



**Australian Government**

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**The Treasury**

# Superannuation Clearing House and The Lost Members Framework

Discussion Paper

November 2008

## FOREWORD FROM THE MINISTER



The Rudd Government is committed to cutting red tape and reducing costs for small businesses across Australia.

One cost facing small businesses is in meeting the requests of their employees to have their superannuation paid into many different funds. Whilst we are committed to the right of staff to choose their superannuation fund, we are equally committed to making sure the costs of allowing such choice don't disproportionately hit small business owners.

The introduction of a superannuation clearing house facility will deliver on our election commitment and will be cost free for employers with fewer than 20 staff. That means around 90 per cent of employing businesses across Australia stand to benefit. As such, the clearing house initiative will be a major simplification of the administration of superannuation payments for this critical part of the economy.

With this initiative, the opportunity also arises to take action on other improvements to our superannuation system.

Many of you will know that I am deeply concerned at the growth in both the number and value of lost accounts on the Lost Members Register. The latest available data indicate that some 6.4 million accounts and \$12.9 billion is currently lost. These are disturbingly large numbers.

This growth has occurred unabated for the last decade, with initiatives such as SuperSeeker, SuperMatch and direct "write out" campaigns unable to stem the growth. Labor has committed to looking at the use of an automatic rolling together mechanism for such accounts as a possible solution. The second part of the consultation paper addresses the possible parameters for this proposal.

I look forward to feedback from industry stakeholders and the community on these important initiatives as the Rudd Government moves forward with making our strong super system even stronger.

SIGNED

**Senator the Hon Nick Sherry**  
Minister for Superannuation and Corporate Law

# DISCUSSION PAPER — SUPERANNUATION CLEARING HOUSE AND THE LOST MEMBERS FRAMEWORK

## PURPOSE

The purpose of this paper is to invite feedback on:

- the issues associated with the implementation of the Government's announced measure to establish an optional superannuation clearing house facility (set out in **Part A** of the paper); and
- possible initiatives aimed at improving the lost members framework (set out in **Part B** of the paper).

## PROVIDING COMMENTS

The Government is seeking submissions and comments on the issues raised in this paper by 19 December 2008. Comments can be forwarded to the following address:

General Manager  
Personal and Retirement Income Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Email address: [chsuper@treasury.gov.au](mailto:chsuper@treasury.gov.au)

## **PART A: SUPERANNUATION CLEARING HOUSE MEASURE**

### **BACKGROUND**

In the 2008-09 Budget, the Government announced that it will implement its 2007 election commitment to establish an optional superannuation clearing house facility. The announcement noted that the Government will provide funding of \$16 million over three years for this initiative, commencing in 2009-10.

The measure is designed to reduce red tape and compliance costs for businesses associated with meeting their superannuation obligations. It will also provide increased certainty for businesses that use the facility, as their superannuation guarantee (SG) obligations would be discharged once the required amount of contributions was paid on time to the clearing house.

Other key features of the policy are that the superannuation clearing house facility will:

- be optional for employers;
- be contracted to the private sector;
- manage employers' obligations under Superannuation Choice; and
- be available free of charge to small businesses with less than 20 employees.

The Budget announcement noted that the Government would consult with industry prior to implementing this measure.

### **POLICY AND INSTITUTIONAL CONTEXT**

In recent years, a number of changes have been made to the superannuation system to promote competition and increase the options available to fund members in deciding how their superannuation savings are managed. At the same time, these changes have added complexity to the superannuation system, in the process increasing the compliance burden on employers and funds associated with meeting their obligations.

The efficiency with which the superannuation system functions — including the way in which transactions are processed and data is exchanged between entities — can also impact on the level of costs faced by industry participants.

Currently, employers interact with superannuation funds in a number of ways, including through electronic means or by cheque accompanied by supporting information. While there has been a trend towards the greater use of electronic funds transfer in recent years, further penetration of electronic commerce, particularly among small businesses, and greater standardisation of data flows within the industry offer the potential to increase efficiency and reduce transactions costs.

Improvements in the quality of data, most notably in relation to information on fund members, can also generate other benefits, such as assisting to address the growth in the amount of superannuation reported on the lost members register.

The Government's announced measure to establish an optional superannuation clearing house facility represents a concrete initial step towards the longer term objective of improving the functioning of the superannuation system. In particular, the clearing house measure will reduce the compliance cost burden for small businesses associated with meeting their superannuation obligations, while at the same time assisting to improve the efficiency with which data and information are exchanged between employers and superannuation funds.

