

7 See section 3.1 below.

8 See section 3.1 below.

9 See ATO at <http://www.ato.gov.au/superprofessionals/content.asp?doc=/content/16442.htm>

10 The number of people not in the labour force who hold a superannuation account is likely to grow in response to the expanded superannuation co-contribution scheme announced in the May 2006 Commonwealth budget, however that scheme will not have affected account numbers to date.

Part 2: Why do we have so many superannuation accounts?

2.1 Superannuation and the labour market since 1992

Since 1992 it has been compulsory for employers to contribute to a superannuation fund on behalf of most employees¹¹. Until July 2005 each employer was entitled to nominate the superannuation fund that they would use for their employees, that is, employees had no choice of fund.

As employees changed jobs they were presented with a requirement that their superannuation be paid into the new employer's preferred fund rather than their previously existing account. Sometimes if they moved jobs within an industry they would be lucky enough to find that their employer's preferred fund was the same as their existing fund, however more frequently the superannuation received from their new employer would be paid into a new account operated by a different fund.

Various barriers, such as those listed in section 2.2 below, mean that many employees did not consolidate past accounts into their new one. It was not uncommon for individuals to build up as many as 10 superannuation accounts over a number of years.

On average, workers change jobs every seven years¹². Of course some employees, especially those in casual employment, change jobs more frequently and some employees hold more than one job. In 2004, 20% of the workforce was in casual or irregular employment at any one time¹³, and this rate is likely to grow.

It was — and remains — possible for most employees to consolidate their superannuation into one account. This could be done at the time of changing employment or any later time. Until July 2005 the only way that an employee could place all their funds in one account was to use their current fund, that is, the one preferred by their employer. Since July 2005 a majority of employees have the right — in theory at least — to require their new employer to pay superannuation into an account of their choice. This has given rise to the notion of the employee's preferred superannuation account as a 'financial backpack'¹⁴ that they take with them from job to job.

We have a long way to go, however, before the financial backpack image corresponds to reality. In an environment of frequent job changes and a high rate of casual and part time employment, the barriers that existed prior to the introduction of choice of fund legislation in July 2005 continue to make it difficult for people to sustain ongoing contributions to one account. Accounts, especially small accounts, are easily left behind. CHOICE research suggests that consumers are having a hard time dealing with the current processes for consolidating accounts¹⁵.

2.2 Factors working against account consolidation

In most situations it is in the employee's interest to have all their superannuation in one account. Apart from the convenience of dealing with only one superannuation fund, the total amount of fees paid on the employee's superannuation account balance(s) will almost always be lower.

11 Exceptions include employees who earn less than \$450 per month and self employed persons.

12 The annual job turnover rate is between 11 and 14 per cent: see Case T (2005) p 25 and ABS (2004) ABS (2004) *Labour Mobility* Cat. No. 6209.0 p 3.

13 ABS (2006a) *Year Book Australian* p 161 – a casual being an employee who does not have leave arrangements in place.

14 Gilbert R (2005) p 31.

15 Thompson J (2006) p 22.

There are two principal exceptions. First, where the employee was a member of a *defined benefit fund*¹⁶ associated with one employer which is now closed to new employee contributions it may be in their interest to keep that separate account. Second, and less happily, consumers may have money stuck in an older style fund with a high exit fee that effectively traps their money in that fund for a large number of years or until retirement age.

The key barriers to consumers consolidating their accounts are:

- onerous administrative and identification requirements to consolidate or transfer funds;
- poor communication by funds and inadequate assistance to fund members, in particular those funds passing on money to a former member's new fund;
- the absence of an industry wide protocol on consolidation;
- inadequate consumer education about the cost of holding multiple accounts;
- exit fees;
- difficulties obtaining simple financial advice about account consolidation; and
- problems consolidating legacy products.

These are discussed in detail in the following sections.

These barriers to account consolidation flow directly from current and past industry practices or insufficient government oversight. Some exist because they make life easier for superannuation funds by transferring effort and risk to consumers. These barriers make it difficult for consumers to take charge of their superannuation. Faced with frustrations in trying to transfer funds, and already daunted by complex issues such as choice of fund and investment option selection, many consumers simply procrastinate and leave their accounts open and inactive. It simply becomes either too difficult or time consuming to follow the transfer process through to a conclusion. Eventually many of these accounts become lost.

The superannuation industry has failed to adapt its practices to respond to the realities consumers face in the current work environment. It must bear most of the blame for the unnecessary increase in the number of superannuation accounts.

Government has not provided the regulatory incentives required to respond to this market failure.

Onerous administrative requirements and poor communication

When we surveyed consumers in March 2005 in the lead-up to the introduction of superannuation choice legislation, we found that 'the paperwork' was the single biggest reason people gave for not consolidating their superannuation¹⁷. Consumers are confused by a number of provisions in the portability rules — the legislation which governs transfer of superannuation between funds¹⁸. Some superannuation funds are being inflexible in their interpretation of these rules. For example, a recent study found that 85 per cent of consumers believe the rollover process should be simplified¹⁹.

Portability rules for accounts with a balance exceeding \$5000 require consumers to supply 100 points of ID (just as when opening a bank account) certified by a Justice of the Peace (JP) on transfer requests²⁰. These rules compel consumers to identify themselves by making multiple copies of documents and finding a JP to assist.

The Association of Superannuation Funds of Australia (ASFA) argues that an appropriate balance must be struck between preventing fraud (by establishing the identity of a super fund member) and timely processing of the member's transfer request. According to ASFA:

*"There can be a tension between member expectations that a transfer or release of money should happen instantly, and the need for proper identity checks"*²¹.

There is obviously a balance of this sort that needs to be struck (although there are few consumers making unrealistic requests for 'instant' transfer as this comment implies). But

16 A defined benefit fund provides the employee with a retirement benefit based on their final salary or similar measure. The risk of poor investment returns falls on the employer or fund rather than on the consumer.

17 Australian Consumers' Association (2005): 28 % of respondents.

18 *Superannuation Industry (Supervision) Act 1993(Cth)* and *Superannuation Industry (Supervision) Regulations 1994 (Cth)*

19 Financial Standard (2006) p 2.

20 Certification is also required on balances between than \$1000 and \$4999 but only one piece of identification is required.

21 Association of Superannuation Funds of Australia (ASFA) (2005).

there is strong evidence that this tension has been exploited by funds. It has been reported that some superannuation funds are interpreting the ID requirements inflexibly as part of a member retention strategy in the superannuation choice environment²². We gathered evidence of this when we asked consumers to contact CHOICE about their problems with consolidating and transferring superannuation. Many consumers told us that their transfer requests were refused due to 'insufficient paperwork'. Importantly, many were not actually told what paperwork was required and were left to get the correct information and documentation through trial and error.

In other words, the balance between ease of transfer and identity checks is very much in favour of the industry. This is highlighted by the hostile response from some industry players to the Government's recent reforms in this area that would require additional efforts by funds²³.

In some instances there is evidence of funds imposing additional procedures not required under the portability rules — for example, an insistence on having the signature of the employer on the transfer request even though this is not required by law²⁴.

Transfer requests have also been frustrated by processing errors. We have seen evidence of funds losing paperwork and requiring consumers to re-satisfy the proof of ID test. Sometimes benefits have been incorrectly calculated resulting in a dispute. At other times funds have simply not responded to transfer requests, later claiming that they never received the request.

ASFA have issued guidelines on how the rules should be interpreted, however this is not binding on funds²⁵. Many funds don't interpret these consistently, and not all funds belong to ASFA.

Funds have an incentive to delay or frustrate account transfer. Every time a consumer leaves a fund the size of the fund is reduced. They certainly have no incentive to put resources into helping consumers consolidate into an account managed by another fund. Superannuation funds have effectively transferred to consumers all the work involved in consolidating accounts and all the risks of failing to do so. Only a persistent consumer investing a significant amount of time will succeed in consolidating their accounts. And where an account consolidation fails, the consumer loses and the fund gains. For the most part the risk of fraud appears to be a convenient excuse.

The following three case studies provide real life examples of consumers frustrated by unnecessary super fund bureaucracy.

BARRIERS TO CONSOLIDATION

Case 1: The identification run-around

*A life company incorrectly calculated benefits within a master trust. ASIC required it to pay additional amounts to the affected members. Where a member had exited the fund, the additional benefit was paid into an Eligible Rollover Fund. This happened even though the life company could have traced the members directly. One member tried to claim a benefit of **less than \$20**. This required submission of 'proof of identity' as defined by the fund.*

The member forwarded copies of her driver's licence, private health care card, credit card and a bank account card, all of which had to be certified by a JP. Unfortunately private health insurance is not deemed to be a suitable form of identification, so the applicant only managed to generate 90 points instead of the required 100 points. The fund then sent her a letter requesting further identification.

A curt letter to the administrator was required to overturn this grossly inefficient bureaucracy. A cheque and ETP form followed within a week²⁶.

