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Debates about superannuation policy are often ideological in tone. This is not surprising: with more than a trillion dollars at stake, we can expect the various stakeholders to argue forcefully for their preferred position.

But one voice is often lost in such debates: that of the ordinary worker. People in finance and investment circles tend to forget that the majority of Australians are profoundly disengaged from their super, at least until they approach retirement. The super system is so complicated that many workers take the simplest option – doing nothing.

That is why the issue of default funds is so important, and why the various players in the super sector are scrambling to maximise their share of the default fund pie. In these discussions you will hear a great deal about the benefits of 'choice' and 'competition', but not much about the millions of Australians who do not take advantage of choice in the superannuation marketplace.

When the Coalition Government introduced its Choice of Fund policy in July 2005, it was heralded as a major victory for consumers. In reality, the changes benefited only some sections of the community, such as the financial services industry and highly engaged individuals.

The key economic rationale for Choice of Fund was to stimulate competition, but low rates of switching between funds raise serious doubts about the policy's effectiveness. Only ten per cent of workers have chosen a super fund since Choice of Fund came into effect, and as little as four per cent of workers switch super funds each year – with around half of this being 'passive' choice due to job change or fund closure.

Widespread disengagement on the part of many fund members means that consumer-driven competition in the super sector is deficient. Instead of competing to attract individual members, funds compete for the attention of intermediaries such as financial planners. This 'distribution-side' competition imposes additional costs on the super system and explains why Choice of Fund has not resulted in lower fees and better performance.

In fact, the failure to promote consumer-centred competition has resulted in considerable waste across the super system. Average fees levied by fund managers have not fallen, remaining at around 1.25 per cent of funds under management (equating to around one per cent of GDP). Significant fee and performance variations also persist between not-for-profit funds and for-profit (retail) funds.

Moreover, it is estimated that Australians pay around $2.4 billion a year in commissions on superannuation assets, including $862 million on their compulsory superannuation contributions. Financial outcomes for workers can vary considerably depending on the fund that their employer nominates as the default fund.

Choice of Fund is the most recent initiative in a long-term shift towards greater individual choice in a largely compulsory system, yet the principles of choice and compulsion sit uncomfortably together.

Choice of Fund was based on the assumption that consumers are interested in and able to make sensible decisions about their retirement. Compulsion, on the other hand, assumes that most individuals need help to save adequately for retirement. What has been missing is a set of policy arrangements that promote the interests of disengaged consumers.

If workers decline to choose a fund, the choice is made for them. Small businesses in particular find it difficult to nominate the right default fund for their employees, and need help in doing so. Since Choice of Fund was introduced, employers have increasingly seen the selection of an appropriate fund as the responsibility of individual workers.

If an employer chooses the wrong fund – one that has high fees and low returns – then workers who are not engaged with their super arrangements may never realise that their retirement savings are not what they could be, at least until it is too late.

Until now our financial systems have been built on the assumption that consumers are utterly rational creatures who always make decisions in their own best interests. But a new study from the Australia Institute and Industry Super Network, *Choosing Not to Choose*, suggests that more realistic behavioural traits, such as apathy, procrastination and profound disinterest in financial matters, need to play a greater role in how the superannuation system operates.

Default arrangements are a highly effective policy option because they can improve financial outcomes for those who decline to make an active choice while retaining flexibility for those who want it. On a practical level, this means that super funds should be required to meet certain standards before they can be nominated as an eligible default fund for workers who choose not to choose.

For example, ongoing fees and charges should be capped at a level determined by an independent body, such as the Australian Prudential Regulation Authority.

Entry and exit fees should be prohibited, since these act as a major barrier to consumer choice and distort competition.

Ongoing fees and commissions for financial advice should be prohibited. If workers are placed in a default fund, by definition they have not made an active decision about their fund. It is therefore unlikely that they have received any formal financial advice and they should not have to pay for it.

These standards would benefit employees by lowering fees and protecting savings, and would benefit employers by reducing the costs associated with administration and selecting an appropriate default fund.

Best of all, any fund – whether retail, corporate or industry – could in theory meet these standards. The reason that high-cost funds do not currently approach such benchmarks is that they do not meet the needs of ordinary workers, instead overwhelming them with investment options that they don't understand.

Maximising choice remains at the heart of superannuation policy in Australia. Yet choice is only beneficial where people want more flexibility and where they have clear notions of what they want. This is evidently not the case for many Australians. Governments therefore have a responsibility to examine how people really behave and to structure policy accordingly.

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