PRODUCTIVITY COMMISSION DRAFT REPORT
SUPERANNUATION: ALTERNATIVE DEFAULT MODES

ACTU SUBMISSION

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SUBMISSION BY THE ACTU TO THE PRODUCTIVITY COMMISSION DRAFT REPORT INTO SUPERANNUATION : ALTERNATIVE DEFAULT MODELS

The ACTU is the Peak Council for Trade Unions in Australia. The ACTU played a pivotal role in the delivery of universal superannuation for Australian workers in the 1980's through a range of initiatives including the following:-

- The negotiation of the Accord with the incoming Hawke Labor Government which specified the commitment to deliver a universal scheme for superannuation for the Australian workforce;

- The running of a series of cases in the High Court of Australia which resulted in determinations to the effect that superannuation was an industrial issue and that Unions, as the collective representative of workers, had a legitimate role in determining how superannuation should operate at the workplace, including a role in determining into which fund contributions should be paid;

- The running of a number of National Wage Cases in which the Full Bench brought down decisions to incorporate superannuation payments into Awards;

- The negotiation of a further Accord which specified the commitment to expand superannuation payments to levels eventually incorporated into the Superannuation Guarantee Charge legislation;

- The establishment alongside affiliated trade unions and employers, and the participation in the industry super fund framework.

The ACTU seeks to make a range of comments to the Draft Report prepared by the Productivity Commission into Alternative Default Models and where appropriate respond to the Findings, Recommendations and Requests for Information sought by the Commission.

ISSUES OF PRINCIPLE

Firstly the ACTU wishes to make a statement in respect of some issues of principle which we believe are worthy of placing on the record.

Role of the Productivity Commission

The ACTU's submission to the Issues paper for Stage 2 commenced by highlighting the historical industrial nature of superannuation. The ACTU highlighted the decision of the High Court in Manufacturing Grocers which recognised a long held tenet in Australian society – namely that workers, acting collectively and through their Unions have a legitimate right to be involved on a collective basis in decisions which affect them in the workplace. This right recognises the well-established principle that workers, acting individually, are in an unequal bargaining position with their employers. Further, to avoid the prospect of being singled out, workers collectively have a right to have a say about how their conditions of employment are framed.

This is a principle which is central to the very elements of economic and social activity in Australia. It is a principle which has been supported on numerous occasions by the Courts and has become an essential ingredient in the way in which Australian workplace law has been founded.

Faced with this tenet of law and principle, the Productivity Commission has chosen to simply ignore that it exists or to take a view that such a principle is redundant to the Commission's view of how economic activity should be conducted. The Commission has chosen to ignore processes of collective bargaining and the equalisation of power on industrial matters to the extent that it believes that textbook approaches to economic activity are more important than understood social norms.

The ACTU believes the Commission should be very considered in adopting this approach. Whilst the Commission can play an important role in reviewing and highlighting issues which will enhance economic activity, the ACTU believes that mandate should be balanced against social norms and a realistic assessment of community behaviour and reaction. Indeed the benefit of having an organisation such as the Commission is enhanced when it carefully considers this balance in its reviews; if it doesn't do so, then the Commission leaves itself open to considerations of its utility in advising Government on economic activity.

The ACTU Submission on an Alternative Default Model

The ACTU also presented a submission in which it proposed an alternative model for the determination of default superannuation – a model which we believed was capable of being tested and which highlighted the strengths of the existing models which have operated for 30 years. Instead of analysing this model, the Commission appears to have dismissed it without comment.

The Commission also raised the issue of using "net benefit" as an objective means of evaluating the merit of alternative default models. Essentially our view was that this was possible to achieve through recognising that industry superannuation and retail superannuation are two different systems with different operating characteristics and different outcomes for participants. Faced with accepting this obvious statement of fact and using the most commonly used system for defaults – that is industry superannuation – the Commission has chosen to blur the lines around existing systems and use an artificial, unmeasurable construction called Unassisted Employee Choice as the model against which it would be comparing its proposed alternative systems. Such a technique weakens the results of the Review and allows for skewed results, based on self-constructed assumptions, to justify outcomes on net benefit. The lack of comparison to industry super models or to both industry and retail super models weakens the legitimacy of any outcomes the Commission arrives at.