22 Wright C (2005) pp 1, 20.

23 Mercer Human Resource Consulting (2006) Submission 3 to Treasury on *A Plan to Simplify and Streamline Superannuation*.

24 Wright C (2005) p 20.

25 Association of Superannuation Funds of Australia (ASFA) (2006) *Transfer, rollover and cashing of benefits: a guide to processing superannuation fund member requests*.

26 Rice Walker (2005).

BARRIERS TO CONSOLIDATION

Case 2: "Is anybody there?"

A member tried transferring money out of a Retirement Savings Account (RSA) run by a master trust. The consumer's new fund provided a service consolidating accounts. It was able to convert three inactive accounts into her active one. However, it was unable to obtain the money from the master trust despite writing to the old fund with her full details. The new fund contacted the member to advise it had been unsuccessful.

The member also wrote to her old RSA requesting the transfer but she did not receive a reply. The money remains in the RSA²⁷.

BARRIERS TO CONSOLIDATION

Case 3: Eligible Rollover Fund

A member had left her company plan some three years ago and exited the workforce to start a family. As she had provided no instruction to her company fund, her superannuation account was transferred to an ERF. After recently commencing a spouse account with her husband's fund, the fund encouraged her to consolidate her old accounts. However, it did not actively promote a consolidation service despite having one.

The member contacted the ERF directly and offered to attend the administrator's office in person with documents showing proof of identity. The ERF would not allow this and insisted she send copies of documents certified by a JP, despite this being more time consuming for the member. Without direct access to a photocopier or a JP, the process took some months to complete. The amount in question was approximately \$800²⁸.

The absence of an industry wide protocol on consolidation

The superannuation industry has come to interpret the Government's rules on super transfers and portability in a wide and varied manner. These differences of interpretation reflect the fact that there has been no oversight by Government as to how funds interpret the rules. To its credit, one industry association has begun working on the issue²⁹, but without Government leadership and enforcement varying standards will continue.

Inadequate consumer education

Most consumers find superannuation to be both boring and confusing which is not surprising in a compulsory and complex system. Recent consumer information messages from the Commonwealth Government have focused on consumers' right to choose their superannuation fund. There is little consumer information available, however, focusing on the costs of holding multiple accounts and how to consolidate those accounts. Clearly there is a need for this information. The CHOICE survey of consumers found that 24 % of consumers with multiple accounts gave as a reason that they did not want to put all their eggs in one basket³⁰. This response illustrates a lack of consumer awareness about the true cost of multiple accounts and a basic misunderstanding of risk and asset allocation.

Exit fees

CHOICE's consumer survey found that 14 % of respondents did not want to leave their fund because they did not want to pay high exit fees³¹. Most funds charge an exit fee when consumers request a transfer to another fund. Exit fees are generally higher on older products³² and some master trust funds. Many of these fees are charged at a flat rate and thus disproportionately affect small balance accounts. Exit fees are a disincentive for consumers to consolidate and consequentially assist a fund to retain inactive accounts.

If exit fees were purely a cost recovery for the administration expense associated with fund transfer then they might be justified, however many are at levels much higher. To the extent that exit fees are set at a level designed to promote account retention then they are

²⁷ Rice Walker (2005).

²⁸ Rice Walker (2005).

²⁹ ASFA (2006) *Transfer, rollover and cashing of benefits: a guide to processing superannuation fund member requests*.

³⁰ ACA (2005). This also reflects the findings of the ICAA survey which found that most Australians have not regarded consolidation a priority. The ICAA concluded that more education is required to help people understand the benefits of consolidation: see, ICAA (2006).

³¹ ACA (2005).

³² Australian Securities and Investment Commission (ASIC) (2005).

anti-competitive. Some consideration needs to be given to prohibiting exit fees through law reform. At the very least there should be no exit fees charged for consolidation of smaller amounts (for example, where the balance is under \$50,000).

In some cases the long term benefit of consolidation will outweigh the expense of an exit fee. However, some exit fees are so high that no matter how poorly a fund is performing the consumer would be well advised to leave their superannuation in that account. They will thus have a valid if undesirable reason for maintaining two accounts.

In other cases exit fees do not prevent rational consumers exercising their right to choice, but they do operate as an unnecessary barrier to account consolidation (consumers require advice to work out whether the benefit of consolidation outweighs the exit fee) as well as being anti-competitive (consumers that may wish to move to a new fund must weigh a concrete disincentive against the mere possibility of better returns).

Some related issues are addressed under the heading *Legacy products* below.

EXIT FEES

Case 4: Stuck with poor returns

In 1994 Ron was in his mid twenties and self employed. He took advice from a financial adviser who recommended a particular superannuation fund.

After about seven years in the fund Ron had a balance of \$30,000. He again sought financial advice. Among other things the second adviser looked at his existing super fund and suggested it was performing badly in comparison to others. He recommended that Ron should move his account to another fund to obtain a better return.

Unfortunately Ron discovered that he would lose around \$12,000 in exit fees – close to a third of the balance – if he left the fund prior to retirement age. Worse still, if Ron fails to continue to contribute to this fund he will be deemed to have left the fund and suffer the exit penalty.

Difficulties obtaining financial advice

Some superannuation funds have argued that provisions of the *Corporations Act* make it uneconomic for them to provide advice and related administrative assistance to members on account consolidation. In particular, the likely requirement to research the ‘from’ and ‘to’ funds may render the provision of advice in this area relatively expensive.

The Australian Securities and Investments Commission (ASIC) may need to give some consideration to facilitating the provision of targeted advice about a financial product so that consumers can receive assistance when consolidating their superannuation³³. If the relief is carefully targeted at advice required for account consolidation only, valuable consumer protection measures under ASIC licensing provisions should not be compromised. However, we caution that this will be a balancing act. Relief from advice should not be used to pressure consumers, with legitimate reasons for holding multiple accounts, to consolidate their accounts or switch accounts unnecessarily.

Legacy products

Significant superannuation assets are held in life office statutory funds and backing endowment policies written prior to 1992. Many of these are not included in the total of 27.8 million superannuation accounts recorded by APRA — so to the extent that they are held by current members of the workforce with a different active account, they are *additional* multiple accounts to those counted in our calculation of the cost to consumers.

A Rice Walker Report for CHOICE estimates funds in these accounts amount to approximately \$8 billion as at 30 June 2004³⁴. Legacy products were not designed with contemporary working arrangements and modern flexibilities in mind and there are significant barriers for policyholders wishing to consolidate these into standard superannuation products.

For example, an endowment policyholder who wishes to surrender their policy and roll it into an accumulation account in a superannuation fund would face:

- a transfer of inflation and investment risk from the insurer to the policyholder, as the

³³ Section 766B, *Corporations Act 2001 (Cth)*.

³⁴ Rice Walker (2005) p 6.

member bears these risks in an accumulation environment; and

- a significant exit fee in surrendering the policy early³⁵.

In addition to these accounts, the 27.8 million total superannuation accounts at 30 June 2005 include an estimated 1.9 million accounts which provide a defined benefit³⁶.

Members of a defined benefit fund who wish to transfer their superannuation entitlements to an accumulation fund could face:

- a transfer of inflation and investment risk from the employer to the member;
- a transfer of plan and insurance costs from the employer to the member; and
- a vested withdrawal benefit that is potentially worth less than the defined benefit that would have accrued if the member had stayed with the fund.

2.3 Factors working towards account consolidation

There are four factors that should encourage the future consolidation of superannuation accounts:

- the introduction of choice of fund legislation;
- the reduction in numbers of trustee licences by APRA which is likely to force a degree of industry consolidation and thus offer some opportunities to match and consolidate multiple accounts;
- the steady growth in 'self-managed' superannuation which provides encouragement for some consumers to consolidate accounts under their own control³⁷; and
- 'partner accounts' which are single accounts covering two people.

Of these, it is choice of fund that is likely to have the most significant impact.

Until July 2005 when choice of superannuation fund legislation came into effect, employees were often forced to set up a new superannuation account each time they changed employer. As noted earlier, a majority of employees may now require their new employer to pay superannuation into an account of their choice.

In practice, choice of fund legislation provides a framework for those consumers who can actually make a choice. Where applicable, it provides the opportunity and makes it easier for astute, informed consumers to consolidate their accounts, but there are factors which limit or even undermine the operation of choice of fund.

First, many consumers will not be prompted to take action until they change jobs, which for some may not be for many years, or until their attention becomes more focused on their post work income as retirement age approaches. As noted in the previous section, many consumers remain ignorant of why account consolidation is important or how to go about it.

Second, the barriers to easily consolidating accounts listed in section 2.2 above are still in place.

Third, there are large numbers of employees not yet covered by choice of fund legislation; for example, many government employees in most States. As at July 2005 approximately half of Australia's workforce was entitled to choice of fund³⁸.

