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Submission DR79 - ACCI - Alternative Default Fund Models - Public inquiry

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Australian
Chamber of Commerce
and Industry

**WORKING FOR BUSINESS.
WORKING FOR AUSTRALIA**
Telephone 02 6270 8000
Email info@acci.asn.au
Website www.acci.asn.au

CANBERRA OFFICE
Commerce House
Level 3, 24 Brisbane Avenue
Barton ACT 2600 PO BOX 6005
Kingston ACT 2604

MELBOURNE OFFICE
Level 2, 150 Collins Street
Melbourne VIC 3000
PO BOX 18008
Collins Street East
Melbourne VIC 8003

SYDNEY OFFICE
Level 15, 140 Arthur Street
North Sydney NSW 2060
Locked Bag 938
North Sydney NSW 2059

ABN 85 008 391 795
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Summary of recommendations

The Australian Chamber of Commerce and Industry (Chamber) thanks the Productivity Commission for the opportunity to comment on its draft report, *Superannuation: Alternative Default Models – Draft Report*.

The submissions do not deal in detail with draft findings 5.1, 6.1, 7.1 or 8.1. With modifications in the case of draft finding 3.4 and draft recommendation 3.2 the Chamber supports the Report's proposed draft findings and recommendations being made.

The Chamber does not any specific recommendations, but the Chamber does not support persevering with the assisted employer choice model or a variant of it.

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1 Submission

Introduction

- 1.1. As part of its inquiry into the efficiency and competitiveness of the superannuation system the Productivity Commission (Commission) released a draft report, “*Superannuation: Alternative Default Models – Draft Report*”, (Report) and invited comment. The Report advises how the Commission went about the task of identifying potential methods of default allocation and proposes four archetypes for consideration. The Commission has also identified a number of draft findings and potential recommendations.
- 1.2. The Australian Chamber of Commerce and Industry (Chamber) thanks the Commission for the opportunity to comment.
- 1.3. As previously advised to the Commission, the Chamber’s interest in the superannuation system is to improve the employer interface with the system and to ensure that it is functioning appropriately to deliver retirement incomes efficiently. The Chamber’s engagement with the superannuation system arises from this advocacy role.
- 1.4. The Chamber’s interest in the superannuation system means that it seeks to promote system efficiency. Improving system efficiency is an interest which employers share with their employees (members) on behalf of whom they make contributions. The Chamber agrees with the Commission about the importance of competition, or the credible threat of competition, in driving superannuation system efficiency gains.
- 1.5. Apart from its role as a contributing employer the Chamber has no material interest in the superannuation system. The Chamber does not nominate to any RSE trustee, nor have any interest in a system service provider.
- 1.6. Some of the Chamber’s members do engage with the superannuation system in different ways, such as nominating to RSE trustee boards. They may wish to respond to the Commission about matters canvassed in the Report.
- 1.7. The Chamber also agrees that the superannuation system has features which mean that there is an important role for government intervention; and in respect of competition, the way that it is channelled. In the context of the superannuation system competition is something of a blunt weapon. For example, the introduction of choice introduced competition but it did not generate improved products and efficiencies leading to bigger asset bases for members’ retirement. The introduction of choice tended to promote increased product differentiation and the growth of product ranges offered by funds. As it was introduced, choice did not simplify member engagement.
- 1.8. Superannuation is distinctive in a number of ways. It has a mandated income stream imposed on third parties (employers) rather than the direct beneficiaries (members). Indeed the Australian superannuation system is distinctive amongst private pension systems which are linked to individuals’ labour market earnings in not requiring worker co-payments. These features all lessen market signals thereby reducing member driven

competition and permitting continuing non-engagement. Non-engagement is compounded by the complexity of retirement saving and expenditure decisions and by psychological biases against consumption deferral and long term decision making. As the Report points out, most pension schemes which are not publicly funded like the Australian age pension have some form of default arrangement.