THE COMMON PROBLEMS WITH THE ALTERNATIVE MODELS

Is Genuine Choice Possible in Real World Situations

Where the Commission proposes a Choice Model for consideration it does so on the basis that informed choice will occur in a meaningful sense. Of course, the very notions of their being a need to have checks and balances on how issues like fair choice are implemented and having equality in decision making and bargaining in the workplace are among the principle reasons why the High Court has supported a legitimate role for collective approaches to the determination of industrial matters.

The Commission's theory for new starters to the workforce (let's say the majority are aged 17 to 21) is that because they are making an important decision about their retirement needs, they will actively engage in the choice process. The Commission believes they will research the available products in the short list, they'll understand the mechanics of how the short-listed fund's asset allocations work and how the fee structures associated with those allocations work and they will make a judgement on the capability and willingness of the provider to deliver the best performance for their proposed model.

This assumption is made despite the fact the Commission, in its own findings, believes that 90% or more of the participants in this age cohort are significantly disengaged from superannuation.

So the reality is when the Commission makes this recommendation it does so fully understanding that genuine employee choice is not going to occur – that in fact if the model is more likely than not going to be either Employer Choice/Preference or perhaps no choice at all.

This line of rationale is precisely the reason why the High Court has consistently intervened to create a balance in "decisions" that are made at the workplace – including a decision like which fund should apply. It is simply not a decision for the Employer to make alone. If a decision has to be made, it is made as a balanced approach in which the employer and the collective representation of the workforce jointly make, or if they can't agree, then an independent body assists or arbitrates on the outcome.

The ACTU's comment on Assisted Employer Choice and Assisted Employee Choice is the same – the High Court says that in industrial issues of this nature there is a valid role for unions, as the legitimate collective representatives to be involved in establishing that Choice framework.

Further the ACTU wishes to make a further comment on the issue of no choice because we are concerned about the Commission's apparent line of thinking in this area. In its analysis of unassisted employee choice, as part of its discussion of establishing a baseline (p98 of the Report), the Commission makes the quaint observation that there would be an option for employees to refuse to make a choice and that the consequence they would bear would be the forfeiture of employer contributions. The Commission should consider how a regime might operate in a world like petrol station attendant or pizza delivery operator where the choice might be "do you really want to have superannuation and if you do I can find another casual who wants this job who isn't going to ask for superannuation".

These issues again reiterate the role of the industrial system. No choice is not an option. If it was, vulnerable workers would regularly not receive benefits. So "industrial choice" means a mandatory outcome for all – the appropriately determined default fund for all at the workplace.

The Introduction of the Principal and Agent World

A natural outworking of a world in which there are choices from different types of superannuation services in default fund selection, is the inevitable development of a distribution system at the heart of which will be the aim of getting employers to choose a particular sponsor's product. The Commission does not favour effective barriers to the selling measures associated with such a lucrative business opportunity, rather it favours softer more self-regulatory-like measures.

Fierce competition in the default space will be an inevitability under the alternatives where a short-list of funds exists and employers are pushed to choose one of those as a default.

What is the impact of such an outcome:-

- The advent of principal and agent conflicts in which agents, in seeking to maximise rewards, will cross the lines of Integrity, as they have with every other financial product or service delivered in this country;

- Not every product can be the best performer in the market. Agents will know this, but to maintain their reward, will promote products which they know to be inferior. It simply becomes a return of selling in the agent's interest and not the best interest of the clients;

- There is substantial cost in the introduction of a sales based distribution system. These systems were the backbone of the financial products industry for many years and were at the heart of why many products, such as traditional life insurance cotracts, had negative surrender values for the many years of their policy's operation. Whether they become an individual cost for the member or a system wide cost, there can be no doubt that sales/distribution costs will significantly increase administration costs. Further there is no submission which believes that general efficiency costs from having a competitive market will offset these additional costs.