## DETAILED ISSUES FOR DISCUSSION

### Single clearing house provider versus multiple provider model

As a general principle, it is desirable that the measure be implemented in a way that minimises any disruption to existing arrangements between employers and clearing house providers.

Under the announced measure, the subsidised superannuation clearing house function would be contracted to the private sector. The clearing house function could be undertaken either by a single provider or by multiple providers. The approved clearing house provider or providers would receive government funding in return for providing a specified service to small businesses.

Contracting the subsidised clearing house service to a single provider would be the simplest approach from an administrative perspective. In particular, budget funding would only need to be directed to one clearing house provider.

However, a single provider approach might increase the likelihood that existing clearing house services lose business to the approved provider. Also, clearing houses can package a range of services for businesses in addition to superannuation, including payroll, payroll tax and workers' compensation premiums. To the extent that small businesses utilise the free clearing house service for superannuation contributions but continue to use a separate clearing house for their other needs, the intended cost saving to small business may not be fully realised.

An alternative approach could involve financial service providers applying to become approved providers of the subsidised superannuation clearing house service. The Commissioner of Taxation could be given the power to approve clearing house providers, subject to the provider satisfying certain criteria. These criteria could include that the provider:

- is the holder of an Australian financial services licence;
- undertakes to deliver a minimum standard of service (which would include having the capacity to pay and accept superannuation contributions in both hard copy and electronic form, processing both default fund and choice fund member enrolments on the employer's behalf, resolving any issues which superannuation funds have with the delivered data, and ensuring an appropriate level of privacy protection for employee tax file number information provided by employers); and
- undertakes to report certain data on superannuation contributions to the ATO on a regular basis.

Under this multiple provider model, approved superannuation clearing houses would potentially operate in competition with each other and with other (non-subsidised) clearing house services. A possible advantage of this approach would be that it reduces the extent of disruption to businesses that are already using a clearing house service to meet their superannuation obligations.

### Your feedback

Your feedback is invited on the issues discussed above.

In particular, should the approved clearing house function be allocated to a single provider or to multiple providers?

Are there additional criteria that approved clearing houses should be required to satisfy? If so, what are they?

### Choice of fund

The choice of fund rules require employers to provide their employees with a choice of the fund into which their SG contributions will be paid.

In general terms, employers must provide a standard choice form to their new employees within 28 days of the employee commencing work, and to their existing employees within 28 days of the employee requesting a form. Employees wishing to exercise choice must complete the form with the required information and return it to their employer. An employee may also initiate the choice process by giving the employer written notice proposing a particular fund as their chosen fund. In either case, an eligible fund nominated by an employee becomes the employee's chosen fund two months after notice is given to the employer (or at such earlier time as the employer determines). Employers must make contributions to their employee's chosen fund by the next due date.

Many employers may find that complying with the choice of fund rules, including the process of giving effect to an employee's exercise of choice and having to interact with a number of different superannuation funds, imposes costs and diverts effort away from their business's core activities. Smaller businesses, which typically have fewer human resources at their disposal, are less likely to be able to absorb this additional cost and inconvenience without impacting on the operation of the business.

A key aim of the clearing house measure is to reduce the cost and inconvenience to small businesses associated with meeting their choice of fund obligations. To this end, the clearing house would manage the process for giving effect to an exercise of choice. This would involve the clearing house checking details entered on the standard choice form, verifying that the employer can make contributions to a chosen fund, and distributing contributions to the nominated (or default) superannuation funds.

Currently, employer superannuation contributions are made in compliance with the choice of fund rules if they are made to an employee's chosen fund or, where there is no chosen fund, to an eligible choice (that is, default) fund.

Under this measure, it is proposed that an employer would be able to comply with the choice of fund rules by making a contribution to an approved clearing house. The remaining obligations on employers under the choice of fund rules would continue to apply, including the requirement to provide a standard choice form to their employees in accordance with the relevant provisions in the *Superannuation Guarantee (Administration) Act 1992* (the SGAA).

A penalty would continue to apply to employers for non-compliance with their choice of fund obligations. This penalty would be the same as that currently provided for in the SGAA — that is, an increase in the employer's SG shortfall.

Where an employee elects to exercise choice, they would provide the completed choice form, or other written notification of their chosen fund, to the approved clearing house through which their employer directs contributions. The clearing house would handle the processing of the form and the payment of contributions to the nominated fund.

