

THE PRODUCTIVITY COMMISSION INQUIRY INTO SUPERANNUATION: ALTERNATIVE DEFAULT MODELS SEPTEMBER 2016

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Introduction

Standard ACTU introduction words from the last couple of submissions.

Structure and Principles of the Superannuation System

The ACTU has enunciated its view in several recent Inquiries as to the structure and principles of the superannuation system in Australia. The ACTU believes it is entitled to put forward this view given the pivotal role which has been afforded to the Union movement since the mid-1980's to essentially be the guardians of a universal system of superannuation – one which has been eminently successful in building adequacy for Australian workers in a uniform, high performing manner; a system which has greatly assisted Australia through the Global Financial crisis and has built a strong and vibrant investment framework, particularly in areas like infrastructure. Further this has all been achieved in an environment effectively untarnished by scandal and in a manner which has high levels of confidence and support by the Australian population.

The ACTU's view of the structure and principles of the superannuation system is best set out in our submission to the Treasury Inquiry into the Objective of Superannuation. In that Inquiry we reinforced the point that the ultimate aim of the system is to deliver the highest level of accumulated benefit to retiring Australian workers as was possible.

Our Objective for Superannuation was the following:-

“Superannuation, together with the Aged Pension, should provide for an Australian worker to maintain his or her standard of living when he or she retires from the paid workforce or reaches the national retirement age”

The ACTU went on to define the following as essential features which are needed to facilitate this Objective:-

1. Adequate funding of the superannuation system as part of the worker's remuneration during their time in the paid workforce or equivalent service in the unpaid workforce.
2. The designation of appropriate funds into which occupational superannuation should be paid and from which retirement income is to be drawn, subject to those funds meeting appropriate standards in their governance, efficiency and performance.
3. Encouragement of a reasonable level of voluntary contributions to support the primary objective.
4. Fair and progressive tax treatment.
5. Interaction with the Aged Pension system to form a complementary approach to meeting the primary objective.
6. Investment of funds on a long term risk ad-adjusted basis in which the dual objectives of investing in the members' best interests and investing in the national interest are able to be addressed in as complementary a manner as is possible.

The point the ACTU seeks to make from this is that the issue of “appropriate funds” is one of a number of factors which determines the essential structure and principle of our superannuation system. Fund alone, is not a be all or end all of what makes our system robust or optimal – it is simply one of a number of features. Further the ACTU believes that the issue of Fund has only a minimal impact on the other essential features – by and large these are not features of the market but are, by definition, features of public Policy to which other factors, like the appropriate fund respond.

This is not to say that the issue of appropriate fund is not an important part of the superannuation system. Indeed, the ACTU believes it is an essential feature of delivering an optimal system and our submissions to the Productivity Commission Review so far have highlighted that there are essentially different types of scheme structure in operation and that the most effective of those structures has clearly and demonstrably been the all profits to members or industry fund model.

The ACTU clearly believes that this Review is a danger to this situation. The ACTU’s concern is not that we will end with a system which changes existing structural features of the superannuation system (if it were the case that there was reliable evidence that such a change was beneficial to workers, the ACTU would support such a change) but that we will, in the name of a competition and efficiency, end with a system which produces inferior outcomes for Australian workers than the current system does.

The ACTU believes this is the direction this Review is headed in. The ACTU would summarise the Review as one which is trying to build in a wide range of structural optionality believing this adds varying levels of efficiency. The ACTU further believes this is being done in a theoretically modelled approach and in doing so is ignoring both the evidence and the structure of systems which are currently delivering significant outcomes in a real and practical sense.

The ACTU reiterates its view that we should only move away from such a model when there is a strong evidence-based case for doing so. This is why we have criticised the view of the Commission in not establishing a base model (which essentially would replicate the model which broadly has operated during most of the past 30 years) and then applying qualitative and quantitative tests to see whether alternative models would improve outcomes for fund members/workers.

The ACTU will continue to publically advocate to defend a highly successful and beneficial system.

Superannuation as an Industrial Issue

An issue which concerns the ACTU is that one aim of the Review appears to be to attempt to define default superannuation fund in a manner other than in connection with an industrial or employment setting.