The Belief That Selection Panels will be Independent

The Commission makes an interesting observation on page 84 of its Report when dealing with Who is Responsible for Selecting Products when it opines.

"A significant risk in constituting the body is if the process for selecting members becomes politicised and genuine independence is replaced with an objective of ensuring that all of the relevant interests – such as employee and employer groups – are represented. As discussed in the Commission's report on workplace relations (PC2015b, pp.161-167), the latter is a recipe for partisanship and unresolvable conflicts of interest".

What is conveniently ignored in this opinion is that employee and employer groups, for thirty years or more, and almost universally without displays of partisanship or unresolvable conflicts of interest, have acted to select funds on a basic principle of "what is in the best interest of working people".

The ACTU finds it unusual, if not unsurprising, that the Commission believes the only groups which need to be singled out for potential partisanship are unions and employer groups – and particularly against the backdrop when the processes these groups have followed are processes which not only have had the best intentions for workers, but demonstrably and unequivocally, produced the best outcomes for workers.

Nothwithstanding this, the ACTU does believe there is a grave risk of partisanship in the selection process. When the superannuation sector has been divided on all profits to members and retail products for so long, it is not possible to find participants who have not be influenced by one side of the debate or the other. Such partisanship was seen to the fore in the Cooper review, it is also seen in the way in which the Commission has chosen to ignore the evidence and positions of many participants.

It is also true to say we live in a partisan political world where many senior political figures have avowed prejudices against one sector or another. Those same political figures have established track records of never appointing people who are regarded as not of the same political outlook to any Board, Committee or Agency. In such an environment, how could any objective observer believe that the selection process – its terms of reference and its appointees – won't be corrupted.

COMMENTS ON SIGNIFICANT FINDINGS

The Model Assessment Criteria

The ACTU notes the Commission's decision to adopt five criteria for assessing the alternative models. The ACTU's view is that the manner in which these criteria have been described in the Draft Report mean they are all, to some extent or other, inappropriate for the analysis needed for the final section of the Review.

As the Commission is aware, the ACTU has been a strong support of the "net benefit test" as the appropriate criterion for assessing whether it was appropriate to adopt an alternative model for default fund arrangements. But for such a test to be relevant, it means establishing a proper baseline from which assessment could be made. This baseline was clearly available to the Commission – it simply had to accept the reality that there is an industry fund model which has been the dominant default fund structure across the workforce and that measurement of alternative systems could be made against this baseline.

The ACTU views the development of a baseline which the Commission has named as Unassisted Employee Choice to be a non-relevant creation from which no meaningful conclusion can be drawn. The findings in the draft report that all the chosen alternatives outperform this baseline is essentially a non-finding: the problem that the Commission (and ultimately) the Government will have in regard in this finding is that it ignores the baseline that the wider community understands to be the baseline and against which they want changed models to be measured. For this Review not to undertake this exercise leaves the Review open to significant criticism.

The Commission then seeks to add four essentially qualitative assessment criteria to its processes. No Review of this nature should rely so substantially on qualitative assessment.

In respect of the Competition Criterion – the ACTU reiterates its view that a means to an end is not an assessment criterion.

The ACTU accepts that some regard should be held as to the Integrity of the system; but quite simply the Draft Report fails to meaningfully deal with fundamental issues in relation to Integrity – such as conflicts of interest and partisanship.

The ACTU that the development of an alternative model should maintain stability of the system and not add to system costs. These however are not significant assessment criteria.

The Non-inclusion of Insurance in the Default Model

The ACTU notes with regret the decision of the Commission not to include Insurance as an essential feature of the default model. In many ways this decision reflects the short-sightedness of the Federal Government in deciding the Objective of Superannuation should be solely focussed on the provision of retirement incomes.