Contributions by an approved clearing house would be made in compliance with the choice of fund rules if they were made to an employee's chosen fund or, if there is no chosen fund, to an eligible choice fund for the employer. Employers would be required to notify the clearing house of the employer's eligible choice (that is, default) fund in respect of each of its employees.

A clearing house's obligations under the choice of fund rules would be activated when the clearing house received a completed choice form, or other written notification of an employee's chosen fund. On receipt of the notification, the nominated fund would become the employee's chosen fund after a specified time.

A penalty would apply to the clearing house for non-compliance with these obligations. The penalty would be along similar lines to the current penalty imposed on employers for non-compliance with the choice of fund rules.

### **Your feedback**

Does the approach outlined above represent an appropriate division of responsibilities and obligations between employers and clearing houses in relation to choice of fund?

Should employers continue to be required to provide a standard choice form to their new employees, or should this be the responsibility of the clearing house?

Should employees exercising choice have the option of returning the completed choice form to their employer rather than to the clearing house?

### **Superannuation guarantee obligations**

Where a business chooses to use an approved clearing house service, its obligation to make compulsory superannuation contributions would be discharged to the extent of payments made to the clearing house.

This could be achieved by allowing an employer to reduce its SG charge percentage for a quarter by making contributions to an approved clearing house. This differs from the current arrangements whereby superannuation contributions are only considered to have been made for SG purposes when they are paid to a complying superannuation fund.

As the employer's SG obligation would be discharged on payment to an approved clearing house, the regulatory arrangements for the measure will need to ensure that employees' superannuation entitlements are protected after they are paid into the clearing house. This is because the SG charge could not be raised against an employer once it had paid the required amount of contributions on time to the clearing house.

In this context, there will be a need to impose obligations and associated penalties for non-compliance on an approved clearing house to support the timely payment of SG

contributions to superannuation funds. The penalty could take the form of the application of a charge on the clearing house where contributions were not forwarded to a fund within a specified time frame.

Currently, superannuation contributions made in fulfilment of an employer's SG obligation must be paid to a superannuation fund within 28 days after the end of the relevant quarter. This time limit could continue to apply to employers where contributions are paid to an approved clearing house. However, the clearing house itself would need to be given additional time in which to forward the contributions to the appropriate funds — for example, this could be a period of seven days from the expiry of the employer's time limit for quarterly SG contributions.

Alternatively, employers could be required to pay contributions to an approved superannuation clearing house within 21 days after the end of the relevant quarter, with the clearing house having a further seven days in which to forward the contributions to the fund. This approach would ensure that where an employer uses an approved clearing house, compulsory superannuation contributions are required to be paid into an employee's fund no later than under the current arrangements.

In the case of late superannuation contributions from employers, the time limit for the clearing house to pass on these contributions to a superannuation fund could be seven days from receipt of the contribution from the employer.

When making superannuation contributions through an approved clearing house, employers would be required to advise the clearing house of the quarter to which the contributions relate. This information would be needed for the clearing house to determine the time limit which applied for forwarding the contributions to the relevant funds.

Where employers wished to have contributions paid to their employees' superannuation funds more frequently than once a quarter, for example in accordance with an industrial award, it would be open to them to have this reflected in an agreement with the clearing house.

## Your feedback

Does the above approach represent an appropriate division of responsibilities between employers and clearing houses in relation to meeting SG obligations?

In this context, should SG obligations and associated penalties apply to the clearing house to support the timely payment of contributions to superannuation funds? If so, what form should the penalty on the clearing house take?

What time limit should a clearing house have for forwarding employer contributions to the appropriate superannuation funds?

Should the clearing house be required to process salary sacrifice and personal contributions in addition to contributions made to discharge an employer's SG obligation? If so, should the same time limit apply to the clearing house for forwarding these contributions to superannuation funds?

Are there any other issues of relevance? For example, could the measure provide a vehicle for the implementation of a uniform protocol for data transfer between parties that interact with the clearing house? If so, what cost implications would there be for small businesses in complying with such a protocol?

## Regulatory framework

It is proposed that approved providers of the subsidised superannuation clearing house service would be required to hold an Australian financial services licence (AFSL), with specific authorisation to deal in/issue a non-cash payment product.

In order to obtain an AFSL, the service provider would need to meet certain requirements set down in the *Corporations Act 2001* (the Corporations Act). These requirements include satisfying the Australian Securities and Investments Commission (ASIC) that it can provide the service efficiently, honestly and fairly; that it has in place arrangements for the management of conflicts of interest as well as dispute resolution; and that adequate risk management systems are in place. Licensees are subject to ongoing supervision by ASIC.