The ACTU believes that in both a practical and a legal sense, this approach is not a valid one.

In a practical sense, superannuation is an employment related matter. Superannuation contributions arise because of a worker’s employment. Contributions are made by a worker’s employer – they start when a worker commences his or her employment, they end when employment ceases. It is often argued that the basis for our superannuation system is that contributions are a foregone wage payment. Superannuation law essentially says that the benefit arising from contributions or insurance is achieved upon cessation of employment (or in transition to retirement). It would be a practical nonsense to say all these aspects of superannuation

are employment related but that the issue of default fund was determined on some unrelated basis.

In a legal sense, this matter has been decided by the High Court as to the issue of superannuation itself and the particular matter of the choice of fund being industrial matters. In the *Manufacturing Grocers Case* (160CLR341)(1) the High Court determined superannuation, including the issue of a claim for a particular fund, to be an industrial matter. In that case, the High Court observed that:

“What is important for the purposes of this case is that claims made are, as we have said, no more than demands for the payment during the currency of an award or employer contributions to superannuation schemes which will take an approved form. It is because the claims are in this limited form that is, in our view, impossible to sustain the argument that they are not made with respect to industrial matters, whatever may have been the position had the claims been in a more elaborate form.

It may be observed generally that superannuation benefits are commonly regarded as being an aspect of the terms and conditions of employment ... As a matter of common understanding, entitlement to participate in a superannuation scheme and the means by which that scheme is to be funded are matters which pertain to the relations between employers and employees and fall within pars. (b), (c) and (h) of the definition of industrial matters in s.4 of the Act.”

Hence the High Court recognised that a claim for superannuation to be paid to a particular fund was an industrial matter and one which could be legitimately determined as a matter for inclusion in an Award. In the ACTU's view, it does not matter that claims for quantum of superannuation are no longer part of the manner in which claims are made; what remains a principle is that the claim by a Union for workers to have their superannuation contributions paid into appropriate (default) funds is still an issue which is in connection with employment and the general principle of matters relating to employment being able to be regulated as industrial matters still applies.

It is against this framework that the Productivity Commission must focus this Inquiry.

Notwithstanding there being a desire to develop a system for reviewing the default fund selection process, the system must be framed within an industrial context – a context in which Awards or Agreements are the means of determining or prescribing the default fund, through an appropriate selection process. The role of the policy setters is thence to determine various aspects of the selection process for default funds. Default fund selection will ultimately occur on an individual Award or Agreement basis bearing in mind that it might be it through a ratification, conciliation or arbitral process. The history of the way in which the Parliament has approached this issue in recent years reflects its understanding of the need to follow this procedure.

This is demonstrated by the approach the Parliament took to fund selection in commissioning the Productivity Commission Inquiry in 2012 into Default Superannuation Funds in Modern Awards in which “the purpose of the Inquiry was to design transparent and objective criteria for the selection and objective assessment of superannuation funds eligible for nomination as default funds in modern awards”. This led to the Fair Work Amendment Bill of 2012 which established an Expert Panel to assess funds against prescribed selection criteria (which follow recommendations from the Productivity Commission) with the aim being that the Fair Work Commission would then determine which funds from a Default Superannuation List to be included in each modern Award, award by award.

The ACTU's position is that the principles which underpinned the establishment of a workplace-oriented default system, which is based upon the established legal position of the choice of superannuation fund being an industrial matter, is as relevant in 2016 to issues of default fund determination as it was when the High Court resolved this issue in 1986. Any move to a system which did not rely on this principle would be resisted by the ACTU and the broader labour movement.

The Fair Work Commission Principles on Default Fund Determination

The Fair Work Commission Statement of 30 January 2014 ((2014)FWCFB590)(2) outlines the current status of consideration by the Fair Work Commission of its requirements under the Fair Work Act 2009 to conduct a Review of Default Fund terms. Whilst the Review Process commenced after this Statement was issued, it has not concluded largely, the ACTU would say, because of the situation that the Expert Panel, as prescribed by the legislation, has not been fully constituted.