Finally, regulatory agencies will need to be vigilant about the possibility of employees being refused their choice of fund or encouraged to use their employer's preferred default fund, despite the potential fines under the choice of fund legislation. In the lead up to the introduction of choice of fund legislation, it was argued that employers would have incentives to recommend their default fund to their employees because of the financial advantages where the employer already had a direct financial relationship with the financial institution offering that fund³⁹. This has been a concern for ASIC which recently released a paper reminding employers, among others, of their obligations under superannuation choice legislation⁴⁰.

35 Rice Walker (2005) p 6.

36 See section 3.1 below.

37 The number of self managed funds has grown from 210,667 in 2001 to 302,249 in 2005: Australian Prudential Regulation Authority (APRA)(2005a) Table 1 p 17.

38 Investment and Financial Services Association (IFSA)(2006) p 17.

39 Coates N (2004) p 26.

40 ASIC-ATO (2005).

2.4 Future trends: up or down?

Choice of fund means that, for more than 50% of the workforce, one of the important structural barriers to consolidating accounts has been removed. However, all the barriers outlined in Section 2.2 above remain in place.

At the time of writing there is little evidence of the impact of choice of fund on the problem of multiple accounts. A survey by the Institute of Chartered Accountants in March 2006 suggested that at least 27% of the adult population, equating to at least one third of the workforce, still has more than one account. This is a similar result to a survey conducted by the ABS in 2000, which suggested 31% of the adult population held multiple accounts⁴¹.

Choice of fund *may* help by slowing the growth in new account creation or assisting consumers consolidate existing accounts. But it should properly be viewed as a necessary but insufficient step in addressing the multiple accounts problem. There is little chance that choice of fund on its own will reduce unnecessary account growth to zero, and it certainly will not result in a reduction in the current number of accounts to an acceptable level anytime soon.

Unless further policy changes are made we believe that the factors encouraging the growth of multiple accounts will outweigh the countervailing pressures for consolidation. Significant labour market trends — such as the growth of forms of non-standard employment where people change jobs more regularly due to the increasingly precarious nature of modern working arrangements — are likely to more than offset any pressure for consolidation brought about by choice of fund legislation.

⁴¹ ABS (2001) Table 5.

Part 3: The cost of too many accounts

The costs of multiple superannuation accounts are felt at two levels — the aggregate level and the individual level.

At the aggregate level

- Consumers as a whole pay \$1 billion to \$2 billion in unnecessary fees to the superannuation industry each year⁴².
- There is \$8.2 billion identified as ‘lost’ superannuation. A significant portion of this money will never be paid to consumers as retirement benefits.
- Duplication of account administration, including mailing member statements and annual reports, is wasted economic activity and environmentally wasteful (see *Environmental impact*).
- Government is already incurring increased expenditure on aged pensions and related benefits as many consumers are forced to rely on the aged pension in retirement as their superannuation income is lower than it otherwise would be. This impact is likely to increase as more consumers affected by the multiple account problem reach retirement age.

- A significant bureaucracy within government and superannuation funds exists to manage the 5.4 million ‘lost’ accounts and to attempt to track down missing account holders.

The value of each of these costs could be estimated. Our focus in section 3.2 is on the direct costs borne by consumers.

At the level of the individual

- Consumers suffer lower retirement incomes when they lose contact with their superannuation and do not have that money to retire on.
- Consumers suffer lower retirement incomes when their funds are in ERFs which do not grow or grow more slowly than they would if invested in a normal superannuation account.
- Consumers suffer lower retirement incomes when their balances are reduced through paying multiple fees.
- Consumers incur costs in keeping track of multiple funds and taking steps to consolidate them.

For a typical individual consumer, holding a second account for a number of years can reduce their retirement benefit by tens of thousands of dollars.

In sections 3.2 and 3.3 we attempt to calculate the overall loss to consumers each year in unnecessary account fees and then illustrate the costs to individual consumers in a range of typical scenarios. In the next part we set out the impact of ‘lost’ superannuation and superannuation transferred to ERFs.

In addition to the costs listed above, the proliferation of low balance accounts increases the cost of administering superannuation funds through lost economies of scale and increased administration costs. These costs are passed on to consumers in fees and as an impact on benefits; however the amount is difficult to estimate.

Environmental impact

When consumers complain about paperwork they mean it literally. Multiple accounts have an impact that goes beyond the financial costs for consumers and the economy. Excess, multiple accounts result in the creation of many millions of unnecessary copies of documents. The increase in paper costs us heavily.

If there were 15 million accounts rather than 28 million then the saving on paper would be well over 2000 tonnes each year. To print and mail 13 million copies of an annual report of 42 pages requires the equivalent of around 40,000 trees per year, without allowing for unnecessary copies of application forms, product disclosure statements, member statements, and so on.

⁴² See section 3.2, p20.

3.1 How many accounts should there be?

It is in most consumers' interest to hold only one account. There are, however, valid reasons why some consumers may need more than one account. There are also accounts that a consumer may prefer to consolidate but cannot because they do not have the right to choice of superannuation fund, or they would be unwise to do so because of punitive exit fees. But many accounts *can* be amalgamated, and most would be if the processes supporting consolidation of accounts were improved as recommended in this report.

In this section we attempt to estimate the number of accounts that would be needed if the superannuation system was operating in the best interests of consumers. We estimate that around 1.4 accounts per member of the labour force are appropriate.

An approach to estimating the required number of accounts

Valid reasons why an individual consumer may rationally maintain more than a single superannuation account include the following:

- where an account they hold will pay a 'defined benefit'⁴³ at retirement but it is not their currently active account; and
- in a small number of cases, to maintain better insurance cover available in an old fund to which the consumer can no longer contribute.

There are other reasons why a consumer may need to maintain two accounts which may be undesirable but which are difficult to change. Generally these arise either from the fact that consumers cannot amalgamate accounts which pay a defined benefit where they hold more than one account, or through being trapped in a product with a high exit fee.

Some second accounts may be required through the limitations of current superannuation choice policy settings which do not apply to certain state government employees.

In addition to the second and subsequent accounts held by current members of the labour force because they have been unable to consolidate accounts, the total number of superannuation accounts will also include:

- temporary second accounts created as an employee moves from one job to another⁴⁴;
- working holiday-makers and other temporary workers who have left the country but not (yet) reclaimed their superannuation; and
- accounts held by former members of the labour force who have not yet reached retirement age, many of whom may return to the labour force in the future (for example, parents engaged full-time in raising children).

From 1 July 2006 there will be a new category of people who hold a superannuation account solely to take advantage of the new superannuation co-contribution scheme.

On the other hand, some of the 10.5 million members of the labour force may not have a superannuation account. Self-employed people are not required to have a superannuation account, and some employees who have not yet had a month in which they earned more than \$450 may not yet have an account.

Using available data to estimate the number of accounts required

It is impossible to precisely calculate the number of accounts in each of the categories listed above as insufficient accurate data is collected. Some ranges for the number of accounts held in each category follow.

Accounts held by persons not in the labour force

There were 94,000 working holiday makers and other working visas issued in 2003/2004 and 105,000 in 2004/2005⁴⁵. A scheme administered by the Australian Taxation Office (ATO)

43 A defined benefit account pays a retirement benefit typically calculated on the basis of the employee's salary at retirement rather than a benefit derived from how much has been accumulated in the fund through its investment performance. In years gone by most government superannuation and some corporate funds offered defined benefits plans. These days accumulation funds are the norm. This change has transferred the risk of poor investment returns and 'longevity risk' – the risk of outliving your retirement income – to consumers and away from funds and/or their government and corporate backers.

44 The annual job turnover rate is between 11 and 14 per cent: see Case T (2005) p 25 and ABS (2004) p 3.

45 Department of Immigration and Multicultural Affairs (2005) *Annual Report 2004-05*.

enables temporary working visa holders to reclaim their superannuation when they leave Australia permanently⁴⁶. The ATO has not been able to provide information to us on the rate at which departed working visa holders have successfully reclaimed their superannuation to assist in estimating the number of super accounts that may be unnecessary. What we can assume is that all of these accounts that have been inactive for two years, and some others, will have been transferred to Eligible Rollover Funds (ERFs) or recorded as 'lost' superannuation with the ATO, in which case they are adequately accounted for. The number of accounts belonging to former working holiday-makers — probably in the order of a few hundred thousand — will not substantially affect the number of 'other unnecessary' accounts, but it does affect the lost superannuation problem. Nevertheless, to the extent that 'lost' super belongs to overseas citizens, it is not a problem for Australian consumers, and it will in any case require different solutions to those proposed in this report to assist Australian consumers. We have allowed 500,000 accounts to cover this category of people.

We estimate there are about 2.85 million Australians 15 or over who are neither retired⁴⁷ nor current members of the labour force⁴⁸. There is no current information available about the number of these who do not have superannuation accounts⁴⁹. Many of these will have worked and earned more than \$450 in a month since the advent of compulsory superannuation in 1992. Others may have been entitled to superannuation prior to 1992. We estimate that no more than half this number (1.43 million) hold a superannuation account. Some may hold two accounts. If we allow for 27% to hold a second account (consistent with the rate reported for the adult population as a whole in recent research, but likely to be overestimating the rate for this group⁵⁰) then this would account for 0.39 million, bringing the total to 1.82 million.

