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Karen Chester, Deputy Chair
Angela MacRae, Commissioner
Productivity Commission

By Email

Superannuation Inquiry: Queen's Counsel opinion on the Fair Work Commission

Dear Deputy Chair and Commissioner,

The Productivity Commission's Draft Report, *Superannuation: Assessing Efficiency and Competitiveness*, offered a view that that default super fund selection should be removed from the remit of the Fair Work Commission (FWC) in favour of a new body.

In support of this view the Draft Report questioned whether the FWC was suited to making merit-based assessments of superannuation products.

ISA has responded to the Draft Report's criticisms of the FWC as a venue for default selection in our submission.

In addition, ISA recently requested Mr Warren Friend QC to review the Draft Report's arguments and to offer an opinion as to the suitability of the FWC for selecting default funds. A full copy of that opinion is enclosed.

We wish to draw attention to two aspects of Mr Friend's opinion: the institutional characteristics of the FWC that help make it a suitable venue for default selection, and the importance of the 2012 amendments to the Fair Work Act for understanding how the FWC would conduct selection if it were allowed to operate as intended.

In relation to the characteristics of the FWC, Mr Friend highlights the independence of FWC members and the transparency of its deliberations:

> "…once appointed, [Fair Work] Commission members are completely independent. Their allegiance is to the FW Act and the law. This independence is promoted by the fact that regular Commission members are generally appointed on a full-time basis, they have tenure until the age of 65, and receive a high remuneration. This means that members need not seek outside income, and need not curry favour with potential future employers." (Para 57)
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> "Another feature of the [Fair Work] Commission's work is its transparency, meaning that it operates in public as much as possible. The FWC is required by law to act in a way which is "open and transparent." As part of that obligation, if (as usually occurs) the Commission holds hearings, it must, subject to limited exceptions similar to those applied by courts, hold them in public." (Para 67)

These are among the features that make the FWC preferable to the body recommended by the Draft Report. The tenure and remuneration levels of FWC members, who would form the majority of a functioning Expert Panel, secures a degree of independence from external pressures that the periodic appointment of fixed-term panel members cannot.

In addition, the transparent nature of the FWC's decision making – which would involve a public process of collecting and testing evidence, together with the availability of judicial review of decisions on appeal – is more conducive to securing merit-based outcomes that command public confidence than one in which Ministerial appointees alone announce final decisions that are subject only to judicial review of procedure.

On the implications of the 2012 amendments to the Fair Work Act, Mr Friend emphasises how they will give added priority to member interests:

> "The 2012 amendments have now given the Commission specific direction on how to nominate funds in an award. In particular, the "best interests" test has been enshrined in law as the test to be applied when determining, first, which superannuation products will be placed on the List and the Schedule, second, which products (drawn from the List) will be named in an award." (Para 71)

Further, Mr Friend found unpersuasive the argument of the Draft Report that the FWC is irreversibly flawed as a default selection venue because of past concerns with resolving disputes and industrial precedent:

> "…the PC's criticism is misdirected, in that it is historical. The real question is whether the current system, as it exists in light of the 2012 amendments, promotes member benefit. We think that it clearly does, or at least will, once it is allowed to function as intended. In particular, the PC's historical concerns about merit and about potential conflicts have been specifically addressed: the FWC is now explicitly required to make decisions in the "best interests" of members, and it is not limited to acting on the motion of the industrial parties." (Para 77)

In summary, Mr Friend concludes that the FWC possesses strong characteristics of independence, transparency and fairness of process. Mr Friend supported this view by, among other things, noting the judicial deference afforded to the FWC's decisions (Para 54). These characteristics of transparency, independence, and fairness of process, applied in the context of the obligations on the FWC legislated in 2012 to prioritise the best interests of members, makes it an appropriate institution for default superannuation fund selection.

We would welcome the opportunity to discuss further the issues raised by Mr Friend's opinion and their implications for the Commission's Final Report.

Yours sincerely,

Zachary May
Director of Policy

OPINION

Introduction

1. We have been asked to provide an opinion about the process for selecting default superannuation funds for modern awards, as set out in the *Fair Work Act 2009* (Cth) (**FW Act**), and to consider whether that process is an appropriate one having regard to the history of default superannuation fund selection and the status and functions of the Fair Work Commission (**FWC**).

Summary of conclusions

2. In our view, the process is indeed appropriate, for two main reasons.

3. First, since 2012, the FWC has been specifically required by law to make decisions about default fund selection according to the "best interests" of members, having regard to relevant criteria such as fund performance, risk, fees and governance. This approach promotes optimal outcomes for members.

4. Second, the FWC possesses strong institutional characteristics which make it a suitable body to perform this important function. These features include independence, transparency, and fairness of process, including the capacity for all interested parties (including superannuation funds) to make submissions.

Background

5. In February 2016, the federal Treasurer commissioned the Productivity Commission (**PC**) to conduct a study and inquiry into the efficiency and competitiveness of the superannuation system.

6. On 25 November 2016, the PC released the first stage of its work, a "Stage 1" study determining the criteria the PC would use for assessing the competitiveness and efficiency of the system. Eighty-nine assessment criteria were developed, which the PC collated under five headings, indicating the ideal features of a system.[1] We summarise those as: (1) maximising long-term returns; (2) meeting member needs for products and information; (3) improving efficiency over time; (4) providing value-for-money insurance; (5) efficient outcomes (including lower fees) driven by competition for members.

7. On 29 March 2017, the PC released its draft report for its "Stage 2" inquiry into alternative default models. This report set out four alternative models for establishing default superannuation. Model 1 requires employees to choose their own superannuation fund from a shortlist of 4 to 10

[1] PC, *How to Assess the Competitiveness and Efficiency of the Superannuation System* (Nov 2016) 10.