The principles which upon which a determination of a superannuation product being included in a Default Superannuation Fund list are essentially contained in paragraph (9) of the Commission's Statement in which a series of "first stage criteria" are to be assessed by the Expert Panel to determine the product's suitability as a Default Fund product. Those first stage criteria (as contained in Section 156F of the Fair Work Act 2009 and which arise from the Productivity Commission's 2012 Inquiry into Default Superannuation in Modern Awards) are set out at paragraph 12 of the Commission's Statement and are as follows:-

- “(a) the appropriateness of the MySuper product's long term investment return target and risk profile;
- (b) the superannuation fund's expected ability to deliver on the MySuper product's long term investment target, given its risk profile;
- (c) the appropriateness of the fees and costs associated with the MySuper product, given;
 - (i) its stated long term investment return target and risk profile; and
 - (ii) the quality and timeliness of the service provided;
- (d) the net returns on contributions invested in the MySuper product;
- (e) whether the superannuation fund's governance practices are consistent with meeting the best interests of members of the fund, including whether there are mechanisms in place to deal with conflict of interest;
- (f) the appropriateness of any insurance offered in relation to a MySuper product;
- (g) the quality of advice given to a member of the superannuation fund relating to the member's existing interest in the fund and products offered by the fund;
- (h) the administrative efficiency of the superannuation fund;
- (i) any other matters the FWC considers relevant.”

As stated above, the process of determining a Default Fund List for each Award has not been finalised and as such a definition of what the evolving superannuation default fund system might be, is not possible to be provided. At one level, it could be argued that the most logical process for developing a default fund model would be to allow the process contemplated by the Act to run its natural course – that is for the Government to fill the existing vacancies in the Expert Panel, for the Panel to complete its first stage criteria review and determine a Default Fund List and for a Full Bench of the Fair Work Commission to determine default funds from this List for each Award.

However, the ACTU believes that a number of circumstances have emerged since the process of determining Default Fund Lists was commenced and that it would be appropriate to revisit the list of criteria listed above to make them both more contemporaneous and more relevant to delivering a more efficient Default Fund List.

The ACTU believes those circumstances meriting a review of the criteria are as follows:-

1. That more information is available on the effects of competition under the existing structure (whereby a number of funds are still listed in Awards as default funds and a range of MySuper products are essentially offered as alternatives to individuals covered by those Awards);
2. That more information is available on the inability of “retail” MySuper products which is increasingly demonstrative that those products damage the overall ability of the superannuation system, together with its interaction with the Aged Pension system, of achieving an objective of workers being able to maintain their standard of living when they retire;
3. That there is increased community concern over the issue of “conflicted selling” of financial products and services
4. That the current criteria do not fully reflect the industrial nature of the issue of the “selection of a default fund” for workers in particular industries or sectors of those industries;
5. That the guidelines do not provide sufficient rigour to allow the Expert Panel or the Full Bench to determine the ongoing capability of the superannuation fund to deliver a structure which will maximise achievement of the objective of superannuation.

To this end, the ACTU accepts the current range of criteria are such which would assist the Expert Panel in evaluating the investment profile, investment return, insurance arrangements and administrative elements of MySuper products wishing to name on the Default Fund List for a particular Award. However, the ACTU believes this list of criteria needs to be amended and supplemented to allow it to meet the issues which have emerged in the changed circumstances referred to above.

The ACTU, in fact, goes further than simply saying modifying a set of criteria would improve the Default Fund Selection process. The ACTU says that it is essential to update the criteria to ensure unintended competitive arrangements are not brought into the system.

The ACTU believes the current criteria, together with a broad impetus for more liberalised selection processes, there is a real danger that recommendations from this Review could lead to a criteria being used to implement a widespread competitive distribution system. This could significantly damage the Retirement Incomes system which has been built over the past 30 years.

Potential recommendations emanating from this Review can only be seen as heading in one direction – and that is the misconceived view that a more competitive model of default superannuation fund selection is desirable. The current criteria left in the format in which in presently exists could lead to a default system based on competition driven outcomes.

The ACTU says, with considerable input from the superannuation sector as to the financial effects of existing sub-standard performers gaining access to the Default Fund system and the additional costs which will flow from a competitive environment and with the experience of recent years in which broader choice has been allowed to flourish, that a more competitive model of default fund selection is harmful to the superannuation system, to workers who participate in the system and to the public policy imperative of having an effective superannuation system in place.