Valid second accounts

At 30 June 2005 there were 600,000 accounts in pure defined benefit superannuation funds and 8.7 million accounts in hybrid funds⁵¹. Hybrid funds are superannuation entities that have a combination of both accumulation and defined benefit members⁵². Rice Walker Actuaries estimate 15% of the assets of hybrid funds are held in defined benefit accounts⁵³ with the remainder in standard accumulation accounts⁵⁴. This suggests something in the order of 1.3 million defined benefit accounts are held in hybrid funds, for a total of 1.9 million defined benefit accounts. ABS research on superannuation in 2000 recorded a similar figure of 1.84 million people with defined benefit or hybrid accounts⁵⁵. Many consumers will hold one of these accounts as their only super fund; however for the purpose of producing a conservative estimate of the number of unnecessary accounts we have assumed that 75% of these accounts, 1.43 million, are 'valid second accounts'.

Some second accounts are held temporarily by employees moving from one job to another. As noted earlier in this section, between 11% and 14% of the 10.5 million members of the labour force change job each year; if we allow 60 days as the average time that a second account is held prior to the effect of superannuation choice, then this would account for around 250,000 accounts.

Table 2 summarises these conclusions.

46 Australian Taxation Office (no date) *Departing Australia superannuation payments (DASP) system help – frequently asked questions* <http://www.ato.gov.au/superprofessionals/content.asp?doc=/content/29527.htm> accessed 27 September 2006.

47 While 1.3 million of the 3 million retirees paid money into a superannuation account at some time in their working life (ABS 2006c) a majority of these have taken their superannuation as a lump sum after retirement, including those who have used the lump sum to purchase an annuity. Even where a retiree is still contributing to an account, if the account is paying a pension it will not be recorded in the number of superannuation accounts and so is not included in the 27.8 million superannuation accounts at 30 June 2005 nor our projections for account growth.

48 ABS (2006b), ABS (2006c).

49 In 2000 there were 2.8 million people aged 15–69 who had no superannuation, this was 25% of the 11.3 million people over 15 who had not retired, and 1 in 6 of people aged 25–59 – see ABS (2001) Summary of Findings.

50 ICAA (2006); ABS 2001 reported 31% of the population aged 15–69 had multiple accounts in 2000, but only 24% of those out of the labour force had multiple accounts.

51 APRA (2006a) Key Statistics.

52 APRA (2006a) Glossary.

53 Noting that not all defined benefit funds are fully funded.

54 Rice Walker (2005).

55 ABS (2001) p 26.

Table 2: Unnecessary superannuation accounts (millions)

Total accounts	27.88
One per worker	10.55
Not in labour force	1.82
Overseas	0.5
Defined benefit	1.43
Job transition	0.25
Total valid	14.55
Unnecessary accounts	13.33

Sources: APRA 2006, ABS 2006b, ABS 2006c, DIMA 2006, Rice Walker 2006

Based on the information that is available, we estimate that there is currently a legitimate need for no more than 40% more accounts than current members of the labour force⁵⁶. We think this is sufficient to cater for current members of the labour force who hold a defined benefit account and another account, and government employees who hold a second account due to restrictions on their current government account combined with no access to choice of fund.

As superannuation is essentially a product linked to employment, it is useful to think of the number of superannuation accounts in terms of the number of accounts per member of the labour force. As noted above, there are currently 2.64 accounts per worker. Our estimate in Table 2 of 14.55 million necessary accounts suggests there should be about 1.38 accounts per member of the labour force rather than the 2.64 at 30 June 2005. In the next section we use this estimate to explore the implications of having too many accounts.

3.2 The aggregate cost of multiple accounts to consumers

In this section we provide a range of estimates for the aggregate annual cost to consumers of multiple superannuation accounts. In section 3.1 above we estimated that there were about 14.55 million superannuation accounts required at 30 June 2005 rather than the 27.88 million we had. We showed that this represented no more than 1.4 accounts per member of the labour force.

In this section we calculate the aggregate cost to consumers that flow from having so many unnecessary accounts. We take our estimate of a reasonable number of accounts expressed as a number of excess accounts per member of the labour force and multiply it by various estimates for the fees that consumers are paying on those unnecessary accounts. Again, we have allowed for the fact that some fees will be incurred irrespective of the number of accounts (for example, some asset-based accounts).

These calculations show, in Table 5, that if 1.5 accounts per member of the labour force could be justified, then the minimum aggregate cost would be \$500 million per year using the most conservative assumptions as to lost fee income. On the other hand if worst case assumptions about fee income are used, and we allow only 1.3 accounts each, then the estimated loss is \$4.83 billion per annum. **We believe the best estimate is that, on the basis that we really only need 1.4 accounts per member of the labour force, the annual aggregate loss is in the range of \$1.16 to \$2.01 billion per annum.**

Ignoring potential economies of scale, we can estimate the aggregate costs to consumers of multiple accounts leaving administration and investment costs constant. This estimate understates the gains that can be made from consolidating accounts as it is likely that consolidation of accounts will lower overall investment and administration fees in the longer term.

Table 3 shows a range of estimates for the annual cost per account by calculating the annual fees per account for industry funds and retail funds (that is total fees per number of accounts for each segment). At 30 June 2005 industry funds, which generally have lower fees, held 34% of all accounts. Retail funds held 51% of accounts⁵⁷.

⁵⁶ In future years this ratio may grow as a consequence of the impact of various policies, in particular the superannuation co-contribution scheme which is likely to mean more people outside the labour force investing in superannuation.

⁵⁷ APRA (2006a) Key Statistics.

The costs for each type of fund have been estimated twice as there are two different sources of fee data — that provided by the government regulator APRA⁵⁸, and data estimated by Rainmaker Information (Rainmaker)⁵⁹. The table shows that the cost per account for industry funds is either \$88.30 or \$153.44 depending on the data source⁶⁰. On the same basis the cost per account of retail funds is \$136.60 or \$340.16. It is hard to reconcile this significant difference except to say that the APRA data is a new series and the fee information is being reported to APRA in a way that we believe underestimates the size of the fees being charged to consumers. As this APRA fee data evolves, and the reporting of fees is finetuned, it is likely to become more refined.

Table 3: Annual cost per superannuation account

Assumed fund type	NOT-FOR-PROFITS	RETAIL
<i>Using APRA 2005 figures</i>		
Investment expenses of industry funds (\$'000)	302,000	307,000
Operating expenses of industry funds (\$'000)	539,000	1,647,000
Total	841,000	1,954,000
Number of accounts ('000)	9,524	14,305
Total fees per account	\$88.30	\$136.60
<i>Using Rainmaker figures*</i>		
Total assets of industry funds (\$'000)	119,800,000	242,600,000
Per account	12,579	16,959
Management fee of industry funds (% of balance)	0.81%	1.76%
Per account	\$101.89	\$298.48
Fixed fees	\$51.55	\$41.68
Total fees per account	\$153.44	\$340.16

Sources: APRA (2005), Rainmaker (2006)

* Notes: Not-for-profits include industry and corporate funds.

Table 4 takes these estimates and multiplies them by our estimate of the excess number of accounts (that is 13.33 million after allowing for 1.38 valid accounts per member of the labour force). Together they provide a range of cost estimates that we can use to begin to understand the size of the problem. At the most conservative end we simply multiplied the number of excess accounts by fixed fees *only* (even though funds charge a variety of other fees). On these figures multiple accounts are costing between \$0.56 billion and \$0.69 billion a year.

If we assumed that the average fees charged by all funds were similar to the average industry fund fees then the 13.33 million excess accounts would cost consumers between \$1.18 and \$2.05 billion a year. Retail funds with higher relative fees increase these costs significantly — from \$1.82 billion on the APRA data to \$4.53 billion a year on Rainmaker data. As not all multiple accounts are in retail funds this latter figure will overstate the costs.

Table 4: Total annual administration cost of 1.33 million excess accounts

	Per account	Total cost for all accounts (\$billion)
Using Not-for-profits* (APRA figures)	\$88.30	1.18
Using Not-for-profits* (Rainmaker figures)	\$153.44	2.05
Using Not-for-profits* (fixed fee only)	\$51.55	0.69
Using retail fund (APRA figures)	\$136.60	1.82
Using retail (personal) fund (Rainmaker figures)	\$340.16	4.53
Using retail fund (fixed fee only)	\$41.68	0.56

* Notes: Not-for-profits include industry and corporate funds.

58 APRA (2005).

59 Rainmaker (2006).

60 Note however that Rainmaker fee data will also include corporate funds with industry funds under their not-for-profit classification.

As not-for-profit funds charge relatively lower fees than retail funds, a conservative ‘ball park’ estimate of the aggregate cost of around 13.33 million excess accounts is around \$1.5 billion in additional fees and charges per annum.