- 1.9. For this reason, and also because the Commission is reviewing a developed operating system which is large and has its own head of steam, the Chamber agrees that default products (third party selection of investment products for non-choosing employees' contributions to be allocation into) has a continuing role in the superannuation system.
- 1.10. However, default systems also support non-engagement, and the current Australian default system also produces account proliferation because most people have multiple jobs with different employers during their working life. Multiple accounts are a source of system inefficiency and holding them reduces the member's overall superannuation assets. Non-engaged default fund members, the subject of the Commission's inquiry, are the most likely to hold multiple neglected accounts.

Default members

- 1.11. Currently employers select their employees' default fund and the fund's trustee selects their members' default investment product (MySuper). For most default members both "default" selections are made, for some only one. As noted in the Report, apparent non-engagement is really a consequence of the fact that the member is satisfied about where his or her contributions are going (and so they do not return the choice form), but in the majority of cases passivity reflects a lack of engagement. The Chamber agrees that it is appropriate to design a default selection process on the basis of member non-engagement.
- 1.12. Turning to employers:
 - 1.12.1. Some employers regard their default superannuation as one of the reasons that their employees want to be there and are very active in determining the most appropriate superannuation for their default fund. For large employers this is most clearly seen where there is a corporate fund, but might also show up where the employer organises better insurance, reduced administration fees and the like. In smaller employers this might show up as periodical reviews of default funds.
 - 1.12.2. Conversely, many, if not most, employers feel inadequate to select the best default for their employees, don't have the time or capacity to do so or are influenced by non-relevant criteria. It is not a job which they want, nor one they are equipped for.
- 1.13. There is no systemic reason why employers should choose their employee's default fund. Employer selection applies because early superannuation entitlements, including the

identity of the fund or funds contributions were to be made into, were often determined by industrial outcomes (agreements or arbitrations). The introduction of statutory choice formalised the notion, and role, of default funds. One of the historical benefits for employers was that enrolling employees into one or few defaults (depending on award coverage) meant that employers did not have to deal with many funds. Minimising the number of contribution destinations produced significant administrative savings for employers because different funds imposed a diverse range data, contributions and transactional requirements and had different follow up processes. Multiple funds meant that contribution time was very time consuming and often gave rise to key person dependence. It also supported the growth of a significant clearing house industry.

- 1.14. SuperStream requires standard data and standard form electronic transactions and allows simultaneous contributions to multiple funds. The introduction of Superstream and for small employers, the Small Business Superannuation Clearing House, have significantly reduced the costs of contributing to more than one fund.
- 1.15. SuperStream and its continuing development is one of the reasons why the Chamber supports extending choice to all employees (Recommendation 12 of the Financial System Inquiry – Final Report and the *Superannuation Legislation Amendment (Choice of Fund) Bill 2016*). SuperStream is one of the reasons that Recommendation 10 of the Financial System Inquiry – Final Report (to introduce a formal competitive process to allocate new default fund members to MySuper products) is feasible.
- 1.16. As noted in paragraph 1.1 above, in its Report the Commission identified four different models for evaluation. These models were linked to the type of decision maker and ranged along a spectrum of light to heavy filtering:
 - 1.16.1. Assisted employee choice
 - 1.16.2. Assisted employer choice
 - 1.16.3. Multi criteria tender
 - 1.16.4. Fee-based auction
- 1.17. These models were all developed to meet the same member and product market,
 - 1.17.1. (members) those in or entering the labour market who do not currently have any fund membership and are not doing something about that (new default members)
 - 1.17.2. (products) the default superannuation product in the accumulation phase only and absent insurance;

but the models differ with respect to the type of selection mechanism and the decision-making process giving rise to selection. The models deliver differently with respect to the framework of member benefits, competition, integrity, stability and system costs.

- 1.18. The Commission has also left open the question of derivative or hybrid models. Final recommendations may not look like current potential ones or may be modifications of them.