An AFSL would bring clearing house providers under the disclosure requirements and the conduct provisions of the Corporations Act. The latter provisions make licence holders liable for engaging in dishonest, misleading, deceptive or unconscionable conduct.

As money would be paid to an AFSL holder in connection with a financial service that has been provided to a client, there would also be an obligation to pay that money into an account that satisfies the requirements under the Corporations Act.

The Commissioner of Taxation would have responsibility for administering the obligations of approved superannuation clearing houses under the SGAA.

## Your feedback

Does the proposed requirement to hold an AFSL constitute an adequate level of regulation for approved clearing houses?

Is there a need for additional regulation beyond the AFSL requirement? If so, what additional regulation?

## Funding arrangements

It is envisaged that approved superannuation clearing houses would receive funding from the ATO based on the volume of transactions processed on behalf of small businesses within a specified period. In this context, there may be a need to set an upper limit on the frequency of superannuation contributions that would be eligible for the subsidy — for example, this could be a maximum of two contributions per employee per month.

The method of calculating the subsidy to the clearing house would be determined by the Government. The subsidy might consist of a fixed component for the cost of establishing a link with each employer's accounting system, and a recurrent component based on the number of transactions processed on behalf of each employer.

For payment validation purposes, approved clearing houses would be required to provide certain information on a quarterly basis to the ATO. This information would need to include the number and value of contributions processed on behalf of individual businesses utilising the service, but could also include the name and ABN of each employer, the name and tax file number of each employee, as well as the dates of receipt and payment of contributions.

## **Your feedback**

What would be the likely cost to clearing houses of providing the service to small business envisaged under the policy?

Should the government subsidy to clearing houses include both a fixed and a variable component? If so, what are appropriate amounts for these components?

Is there additional information that clearing houses should be required to report to the ATO as part of the measure? If so, what is it?

## **Are there other potential roles for the clearing house?**

Your feedback is also invited on whether there are any additional functions which approved clearing houses could reasonably undertake, beyond those that have already been discussed in this paper.

For example, is there a role for approved clearing houses in consolidating lost and inactive accounts? If so, what is that role and how effective would it be in helping to address this issue?

Also, could clearing houses be required to deal with unallocated contribution amounts from employers which are currently left to administration houses to resolve — that is, could clearing houses ‘clean up’ contribution data before it reaches superannuation funds and administration houses? If so, what implications would this additional processing role have for the time limit for clearing houses to forward contributions to superannuation funds?

As government funding for the measure is limited, any additional roles or functions which were assigned to approved clearing houses would need to be funded from outside sources. What alternative (non-government) funding models could be examined in this context?

## PART B: IMPROVING THE LOST MEMBERS FRAMEWORK

In this part of the paper the issues related to addressing the problem of lost members are discussed in two separate sections as follows:

- **The lost members framework:** Improving the efficiency and effectiveness of the lost members framework to ensure fewer superannuation accounts become lost and more Australians are reunited with their lost superannuation.
- **Automatic consolidation of lost accounts:** Key design issues and possible models for the automatic consolidation of lost superannuation accounts.

The Government will need to fully consider potential compliance costs and budgetary implications of options in relation to the lost members framework or automatic consolidation.

### THE LOST MEMBERS FRAMEWORK

As at 30 June 2008 around 6.4 million lost superannuation accounts with a total value of \$12.9 billion were reported on the lost members register (LMR). This represents approximately one in five of all superannuation accounts, with an average of one lost account for every two Australian workers. These accounts not only directly impact on the retirement savings of many individual Australians but also increase superannuation provider costs that may be passed on to all fund members.

The current lost members framework has been ineffective in stemming the growth of lost superannuation, with both the number and value of lost accounts rising sharply between 2001 and 2008.

Under this framework, superannuation providers report members that 'may' be lost to the LMR, which is maintained by the Australian Taxation Office (ATO), on a biannual basis. The members' accounts remain with the superannuation provider concerned. The LMR can be searched by individuals and superannuation providers. The ATO also regularly attempts to contact lost members to encourage them to contact their superannuation provider. Members finding lost superannuation can transfer accumulation balances to another provider using a standard portability form. Small lost accounts with balances less than \$200 can be cashed from the superannuation system and do not attract tax.