An essential feature of superannuation arrangements has been that they provided for the needs of an Australian worker after his or her work life finished, no matter how they left the workforce. It is relatively simplistic to see superannuation as a means for providing for an adequate retirement and it goes without saying that all parties would like to see an optimal world where superannuation was only needed in retirement.

However, the reality of the situation is that many workers leave the workforce because they die or are disabled and that superannuation has been a vital tool in ensuring that their families are provided for, in as adequate a manner as is possible, should these unfortunate circumstances arise.

Superannuation has become the major form of family-oriented insurance in society. Something of the order of 70-80% of insurance coverage for workers comes through superannuation. There is no cost effective replacement for this level of coverage and indeed without bundled insurance, either through oversight or lack of knowledge, many workers will not have adequate insurance for themselves or their families.

Whilst the industry has acknowledged some recent issues in relation to insurance coverage, significant work is being undertaken to address all identified problems with insurance. Removing it as a default product by reference to some of these issues is a “throwing the baby out with the bathwater” response.

The Commission postulates that providers might still offer insurance as an additional, what might well be an opt-in style of arrangement. Opt-in arrangements provide lower value for money than opt-out arrangements. In the highly competitive world the Commission envisages, it would simply become a much more difficult exercise to justify the provision of almost any cover at all.

The ACTU disagrees strongly with the approach adopted by the Commission in this regard.

Mergers

The Commission includes a section in its Report in relation to mergers. Much of the section seems to be based on a less-than-fullsome commentary contained in the Report that “Several

stakeholders have contended that some trustee board directors (and their sponsoring bodies) have an incentive to avoid mergers that would force them to relinquish their position on the board."(page 89 of the Report).

Firstly the ACTU complains about the nature of second-hand style commentary by the Commission to apparently make some form of generalised statement on an issue of this nature. An assertion of this nature needs a level of specificity to have any credibility at all. No body should allow generalised, unsubstantiated commentary to be admitted as having any validity, let alone what appears to be some sort of assertion of fact.

The ACTU is unaware of any circumstance in which a trustee or a sponsoring organisation has opposed a merger because that merger would have led to a loss of a position or a level of representation. The ACTU would be pleased to respond to specific cases and would welcome the opportunity to provide the Commission with a factual account of events around failed mergers so that we can avoid further unsubstantiated, vague assertions.

As an example of this the ACTU would cite the well-publicised circumstances around the failed merger attempt between the Vision and Equip Superannuation funds as the most high profile case in this area in recent years.

The ACTU would point to the following facts in this case:-

- A principal initial ground of opposition to the merger was that the assets to be transferred were to be signed off without proposer due diligence, an issue we would expect any competent Director to pursue. This ground was subsequently found to be factual;

- Trustees, whether they supported the merger or not, kept APRA aware at all stages of steps that were being taken in respect of the proposed merger and their position in respect of where the best interest of members test fell;

- APRA, in its review of the failed merger, had the opportunity to make findings of inappropriate behaviour by any Trustee. No such finding was ever made;

- A number of the Union Trustees who spoke out in opposition to the merger in fact voluntary retired from the Board soon after the merger was rejected: rather than opposing the merger to protect their positions, the issue of whether or not they were not going to continue in a Board position on an ongoing non-merged entity was in fact a non-issue.

The ACTU further refers the Commission to the submission made by Mr Tony Tuohy to an earlier part of this Review on this matter.

The Advent of Centralised Online Services

In the ACTU's opinion, the Commission rightly points to a problem in that there are too many inactive accounts in the superannuation system and that it should be a priority to reduce this excess of accounts. The ACTU accepts the numerical findings the Commission refers to and supports initiatives to ensure that some of this money is not lost in fees paid for inactive accounts, particularly where inactivity has occurred an "inadvertent" basis.

The ACTU supports the proposal of a central record of default/chosen fund for every worker as a sensible and practical means to commence the process of workers inadvertently having more than one superannuation arrangement.