'good' funds selected by a government body, with contributions going to a last-resort fund in the event no choice is made. Model 2 permits employees to choose their own fund, but in default of that choice their employer would choose a fund from one of two lists; the first list would include a wide range of funds meeting minimum standards, and a second list (designed for employers poorly placed to make a good choice from the first list) would be comprised of the best performing funds. Model 3 would allow up to ten funds to tender to share in the default superannuation pool, by competing against specified criteria; the winners to be chosen by a body accountable to government. Model 4 is a fee-based auction, whereby one or more funds submitting bids for the lowest member fees would be selected to share in the default pool.

8. The draft report recommended these models be assessed against five assessment criteria,[2] which suggest the following ideal features of any model: (1) **Member benefits**: maximising long-term net returns and meeting member needs; (2) **Competition**: encouraging open competition and rivalry between funds that drives innovation costs reduction and more efficient long term outcomes; (3) **Integrity**: promoting integrity in the process of selecting funds, and integrity of fund operations; (4) **Stability**: promoting stability of the system; (5) **Costs**: minimising system-wide costs.

9. On 29 May 2018, the PC released its draft report for "Stage 3" of its inquiry, which assessed the four alternative models against the existing model, which (as we set out in more detail below) involves the FWC in selecting default superannuation funds in modern awards. The PC said that it had reviewed the existing system considering both the way in which the system was operating in practice, as well as how it might operate were the 2012 reforms (discussed below) fully implemented.[3]

10. Overall, the PC was critical of the existing model. In relation to "member benefits", while the PC conceded that most default members were delivered into well-performing funds, it was concerned that an unspecified share of members had been directed into poorly performing funds by their employers.

11. The PC criticised the FWC for allowing underperforming funds into the system. Its assessment as to why that had occurred was as follows:[4]

> *In making listing decisions, the Fair Work Commission (FWC) (until it was rendered unable to do so) has historically drawn heavily on precedent, and viewed itself as a dispute solving*

[2] PC, *Superannuation: Alternative Default Models* (March 2017) ch 2.
[3] PC, *Superannuation: Assessing Efficiency and Competitiveness* (Apr 2018) 427.
[4] Ibid, 26.

body — not as an arbiter of the quality or merit of funds put up for inclusion. Members' interests are a secondary consideration to questions of standing and history.

Only funds backed by employer or employee representatives are generally able to have themselves considered by the FWC — but these industrial parties have themselves sponsored the joint development of funds, and so are not unhindered by conflict when reviewing other funds' requests to be registered.

12. On "competition", the PC did not rate the existing system highly, for two reasons. First, the (perceived) exclusion of standing for superannuation funds, referred to above, was said to create "an uncompetitive barrier to entry".[5] Secondly, the process of selecting default funds was considered to be "manifestly" not determined through a "genuinely competitive process focused on merit".[6]

13. On "integrity", relevantly, the PC was concerned about two integrity deficits. First, the PC concluded that the FWC was not "interested" in the best performing funds being preferred. It considered that if the 2012 reforms were fully implemented, this problem might have been mitigated "somewhat".[7] Secondly, the PC was concerned that "industrial parties" played a "key role" in nominating default funds but were "not unhindered by conflict" because they also sponsored some of the funds.[8]

14. In relation to "stability", the current system was rated highly, but the PC notes that stability "also promotes inertia and props up some poorly performing funds" because there is "no active FWC process for reviewing and delisting funds".[9]

15. On "costs", the PC concluded the existing costs were reasonably modest, noting that one cost was the cost of funds participating in the FWC process.[10]

16. We note here that we consider that in coming to its conclusions, the PC appears to have proceeded upon a number of misconceptions about the role of the FWC, which we shall explore further below.

17. Ultimately, in its Stage 3 draft report, the PC concluded that a version of the first model which it considered in its Stage 2 report was to be preferred.

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[5] Ibid, 429.
[6] Ibid, 430.
[7] Ibid.
[8] Ibid.
[9] Ibid.
[10] Ibid.

History of superannuation in awards

18. The award system dates back to the 1890s, when a number of Australia's colonial Parliaments legislated to establish tribunals to settle industrial disputes by conciliation and arbitration leading to the making of binding 'awards'. The first Commonwealth Court of Conciliation and Arbitration was established in 1904, and is the predecessor to the current FWC. The first three Presidents of the Court were judges of the High Court and it operated both as administrative body with arbitral functions and a court until the decision of the Privy Council in the *Engineers' Case.*[11] Throughout the institution's history in each of its manifestations — the Conciliation and Arbitration Court, the Conciliation and Arbitration Commission, the Australian Industrial Relations Commission, Fair Work Australia and the Fair Work Commission — it has acted in a quasi-judicial manner. That is to say: it was staffed by members who acted impartially; it gave each side a fair opportunity to present its case; and it weighed up the evidence and submissions presented to it according to merit. Indeed, its last three Presidents have also held appointments as judges of the Federal Court of Australia. A key feature of the system was that unions and employer organisations could be registered and would thereafter have standing to make claims in the Commission in the interests of their members.

19. Until the 1980s the Commission had no cause to consider issues of superannuation, as it was widely believed[12] that a union claim for superannuation could not form part of an "industrial dispute" where the existence of such a dispute was, until 2006, the foundation of the Commission's jurisdiction.