As noted above, these estimates are based on our conclusion that there are 13.33 million unnecessary superannuation accounts, equivalent to around 1.38 valid superannuation accounts per member of the labour force. Alternative conclusions produce different levels of aggregate loss — but by any measure the loss to consumers remains enormous. Table 5 provides similar cost estimates using calculations based on 1.3, 1.4, and 1.5 accounts per person respectively, equivalent to around 14.2, 13.1 and 12.1 million excess accounts. The table shows the range of costs using the same fee data as we increase the reasonable number of accounts up to 1.5 per person. Not-for-profit fund results range between \$0.62 billion (on fixed fee only) and \$2.18 billion depending on the fee data used. Retail fund results vary between \$0.5 billion (on fixed fee only) to \$4.83 billion. In other words, the size of the multiple account problem remains substantial regardless of whether the target number of accounts per person is set at 1.3, 1.4 or 1.5.

Table 5: Aggregate annual costs to consumers of varying levels of valid accounts

Total annual admin cost (from Table 3)	Total for 1.3 accounts (\$bn)	Total for 1.4 accounts (\$bn)	Total for 1.5 accounts (\$bn)
Using Not-for-profits* (APRA figures)	1.25	1.16	1.07
Using Not-for-profits* (Rainmaker figures)	2.18	2.01	1.86
Using Not-for-profits* (fixed fee only)	0.73	0.68	0.62
Using retail fund (APRA figures)	1.94	1.79	1.65
Using retail (personal) fund (Rainmaker figures)	4.83	4.46	4.12
Using retail fund (fixed fee only)	0.59	0.55	0.50

* Notes: Not-for-profits include industry and corporate funds.

3.3 The cost to the individual consumer

Multiple accounts cost consumers in three ways:

- consumers must pay multiple sets of fees;
- as a consequence, where a consumer holds more than one account for a significant period of time, the impact on the accumulation of their retirement savings can be substantial; and
- where superannuation is transferred to an ERF, the consumer is likely to incur significant opportunity costs⁶¹.

The way in which multiple accounts impact on individual consumers varies according to the current age of the consumer and their retirement age, the amount of money involved, the level of fees charged, whether or not some part of a duplicated fee would be incurred in an alternative scenario and whether or not the consumer’s funds are transferred to an ERF.

In particular, estimating the cost of multiple accounts is far from straightforward. Fees vary between industry segments and some costs would be incurred at similar levels even if there were fewer accounts (for example, some asset-based fees).

The following worked examples illustrate some typical impacts on individual consumers⁶².

The first three worked examples show:

- a 30-year-old on average wages with \$5,000 in a second account loses more than \$12,000 in retirement benefits;

⁶¹ ERF accounts tend to be invested conservatively (for example using ‘capital guaranteed’ rather than ‘balanced’ or ‘growth’ investment strategies) and generally charge higher fees. Often these relatively higher fees exceed any investment returns (although the principal is preserved by law). Small accounts are costly to run and this cost must be cross-subsidised with relatively higher fees across the industry. Consumers, at an individual level, therefore pay relatively more due to the proliferation of accounts.

⁶² These have been prepared for CHOICE by I A McAuley Consultancy and Rice Walker Actuaries.

- a 30-year-old with \$20,000 in each of two accounts with stepped fees loses more than \$73,000 in retirement benefits; and
- a 30-year-old who leaves just \$2,000 in an ERF loses more than \$7,000 in retirement benefits.

The fourth example shows that a consumer would save \$6,000 in lost fees and charges over just 10 years if they were to consolidate their three typical low balance accounts into one.

EXAMPLES OF COSTS TO THE INDIVIDUAL CONSUMER

Scenario 1: Tom – illustrating the benefit of early consolidation of a small account for a 30-year-old intending to retire at age 65.

Tom is 30, has an average income and has two superannuation accounts: one active, with a balance of \$20,000, the other inactive with a balance of \$5,000. Both accounts earn 6%, before fees. The fees in the active account are 0.8% of capital. The fees in the other account are 2.1%. In addition the funds charge annual fees: \$52 for the active account and \$36 for the inactive account. They also charge contribution fees: 0% for the active account and 3.3% for the inactive account. Tom’s employer is contributing \$4,000 a year. His inactive account has no exit fee. This example assumes a 15% contribution tax and 7.5% tax on earnings.

Final accumulation

	Two accounts	Consolidated	Difference
Account 1	\$421,691	\$447,771	
Account 2	\$13,669	\$0	
	\$435,361	\$447,771	\$12,411

Source: I A McAuley Consultancy. Sources for default fees: Rainmaker Information Benchmarking Sept 2005. Account 1 is “Workplace not-for-profit”; Account 2 is “Personal master trust”.

Conclusion: If Tom consolidated these two accounts now, by the time he retired he would have \$12,411 more in superannuation.

Scenario 2: Barbara – illustrating the benefit of early consolidation when fees are stepped: a 30-year-old intending to retire at age 65.

Barbara is 30 and has two accounts, both active, each with a balance of \$20,000. Both earn 6%, before fees. Both have stepped fee structures. Up to a balance of \$200,000 fees are 2.1% of capital. The entire balance, once this threshold has been reached, attracts fees of 1.4% of capital. Each fund has an exit fee of 5%. (We assume a 15% contribution tax and 7.5% tax on earnings.)

Final accumulation

	Two accounts	Consolidated	Difference
Account 1	\$182,623	\$438,439	
Account 2	\$182,623	\$0	
	\$365,245	\$438,439	\$73,194

Source: I A McAuley Consultancy

Conclusion: This example illustrates the individual economies of scale that can be made when a reasonable balance is reached (usually around \$200,000). In this case Barbara is able to transfer to a wholesale product with much lower fees and would have \$73,194 more in superannuation when she retires than she would if she kept both accounts open.

Scenario 3: Abel – illustrating the cost of leaving funds in a low-yield ‘secure’ account: a 30-year-old who leaves funds sitting in an ERF until retiring at age 65.

Abel is 30 and has \$2,000 in a secure ERF, paying a nominal 5.5%, with fees of 2%. After paying an exit fee of 5% he could switch his balance to a growth fund, paying 8.5% with fees of 0.6%. The ERF, being all interest-bearing, pays tax on full nominal earnings at 15%. The growth fund, being mainly Australian equities, enjoys imputation credits and concessional capital gains tax. It pays tax at an effective 7.5%. There are no new contributions.

Final accumulation

	ERF	Growth	Difference
	\$2,180	\$10,057	\$7,877

Source: I A McAuley Consultancy

Sources for default fees: Nominal returns and inflation from FIDO super calculator V6, capital stable and growth funds. Fees from Reserve Bank Australian Funds Management: Market Structure and Fees Feb 2003, Tables 3 and 4. Note: model uses nominal rates and inflation and then converts the balance back to real figures. This is because tax is levied on nominal interest.

Conclusion: The opportunity cost of not earning a higher return in a more aggressive account is significant for Tom given the size of his contribution. By the time he retires this part of his retirement savings will be \$7,877 less than what it could potentially earn elsewhere. This is several times more than he stands to gain if he leaves the funds in the ERF.

Scenario 4: George has three superannuation funds including an ERF.

George is aged 40. He earns \$50,000 p.a. in his current job and his employer makes a 9% Superannuation Guarantee contribution into an industry fund account with a current balance of \$6,000. George also has \$11,000 saved in a personal superannuation account and \$3,000 in an ERF from previous employment.

The three funds charge the following fees:

- Industry fund: \$1.10 per week + 0.5% of the account balance per annum
- Personal super product: 2.3% of the account balance per annum
- ERF: 1.6% of the account balance per annum

George is in the balanced investment options of the industry and personal superannuation funds, but the ERF is capital guaranteed and therefore conservatively invested. To measure the benefit of consolidation, we make the following assumptions.

- Each of the balanced investment option accounts returns 8.5% p.a. before fees and tax over the next ten years.
- The Eligible Rollover Fund returns 5% p.a. before fees and tax over the next ten years.
- Investment earnings are taxed at 15% in the ERF and at 6%⁶³ in the Balanced Investment Options.
- General wage inflation is 3.5% p.a. over the next ten years.

Source: Rice Walker Actuaries

Conclusion: Under these assumptions, George would save \$6,000 (in today’s dollars) over the next ten years in fees and lost investment returns (a result of the short-term investment strategy of the ERF) if he consolidated his accounts into the industry fund.

⁶³ This rate reflects the concessional tax treatment of capital gains as well as imputation credits available with Australian equity investments.

Part 4: Lost superannuation and Eligible Rollover Funds

A significant number of multiple superannuation accounts containing an estimated \$8.2 billion in consumers' money are recorded on the Lost Members Register⁶⁴. Much of this 'lost' superannuation is held in low return, high fee Eligible Rollover Funds (ERFs).