It is increasingly apparent that there are particular systems with the financial services sector which have not benefitted from the entry of “selling” cultures into the provision of core financial services. This has been demonstrated by the acceptance by bankers at Parliamentary Inquiries that cultural aspects within their operations have contributed to significant problems in their sector. Further the recent announcement by APRA on 19 October 2016 that it intends to conduct a review into remuneration structures in the financial services sector reinforces the public concern that a selling culture is dangerous and may well be completely incompatible with particular financial products. It was this type of revelation which led to the need for a highly regulated universal superannuation system in the 1980’s and it would be irresponsible to promote the introduction of such a culture into a high performing system such as exists today.

Re-Designing the Default Fund Model

The ACTU remains a strong supporter of there being a default fund in place. We do not wish to engage further with the Commission on the rationale for starting from a measurement base of “no defaults” albeit we have had an effective default system in operation for the past thirty years and the Commission has chosen to elect to do its work from another base: our views on the preferred approach to evaluating the system – that is looking at whether proposals to move away from current default arrangements actually improve outcomes for workers is well covered in our previous submissions to the Commission.

We have not sought to advocate further the need for a default system. In our view this is a well settled issue and in any case, as the choice of superannuation fund is an industrial matter, there will be a regime of defaults needed within the award system. In our view, the challenge is now to get on and best define what this system should look like.

Below is a description of what the ACTU believes is a model for establishing a default fund regime.

The ACTU’s proposal for a default fund regime is establish a regulated regime, the manner of the regulation being as described by the provisions of Section 156 of the Fair Work Act (2009), but modified by a series of proposals to amend certain provisions to cater for the changed circumstances we describe above.

The amended regime is described as follows (with reference to the Section 156 of the Fair Work Act (2009)(3):-

- 1) The ACTU supports the process of a four yearly review of default fund terms (as per Clause 156A).
- 2) The ACTU supports the development of a Default Fund Superannuation List and the use of an Expert Panel which would determine, from the Funds which make application to be on the Default Fund Superannuation List, those funds who meet the selected criteria and who are to be placed on the list. The ACTU also supports the second stage process in which the Fair Work Commission, as constituted by a Full Bench, varies modern awards to incorporate a new regime of default funds. The ACTU further supports a similar regime applying to tailored and corporate MySuper products and the process by which Funds can make application to be considered for the Default Fund Superannuation List and the Schedule of Approved Employer MySuper Products(as per Clauses 156A, B, C, D, E, L, M, N, P, Q and R).
- 3) The ACTU believes the first stage criteria should be amended to include the following provisions in addition to those currently prescribed by Clause 156F:-
 - a) The distributional system for the fund does not involve remuneration arrangements which are based on bonus or commission structures and that all those persons who are responsible for the distribution or engaged in the distribution act in a manner in which the interests of the potential member, as measured by the other first stage criteria, have pre-eminence
 - b) The default investment regime within the MySuper product is one in which the asset allocation has been determined, on a risk-related basis, to achieve an investment return which meets industry best performance standards, as determined by reference to APRA performance tables and the performance of that investment regime, as measured by its long-term performance results, has met benchmarks as determined as appropriate by the Expert Panel
 - c) The fund has in place systems to meet the appropriate standards for Environmental, Social and Governance investment practices as prescribed by the United Nations Principles for Responsible Investment
 - d) The fund produces an Annual Report and Annual Financial Statements in a manner which is consistent with the standards prescribed by APRA and which are published in a readily accessible format

(These provisions would be in addition to the provisions contained in Clause 156F).
- 4) The ACTU believes the parties to a modern award should have an absolute right to present any case they wish in respect of the default fund provision to be inserted into the modern award at an appropriately convened case to consider the issue of the default fund provision for the relevant award (in addition to a right to make written submissions as outlined in Clause 156G).
- 5) The ACTU proposes that paragraph 156H (1) (b) be amended to remove the reference “at least 2, but no more than 15 “ from the provision. The ACTU proposes that a further sub-clause be inserted into Sub-Clause 156H(1) to the effect that the Fair Work Commission would be required to consider the following matter:-