The ACTU notes that this, alongside the additional measures proposed by the Commission and the Australian Taxation Office – such as myGov and the Single Touch Payment system - are essentially new developments which could, equally, easily apply to the existing default fund arrangements, the ACTU's proposed model for Default Fund determination or any of the alternative models proposed by the Commission. It should not be seen, nor can it be said, that these arrangements are either critical or an integral part of the Commission's alternative models.

Hence any modelling to be done on the effectiveness of these services should be seen to apply to all models. Indeed the ACTU believes the streamlining of models which are inherently straightforward database collection and payment systems can make all those systems more efficient. Given the size of the current default fund systems, which are substantially based around industry funds, the economies to be gained in these areas would be substantial.

ADDITIONAL COMMENTARY ON DRAFT FINDINGS AND RECOMMENDATIONS

The ACTU seeks to comment on findings and recommendations where we think such comment is appropriate.

Draft Finding 3.3

The ACTU believes a more appropriate approach for the Commission would have been to propose the extension of the default system into the retirement stage of superannuation. It is clear that much of the issues associated with the integrity of the financial services systems in recent years has arisen because of improper behaviour by investment providers in the retirement phase – Westpoint, Storm and Trio are three of the more infamous examples of recent years which have particularly targeted the retirees.

Extending reputable default providers into the retirement system has many potential spin-offs beyond the extra protection from disreputable providers which might be afforded to retirees. For instance, it can provide a better basis for more society-wide integration with the Age pension system through better information and consolidating retirement drawdowns alongside pension payments, it has the potential to lead to better asset allocation in retirement, avoiding poor choices which proliferate in life style products. Broader default arrangements have the potential to make the system more sustainable, better returning and more likely to participate in a national savings approach to the investment of retirement savings.

The ACTU also refers to its comments on the decision not to include a bundled insurance product in the design of default products.

Draft Finding 3.4

The ACTU refers to its comments to earlier stages of the review in respect of the desirability of lengthy periods between selection processes. It is the ACTU's view that such a process will lead to significant consolidation of the superannuation sector, but at a price in which many funds will turn to more conservative asset allocations as they are forced to manage significantly reduced

net cash flows. Such an outcome will have an effect on the overall performance of the system and its ability to meet the expectations of policy makers to play a role in national economic development.

Draft Recommendation 3.3

The ACTU believes any templated merger framework should be approached carefully and considerately. Under a heavy handed approach, there could be an extreme finding that every merger, including the merger of all funds into a single fund, would be required to be mandated since, if it could be shown that any scale of economy benefits existed and were the only measurable test to be conducted, then all and every merger would be beneficial.

Mergers, as in most areas of business activity, are best delivered when there is an appropriate commonality of interest between the merger partners. This is not an easy or precise measure and should be seen as an issue which sponsoring organisations can and should have a clear view on.

Measures should also produce genuinely better servicing arrangements – often meaning that servicing arrangements and support for and trust in funds are best analysed through members' eyes.

Further mergers will need sometimes to look more deeply into the characteristics of various fund memberships. One fund, for example, might have default insurance arrangements that suit the particular demographics of that fund; the second fund may well have differing membership demographics and the resultant insurance arrangements may not suit both funds. This is simply to say mergers can be and often are complex arrangements and need to be managed carefully, with proper oversight from APRA, rather than through a heavy handed legislative approach.

INFORMATION REQUESTS

Information Request 3.1

The ACTU reiterates its concern that the establishment of cost-oriented selection processes have the potential to distort behaviour in other aspects of an individual fund's operation and indeed in the system at large.

Cost-oriented auctions are blunt instruments, where the prize is seen as substantial, have a predisposition to unsustainable tendering practices. Further they have a predisposition to shape fund design to one outcome – that being winning the auction with the lowest cost bid – even though this will almost certainly distort other, more significant outcomes – such as having the best asset allocation structures to achieve optimal long-term risk adjusted outcomes; or comprehensive and responsible bundled insurance arrangements.

Information Request 3.2

See our comments in relation to Draft Recommendation 3.3.

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