The framework is cumbersome and imposes considerable red tape on members wishing to find and consolidate their lost accounts. It also does little to prevent accounts from becoming genuinely lost or uneconomic to consolidate. In addition, superannuation provider practices under the framework vary with some providers being more proactive than others in finding lost members and consolidating accounts.

### Who is a lost member?

The current definition of a lost member in the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations) is broad and is intended to capture any member who **may** be lost.

Superannuation providers are required to report a member to the LMR if:

- the fund has never had an address for the member or the member cannot be contacted at their last known address and mail is returned on two occasions (if one piece of mail is returned the fund may choose to report the member as lost);
- the member joined the fund as a standard employer-sponsored member, more than two years ago, and their account has been inactive for the last five years; or
- the member has been transferred to the fund as a lost member and the fund has not been advised of a new address for the member.

A member is not lost if within the last two years the provider has verified that the member's address is correct and has no reason to believe it is now incorrect, or the member has contacted the fund and indicated (including through a positive act such as deferring a benefit) that they wish to remain a member. Members of self-managed superannuation funds are also excluded from the definition of a lost member.

## How much is lost?

As at 30 June 2008, 6.4 million accounts with a total value of \$12.9 billion were reported on the LMR, with an average account balance of \$2,016. This represents around one per cent of the total superannuation funds under management. Eligible Rollover Funds (ERFs) reported around 42 per cent of all lost accounts in number, and 10 percent of lost accounts in value, with an average account balance of \$467.

The number and total value of lost accounts has risen sharply from 2001 to 2008 (see *Chart 1* and *Table 1*).



Source: ATO annual reports and APRA data.

**Table 1: Number and value of lost accounts**

Year ended	Number of Lost Accounts	Value of Lost Accounts	Total Industry Assets	Value of Lost Accounts as Percent of Total	Average Lost Account Balance
June 2001	3.8m	\$5.5b	\$519b	1.05%	\$1 444
June 2002	4.7m	\$6.8b	\$518b	1.30%	\$1 442
June 2003	4.6m	\$7.3b	\$538b	1.35%	\$1 575
June 2004	4.9m	\$7.3b	\$631b	1.15%	\$1 489
June 2005	5.4m	\$8.2b	\$742b	1.10%	\$1 518
June 2006	5.7m	\$9.7b	\$914b	1.05%	\$1 711
June 2007	6.1m	\$11.9b	\$1 195b	1.00%	\$1 951
June 2008	6.4m	\$12.9b	\$1 172b	1.10%	\$2 016

Source: ATO annual reports and APRA data.

## The cost of lost accounts

Lost accounts can materially impact on the adequacy of many individuals' retirement incomes particularly where accounts remain unclaimed at retirement, are eroded by unnecessary fees or charges, or receive poorer investment returns than other retirement savings. Lost accounts also collectively increase administration costs for providers. The cost of administering lost accounts may be passed to lost members through direct fees or lower investment returns, or shared by all members of the fund.

It is not possible to accurately estimate the annual cost of administering lost accounts for superannuation providers due to different cost structures that apply to individual accounts and funds. However, based on the current profile of accounts on the lost members register and average annual fees for various sectors this could be in the range of \$260 — \$300 million per annum.

Around 42 per cent of all lost accounts in number and 10 per cent of lost accounts in value are held in ERFs. These accounts incur average annual fees of around 2.5 per cent of the account balance<sup>1</sup> or around \$25 on a balance of \$1,000. Retail funds hold over a third of all lost accounts in number and over half of all lost accounts in value. A retail fund account with a balance of \$5,000 would attract average annual fees within the range of 2.5 to 3.4 per cent or between \$125 and \$170<sup>1</sup>. Industry funds hold around one fifth of all lost accounts both in number and value. These accounts generally have lower average fees than retail funds, however fixed dollar account fees can impact on smaller account balances. An industry fund account with a balance of \$5,000 would attract average annual fees of around 2 per cent or \$105 dollars<sup>1</sup>. The majority of remaining lost accounts are with public sector and corporate funds that typically have low fee structures.

Where a lost account is duplicated, or unnecessary, these fees, and other additional charges such as insurance premiums, can significantly erode an individual's retirement income. The ATO has identified that over half of all lost members also have an active superannuation account, with around 450,000 of these accounts being with the same superannuation provider. Many lost accounts also have very small balances and could be cashed tax-free from the superannuation system. Around forty per cent of lost accounts have balances of

1 IFSA Superannuation Fees Report - Market Segment Analysis as at 30 June 2006 – Rice Warner Actuaries May 2007.

less than \$200. A significant number of lost accounts are also in false names or have insufficient member particulars to ever identify the owner of the account.

