Default funds a consumer protection worth keeping

By Tom Garcia | 23/12/2016

OPINION | The industry is working hard to get members more engaged with their super, but there will always be a need for strong defaults.

Convincing younger workers to think about retirement is tough and, even among older workers, many lack the financial literacy to make a truly informed choice.

Regardless of product features, retirement is simply too far away for many people to take an active interest in the process.

For twentysomethings, selecting super will never compete with more immediate concerns such as their hourly pay rates, workplace conditions or even where to find a decent coffee.

Low financial literacy is another roadblock.

It is also the reason why many of those who do choose their own fund wind up worse off. Worse retirement outcomes for those individuals is not the only negative consequence, with all of us bearing the load of a higher age pension bill.

A 2016 study commissioned by the Australian Securities and Investments Commission found only one in three of those surveyed had ever heard of, or understood, the concept of "risk-return trade-off". Two in five people had never heard of the concept of "portfolio diversification". An understanding of both concepts is arguably important when choosing a super fund.

It is estimated that almost two thirds of fund members rely on their employer's default fund.

This includes individuals who make an active choice to stick with the default fund, trusting it to serve their best interests.

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And for as long as compulsory super has been around, this trust has been well placed.

The Productivity Commission, which the government has tasked with developing an alternative to the current default system, found in 2010 that the mostly not-for-profit default funds named in modern awards had generally outperformed choice products.

Around $400 billion of savings are invested in default funds under the industrial relations selection framework, currently overseen by the Fair Work Commission. The bank-owned super funds pushing to open up the default market claim the market for super needs to be more competitive.

But compared to the banking sector, super is already highly competitive.

As large as $400 billion sounds, this represents less than 20 per cent of the total market. In terms of overall market share, super funds owned by banks and other financial institutions manage about one third of the super savings pool, roughly the same amount as that managed by the non-profit super sector, with the remaining third being self-managed super funds.

The Australian Institute of Superannuation Trustees believes that the complexities involved in selecting a super fund support the need to maintain existing merit-based regulation of default fund selection arrangements.

We see lessons to be learned from what happened when the Victorian energy market was opened to new entrants, only to see providers emerge as the clear winners rather than consumers.

There are strong parallels. Like super, there is a high level of consumer disengagement in the electricity market.

Complex financial decisions are required to differentiate between the pricing alternatives offered by the various providers.

Low levels of financial literacy combined with inadequate information and search costs have resulted in low active choice levels.

The existing default super fund selection process, overseen by the Fair Work Commission, helps instill confidence. It is also a process that has been strongly supported by employers, who do not want to take on the cost and burden of default fund selection.

Regardless of their level of engagement, all working Australians should be able to trust that our compulsory super system comes with a functioning safety net that provides adequate consumer protection.

> *Tom Garcia is chief executive officer of The Australian Institute of Superannuation Trustees. This article first appeared in the December print edition of* Investment Magazine*. To subscribe and have the magazine delivered CLICK HERE. To sign-up for our free regular email newsletters CLICK HERE.*