20. In 1985, the federal government and the union movement agreed, as part of the Accord process, that 3% occupational superannuation should be introduced. In May 1986, the High Court handed down its judgment in the *Manufacturing Grocers'* case,[13] confirming that a claim for superannuation could be the subject of an industrial dispute, and therefore an award. Immediately, the union movement (with the support of the federal government) applied to the Commission for existing awards to be adjusted to provide for 3% superannuation, to be paid into funds which complied with certain standards set by the Treasurer. In June 1986, the Commission approved this proposal.[14] There followed disputation between unions and employers over the identity of funds to be included in awards, and employers sought a moratorium on the introduction of

[11] (1957) 95 CLR 529.
[12] See *R v Hamilton Knight; Ex parte Commonwealth Steamship Owners' Association* (1952) 86 CLR 283.
[13] *Re Manufacturing Grocers' Employees Federation of Australia; Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341.
[14] *National Wage Case June 1986* (1986) 4 IR 187.

superannuation. In December 1986, the Commission refused the moratorium but called a conference of the parties seeking to resolve the matter.[15]

21. By March 1987, the Commission had decided that the "vexed issue" of fund identity was one which it was prepared to arbitrate as a "last resort" if agreement could not be reached.[16] The Commission indicated that, without pre-judging the issue, it was inclined to prefer multi-employer funds (jointly controlled by employers and unions), and it was opposed to any single employer being required to pay into more than one fund.[17]

22. Following this decision, many awards were adjusted to include superannuation. This was mostly done by consent, but on occasion the Commission arbitrated. When it did so, the Commission acted on the usual basis of reason and merit. For example, in 1989, the unions and employers agreed on a superannuation clause to be inserted into the Metal Industry Award, which was the major award in the manufacturing industry. The clause contained three default funds from which the employer could select one. The National Union of Workers objected to the settlement, on grounds the employer should not have the right to choose the fund, and proposed that it retain a right to veto the employer choice and instead nominate a fourth fund. In a reasoned decision, Deputy President Keogh rejected the NUW's position and approved the proposed clause.[18]

23. As another example, in September 1991, the Commission (renamed the Australian Industrial Relations Commission in 1988) decided on a superannuation clause for the national building industry award.[19] The unions advocated for a single fund, BUSS, on grounds of its good track record of returns and the desirability of having a single fund in the industry. The employers advocated for a list of 12 funds (including BUSS), plus any other fund agreed between an employer and a relevant union, to allow additional choice and to hedge against Building Unions Superannuation Scheme performing badly. Some employer groups opposed BUSS being the sole fund on the ground that the Master Builders' Association dominated the employer seats on its board. The AIRC considered these arguments and adopted the employers' suggested clause.[20]

24. In 1992 and 1993, the superannuation guarantee (**SG**) legislation was passed, allowing employers to discharge a notional tax liability by paying employee superannuation into a complying fund. "Standard employer-sponsor funds" were required to have equal representation of employers and members on their boards. The government's position, stated by the Treasurer in the Second

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[15] *National Wage Case December 1986* (1986) 15 IR 395.
[16] *National Wage Case March 1987* (1987) 17 IR 65, 87, 88.
[17] ibid. 88.
[18] *Re Australian Glass Workers Union* [1989] AIRC 435 (Print H8588).
[19] Re *Building Workers' Industrial Union of Australia* (18 Sep 91, AIRC, Print J9535).
[20] See the summary in *Re National Building and Construction Industry Award 1990* (11 Aug 99, AIRCFB, Print R7700) [20]-[25].

Reading Speech when introducing the legislation, was that awards could continue to nominate default funds as agreed between the industrial parties or, failing agreement, as determined by the Commission "in the best interest of the beneficiaries".[21]

25. In July 1993, High Court decided, in the *Financial Clinic* case,[22] that a union could make a claim that superannuation be paid into a particular fund on behalf of its members, but could not seek that awards prescribe the identity of superannuation funds for non-members, unless there was some "special circumstance" making that selection of legitimate concern to union members. This decision did not ultimately pose an obstacle to the specification of funds for non-members in awards, as the Commission took the view that union members had a legitimate interest in specifying funds for non-members, so as to avoid the risk that the employer would choose a fund from which it derived a benefit, thereby leading the employer to give preference in employment to non-members.[23]

26. In September 1994, the Commission decided the *Superannuation Test Case*[24] which dealt with, inter alia, the effect of the SG legislation on the award system, and the harmonisation of superannuation clauses across awards. Its default clause was silent as to fund choice, allowing the employer to select any complying fund. However, the Commission indicated it would hear and arbitrate individual claims to include named funds in particular awards and in doing so would have regard to its previous pronouncements on the question of appropriate fund selection.[25]

27. Throughout the 1990s, there were many such applications to specify individual funds in awards. As was usual in the Commission, these were often done by consent. However, where there was no consent, the Commission would scrutinise a claim on its merits.

28. From time to time there were also applications to vary the funds specified in awards. For example, the *Hospitality — Accommodation, Hotels, Resorts and Gaming Award* specified two named funds. In 1994, an employer association applied to vary the award so as to allow employers to pay into any complying fund, or alternatively, into any complying fund which a majority of workers in the enterprise supported. The AIRC considered a range of documentary material and heard from two witnesses. It rejected the application, including on grounds that the existing funds had

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[21] Second Reading Speech, Superannuation Guarantee (Administration) Bill 1992: *Hansard* (2 Apr 92) 1765.
[22] (1993) 178 CLR 352.
[23] See, eg, *Re National Building and Construction Industry Award 1990* (11 Aug 99, AIRCFB, Print R7700); *Re Metal Industry (Superannuation) Award 1989* (19 Jan 01, AIRC, PR900519).
[24] (1994) 55 IR 447.
[25] Ibid, 458-9, 466.

performed well and charged low fees, which features were particularly important in the hospitality industry where workers tend to be low paid.[26]

29. Many decisions from this time reinforced that the choice of fund must be decided according to what was in the "best interests" of employees.[27] In February 1995, this approach was apparently endorsed by the Full Bench in the *Insuper* case.[28] The facts were as follows. The awards for the insurance industry had specified Insuper as the only default fund. A number of employers applied to vary the award to allow employers to pay contributions to any complying fund. The union opposed the application, seeking to show why it was in the interests of employees to retain Insuper as the sole fund, including on grounds of its "flexibility", "cost-effectiveness" and the "range [and] quality of delivery of membership benefits". The Commissioner decided to vary the award, without deciding any of the matters raised by the union, simply on the basis that the SG legislation permitted employers to pay into any complying fund.