Structuring competition to drive efficiency

- 1.19. In Chapter 1 of the Report the Commission identified three draft findings: the first is that

Complementary policy action (including to extend genuine member choice to all employees) will be needed to deliver the full potential of member driven competition under the alternative models developed in this Inquiry and also under current default arrangements.
- 1.20. The Chamber supports the making of this finding and the Commission's reasoning.
- 1.21. Depriving employees eligible for employer superannuation contributions of statutory choice of fund, although not usually depriving them of product choice, supports and encourages employee disengagement.
- 1.22. Under the current default system agreement coverage is the systemically most significant source of statutory exclusion from choice for the more than 80% of employees who work in the private sector. Exclusion from choice of fund because of agreement coverage not only reduces the pool of employees under a model of once-only default allocation to new entrants, it also distorts competition for the market and inter-fund competition because employment under agreements is not evenly distributed across industries. Competition requires the credible threat of choice.
- 1.23. The Report's second draft finding is that

Where there is third-party involvement in the selection of a default product, there needs to be effective regulation or arrangements in place to ensure these third parties act in the best interests of members.
- 1.24. The Chamber supports the making of this draft finding. The Chamber also observes that this finding tells against the retention of employer default fund selection.
- 1.25. As the Report notes, unlike trustees, employers are not obliged to act in members' best interests and nor could they be where employer selection as it developed was constrained or determined by award prescription. Section 32ZA of the *Superannuation Guarantee (Administration) Act 1992* introduced with the choice of fund amendments explicitly excludes employers from liability for the consequences of default fund selection. Section 32ZA of the SG(A) Act is a necessary statutory safeguard for the current default allocation process to operate because employers generally do not have the skills or understanding required to meet a statutory members' best interests obligation and few are licensed to give financial advice. Their selection range remains constrained by awards.
- 1.26. The Commission's third draft finding is that

For the purposes of this Inquiry, a formal competitive process for allocating default members constitutes any new alternative process that permits open participation (contestability), encourages rivalry between funds (competition) to the benefit of members, and involves products being selected for members based on merit.
- 1.27. The Chamber supports the Commission making this finding.

- 1.28. Inter-fund competition must be supported by requirements for and drivers of member benefit and materially disinterested selection and these constraints need to be carefully thought through. In a formal competitive process of allocation inter-fund competition of itself is insufficient to raise system efficiency and produce the member benefits which are that policy's objective. Statutory words are not enough – it is too easy to set rules which allow or support the material interests of system actors.
- 1.29. This can be clearly seen in the current process of allocating (and retaining) funds offering MySuper into awards and the consequences of this process on competition which promotes system efficiency. Nor is Division 4A of Part 2-3 of the *Fair Work Act 2009*, “4 yearly review of default fund terms in modern awards”, well suited to improving on this outcome.
- 1.30. Putting aside the difficulties of constituting an expert panel which is both expert and materially disinterested, the Division 4A expert panel which undertakes the FW Act's two stage process of developing the default superannuation list and allocating funds with listed products into particular awards comprises 3 part-time external experts and four ordinary (in the sense of non-expert) FWC members. The default superannuation list must only comprise MySuper products.¹ The expert panel must be satisfied that a product's inclusion in the default superannuation list is in the best interests of default fund employees to whom modern awards apply or a section of them.²
- 1.31. The second stage process proceeds on the basis of the submissions of employers and/or employees covered by, or organisations representing those covered by, the particular award. The submissions are essentially requesting the inclusion of one or more funds with listed MySuper products in the award. Section 156G(2) of the FW Act requires the FWC to ensure that these employee, union or employer interests have a reasonable opportunity to make submissions. The expert panel must be satisfied that the fund's inclusion on the basis of its MySuper product is in the best interests of employees to whom the award applies.³
- 1.32. It is difficult to see that contributions stability would not be a significant factor in shaping the outcome of each 4 yearly review particularly under the current statutory triggers for employers' choice obligations.

Allocation once

- 1.33. In Chapter 3 the Commission proposes to find that current default allocation arrangements whereby each new employer assigns a non-choosing new employee to a default applying

¹ The MySuper products are assessed against specified “first stage criteria” (s 156F FW Act) including the appropriateness of the insurance offering of the product. Whether or not appropriate this would seem to favour the inclusion of non-public offer MySuper products over those offered on a public offer basis.

² That is, excluding employees who are covered by an award but to whom an enterprise agreement applies (s 156E(2) FW Act).

³

in its workplace increases account proliferation which increases costs to members and reduces member balances at retirement. Its draft reads

The current arrangements where members can be defaulted to a new account on every change of job increases the proliferation of accounts. This materially adds to costs for members and reduces member balances at retirement.