## DETAILED ISSUES FOR DISCUSSION

The current lost members framework does not provide an efficient or effective means of preventing superannuation accounts from becoming lost or reuniting many members with their lost superannuation. Key shortcomings with the current framework include a broad definition of a lost account, poor reporting and information sharing, unclear trustee obligations to lost members and a lack of member engagement with their superannuation.

### The definition of a lost member

The current definition of a lost member is broad and is intended to capture any member who may be lost. The definition includes members a fund has lost postal contact with, as well as members with inactive accounts that were opened by employers. The definition does not impose any obligations on trustees to find members, or confirm an inactive member's address, prior to classifying a member's account as lost. The definition therefore captures many accounts that are not 'genuinely' lost.

The inactive arm of the definition is also not well understood, and in practice is difficult for providers to administer without systems recording member contact. There is anecdotal evidence some providers, for simplicity, are reporting all their inactive accounts to the LMR.

The definition is also not aligned with tests for treating members as non-contactable for disclosure purposes in the *Corporations Regulations 2001* (Corporations Regulations). In particular, these regulations include specific requirements that reasonable steps be taken to locate these members.

The 2003 Australian Securities and Investments Commission review of disclosure practices of ERFs found some trustees were using the 'lost' rather than the 'non-contactable' member test for determining whether to disclose to members. These members were not receiving disclosure information about the ERF or their benefits and were potentially becoming 'genuinely' lost within the superannuation system.

### Your feedback

Should a new definition of a lost member be adopted based on the definition of a non-contactable member in the Corporations Regulations?

Should inactive accounts continue to be recorded on the register for search purposes? If so, what would be an appropriate definition of an inactive account?

### Information sharing and reporting

Information recorded on the LMR is often inaccurate and out of date. Superannuation providers lodge biannual returns to the register listing accounts that have been lost and found during the previous six month reporting period. Providers have up to four months to lodge these returns. Account balances recorded on the register are also often higher than the actual withdrawal balance for many lost accounts.

## Your feedback

Should superannuation providers report to the LMR on a more frequent and timely basis? If so, would it be feasible for providers to lodge quarterly returns, within say 28 days of the end of each quarter?

Should superannuation providers re-report all lost accounts and their estimated withdrawal balances on each return rather than using the current lost and found reconciliation format?

Is it feasible for an electronic data exchange protocol to be developed between the ATO and superannuation providers to ensure the timely updating of the LMR?

## Member protection

The member protection rules generally prevent administration fees exceeding the investment gains on a member's account. Until 2002 all lost superannuation accounts were subject to these rules. Member protection rules still apply to lost accounts that are transferred to eligible rollover funds or accounts that include compulsory employer contributions, and have balances below \$1,000.

There are exceptions from these rules that allow fees and charges to be deducted from small accounts (on a proportional basis) at the fund level. The rules also do not cover insurance premiums and taxation costs.

## Your feedback

Should member protection rules apply to all lost accounts?

## Trustee obligations

There are few obligations set out in the superannuation legislation that apply to trustees in respect of lost members. Trustees are required to report, on a half yearly basis, details of lost accounts under the *Superannuation (Unclaimed Money and Lost Members) Act 1999*. If a lost member is transferred to another fund the transferor fund must provide certain information about the member to the transferee fund.

Outside a trustee's general fiduciary duty to act in the best interests of members, the SIS Act is silent on obligations in respect of lost members who remain in the fund. The process of finding lost members is costly and some providers are less willing than others to bear that cost. There are also significant variations in the practices adopted by funds in managing small, lost and inactive accounts.

Similarly, while trustees are permitted to transfer lost accounts to eligible rollover funds, these funds do not have specific obligations to find lost members. Around one half of all rollover accounts in number and 20 per cent in value are lost accounts.

## Your feedback

Should the SIS Regulations include specific operating standards for trustees of superannuation funds to prevent and reduce the number of lost accounts?

If so, what should these standards be? For example trustees could be required to:

- take reasonable steps to identify new members when opening accounts on behalf of an employer;

- put standard search procedures in place to locate lost and duplicated accounts when opening new accounts; and
- undertake annual searches of public databases to find lost members.

Alternatively, should specific operating standards only be applied to trustees of eligible rollover funds?