- a) Before determining the particulars of any superannuation fund or funds to be inserted into the award, the views of the industrial parties to the award as to the means of reflecting the wishes of employers and employees in default fund selection should be taken into account

Further the ACTU proposes that a further point be inserted into paragraph 156H(2)(b) of the Act to the effect that a standard MySuper product would only pass the second stage if

- i) That if the industrial parties propose that a fund be inserted into the award as a default fund which is not an all profits to members fund, then the industrial parties be required to make submissions as to why they believe the insertion of such a fund as a default fund is in the interests of the employees covered by the award including why they believe the payment of a fee or equivalent to the promoter of the fund is in the interests of those employees.

The ACTU proposes that Sub-Clause 156(3) of the Act be deleted.

Similar changes would need to be made to Clauses 156S and T to that described above.

- 6) The ACTU supports the provisions of Clauses 156J, K and U.

A proposed amended Section 156 is attached to this submission (4).

Non-Award Employees

An issue which appears to have exercised the Commission's mind is the issue of coverage of employees outside the award system and it is on the rationale that the award system doesn't adequately cater for these people, that it appears that the Commission is proposing the idea of default arrangements which are modelled outside of an employment-related model.

(For the purposes of this element of our submission in respect of employees covered by Enterprise Agreements we agree with the Commission's view which says these workers essentially follow a regime, in practice, almost identical to the Award system).

It is the ACTU's view that non-Award employees should not be the "tail that wags the dog" when it comes to the development of an Award system capable of robustly handling default coverage for Australian workers. The ACTU's view on this derives from the following:-

- A number of non-Award employees work in industry sectors in which there are Awards which apply to employees who work under more traditional employment arrangements; in many cases employers think their workers are Award-free, when they are not. In these cases, the regime should simply be that the fund or funds which are the default funds for that sector, should apply to the all the workers in that sector, be they in traditional award based contracts of employment or non-traditional contractual arrangements. There will be several legislative mechanisms which could bring this about – one of them may well be a reference to the National Employment Standards in the Fair Work Act.
- The nature of a default fund in a true common law contract in an award-free area is somewhat of an anachronism. Whether any arrangement to bind an employer to a default fund regime in a case like this is possible is doubtful and probably unenforceable. The prescription of a single general industry fund, to be prescribed by the Commission, would adequately cater as a Default Fund mechanism.

Criteria for Assessing Alternative Models

The Commission has identified five criteria to assess alternative models against, namely being:-

- Members' best interests
- Competition
- Integrity
- Stability
- System-wide costs

The ACTU continues to support the Members' best interest (or the ultimate benefit to member) as the principal criteria against which any assessment of alternate models (against the existing default arrangement) should be made. The ACTU does not support "trade-offs" as such in this evaluation. In specific terms, maximising the net benefit to the member at their retirement is the single, substantive goal which the system should be aiming to produce.

Naturally bringing in any optionality into fund's operating arrangements comes at some operational cost and in a theoretical sense means that any optionality actually (to some small extent) decreases the net benefit a worker receives at retirement. To this end we accept that there will be a balance between establishing a level of desirable optionality and the cost this will incur – but sticking to the principle that this optionality can only occur within a controlled cost regime.

The ACTU believes it might be desirable to more formally define some of the areas where "optionality" has reached a stage that it is a necessary feature of product offerings. Without limiting the consideration of this potential list, we think there are areas to be considered within investment choice, insurance (albeit we favour the approach of a more standard Group Life product being provided in the default fund with individuals able to elect, at their own cost, to increase their cover), communication and limited financial advice and service. With an acceptance these were commonly regarded as design features of the default fund arrangements, these features would become a normal part of the core offering and an allowance for known costs could be factored into how a true net benefit emerged.

The ACTU does not support competition as either an aim of the system or an appropriate assessment factor. The ACTU has made the case on numerous occasions that competition, perceived or otherwise, in the 30 year history of occupational superannuation in Australia, has done nothing but add to the costs within the funds (and led to a diminution of outcomes for workers). It is no longer for the ACTU to make this case – it is now for the proponents of a competitive model to show the Commission and others how competition will reduce costs or improve outcomes.