Some 'lost' superannuation is not really lost. The consumer knows they have a superannuation account and where their superannuation is, but for one reason or another has chosen to leave it there even though they have another active superannuation account. Their owners might simply be procrastinating, disinterested or unsure what to do. Some amounts really are lost. There are of course many cases where the consumer does not know where their superannuation is, or even that they have any money in a lost account⁶⁵.

Lost superannuation and ERFs are a problem for consumers for three reasons:

1. Lost superannuation is not available to consumers to form part of their retirement incomes.
2. Most of the money in ERFs is subject to high fees and low returns. Superannuation in ERFs rarely keeps up with inflation let alone grows in real terms.
3. Lost superannuation is by definition an inactive account and for most consumers this means that they are unnecessarily paying fees on two or more accounts.

4.1 Lost superannuation

Superannuation can become lost⁶⁶ when employees change jobs and forget about their super. When a superannuation fund has not received a contribution from a member for more than two years, or when two written communications have been returned to the fund, the fund must notify the Australian Taxation Office (ATO)⁶⁷. The name of the owner of the account is then placed on the ATO's Lost Members Register (LMR). The superannuation is 'lost' in the sense that the fund has lost track of the member.

At 30 June 2004 there was \$7.3 billion dollars in 4.9 million 'lost' accounts⁶⁸. This amount increased to \$8.2 billion in 5.4 million accounts at 30 June 2005⁶⁹ and is likely to have increased further since. That's one account for every second person in the labour force with an average of \$1500 in each account.

During 2004/2005 the ATO removed almost 745,000 accounts from the LMR, mostly because consumers had reclaimed their funds⁷⁰. On the other hand an incredible 1.2 million accounts were reported as newly lost and the total amount recorded on the LMR increased by around \$1 billion⁷¹!

The money in lost superannuation accounts is not transferred to the ATO or any other central fund. It remains with the original super fund or may in certain circumstances be transferred to an Eligible Rollover Fund operated by that super fund or by another organisation.

Any superannuation which is not claimed by the time the consumer reaches age 65 or dies is transferred to State and Territory government agencies as unclaimed money. Thus the amount of lost super is in fact greater than the \$8.2 billion recorded, as each year some 'lost' super is removed from the ATO register other than through returning it to consumers⁷².

64 Australian Taxation Office (ATO) (2005) *Annual Report 2004-2005* Table 2.34.

65 Mendham T (2006) p 4.

66 See reg 1.03A *Superannuation Industry (Supervision) Regulations 1994 (Cth)* for a definition of 'lost member'.

67 ASIC (2004) p 10.

68 ATO (2004) p Table 2.12.

69 ATO (2005) p Table 2.34.

70 ATO (2005) Section 2.4.

71 ATO (2005) Table 2.34.

72 ATO (2005) Table 2.34.

4.2 Eligible Rollover Funds

A super fund may transfer the funds in a super account into an ERF if the balance is small (generally considered to be less than \$1,000) and no further contributions have been received⁷³. Regardless of amount, the account balance can also be transferred to an ERF when a consumer does not nominate where they wish to transfer funds after a given period of time or where the fund has had two 'return-to-sender' communications⁷⁴. An estimated \$5.1 billion of lost superannuation is held in ERFs⁷⁵.

ERFs were devised as a temporary holding mechanism until the low balance or lost funds could be rolled into another superannuation account. ERFs have a number of purposes. One is to ensure that low balance accounts are not reduced in value as a result of fees. They are effectively capital guaranteed. However ERFs are generally not a good investment.

Research shows that a number of ERFs charge up to 2% for management fees on balances as low as \$1,000⁷⁶. This is excessive when compared with the fees charged by competitive funds (industry funds charge less than 1%).

An Australian Securities and Investment Commission report on disclosure by ERFs in 2004 found that:

- disclosure by ERFs about fees and operation of member protection rules was often inadequate and potentially misleading;
- most ERFs were not making efforts to locate members;
- the circumstances in which benefits were being paid into ERFs by superannuation funds were often non-specific and unhelpful to members;
- disclosure about the effect of a transfer to an ERF was often minimal and lacking in detail; and
- disclosure about changes to a fund's nominated ERF was not timely or clearly explained to members, and details for the nominated ERF were sometimes incomplete⁷⁷.

Over a person's working life it is quite possible for their money to sit in ERFs for a prolonged period, even if they do eventually claim it back. While there are some exceptions, the conservative investment strategies used by most ERFs generate poor returns and do not justify high fees. Where fees are high and returns are low, superannuation assets do not accumulate (compound) and so affected consumers are not 'growing their super'.

4.3 Finding 'lost' super

The ATO has administered the Lost Members Register from 1996, at first on delegation from the Insurance and Superannuation Commission, and then in accordance with the *Superannuation (Unclaimed Money and Lost Members) Act 1999* (Cth) which established the legislative framework to support the ATO's administration of the LMR. The aim of the Act is to re-unite people with their 'lost' superannuation, particularly casual and itinerant workers and those with broken employment patterns. The Act and its accompanying regulations outline responsibilities for providers and the ATO.

The providers' key responsibilities are to:

- report details about lost members every 6 months;
- apply the lost members criteria (which are satisfied where a member cannot be contacted, has an inactive account or joined the provider as a lost member); and
- lodging statements to contain a member's tax file number (where this has been quoted to the provider).

The ATO's key responsibilities are to:

- keep a register of lost members;

73 ASIC (2004) p 9.

74 ASIC (2004) p 9.

75 Collett J (2006) p 8.

76 Hage K (2006) p 2.

77 ASIC (2004) pp 5-7.

- apply penalties where lost member data is not reported; and
- reduce at an early stage the amount of unclaimed superannuation⁷⁸.

The ATO operates a number of facilities to enable consumers to search for any lost super that may be in their name and which has been registered with the Lost Members Register⁷⁹. The ATO also undertakes its own data matching and in 2004/2005 sent out 500,000 letters to individuals advising them that they may have lost superannuation and how to claim it. Consumers who use the online register or receive a letter from the ATO must contact each superannuation fund directly and satisfy the normal identification and administrative processes described in part 3 above in order to reclaim their money.

Some funds and ERFs have active programs to locate consumers' lost super⁸⁰, others are not so active. There are no incentives for funds to locate the missing account holders (indeed they profit from holding funds in ERFs).

Despite these measures, a good proportion of the \$8.2 billion or more now in 'lost' accounts will never be used for retirement. Some will be taken in fees, particularly from money held in ERFs. Some will be reclaimed by consumers. As noted above, a proportion of unclaimed superannuation will be passed to the revenue offices in various States and Territories.

4.4 Problems with the current administration of the lost super and ERF systems

Funds apply the rules about reporting lost super and transferring low balance amounts to ERFs in inconsistent ways⁸¹. It has been reported to us that in practice some funds do not notify the ATO when the conditions for lost superannuation are met.

Tax file numbers are not routinely collected by superannuation funds. Other data is not recorded or reported to the ATO in uniform ways. The data held by the ATO's Lost Members Register is not as good as it could be⁸².

All these problems make it harder for consumers to be reunited with their lost superannuation. Any effective response to the multiple superannuation accounts issue must deal with the lost super and ERF problem. We make some suggestions in Part 6.

78 Australian National Audit Office (ANAO) (2005/06) p 4.

79 Including an online and telephone service : see ATO at <http://www.ato.gov.au/superprofessionals/content.asp?doc=/content/16442.htm&pc=001/007/122/006&mnu=2732&mfp=001/006&st=tp&cy=1>

80 For example AUSFUND, the ERF used by a number of industry superannuation funds: <http://www.unclaimedsuper.com.au/find/lost-super-search/>

81 ASIC (2004), pp 26-31.

82 ANAO (2005/06).

Part 5: Winners and losers

5.1 Who benefits from multiple accounts?

Multiple accounts impose costs on consumers, taxpayers, government and regulatory agencies, but they generate extra fee income for superannuation funds. Many funds also benefit from administering low return, high fee ERFs.

There are additional administrative costs for funds dealing with multiple accounts. But ultimately these are passed on to consumers. The additional fee income means it is not in the interests of funds to actively take measures to solve the problem. They benefit by doing nothing. We do note that some funds, mainly not-for-profit industry funds, have introduced some measures to assist consumers avoid losses from multiple accounts other than measures which are in the funds' own interests⁸³.

One group of funds which does stand to gain disproportionately from the multiple accounts problem is the ERFs. As noted above, most consumers' money in ERFs earns very little in investment income because of the relatively high fees charged. When you consider there are millions of ERF accounts worth more than \$5 billion in total⁸⁴, it's clear that this is a lucrative industry. Based on the fees that apply to their average account balances, we estimate the five biggest ERFs rake in over \$100 million in fees from investors annually; a proportion is passed on to third parties like investment managers.

The scale of these profits, and the fact that a significant number of consumers with ERF accounts will never be reunited with their money sitting in ERFs, calls into question the adequacy of the ERF system. Any serious policy engagement on this issue must reconsider the current approach to dealing with lost and inactive accounts.