30. The union appealed, with the federal Minister for Industrial Relations intervening in support. The union and Minister both submitted that the Commissioner had erred by not arbitrating the question of fund choice on the merits, as required by the *Superannuation Test Case*; the Minister went further and, quoting the Treasurer (as referred to above), suggested that the Commissioner had to determine what was in the "best interests" of employees. The Full Bench allowed the appeal, deciding that the Commissioner had indeed failed to arbitrate the question on the merits, including by failing to evaluate and "weigh in the balance" the matters raised by the union.

31. In 1996, legislation for the first time explicitly recognised that awards could include a term about superannuation as an "allowable" award matter. The same legislation required the AIRC to review and simplify the existing awards.

32. As part of this simplification process, the AIRC was required to, and did, reconsider the funds selected in each award. A significant example occurred in August 1999, when the AIRC handed down its decision on the superannuation clause in the awards for the building and plumbing industry.[29] As set out above, the building award allowed the employer to choose from one of several named funds, or any other fund agreed with a relevant union. The employers and unions jointly agreed that this provision should be retained. The Commission heard evidence from three witnesses as to why retention was desirable. Two of the witnesses were cross-examined. The evidence canvassed positive features of the selected funds, including their low fees, automatic

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[26] *Re Australian Hotels Association* (3 May 96, AIRC, Print N1387) p 9.
[27] See, eg, *Clothing and Allied Trades Union of Australia* [1988] AIRC 786 (Print H4817); *Clothing and Allied Trades Union of Australia* [1988] AIRC 1034; Federated Miscellaneous Workers Union of Australia [1989] AIRC 517.
[28] *Re Finance Sector Union* [1995] AIRC 2604 (Print L9284).
[29] *Re National Building and Construction Industry Award 1990* (11 Aug 99, AIRCFB, Print R7700).

insurance cover, availability of member investment choice, and equal representation on the governing boards. The AIRC accepted this evidence and decided to retain the clause.

33. In December 2005, the Coalition government's *Work Choices* legislation was enacted. Effective from March 2006, it put the award system on a new constitutional footing. No longer were awards made to settle "industrial disputes", as had been the case since 1904. Instead, the awards were reconstituted as instruments setting minimum wages and entitlements for those employees working for "trading corporations" and other entities which the federal Parliament was competent to regulate.

34. In March 2008, the AIRC was requested by the Minister to consolidate the several thousand existing awards and create a small number of "modern awards" for major industries and occupations. It undertook this "award modernisation" process over a two year period. As part of the process, it gave detailed consideration to the superannuation funds which should appear in modern awards. The process adopted for one of the most significant awards, the retail award, is illustrative. The decisions made in relation to the retail award were applied more generally in subsequent award modernisation decisions.

35. Between July and September 2008, the AIRC received public submissions on the content of the modern retail award. Thirty-five organisations made written submissions, and many addressed the question of superannuation, including the federal Minister for Superannuation, whose submission urged the AIRC to consider fund performance when specifying funds in the award.[30] There were also two days of hearings, where the issue of fund specification was also raised.[31]

36. On 12 September 2008, the AIRC published an "exposure draft" of the award, for public comment, nominating REST as the only default fund.[32] This was the pre-existing position in the main federal and State awards.[33] In an accompanying statement, the AIRC indicated that it had decided it would not itself appraise fund performance, but was willing to accept funds agreed by the major industrial parties.[34]

37. Following publication of the exposure draft, 66 people and organisations made further written submissions, including 17 superannuation fund providers or superannuation industry bodies. Many of the submissions argued for different funds to be nominated in the award, or no funds at all.

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[30] Minister's submission (18 Jul 08). Available at < www.airc.gov.au/awardmod/databases/retail/Submissions/Default_Superannuation_Funds.pdf>.
[31] Transcript (8 Aug 2008) [261].
[32] Exposure draft (12 Sep 08) cl 20.4.
[33] REST was the recommended fund in the retail awards covering Victoria, Western Australia, South Australia, the ACT and the NT.
[34] Statement (12 Sep 08) [29].

38. On 30 and 31 October 2008 there were two days of hearing in Sydney, at which a number of the superannuation bodies were represented. Much of the first hearing day was occupied with the question of naming funds in the award. A third hearing occurred on 5 November 2008 in Melbourne, where superannuation was also dealt with.

39. On 19 December 2008, the AIRC published a draft retail award. The award specified REST as the default fund, but grandfathered other arrangements which were on foot prior to the publication of the exposure draft, as urged by some of the submissions.[35] An accompanying decision explained that the amendment was done to minimise inconvenience for employers.[36] The modern award took effect in this form on and from 1 January 2010. A few weeks later, the clause was varied to include four other funds, which had pre-existing coverage in the sector, and which had effectively been omitted by accident. It remains the position to date that these four funds, and REST, are the only named funds in the retail award.

40. Also from 1 January 2010, the *Fair Work* system came into effect. Amongst other changes, due to referrals of legislative power from the States, the award system came to apply to the overwhelming majority of private sector employees in Australia.