- 1.34. The Chamber supports this finding being made.
- 1.35. This finding gives rise to draft recommendation 3.1 which is that employees should be allocated to a default product only once. The Commission is considering recommending the following

To avoid perpetuating the legacy problems of the current system, any future alternative system for allocating members to default products should be premised on employees being assigned a default product only once, when they join the workforce.

- 1.36. The Chamber supports the Commission making this recommendation. As submitted above, the development of SuperStream and current developments in electronic transactions and pre-populating allow a system whereby new employees bring their fund with them administratively feasible for employers. The key for employers is that they know where to make contributions on behalf of their employees.
- 1.37. It might be noted that although under the assisted employer choice model funds rather than products would be allocated, in practice most members so allocated would be unlikely to choose an investment product in the fund at or near the time it was allocated to him or her, and the trustee would therefore allocate into the fund's MySuper product. It could be that under the employee assisted model employees may have a slightly greater propensity to consider products. Under the formal competitive process models funds would be competing directly on the basis of their default product and it would seem relatively unlikely that new members would seek to alter their investment product early in their selected membership.
- 1.38. Apart from assisting system stability and removing the most powerful motor for account proliferation from the system the policy of allocating a default only once seems more likely to support improved member engagement than do the current default allocation arrangements. Funds would have a greater reason to establish a working contact with members whereas the current default allocation arrangements require and encourage funds to engage with employers for members.
- 1.39. Draft recommendation 3.2 is in the following terms

The Australian Government should establish a centralised online service for members, employers and the Government that builds on existing functionality of myGov and Single Touch Payroll. The service should:

- allow members to register online their choice to open, close or consolidate accounts when they are submitting their Tax File Number on starting a new job
- facilitate the carryover of existing member accounts when members change jobs

- collect information about member choices (including on whether they are electing to open a default account) for their employer and the Government.

There should be universal participation in this process by employees and employers.

- 1.40. The Chamber broadly supports a recommendation of this kind in the sense that it supports a recommendation with the effect that the Australian Government should establish and develop establish a centralised on-line system which would allow members and their employers to engage with the superannuation system and addresses the identified capacities, but the Chamber is less convinced about all of the detail in the present draft. For example, MyGov requires the individual to have the confidence to use a government provided repository for identity related information. It seems likely that there will be a growth in usage of single location on-line identity information to underpin electronic transactions, but it is less clear that MyGov would be the solution, or the only solution, that individuals will have available or choose.
- 1.41. As a second example, it is not clear that a new or expanded clearing house is required to direct the flow of funds to funds. Under SuperStream transaction data travels separately from the actual transfer of contributions.⁴ Contributions money transfer is currently effected by the ordinary bank clearing processes and this seems likely to continue. System clearing times seem likely to improve. Developments such as increasing pre-population capacities supported by better real time, or near real time information, may reduce the need for data clearing houses.⁵

Becoming an identified default

- 1.42. The Commission's next proposes to find that

There are strong grounds for requiring a fund that wins default status for contributions of new default members to extend the same fees and service terms to all its existing members of the default product.

- 1.43. The Chamber supports the Commission making this finding for the reasons the Commission identifies. It is true that the current MySuper system contemplates funds offering more than one MySuper product (large employer or material goodwill products), and the current Division 4A of the FW Act recognises large employer MySuper products, but MySuper is really based on the idea that a fund provides the one standard product to all its members. The expert panel's default superannuation list comprises standard (generic) MySuper products.

⁴ New employee (member) registration does not involve a linked money transfer and it transfers only within the SuperStream data network. However new employee registration is required only for default fund employees who do not advise the employer of their destination (chosen) fund. It may be that, except for the assisted employer choice model, employer enrolment would not be necessary, and therefore non-linked transactions might disappear.

⁵ For example, the introduction of the transfer balance cap for retirees' income asset bases raises the possibility that funds will provide the ATO with increasingly contemporary information about member accounts and transactions.