As noted in part 3, many of the barriers to account consolidation flow directly from current and past industry practices — they make life easier for superannuation funds by transferring effort and risk to consumers. The superannuation industry has failed to adapt its practices to respond to the realities consumers face in the current work environment, and so it must bear most of the blame for the enormous unnecessary transfer of money from consumers to the industry detailed in this report.

5.2 Who are the biggest losers?

It's consumers who are paying more than \$1 billion in additional fees on multiple accounts, and consumers who are losing through the poor performance of the lost superannuation system. Assuming competition is working to some degree, consumers are also losing through the loss in economies of scale in funds.

The problem of multiple superannuation accounts disproportionately affects people with broken work patterns or a series of casual jobs. Women and casual employees generally have lower superannuation balances⁸⁵ and are also more likely to have several superannuation accounts.

This should not simply be seen as an example of select groups in the community having a "disorderly paid work history"⁸⁶ but as a structural trend in the labour market that has been increasing steadily over the last twenty years. The trend is likely to further increase, considering the shift away from full-time permanent work toward non-standard forms of employment is likely to accelerate. This structural trend does not just affect part-time employees: the greatest increase in casual employees has taken place where employees work

⁸³ The not-for-profit member structure in the industry funds sector has led them to encourage account consolidation and to provide assistance to members to find lost superannuation.

⁸⁴ Collett J (2006) p 8.

⁸⁵ See Clare R (2004); Olsberg D (2004); O'Brien M and Burgess J (2004).

⁸⁶ Clare R (2004) p 2.

the equivalent of a full-time load, with an increase from 2% to 12% over the same period⁸⁷. That means that the number of multiple accounts held by this group is increasing as casual employees move through a series of sometimes concurrent jobs.

Irregular and discontinuous employment arrangements make it difficult to sustain ongoing accumulation contributions⁸⁸. Employees in these employment arrangements are particularly susceptible to the fragmentation of their superannuation into a series of small accounts that are difficult to track or trace.

⁸⁷ Campbell has estimated that casual employment densities increased from 13.3% of total employees in 1982 to 26.4% in 1999: Campbell, I (2001) p 63. This measures the proportion of casual employees against their segment of employment. The total casualisation density measures the portion of casuals against total employment. The full time casual employment density is measured against total full time employment. ABS data indicates that casual employment was 26% of the labour force in 2004: see ABS (2006a).

⁸⁸ O'Brien M and Burgess J (2004).

Part 6: Fixing the problem

6.1 Past attempts to consolidate multiple accounts

On a number of occasions the Commonwealth Government has introduced measures designed in whole or part to combat the growing multiple accounts problem. It gave increased responsibility to the ATO to manage lost accounts, introduced choice of fund legislation in 2005 and has recently introduced the *Simplifying Super* package⁸⁹.

Choice of superannuation fund legislation may slow growth in account numbers, and the *Simplifying Super* reforms will address some of the barriers to account consolidation, but these changes will not be enough by themselves to reduce the number of superannuation accounts to an acceptable level. More needs to be done.

The superannuation industry has a poor record in responding to the problem and costs of multiple accounts. There are at least two reasons for this:

- some representatives of the superannuation industry appear to believe that the introduction of choice of fund will create the competitive environment necessary for account consolidation; and
- there is no economic incentive for individual funds to effectively fix this problem.

Individual industry participants or industry associations have often stated their commitment to making account consolidation easier, but the growth of accounts is a clear demonstration that they cannot deal with the problem. Government must take leadership on this matter and introduce industry-wide requirements. As super is compulsory, anything less than complete industry coverage will fail or, at best, will only help a limited subset of consumers. We need to look at this problem from the perspective of all consumers, rather than rely on the occasional initiative from a sub-section of industry or the actions of individual funds.

Choice of fund

The superannuation industry argues that account growth has been the by-product of the pre-superannuation choice environment. The number of accounts has multiplied because employees were restricted in taking their superannuation fund with them from one employer to another. The industry argues that the superannuation choice legislation is the trigger to account consolidation. For example, the Investment and Financial Services Association (IFSA) has said that:

“If you have got 3.5 accounts on average with \$2,000 or \$3,000 in them, none of those things is going to be a tipping point to taking an active role [in managing your superannuation].

That is one of the reasons we supported choice legislation. We believe superannuation should become a backpack product that people take from employer to employer. Very quickly it will become a sizable amount and one that they are really committed to and interested in.”⁹⁰

And the Association of Superannuation Funds of Australia (ASFA) has said that:

“The consolidation of accounts is something that the industry has been working hard at, as has the government. Funds are trying to make it as easy as possible for people. With debate around choice, I hope one of the positive things is that we will in fact get more of a catalyst for the consolidation happening.”⁹¹

In fact there is little evidence that the industry has been “working hard at” consolidating accounts. If they have, then they have failed miserably. As noted above, there is a long way to go before the ‘financial backpack’ becomes reality and the ‘tipping point’ is reached. It is fanciful to suggest that choice of fund alone will deliver this new reality.

⁸⁹ Commonwealth of Australia (2006a).

⁹⁰ Gilbert R (2005) p 31.

⁹¹ Smith P (2005a) p 8.

Lack of financial incentive

Although superannuation industry associations are aware of the multiple accounts problem, individual funds have little incentive to assist consumers consolidate their accounts.

Some funds provide information to members about the benefit of consolidating accounts. But there is no incentive for superannuation funds to promote consolidation of the dormant or inactive accounts they manage. Often superannuation funds have sufficient information to locate inactive and lost account members but do not do so. It is costly for funds to take the initiative and it becomes financially expedient to just do nothing. Funds have a further incentive to take no action if the money is being consolidated into a different fund. Many funds provide some form of assistance to members who wish to consolidate another account into an account managed by the fund. Plainly this strategy assists funds to increase their assets under management. If funds were serious about assisting consumers to maximise their retirement incomes they would routinely approach members with inactive accounts informing them that they should consider consolidation of their inactive account into their currently active account. Funds would, of course, prefer that members did not do this as they would lose part of their fee revenue.

Government needs to provide incentives to industry to address this market failure. It is inequitable and inefficient for consumers to rely on piecemeal approaches by sub-sections of the industry.

6.2 A new approach to reform

Action is required on two fronts in order to reduce the number of multiple accounts and thus maximise consumers' retirement incomes. We need:

- reforms which reduce the number of unnecessary new superannuation accounts; and
- reforms which make it far simpler to consolidate existing multiple accounts.

The report recommends nine key actions for government to reduce the barriers to account consolidation and to respond to the particular problem of lost superannuation.

The Government has clearly recognised action is required through recent budget reforms in this area⁹². Our recommendations — set out in full below — include that the Government create a specialist agency within the Australia Taxation Office to target the problem, establish an electronic transfer system using tax file numbers, set up a central fund to better manage lost super, tighten up the rules applying to funds when they receive a transfer request, provide assistance to superannuation funds to consolidate accounts automatically and improve data collection about multiple accounts. We also recommend that a review be conducted after three years to ensure that there has been a significant reduction in the number of accounts.

The problems caused by multiple superannuation accounts can be solved, but to do so will require concerted government action, together with active cooperation from the superannuation industry. To do nothing will cost consumers and government too much in lost retirement savings.

Australia's superannuation system relies on compulsion to solve market failure — that is, it compels consumers to save enough for their retirement. The reciprocal obligation on government and industry is to make it as easy as possible for consumers to keep all their superannuation in one account. Here is a model for action that will save consumers billions of dollars each year.

⁹² Commonwealth of Australia (2006a).

6.3 Recommendations

Recommendation 1

The Commonwealth Government should establish a Superannuation Accounts Office within the Australian Taxation Office. This builds on the expanded role that the Government already plans for the ATO in dealing with lost accounts, but it would extend to all multiple accounts. The Superannuation Accounts Office should be responsible for assisting consumers and superannuation funds to consolidate accounts. It should have the power to investigate and resolve disputes about account transfer. It should work to ensure that industry meets targets for the reduction in the number of accounts.

The process for transfer and consolidation of superannuation must be streamlined. One of the key deficiencies in the current approach is the absence of any coordination or overall responsibility for what is clearly an industry-wide problem. A more focused response is required, and this will come from a body whose primary purpose is to assist with the consolidation of superannuation accounts.

CHOICE believes that a well-resourced Superannuation Accounts Office (SAO), probably located in the Australian Taxation Office, is the best way to manage the consolidation problem. A recent Australian National Audit Office report found that the ATO was struggling to administer lost superannuation and reunite consumers with their lost and forgotten superannuation⁹³. The Auditor-General concluded that the ATO was significantly under-resourced to be able to deal adequately with the size of the problem — the \$21 million paid to the ATO by the superannuation industry since 1994 to administer the lost account register is an insignificant contribution compared to the amounts the industry recoups in annual fees from managing lost accounts.

We believe an office within the ATO would be able to address the problem with a combination of clear legislative direction, adequate powers and sufficient resources. As part of its plans to simplify superannuation, the Government has announced that the ATO will be given a more active role in arranging transfers on behalf of lost members⁹⁴. This is a good first step towards the creation of an agency armed with the necessary powers and responsibilities.