41. In June 2010, the "Super System Review" chaired by Jeremy Cooper delivered its final report. It recommended the establishment of MySuper "products" (i.e, standard low-fee accounts within funds); that awards should permit employers to pay contributions to any complying MySuper product; and that the PC should review the Commission's process of nominating default funds to assess whether it was sufficiently open and competitive.[37]

42. In early 2012, the Commission began the 2012 transitional review of modern awards ("**2012 Review**") to ensure that, two years after their introduction, the awards were operating satisfactorily.[38] The Commission warned that the 2012 Review should not to be used as an opportunity to re-litigate matters already decided during award modernisation, and was only to be used to address anomalies or technical problems created by the new awards, or "changed circumstances" since the modern awards were made.[39] Despite that warning, twelve applications were made to vary the superannuation provisions in 22 of the modern awards so as to include additional named funds.[40] On 9 December 2013, the Commission heard those applications, including by reviewing 23 witness statements and a range of documentary evidence. On 7

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[35] Draft award (19 Dec 08) cl 22.4(b).
[36] Award Modernisation Decision [2008] AIRCFB 1000, [90].
[37] Recommendations 1.2-1.4.
[38] See *Fair Work (Transitional and Consequential Provisions) Act 2010* (Cth) sch 5 item 6(2)(a) and FW Act s 134(1).
[39] *Modern Awards Review 2012* [2012] FWAFB 5600.
[40] *Superannuation* [2013] FWC 8765, [2].

February 2014, the Commission (by now renamed the FWC) handed down its decision, refusing to add any new funds, on the basis that there had been no relevant change in circumstances since award modernisation.[41]

43. In the meantime, in February 2012, the federal government had commissioned the PC inquiry recommended by the Cooper Review. The PC published its report in October 2012. The PC recommended that a Superannuation Panel should be established within the Commission (known as Fair Work Australia, since 1 January 2010), partly composed of outside experts, to select particular MySuper products to be listed as default funds in awards. Fund selection was to be based on specified principles but primarily based on promotion of the employees' "best interests". The PC recommended an initial review of all awards, followed by regular periodic reviews to ensure appropriate fund selection.

44. In December 2012, amendments were made to the FW Act to implement the PC's recommendations ("**2012 amendments**").[42] The key amendments were as follows.

    (a) The Commission was to conduct a review of awards in 2013 (the "**2013 Super Review**") to remove any named funds which did not offer a MySuper product.

    (b) The Commission was to conduct a further review of awards in 2014 (the "**2014 Super Review**") in two stages. In the first stage, it would create a "Default Superannuation List" ("**List**") and a "Schedule of Approved Employer MySuper Products" ("**Schedule**"). In the second stage, the Commission would vary the awards so as to allow employers to pay default superannuation contributions to particular MySuper products (drawn from the List), or to any product appearing on the broader Schedule.

    (c) The first stage was to be conducted by an Expert Panel, normally constituted by four senior permanent Commission members and three outside experts with experience in finance, investment management or superannuation.[43] The second stage was to be conducted by a Full Bench (i.e. three permanent members of the Commission).

    (d) As part of the first stage, the Commission was explicitly required to consider matters such as the fund's net returns, risk profile, fees, insurance, advice services, governance, and administrative efficiency.[44]

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[41] *Modern Awards Review 2012 – Superannuation* [2014] FWCFB 299.
[42] *Fair Work Amendment Act 2012* (Cth); *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth).
[43] FW Act s 620(1A).
[44] FW Act s 156F.

(e) At each stage, the Commission was to make decisions on the basis of the "best interests" of employees.[45]

(f) Finally, the exercise was to be repeated every four years.

45. In November 2013, the Commission commenced the 2013 Super Review.[46] It began by publishing draft determinations of the proposed new superannuation clauses. Twenty organisations made submissions, including eight from the superannuation industry.[47] The Commission held a hearing in Sydney. Ten organisations appeared, including four from the superannuation industry.[48] On 30 December 2013, the Commission concluded the review and varied the awards to remove non-complying funds.[49] Twelve awards accidentally had complying funds removed. The error was later rectified.[50] In nine of the twelve cases, it was the *union* and not the superannuation fund which applied to the Commission to correct the error, illustrating the readiness of the unions to supervise the system, in the face of inattention from some of the funds.

46. On 30 January 2014, the 2014 Super Review began, with the Commission inviting submissions about the timetable and process to be adopted. Eighteen organisations made submissions, fourteen of which were from the superannuation industry.[51] Following those submissions, the Commission set a deadline of 28 April 2014 for funds to apply to join the List and Schedule. By that date, on our count,[52] 62 applications to join the List had been received, together with 40 independent submissions (i.e, excluding submissions from the applicant itself). There were 22 applications to join the Schedule, and five independent submissions.

47. However, the 2014 Super Review did not proceed. In March 2014, two of the three experts on the Expert Panel were withdrawn from the panel due to potential conflicts of interest which they had disclosed. The President appointed himself and an additional outside expert to fill the vacancies. On 6 June 2014, the Federal Court declared that the Panel was invalidly reconstituted, on the basis that both vacancies were required to be filled by expert members. [53] Following the decision, the federal government declined to appoint a further expert member to the Commission, to fill the remaining vacancy on the Panel. This meant that the Panel could not complete the 2014 Super

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[45] FW Act s 156H(2)(b), 156E, 156F(e), 156Q, 156S.
[46] See Superannuation [2013] FWC 8765.
[47] See Superannuation – 2013 review [2013] FWCFB 10016, [8].
[48] Transcript (13 Dec 13).
[49] 13 awards accidentally had complying funds removed. This was rectified in
[50] *Superannuation – 2013 Review* [2014] FWCFB 3206.
[51] See *2014 Review of Default Fund Terms* [2014] FWCFB 1146.
[52] The submissions are listed at < www.fwc.gov.au/awards-and-agreements/modern-award-reviews/superannuation-fund-reviews/applications>.
[53] See *Financial Services Council Ltd v Industry Super Australia Pty Ltd* (2014) 222 FCR 455.

Review, despite the Commission being willing[54] (and indeed, being bound by law) to complete the process should new expert panel members be appointed.