We again point to the obvious problem with a competitive model – that it brings into play the need for a selling or distribution system. Such an arrangement cannot come as other than a cost, and a significant one, to the system. And, of course, aligned to this is the issue of conflicted selling – selling inferior products based on remuneration of the Agent as the motivating factor rather than the best interest of the member. The ACTU again points to the strong community reaction to the existing arrangements of this nature in the financial services sector and reiterates its view that a recommendation which brings in conflicted distribution systems is a recipe for a loss of public support in superannuation.

In relation to the other three criteria, the ACTU's view is that they are useful measures of success of a review of superannuation. But they must simply pale in significance when consideration of the substantive issue – that is the maximised return to the member – is considered.

Alternative Models used in Other Jurisdictions

The Commission has asked our views of four models used in other jurisdictions, and as such we comment as follows.

Chile

We are cautious about a nationally tendered scheme, albeit many features in our preferred model reflect a strong approach to regulation. The issues which make a case for a network of industry funds being more advantageous than a national default fund have been to allow the funds to nuance some aspects of fund operation to their sector (areas like insurance and communication are relevant here, and in some cases designing slightly different investment allocations where the age profiles of an industry sector differ from the community workforce at large).

The ACTU would not support a two-year tender process. Such a process is enormously costly in time and resources and the potential disruption to a system of needing to potentially switch operating systems on a regular and limited timeframe is a substantial risk to the system.

However, significantly longer periods between tenders has an obvious outcome in that alternative providers will never have the scale to prove they can deliver a functional operating system. And, as a monopoly regime without any meaningful way to assess and review its effectiveness becomes more the norm in this type of arrangement, the more is the case that true efficiencies to the system might be lost.

New Zealand

The ACTU supports an Expert Panel being used to establish a Default Fund selection list, subject to the criteria on which selection is done is rigorous and focussed on the real aim of maximising long term benefits to workers.

However, given the industrial context in which superannuation exists in Australia, there is a need for a second stage at which there is an evaluation of qualitative and other issues.

Sweden

The Swedish system appears to operate for a base level of the superannuation system – more a foundation component than the more significant amount of contribution that is needed in a system to provide genuine adequacy in retirement. The appeal of the system appears to be its passive, low-risk approach. This would not have applicability to a more robust system like Australia's in that growth investing is an integral part of a scheme's design so that accumulation balances can grow sufficiently to meet adequacy targets.

United Kingdom

Some of the arrangements around NEST, as they are structured, do not satisfy the industrial relations needs of our system – it is simply not a feature of our industrial relations system that an employer can arbitrarily choose a fund to act as an alternative to the default. Indeed such a process requires a need for a selling mechanism to promote the choice arrangement. A clear problem in such a system is in the issues which arise from the cross-selling of financial products where an employer might have a vested interest in the choice of the alternative fund, which might not be to the best interests of the workforce. NEST, as described, provides a type of investment choice option, which the ACTU supports as being part of the basic optionality we believe should exist in funds.

Options for an Allocation Model

The ACTU does not wish to comment substantially on a range of options from Administrative through to Market Based or Active choice by employees. Clearly the primary aspect of our submission is that we have an industrial relations overview which is a given to the manner in which our system design will operate and this heavily directs us towards a regulatory approach. A market based approach would be unable to operate freely in an environment when industrial claims in relation to superannuation fund can be made and determined in an industrial relations setting. We have elements of active choice by employees beyond the default system and given the levels of engagement which exist in superannuation, a clearly defined path to a regulated default model is going to be needed in any potential variation to current arrangements.

Attachments

1. Manufacturing Grocers Case (160CLR341)
<http://www.airc.gov.au/kirbyarchives/decisions/1986superannuation.pdf>
2. Fair Work Commission Statement Re: 2014 Review of Default Superannuation Funds (2014)FWCFB 590
<https://www.fwc.gov.au/documents/decisionssigned/html/2013fwc8765.htm>
3. Section 156A – 156U of the Fair Work Act 2009
4. Model proposal for Section 156A – 156U of the Fair Work Act

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