## **A lack of engagement by members with their superannuation**

The continued growth in the number of accounts on the LMR is largely due to a lack of engagement by many fund members with their superannuation. Members may find it too difficult to rollover benefits from one superannuation fund to another, or may have simply failed to contact their fund when they moved house, changed jobs or changed their name.

Other accounts may be forgotten or opened with limited personal details and without the knowledge of potential beneficiaries – for example, accounts opened by employers to satisfy superannuation guarantee (SG) obligations for employees performing short term or casual work. Many of these employees remain unaware of these accounts or their employer's superannuation arrangements more generally.

Given the small balances of many of these accounts there is little incentive for members to stay in contact with their fund or to complete the paperwork for the release or transfer of these benefits. While the standard portability form has streamlined portability procedures, a member using the form still needs to provide certified copies of documents to prove their identity. A separate form must also be completed for each transferring fund in which a member holds a benefit.

The ATO, as part of its current work program 'making it easier to find and transfer lost superannuation' is aiming to produce pre-populated portability forms that it could forward to superannuation providers on behalf of members, and also provide a web-based tool that will verify proof of identity and ownership of accounts for transferring funds by the 2009-10 year.

Portability arrangements could also be enhanced if a member only needed to provide a single portability request to their preferred fund. Under such a portability protocol, the member would instruct the trustee of their preferred superannuation fund to contact their other superannuation funds to initiate the consolidation process on their behalf. Only the preferred fund would sight proof of identity documents. This would not only reduce paperwork but could also improve the timeliness of account consolidations.

Another approach that could be adopted to overcome member inertia would be to automatically consolidate a member's lost accounts into an active superannuation account in their name. Key design issues and possible models for the automatic consolidation of lost accounts are further discussed in this paper. This approach would first require significant improvements to the lost members framework including introducing a new definition of a lost member, and building systems for information sharing and to prove the identity and ownership of accounts.

## **Your feedback**

How can superannuation providers better engage new members with their superannuation to ensure fewer accounts become lost?

Is it feasible for a new portability protocol to be developed that would enable members to provide a single portability request to the trustee of their preferred fund? If so, what identity

documents should be sighted by the preferred fund and should this fund also provide an indemnity against fraud or mistake to the transferring fund?

If a new portability protocol was developed should the protocol operate on a voluntary or compulsory basis? If the protocol was compulsory should rollover information only be able to be exchanged between funds on an electronic basis?

What other strategies could be put in place to overcome member inertia and to further rationalise the LMR? For example:

- lost accounts with less than \$200 could be paid to the unclaimed monies register. The ATO could then put proactive steps in place to return these monies to the members concerned;
- lost accounts that were clearly in false names or where provider records were insufficient to ever identify the ownership of the account could also be transferred to the unclaimed monies register; and/or
- a member, or a provider acting on their behalf, could electronically request the consolidation of their lost accounts through an ATO or industry based portal.

## **AUTOMATIC CONSOLIDATION OF LOST ACCOUNTS**

The ATO can match around half of all lost accounts with an active superannuation account. The LMR could be significantly rationalised through the automatic consolidation of these accounts.

From an individual's perspective, automatic consolidation would remove red tape, reduce account fees and increase retirement savings. Many individuals with larger account balances would also become more engaged with their superannuation. Superannuation providers would benefit from lower costs through administering fewer lost accounts and seamless portability arrangements.

However, key improvements to the lost members framework would need to be made prior to commencing automatic consolidation. The process would also need to be designed in a manner that maximised coverage of lost accounts while minimising complexity and other risks.

## **Key design issues**

### **Legal and privacy issues**

There are currently impediments in superannuation and privacy legislation preventing the consolidation of lost accounts without a member's specific authority or consent.

Legislation would be required to override the governing rules of superannuation funds to compel the consolidation of accounts. Changes to superannuation and anti money laundering legislation may also be required to enable standard electronic processes to be adopted for the proof of identity and ownership of accounts.

The consolidation process would also need to be designed in a manner that meets the requirements of the *Privacy Act 1998*. Legislation may be required to authorise the exchange of personal information between providers or from the ATO to providers.

## Coverage

The policy could be designed to filter out accounts or products with certain characteristics to minimise risks of member benefits being compromised through consolidation. For example the policy could specifically exclude funds that were not generally open to the public such as defined benefit, corporate and public sector schemes. Accounts in 'insurance only' products or legacy accounts that had not matured, and large accounts with balances of more than \$10,000 could also be excluded from the policy.