48. At the time the 2014 Super Review failed, the Commission was also engaged in the first "4 yearly review" of awards, required by the FW Act, to ensure that the award system was providing a fair and relevant safety net ("**2014 Review**"). The 2014 review has not yet been completed. As far as we can tell, after the 2014 Super Review failed, there were no attempts to have the Commission review the superannuation clauses in awards as part of the 2014 Review.

49. Accordingly, the status quo as at late 2018 is that modern awards contain superannuation clauses which generally name particular funds as default funds (each of which offer a MySuper product). Unless the 2014 Super Review is able to be completed beforehand, the Commission may be asked to reconsider which funds are named in awards as part of the next "4 yearly review" of modern awards, supposed to commence in 2018 but probably not to commence until 2019.[55] If that were to occur, the Commission would most likely be prepared to reconsider the funds selected on their merits, rather than simply deal with "changed circumstances", as was the approach it took as part of the 2012 Review.

Features of the current system

50. The history of the Commission's role in regulating default superannuation funds has been set out at some length, above, in order to assess some of the criticisms which the PC made of the Commission, as summarised in the first section of this advice.

51. Before turning to the validity of the PC's criticisms, it is also convenient to note some of the institutional features of the Commission as it presently exists.

Expertise

52. As noted above, the Expert Panel for superannuation must consist of three outside experts and four Commission members, including at least one senior member (the President, a Vice President or a Deputy President).[56] The expertise of the outside appointments is obvious. However, the expertise of the four Commission appointments who sit on the Expert Panel is also significant.

53. In practice, most people appointed to the Commission have had a distinguished career in law, public service, or industrial relations. Only those with a "high level" of relevant experience can be

[54] Justice Ian Ross, Submission to the PC's Stage 2 inquiry (19 December 2016) p 2.
[55] See *Statement – 4 yearly review of modern awards* [2018] FWC 9.
[56] Section 620(1A).

appointed as a Deputy President,[57] and the Vice Presidents and President usually have even greater experience still.[58] The Minister must be particularly satisfied of the relevant expertise of each member in order to appoint them to the Expert Panel.[59]

54. The generally high level of expertise of Commission members is also borne out by the fact that the courts which supervise the Commission have, throughout the twentieth century and into the twenty-first, consistently acknowledged the expertise of the Commission and given significant deference to it on matters within the Commission's remit.[60]

Integrity

55. The PC regards "integrity" as a key desired feature of the superannuation system. We understand this to refer to a desire for the system to work as intended and according to the established rules, without being corrupted by the self-interest of those administering the system.

56. The FW Act contains a number of rules to promote the integrity of the FWC. First, as just described, appointments are required to be based on merit and experience, rather than political favour. The fact that, until perhaps recently, appointing governments have sought to balance appointments with a union background and appointments with a business background does not, in our view, undermine the conclusion that the appointment process has been proper and has not generally been politicised.

57. Second, once appointed, Commission members are completely independent. Their allegiance is to the FW Act and the law.[61] This independence is promoted by the fact that regular Commission members are generally appointed on a full-time basis,[62] they have tenure until the age of 65,[63] and receive a high remuneration.[64] This means that members need not seek outside income, and need not curry favour with potential future employers.

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[57] Section 627(2)(b).
[58] Section 627(1)(b).
[59] Section 627(4).
[60] See, eg, *Attorney-General (Qld) v Riordan* (1997) 192 CLR 1, 38; *Re State Public Services Federation; ex parte Attorney-General* (WA) (1993) 178 CLR 249, 269; *R v Ludeke; Ex parte Queensland Electricity Commission* (1985) 159 CLR 178, 183-184; *R v Williams; ex parte Australian Building Construction Employees' and Builders Labourers' Federation* (1982) 153 CLR 402, 411; *R v Cohen; ex parte Attorney-General (Q)* (1981) 157 CLR 331, 336; *R v Alley; ex parte NSW Plumbers and Gasfitters Employees' Union* (1981) 153 CLR 376, 390; *R v Blakeley; ex parte Association of Architects, etc, of Australia* (1950) 82 CLR 54, 92-93.
[61] See the oath/affirmation of office: FW Act s 634; Fair Work Regulations 2009 (Cth) r 5.03 & sch 5.1.
[62] Section 628.
[63] See section 629(1) and the grounds for removal in ss 641-4.
[64] Commissioners earn approximately $380,000 per annum. More senior members earn greater amounts: Remuneration Tribunal (Remuneration and Allowances for Holders of Full-time Public Office) Determination 2018.

58. The outside experts on the Expert Panel receive substantial remuneration,[65] again facilitating their independence. While they are only appointed for a term of up to 5 years,[66] this is the same term as for other statutory office-holders — including PC commissioners[67] — and there is no evidence that such terms are inconsistent with independence.

59. Third, community confidence in the integrity of Commission members (including the outside experts) is promoted by a number of measures. Members must disclose potential conflicts of interest, and the President may direct them not to deal with matters where even a perception of a conflict might arise.[68] Members cannot perform outside work without approval.[69] Individual members' decisions may be appealed to a Full Bench,[70] and a Full Bench's (or Expert Panel's) decision may be judicially reviewed by the Federal Court,[71] including on ground of actual or perceived bias.

60. Fourth, the large number of people on the Expert Panel (seven) means that individual predilections and idiosyncrasies are evened out, and the Panel as a whole is more likely to deliver outcomes reflecting objective merit, compared to a smaller decision-making body.

Fairness of process

61. The FWC is required to adopt a process which is "fair and just", while at the same time being quick, informal and avoiding unnecessary technicalities.[72] As set out in the history section above, traditionally the Commission adopted a court-like process: waiting for a party to invoke its jurisdiction by making an application, then hearing submissions and evidence from both sides (including through cross-examination of witnesses) before making a decision.