- 1.44. The Chamber also agrees with the Commission that other default products should not be required to match the identified terms of a selected default. In addition to the Commission's stated reasons for this conclusion it seems likely that imposing a winning default's characteristics on other funds' default products could suppress innovation.
- 1.45. The Report also discusses the services which should be included in the contestable default products. The Commission notes that the Government is proposing a statutory objective for the superannuation system – providing income in retirement to substitute or supplement the age pension – and the Chamber agrees this is a relevant consideration in assessing what default products should be assessed on.
- 1.46. The MySuper rules require that all members holding the product have the same benefits, excepting insurance (s 29TC *Superannuation (Industry) Supervision Act 1993*) and insurance is one of the areas where employers seeking to provide something more negotiate with funds. This fact supports the view that insurance should be separately considered from default products themselves.
- 1.47. The Commission is considering the following finding
- The default product in all models will focus on the accumulation stage and include investment, administration of member accounts and intrafund advice. It will be a simple and low-cost (but not conservative) product aimed at the needs of those who are disengaged from the system.
- A bundled insurance product will not be a factor in the selection of products and is best addressed through regulation and regulator oversight.
- Funds will primarily compete on long-term net investment returns and costs, subject to meeting a threshold quality of service, not on the quality or range of ancillary services per se.
- 1.48. The Chamber agrees that the Commission should make this finding. One of the implications of the proposed statutory objective for the superannuation system is that the favourable taxation treatment of superannuation is confined to what is required to meet the system's statutory objective. Insurance premium is deducted from contributions and is in this sense a tax advantaged contribution but deducted premium is contribution which does not contribute to retirement income, nor the activities which support the generation of retirement income assets.
- 1.49. As the Report notes the role of insurance in the superannuation system is not easily determined. There has been some expansion of the types of insurance products associated with superannuation products, including default products, which further complicates this question. It is not clear that MySuper products should differentiate on the nature of their insurance products. This seems particularly true where forms such as salary continuance insurance, as opposed to, say, contributions continuance, which might be more relevant are linked to a MySuper product.
- 1.50. The adoption of a default allocation model based on a single allocation event and universal ongoing member access to choice of fund means that new employees “bring their fund with them” to their next employer (or choose away from it at that time). This structure

implies that contestable defaults (except perhaps under an assisted employee choice model) would need to be public offer. This also has implications for statutory insurance.

1.51. The Commission is also considering finding

The desirable frequency for the selection process is between four and eight years, with the greater frequency best used in the early period.

1.52. The Chamber has no developed view about the frequency of selection. The nature of the selection process may be relevant. The Chamber recognises that there will be system learning which favours more frequent selection initially, or a capacity to select one or more additional funds during the tenure period and also that there is a need to pay regard to system stability.

1.53. The Commission is also considering finding that

The selection of eligible default products should be administered by a government body, and be subject to strong governance rules. The decision-making body must:

- have a strong focus on fund member interests
- have sufficient expertise to evaluate products
- be independent and free of real or perceived conflicts of interest
- have processes that are transparent and afford procedural fairness

be accountable for its decisions.

1.54. The Chamber supports this finding being made.

1.55. Some responses to the Commission's issues paper, *Superannuation: Alternative Default Models – Productivity Commission issues paper*, drew attention to the untested mechanism for selecting default products and prescribing funds with relevant default products in modern awards under the FW Act as meeting the need for an objective and transparently disinterested process. As earlier submitted the FW Act requires that the expert panel's decisions in both phases are subject to its satisfaction that the product, or fund inclusion, is in relevant default fund employees' (members) best interests.

1.56. The Chamber does not support the assisted employer choice model, and the FW Act mechanism, or at least its second phase, is not relevant to the other models. Moving away from employer default selection not only addresses a significant principal-agency conflict currently in the system, it significantly reduces the capacity for bundled non-superannuation benefits or inducements.

1.57. As already submitted the Chamber doubts whether the expert panel under Division 4A, Part 2-3 of the the FW Act is appropriately constituted to have sufficient expertise to evaluate products or to have adequate independence.

1.58. Finally, in Chapter 3 the Commission also advises that it is considering finding that

The Australian Government should introduce a formal framework that specifies the process and obligations of trustees when making or considering merger proposals. As part of the framework,

trustees would be required to disclose all merger attempts involving their fund, as well as the reasons for any decisions.

