Australian Government
Productivity Commission

PRODUCTIVITY COMMISSION

INQUIRY INTO DEFAULT SUPERANNUATION FUNDS IN MODERN AWARDS

MR M. WOODS, Presiding Commissioner
MS A. MacRAE, Commissioner
MR P. COSTELLO, Associate Commissioner

TRANSCRIPT OF PROCEEDINGS

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Continued from 30/7/12 in Melbourne

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MR WOODS: Ladies and gentlemen, we will commence today's hearings. Welcome to the public hearings for the Productivity Commission inquiry into default superannuation funds in modern awards following the release of our draft report in June. My name is Mike Woods. I'm the presiding commissioner on this inquiry and I'm accompanied by fellow commissioners, Angela MacRae and Paul Costello.

The purpose of these hearings is to facilitate public scrutiny of the commission's draft report and to get comment and feedback on it. Following this hearing in Sydney, we will then be working toward completing a final report to government in October, having considered all the evidence presented at the hearings and in submissions, as well as other analysis. Participants in the inquiry will automatically receive a copy of the final report once released by government which may be up to 25 parliamentary sitting days after completion.

We would like to conduct all hearings in a reasonably informal manner but I remind participants that a full transcript is being taken and will be made available on our web site. Comments from the floor cannot be taken during proceedings, but at the end of the day, I will provide an opportunity for any person wishing to do so to make a brief presentation. Participants are not required to take an oath but should be truthful in their remarks. Participants are welcome to comment on all relevant issues, including those raised in other submissions or other evidence.

To comply with the requirements of the occupational health and safety legislation, you are advised that in the unlikely event of an emergency requiring evacuation of this building, you should follow the little green sign there at the back of the room here and the site for assembly is at the corner of Crown and Foveaux Streets. At the end of the session, as I mentioned, there will be an opportunity if anyone wants to make comment from the floor.

I welcome our first participants, the Financial Services Council. Could each of you individually please state your name, the organisation you represent and the position you hold.

MR BROGDEN (FSC): John Brogden, chief executive officer of the Financial Services Council.

MR BRAGG (FSC): Andrew Bragg, senior policy manager, Financial Services Council.

MR WRIGHT (FSC): Nicholas Wright, director and founder of Westfield Wright.

MR WOODS: Thank you very much. I understand you have an opening statement to make.

MR BROGDEN (FSC): We do. Thank you very much. Once again, thank you for the opportunity to be here to present today. Financial Services Council strongly welcomes this Productivity Commission inquiry into default superannuation funds in modern awards. In 2008 we began highlighting our concerns that the Fair Work Act and award modernisation would (1) undermine consumer protection in default superannuation; (2) limit competition in the $1.3 trillion superannuation sector and (3) adversely impact the operations of small and medium-size businesses in Australia.

Since then, each of the concerns has materialised. This inquiry occurs at a time of significant reform in the superannuation industry, primarily the MySuper reforms. These reforms will deliver significantly higher safeguards for Australian workers who, as superannuation fund members, often do not choose their own fund. Throughout this inquiry which commenced in February, we have tabled a formal submission with accompanying independent research into employer superannuation attitudes and preferences. Today we intend to speak to our submission, the research undertaken by Westfield Wright and the commission's interim report released in late June. We will shortly be furnishing the commission with our supplementary submission in response to the draft report. As such, the comments we make today should therefore be taken as preliminary until our final submission is lodged.

We broadly welcome the commission's draft recommendations and findings. We believe they reflect the need to put the member at the centre in redesigning the default superannuation regulatory structure. As identified by the commission, transparency and contestability are necessary elements in maximising member value but are missing features of the current system. As contestability is lacking from any market where service providers have a monopoly or oligopoly, the maintenance of the system of compulsory default funds without the ability for an employer to select another MySuper product would not materially improve contestability. Accordingly, preventing employer choice is the most critical element in improving the system for each of the key stakeholders in the super system.

In summary, we make the following key points in response to the commission's draft report: (1) the Financial Services Council welcomes the Commission's endorsement of the need for an open and contestable market model for default superannuation; (2) we welcome the assessment that the prescriptive MySuper structure which is set out in legislation and requires approval by APRA is sufficient for default fund status and (3) the continuation of default fund listings in awards is not necessary following the MySuper reforms which eliminate the need for any Fair Work Australia process in order to be eligible as a default fund under an award.

In short, we welcome the Commission's desire for contestability and transparency and we believe this would best be executed under the commission's option 1. However, the Financial Services Council believes it is important to engage

with the Commission on considering the viability of options 3 and 4.

If I can talk now about option 1, as noted in our original submission, the advent of the MySuper regulatory framework will deliver a default superannuation product with design features and trustee obligations set in legislation. It will create a designated default product which does not exist today. It will include new trustee duties and the exclusion of certain fees and services, to name but two features. This represents a significant change in the regulatory landscape and we therefore believe that any MySuper product should be an eligible default fund for an Australian workplace. We also believe that to conclude otherwise would be at odds with the parliament's intention to design a safety net super product for all default super fund members. Option 1 embodies this recommendation.

Option 1 would remove the need for Fair Work Australia to have a selection process, as any default superannuation product, MySuper, would be eligible for selection under a modern award. This approach, although not a preferred option for the Commission in the draft report, would remove bureaucracy and cost from the industrial and superannuation systems. It would also formally remove the need for industrial parties to be part of the superannuation system, such as employer groups and unions.

In research undertaken for this inquiry by Westfield Wright, an assessment of small and medium-sized employer preferences showed that such employers do not want industrial parties picking default funds for them. The principle is that employers do not want another group or entity picking service providers for their business.