62. However, in more recent times, as promoted by amendments to the FW Act, when it comes to the award system, the Commission has taken an approach closer to other bodies engaged in rule-making (including the PC): calling for submissions from any interested party, conducting its own research, publishing draft determinations, hearing further submissions on the drafts, and then making a final decision.

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[65] Their daily remuneration of $1,088 equates to an annual remuneration of approximately $400,000: Remuneration Tribunal (Remuneration and Allowances for Holders of Part-time Public Office) Determination 2018.
[66] Section 629(4).
[67] Productivity Commission Act 1988 (Cth) s 26(6).
[68] Section 640.
[69] Section 633.
[70] Section 604.
[71] Section 562; *Judiciary Act 1903* (Cth) s 39B.
[72] Section 577.

63. Whichever decision-making model has been adopted, though, there have been very few complaints historically that the Commission has not given "natural justice" (i.e, a fair chance to be heard) to any interested party.

64. That brings us to the question of who has "standing" (or a right to be heard) in the Commission. Historically only the "parties" to an award (that is, the unions and employer bodies bound by the award) had standing to seek variations to the award. The Commission might — and often did — hear from other persons who might be affected by a proposed variation, but only the parties could seek a variation, or agree to one being made by consent.

65. However, the position changed in 2010 when the FW Act commenced. In each general award review (including the two reviews, in 2012 and 2014, which have already taken place), the Commission is obliged to review all the awards, even without an application from a "party". In conducting the review, the Commission is (under the common law) bound to hear from any person whose rights or interests will be affected by its decision, and who wishes to be heard.[73]

66. The positon with respect to the superannuation clause reviews, provided for under the 2012 Amendments, is even clearer. When making the List and the Schedule in the first stage, the Expert Panel must first "invite" superannuation funds to nominate products for inclusion,[74] and then must give "all persons and bodies" a reasonable opportunity to make submissions.[75] When selecting named products from the List in the second stage, the FW Act requires the FWC to give the employees and employers covered by the award (and the unions and employer bodies eligible to represent them) a right to be heard,[76] but we doubt this provision excludes the obligation of the Commission to hear from other parties whose rights and interests might be affected by its decision.[77] As such, in our view superannuation funds would have a right to be heard at both stages of the process.

Transparency

67. Another feature of the Commission's work is its transparency, meaning that it operates in public as much as possible. The FWC is required by law to act in a way which is "open and transparent".[78] As part of that obligation, if (as usually occurs) the Commission holds hearings, it must, subject to limited exceptions similar to those applied by courts, hold them in public.[79] The

[73] *Plaintiff M61/2010E v Commonwealth* (2010) 243 CLR 319 [75].
[74] Ss 156C(1), 156L(1).
[75] Ss 156D; 156R(1).
[76] Section 156G(2).
[77] Particularly as s 156G(3)(a) specifically contemplates other persons, not mentioned in s 156G(2), making submissions.
[78] Section 577(c).
[79] Section 593(2).

written material (including applications, submissions and evidence) provided to the Commission is also generally available to the public, unless confidentiality requires otherwise,[80] although the protection for secrets is weakened in relation to superannuation reviews, as follows:

(a) if a fund's application to join the List or Scheme contains confidential information, the application cannot be fully suppressed; instead, summaries of the information sufficient to allow a reasonable understanding of its substance must be produced by the FWC;[81] and

(b) all submissions are published, whether or not they contain confidential information.[82]

68. All Commission decisions are published, including the List and Schedule.[83] The Commission generally gives written reasons for all major decisions it makes. The reasons are required to be "easy to understand"[84] and are always published.[85]

Basis for decision-making

69. The Commission is required to make its decisions according to law. Historically, the statute did not prescribe a particular test for determining which funds should be named in awards. The question was left to the Commission's discretion. However, its discretion was not unconstrained. The Commission is required to act rationally, meaning that it was required to make decisions reasonably according to the merits of the proposal placed before it.[86] It was also required to promote the express and implied objects of the legislation; and the legislation, after amendments in 1993 at least, explicitly contained an object of promoting the "welfare of the people of Australia" including by "protecting wages and conditions of employment through awards".[87]

70. As set out in the history section above, it is clear that from the mid-1980s onwards, the Commission did seek to arbitrate default fund selection on the merits and with a view to the long-term welfare and best interests of employees.

71. The 2012 amendments have now given the Commission specific direction on how to nominate funds in an award. In particular, the "best interests" test has been enshrined in law as *the* test to be applied when determining, first, which superannuation products will be placed on the List and the Schedule, second, which products (drawn from the List) will be named in an award.

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[80] Section 594.
[81] Section 156C(6); 156N(5).
[82] Ss 156D(3), 156G(4), 156R(3), 156T(3).
[83] Section 156B(1), 156L(1)(a)
[84] Section 601(3).
[85] Section 601(4).
[86] See now s 578(b).
[87] *Industrial Relations Act 1998* (Cth) s 3(b)(i), effective from 30 March 1994.

Assessment of FWC's suitability

72. Having set out some of the institutional features of the Commission, we now turn to consider whether or not the FWC is an appropriate body to nominate default superannuation funds. In doing so, we focus on the role of the FWC as provided for under the 2012 amendments. In this section we will use the same assessment criteria as the PC proposed, and will respond to some of the PC's criticisms of the Commission.

Member benefits

73. This criterion asks whether the system benefits members by maximising their long-term net returns (adjusted for risk) and meeting their other needs. As set out above, the PC's concern with the current system was that a small proportion of employees had been directed into poorly performing funds, allegedly because (1) the Commission preferred "standing and history" to arbitrating funds on "merit"; and (2) unions and employer bodies had a conflict of interest in promoting industry funds.