The SAO would have the following functions:

- to monitor progress towards meeting agreed targets for account consolidation — a target of 40% more accounts than members of the labour force would appear appropriate based on the research in this report;
- to implement the ‘real time’ electronic transfer system based on tax file numbers recommended below;
- to provide education to consumers about the benefits of consolidation;
- to resolve disputes between funds and between a fund and a consumer in relation to portability, choice of fund and account consolidation;
- to monitor the superannuation market in relation to existing and future barriers to consolidation, including through establishing improved data collection procedures, and to recommend further reform if required; and
- to review the level of exit fees and exit fee charging practices.

The performance of the SAO should be measured by its success in meeting yearly targets for the reduction of multiple accounts.

The SAO would work with other government agencies (principally ASIC) and industry organisations to develop an effective program to increase consumers’ understanding of the cost of multiple accounts and the way to avoid those costs.

The SAO should be established for a set period of say five years. After this time responsibility for ongoing management could be given directly to the ATO.

⁹³ ANAO (2005-06).

⁹⁴ Commonwealth of Australia (2006a).

Recommendation 2

The Commonwealth Government should introduce legislation to establish a new 'real time' electronic superannuation transfer system.

One of the remarkable inefficiencies associated with the current system for transferring superannuation from one fund to another is that it relies on a paper based funds transfer system⁹⁵. There is no reason why a 'real time' electronic based system could not be developed. Legislation should give the SAO responsibility to work with the superannuation industry to establish and run a computer based real-time transfer system that expedites the transfer of super. Once the electronic system was in place, the SAO could establish an electronic interface for consumers to use this transfer system to consolidate their accounts.

The efficiency of this transfer system would depend on the success of a unique identifier, such as a tax file number, in linking lost and duplicate accounts to superannuation members.

Recommendation 3

The proposed electronic transfer system should rely on tax file numbers as the unique identifier.

In the *Simplifying Super* statement in 2006, the Commonwealth Government noted that it was already locating and contacting lost members whose address can be found using tax file number information and that the ATO was in the process of undertaking a direct mail campaign to lost members advising them of the existence of their lost superannuation⁹⁶. This welcome initiative will assist in re-uniting consumers with their 'lost' superannuation. However, we believe the TFN system could have a more important and comprehensive role in the consolidation of super accounts.

Some superannuation funds we have consulted report that the data they collect on their members (that is eventually reported to the ATO if the member becomes lost) is often fragmented and incomplete. Nearly all super funds have some proportion of accounts where the member's details don't include their TFN. The information held by funds needs to be improved so that the TFN can play an important role in account consolidation.

We believe TFNs could act as a unique identifier for matching duplicate and lost super accounts. However to do so, the quality of data held by funds and the ATO needs to be improved.

Improvement of tax file information will need to come from several directions. Employees could be encouraged to nominate their known superannuation funds on their tax returns. Employers should be encouraged or required to record employee tax file numbers with details of the employee's nominated super fund.

The Investment and Financial Services Association has proposed⁹⁷ that government legislate "to require employers and super contribution clearinghouses to provide employee's TFNs" to the employee's superannuation fund.

Those with multiple superannuation accounts would be identified by the ATO through the matching of industry records with employee and employer tax return nominations. Procedures could be set in place for the SAO to contact these individuals and alert them to the consolidation process. In the same way the ATO would be able to match employees with lost and inactive superannuation accounts. Some procedures will also need to be implemented to protect individuals' privacy but we do not see these being a barrier to a more efficient transfer system.

⁹⁵ Note that consumers lose here too – their money is 'out of the market' while the cheque is in the mail.

⁹⁶ Commonwealth of Australia (2006a) p Part 9.2.2.

⁹⁷ IFSA (2006) p 25.

Recommendation 4

The Commonwealth Government should establish a Central Consolidation Fund. This fund should take over the role currently played by Eligible Rollover Funds (ERFs) in the management of lost superannuation accounts.

The House of Representatives Standing Committee on Economics, Finance and Public Administration has proposed:

“... that government introduce a default superannuation fund for casual employees, so that when a casual employee does not wish to choose their superannuation fund, that employee is automatically placed in a government-determined default fund”⁹⁸.

CHOICE strongly supports this proposal but would extend it to also cover account balances now held in ERFs.

Administration of the fund could be allocated by tender to the private operator willing to perform this function to the required standard at the best price or it could be run in conjunction with the Future Fund. Unlike the ERF system this central fund must not be prevented from engaging in investment strategies which set out to provide reasonable returns for members. The pooling of ERFs and lost superannuation into this central fund would increase economies of scale for the fund and provide a holding point until employees enter full-time employment. Due to economies of scale and the absence of market failure it would be likely to charge lower fees than most existing ERFs.

When an employee (re)enters employment and selects a private super fund, any amount held to their credit in the central fund would be transferred automatically to their new fund.

Recommendation 5

The Commonwealth Government should introduce legislation to provide that a superannuation fund has a maximum of 30 days to implement a requested transfer starting from the date on which the transfer request was lodged by a member rather than from when the fund has gathered together all required information. The Superannuation Accounts Office should be asked to audit fund compliance.

This report has highlighted a number of barriers that frustrate consumers in their efforts to consolidate superannuation accounts. Portability problems arise when funds use different rollover forms, have different ID requirements, or use ‘dirty tricks’ as part of member retention strategies.

In its *Simplifying Super* statement the Commonwealth announced that it will reduce from 90 to 30 days the time allowed for a fund to transfer benefits after request by a member.

We agree that one month is ample time for a transfer. But the 30 days should apply from the moment the consumer requests a transfer and the fund should then work with the consumer to process the correct information before that date expires. Currently super funds can frustrate the transfer process for significant periods of time because the 30 day period will only apply after all the information required by the fund has been received regardless of whether the fund does anything to advise the consumer about any additional information reasonably required. The collection of tax file numbers proposed in *Simplifying Super* and further developed at recommendation 2 would greatly assist funds to meet this deadline.

The SAO should benchmark funds on their performance in ‘funds transfer and acceptance’ in relation to account consolidation.

Recommendation 6

Legislation or ASIC guidance should make it easier for funds and financial advisers to provide basic and targeted financial advice about account consolidation.

Consumers often need information and general advice to make informed decisions about account consolidation. For example they need to know whether exit fees apply and the nature of the insurance that is available in their previous and current or proposed

⁹⁸ Commonwealth of Australia (2006b) Recommendation 11, p xxvii.

superannuation accounts. While some funds provide consolidation forms to new members, funds usually fall short of the kind of simple situation specific advice that may be required by consumers.

With a consumer's consent, funds should be allowed to search for missing accounts on behalf of a new member and, with the consumer's authority, to locate and consolidate additional superannuation monies into the new account.

There is some possibility that in doing so under current law the fund would be required to issue a Statement of Advice or risk incurring potential liability under the financial advice provisions of s766B of the *Corporations Act*. ASIC has power to grant relief from the application of these provisions and should consider doing so in relation to basic and targeted advice about account consolidation.

Provided the member's new fund kept its advice within the boundaries of a strict ASIC checklist then it should be possible to avoid potential abuse. Similar relief provisions could be contemplated for other financial advisers.

Recommendation 7

Steps should be taken to improve the information available about superannuation to support more effective policy development. These should include giving the SAO or APRA responsibility for collecting more comprehensive data on superannuation accounts including data on account type (active, inactive, 'lost') and the employment and migration status of the account holder.

As noted earlier in this report, there are a number of areas where there is no, or no publicly available, data relevant to the multiple accounts problem. The SAO should be required to identify the information required, recommend procedures for obtaining it and then to collate and publish relevant information. Where needed information is not available it would either establish or recommend systems to collect that information or undertake survey work to estimate it. Some information could be improved through better data reporting by funds; this may require legislative change.

Recommendation 8

The SAO should review the level of exit fees on superannuation funds. SAO should be given the power to lower exit fees to a set level so that they reflect administration costs and don't inhibit the transfer and consolidation of superannuation.

Exit fees act as a barrier to account switching. In addition to exacerbating the multiple accounts problem they are a barrier to competition. Where exit fees are not a genuine pre-estimate of administration costs these fees act as a barrier to account consolidation, and may be penalties at law⁹⁹. Funds argue that in the pre-compulsory superannuation days, products were designed to recoup their initial costs over the life of the product, and exit costs were the only way to recoup those initial costs should the consumer wish to leave early. Whether or not this is the case, the argument is not valid in relation to more modern products.

Recommendation 9

After 3 years the Commonwealth should ask the Australian National Audit Office or another suitable agency to review progress against the goal of reducing the growth in new accounts and increasing account consolidation.

⁹⁹ For a discussion of when exit and early termination fees may be penalties at law see Lanyon E (2006) 'Regulation of Late Payment and Early Termination Fees' paper presented to Banking and Financial Services Law Association.

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