- 1.59. The Chamber supports this finding being made. A number of obstacles lie in the path of to achieving the systemic benefits (economies of scale and greater efficiency in growing asset bases for income streams) of fewer funds competing with better, more appropriate products. The way that trustee boards, particularly those constituted with equal representation, consider merger proposals is significant among them. Many potential mergers involve different industries or new classes of employee from those already in the target fund. This fact alone significantly complicates for trustee boards the task of determining how members' best interests should be assessed or advanced into the future and the appropriate industry representation to so do.

2. Conclusions

- 2.1. The Report proceeds on the basis of assessing proposed models against the baseline of no defaults. As the Report makes clear the Commission is not contemplating recommending its assessment baseline and as the Chamber submitted to the issues paper, the baseline does not address a fundamental concern for employers – where does the employer contribute if the employee does not provide (what is currently) a chosen fund. The Chamber agrees that a system which is reliant on the employee to select and advise the destination fund for the employer to contribute into provides a moral hazard.
- 2.2. Developments in information capability mean that as long as there is some way of making a first selection (by choice or allocation) linking an employee with a fund, there is not any longer a systemic reliance on the employee to actually tell the employer where contributions should go. Employers can be informed from sources other than the incoming employee.
- 2.3. The draft assisted employer choice model is proposed on the basis that there is scope for an employer which can negotiate an advantageous arrangement for its employees to access a longer list of potential defaults – potential negotiation partners – than employers who are not or who do not feel able to distinguish default products sufficiently well. This seems a questionable benefit when the employer is only allocating for new labour market entrants, not all incoming employees, although there may be a few sectors where a reasonable proportion of incoming new employees are labour market new entrants and there is a reasonable likelihood that these new entrants also have some duration in the industry, but this will be rare. Most new entrants will have the fund associated with their first job where they were eligible for guarantee contributions. For most new employees moving into the fund with which their new employer has negotiated will be an act of choice.
- 2.4. The Chamber does not support the assisted employer choice model nor some variant which required the employer to select an incoming employee's first fund. The Chamber agrees with the Commission's observations

Ultimately, it is implausible to impose an obligation on employers to act in their employees best interests, not least because the best interests of employees are likely to vary (sometimes significantly) across the workplace, and employers cannot know what they are (especially given they are typically not superannuation experts). Rather, the most effective way of ensuring employers' actions are consistent with the best interests of employees is to place obligations on superannuation fund trustees (that is, to ensure inducements are not offered in the first place). Providers should be prevented from offering employers inducements (including preferable deals on non-superannuation products) to choose their products as defaults, and regulators should actively enforce this. The Commission considers the existing provisions in the SIS Act, and their enforcement, would require strengthening if the model presented in this chapter were to be adopted.⁶

⁶ P 198, *Superannuation: Alternative Default Models – draft report*, Productivity Commission, February 2017

- 2.5. No-one has suggested that employers should determine an employee's investment product. This is, and is recognised to be, the role of a trustee in the event that the member does not determine that for him or herself. There are two reasons for this. Where the member is engaged there is no systemic need for the employer to make such a choice, nor to know about it, this is the member's business. Second, no-one seriously suggests that employers as a class have the capacity to make these sorts of decisions for their employees, they do not have the expertise.
- 2.6. This leads the Chamber to prefer either the multi-criteria or fee-based auction models, but it would not dismiss the assisted employee choice model, if it were found to be workable. The two key issues would seem to be
- 2.6.1. who should make the decision about which funds' products should be on the nudge list?
 - 2.6.2. how can a first allocation be ensured?
- 2.7. Of all the models assisted employee choice is most likely to promote member engagement.

3 About the Australian Chamber

The Australian Chamber of Commerce and Industry is the largest and most representative business advocacy network in Australia. We speak on behalf of Australian business at home and abroad.

Our membership comprises all state and territory chambers of commerce and dozens of national industry associations. Individual businesses are also able to be members of our Business Leaders Council.

We represent more than 300,000 businesses of all sizes, across all industries and all parts of the country, employing over 4 million Australian workers.

The Australian Chamber strives to make Australia the best place in the world to do business – so that Australians have the jobs, living standards and opportunities to which they aspire.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

Australian Chamber Members

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