74. We make three observations about the PC's criticism. First, we do not consider the PC to be correct with respect to the first criticism, as a matter of history. As set out in our historical analysis above, funds were originally named in awards either because the industrial parties agreed they should be named or else, where there was disagreement, the Commission arbitrated the competing positions on the merits. In arbitrating, the Commission of course had regard to the history of fund coverage in the sector in question, but we think that was a relevant consideration for the Commission, and we have seen no evidence that the Commission gave that history any undue weight in its deliberations. Similarly, when arbitrating the Commission was, by law, required to hear from (and generally, to hear only from) the parties with "standing" to appear before it, but we do not see anything inappropriate in that position, given that the employer bodies and particularly the unions with standing could be trusted to place before the Commission only the most meritorious funds for consideration. Indeed, we think that the fact that the vast majority of funds named in awards have proven to be good funds proves that the system generally worked. While it appears that a few poor performing funds have crept into the system, we are not aware of all the circumstances in which that occurred, and we do not think that these outlying cases can fairly be used to criticise the system (as it stood until the 2012 amendments) as a whole.

75. Secondly, in relation to the alleged "conflict of interest", the PC produces no evidence to show that unions (or employer bodies, for that matter) were corrupted away from their core mission of advancing members' interests by the lure of fees or some other collateral benefit. A serious allegation like that needs to be supported by serious proof.

76. A range of institutional features ensures that unions act in the interests of their members. These include the fact that union officials are elected, so that officials who are disloyal to the interests of members risk losing their (generally paid) positions. Further, union officials have statutory duties to act in good faith, to act with care and diligence, and not to misuse their position to advantage themselves or disadvantage others;[88] the Registered Organisations Commissioner, amongst others, may enforce these statutory duties,[89] and is well-resourced to do so.

77. Third, the PC's criticism is misdirected, in that it is historical. The real question is whether the current system, as it exists in light of the 2012 amendments, promotes member benefit. We think that it clearly does, or at least will, once it is allowed to function as intended. In particular, the PC's historical concerns about merit and about potential conflicts have been specifically addressed: the FWC is now explicitly required to make decisions in the "best interests" of members, and it is not limited to acting on the motion of the industrial parties.[90]

Competition

78. This criterion asks whether the system encourages competition, including so as to drive down fees. The PC's assessment was that the current system rates poorly because it: (1) denies standing for superannuation funds; and (2) does not select funds based on merit.

79. We make similar responses as we did for "member benefits". First, the PC's criticism is historical and therefore misplaced. The current system does *not* deny standing to superannuation funds, and *does* select funds according to merit. Accordingly, the PC is criticising a straw man.

80. Second, even the historical assessment is incorrect and unfair. On the question of merit-based selection, as we have already set out, the Commission either approved funds nominated by the industrial parties (in which case the unions, at least, were choosing on the basis of merit) or arbitrated competing proposals on the basis of merit. On the question of standing, superannuation funds have had standing (at least in the 4-yearly award review process) since 2010.

Integrity

81. This criterion relevantly asks whether there is integrity in the process of selecting funds. Here, the PC made similar criticisms to those outlined immediately above: (1) that the FWC was not "interested" in choosing the best performing funds; and (2) the industrial parties are conflicted.

82. We have dealt with these criticisms above and do not repeat what we have said previously.

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[88] *Fair Work (Registered Organisations) Act 2009* (Cth) ss 285-7.
[89] Ibid s 310(1)(a).
[90] See paragraph 44(d) above.

Stability

83. This criterion looks to whether the selection process promotes stability across the system. While the PC rated the current system highly overall, it alleged that the FWC propped up poorly performing funds because there was no "active" process for delisting poor performers.

84. Our response is that the criticism is incorrect or at least unfair. There indeed currently exists, under the 2012 amendments, a process for removing poorly performing funds: it is the 4-yearly review of default superannuation clauses.[91] If the PC's point is that this process is not "active" because an Expert Panel cannot presently be convened, that is true, but we think the criticism is unfair, given that it is the federal government which is to responsible for that state of affairs, and not the Commission.

Costs

85. This criterion considers whether the process minimises system-wide costs. Here, the PC acknowledged that existing costs are reasonably modest, noting that one expense was the cost of parties participating in the FWC process.

86. We concur with the PC's assessment that costs are modest. In relation to the costs of participating in the Commission we would also note that these costs are low by design, and have been modest by experience.

87. In terms of design, we note that the Commission is required to act in a way which is "quick, informal and avoids unnecessary technicalities".[92] In line with that obligation, as part of the 2013 and 2014 Super Reviews, it produced user-friendly forms; placed all relevant material (such as copies of submissions, transcripts of hearings and decisions) on its website; used video-link during hearings so as to relieve the need to travel interstate for hearings; and issued "Statements" to give parties guidance on matters to address in submissions.

88. Further, parties are generally not permitted to appear via lawyers, thereby keeping costs down.[93]

Overall assessment and conclusion

89. Based on the PC's own criteria, we would rate the current system, post the 2012 amendments, relatively highly. In particular, we think that the idea of having regular reviews of default funds, conducted by an Expert Panel (and thereby getting the benefits of combining the Commissioners'

[91] Section 156A.
[92] Section 577(b).
[93] Section 596.

industrial expertise with the financial expertise of outside members), with decisions made in the "best interests" of members, is an appropriate mechanism for selecting the best default funds.

90. Of course, that system, as designed, has not yet been given the chance to operate to its full potential. Accordingly, we are making assessments based on design features, understood in the light of past history and practice. However, there is no substitute for actual experience. It may therefore be wisest to wait until the system is operating as intended before any final assessments are made, whether by the PC or anybody else.

91. Finally, we have not been asked to comment on the model which the PC favours. That model encourages employees to select the default fund from a list of pre-qualified funds, where the list is drawn up by independent experts. We simply note that the proposal seems to replicate some of the key features of the current system (after the 2012 amendments) without the institutional advantages which are brought by the Fair Work Commission.

Date: 14 November 2018

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