However, filters add to complexity and could significantly reduce the population of accounts for consolidation.

## Death and disability insurance

Death and disability insurance cover may be extinguished following the closure of a lost account. A member may not have a comparable level of insurance cover in their current active account. However, in many cases members remain unaware of insurance cover attached to lost accounts or the impact of ongoing premiums on their account balances. Moreover, insurance cover may often be duplicated through other superannuation accounts.

One approach to ensuring a basic level of insurance cover could be maintained would be to only consolidate benefits to active accounts that were default funds for SG purposes. These funds are required to offer all members a minimum level of death insurance.

## Exit fees

A member may be disadvantaged by automatic consolidation where exit or early termination fees were incurred on the lost account. Significant early termination fees can apply to old style 'legacy' accounts. Early termination fees can also apply to more modern products, but these fees are generally negotiable and apply over a shorter period in lieu of upfront contribution fees. Many providers also charge a fixed dollar withdrawal fee to cover costs associated with processing a transfer or withdrawal.

Lost accounts in legacy products could be filtered out from the consolidation process. Filtering out modern accounts with early termination fees could be complex and may remove the incentive for advisers to negotiate fee arrangements or notify providers of changes in client particulars.

## Transfer process

The efficient and timely consolidation of accounts would require an electronic transfer protocol to be bedded down across the superannuation industry. While the superannuation industry (through the superannuation, wealth and investment management electronic commerce 'swimEC' program) has a standard for the electronic exchange of rollover information between superannuation providers, the standard is voluntary and is still to be adopted by many providers in the industry.

A central exchange could be established to streamline the administrative burden of consolidating accounts. The exchange could greatly reduce the number of transactions and amount of paperwork required by providers in effecting account consolidations. An exchange could also act as a central point for handling accountholder queries and could implement default rules and other design filters.

### **Level of member involvement in the process**

In a simple case, where a lost account in an ERF is matched to a single active account in an accumulation fund, consolidation could occur without member involvement. However, the process would be more complex where more than one active account was identified or where a transfer could not be accepted under an active fund's rules.

Default rules could be put in place to remove the need for member involvement in these circumstances. One approach that could be taken would be to consolidate to the active account with the largest balance. This would require changes to the member contribution statement to include the reporting of account balances. However, this information may also be useful for other regulatory purposes.

### **System security**

Given the compulsory nature of superannuation, few controls are applied when superannuation accounts are opened. Instead, funds perform identity and ownership checks prior to paying out or transferring superannuation benefits following a request from a member. Removing these checks would require a system which matches the risk and is appropriate in all circumstances.

### **Complaints mechanism**

Consolidations could result in a large number of member inquiries and complaints. There is scope for errors and mistakes through relying on fund reported data and through the sheer volume of accounts that could be consolidated at one time.

Inquiries and complaints on consolidations could be handled using existing internal fund complaint mechanisms. Alternatively, a central inquiries and complaints gateway could be established possibly through the ATO or another regulator. Processes would also be required to reverse consolidations and to compensate members for any losses that arose through errors or mistakes.

### **Possible approaches to automatic consolidation**

Automatic consolidation could occur on an opt-out or voluntary basis. A hybrid approach could also be applied based on the characteristics of a lost account.

The opt-out approach would involve lost members being sent prior notification of a pending consolidation. The member could 'opt-out' of the consolidation process by advising the ATO within a specified timeframe. Alternatively, members could elect to have any lost account in their name consolidated to an active account. An election could be made at the time a new superannuation account was opened, through the ATO's website or the income tax return process.

A third approach would be to limit opt-out consolidation to lost accounts with specific characteristics, such as balances below \$10,000, and then allow voluntary consolidation for all other lost accounts, as well as inactive accounts recorded on the LMR for search purposes.

### Your feedback

Industry and consumer feedback is invited on key design issues and possible approaches to automatic consolidation.

Can a consolidation process be designed in a manner that would maximise coverage of lost accounts while minimising complexity and risk?

Should automatic consolidation be extended to inactive accounts? If so, should this be on a voluntary basis only?

Should funds be able to charge withdrawal fees on automatic consolidation? If so, should these fees be capped to a fixed dollar amount representing fund expenses in processing the consolidation request?

Should default insurance cover continue to be maintained for lost accounts? If so, should lost accounts only be automatically consolidated to active accounts that are default funds for SG purposes?

Should member protection rules continue to apply if inactive and lost accounts can be readily consolidated?