With respect to options 3 and 4, we acknowledge the commission has indicated the presence for options 3 and 4 under which default funds remain embedded modern awards but employers could select an alternative, MySuper. We believe this would be suboptimal compared to option 1, whilst nevertheless representing an improvement on the current arrangements. According to the draft report:

> The Commission is seeking feedback on which body under each of the options presented below would monitor compliance with the requirements that employers choosing a fund not listed in the relevant award justify their choice if called upon and how they would do so.

If the Commission continues to prefer this option, a regulatory structure must be developed which facilitates the ability for employers to select a non-listed MySuper product. The structure must expressly eliminate legal liability for employers and promote employer simplicity and ease of compliance.

According to the Commission, an existing or new regulatory agency would be

required to administer the compliance process. We are considering how this might work and the FSC's submission will provide detailed feedback on the mechanics of such an approach. I might just add, in conclusion, we believe that the option 1 recommendations outlined in your report is the most pure application of an open and contestable market. We acknowledge that options 3 and 4 recognise an ongoing industrial role for superannuation default, but we would strongly submit that as a 1.3, 1.4 trillion dollar industry, we should be absolutely transparent, we should avoid any conflicts of interest, and this opportunity presented by the Commission's review is a once in a generation opportunity to clean the system up.

As a consequence, we believe that option 1 is the most pure option and we believe that it recognises that superannuation is a financial product and that as with all financial products, it should be free of any other influence. We believe that although if it were the Commission's choice, we would obviously work to implement with you and with the government, but we do believe 3 and 4 are, as I indicated earlier, quite suboptimal because they maintain the roots of the superannuation system and the industrial system and we don't believe that that is the forward-looking approach for superannuation in Australia.

Mr Chairman, we've also brought with us Nicholas Wright from Westfield Wright who undertook research for us of small and medium-sized employers and I beg your indulgence to allow him to provide a presentation.

MR WOODS: Indeed.

MR WRIGHT (FSC): Good morning. I intend to be quite brief in order to allow you to ask any questions that you might like. Just ever so briefly, Westfield Wright, my company, we're full members of the Australian Association of Markets Researchers, QPMR. My background is as a pollster for some 15 years now - and obviously a Pom, I'm afraid - originally in the US, Australia and over 20 other countries. We're a fully independent firm and I think it's important to note that.

We were invited to conduct qualitative research; I believe it's the first time it's ever been done for small and medium-sized enterprises. So to do that, we segmented the groups firstly into small and micro - using Fair Work Australia's definition, that's three to 15 and three employees or fewer - and then medium-sized employers in the second group. We ensured that there were segments of administrative and accountancy staff represented, so it wasn't just the owners; we wanted to talk to people who really understood the system.

I believe the full report has already been submitted so I'm just going to give you some edited highlights and then if you have any questions, I would be happy to take them. Overwhelmingly in the minds of small and medium enterprise owners, the system right now is broken. We heard from people who had employees in their

early 20s who had over half a dozen super funds already and it was their contention that as the demographic bubble works its way through the system, this is something that's only going to get worse. It was pointed out I heard, for instance, that most employees simply don't give a toss until they're in their 30s because a lot of the time, people are moving from job to job; it's familiar territory to you.

SME owners feel like they're at the sharp end of reforms when they go well and when they don't. We've heard complaints, everything from the company tax cuts to IR reform to the carbon tax. These people feel that they're very much at the cutting edge. In terms of superannuation, the big problem is opacity. Insiders in both industry funds, union appointees, and in retail, hidden fees and commissions from IFAs, and banks, the lack of transparency is what these people feel is the key problem. Super is highly automated, so the initial selection decision is critical because what your employers do is select and forget. They will select the super and then it's a very automated process. This is especially the case with microbusinesses, those with three or fewer employees.

A good point that I will highlight is that sunlight is the best disinfectant and at the moment, there's a sense from the employer community that that transparency isn't present at the moment. The good news is that the overall direction of travel of MySuper, when you present your work to these groups, it gets a big thumbs up. They like the simplification, they like the standardisation of default fund options and they like the straightforward nature of the proposals. I would add from a political pollster point of view, SME owners are not encumbered by ideological baggage of either type, they tend to put their business first, second and third, as you would understand.

Right now, they choose funds when they're not listed through existing relationships, so most commonly through either a union or IFA recommendation. There isn't a single unbiased source of information for SME owners and that's a problem. They would expect that to be there, to be provided by APRA which would be the most logical source, but the absence is the big issue at the moment. We took the opportunity to get a list of information data that they would expect to see on that kind of web site and I'm happy to supply that, financial data, where funds are placed, managers, that kind of thing.

At the moment they feel that default super is gained right now by both retail and industry funds. They choose between funds mostly on performance but - a very important rider - that cannot be the only consideration. Numerous respondents highlighted the important rider that historical performance should not be used as a guide to future performance. That's the advice we're all given when we sign up to any financial product. So making that the sole criterion is a basic error. Right now - and this is another quote - whether either an IFA or union official, somebody's hands are in the pocket of every single employee under these awards because of the way

these decisions are made.

SME owners expressed a real desire in these groups for standardised data and transparency of the figures. These are people who are numerically smart. They consider themselves well able to decide between funds. So there's a very strong desire for published information, not just on the performance of the funds themselves but who runs them, their qualifications. There's no desire incidentally for a two-tiered process which I believe was in the original brief. They see it as already overcomplicated. There is some concern over liability, particularly amongst smaller businesses, over fund selection. That's a reason for the endorsement of this approach, that they feel that this kind of work would take the threat of that liability away. You don't want, for instance, offhand comments like, "You might be better off this one," being construed as financial advice. If you've got the imprimatur of MySuper, then that takes that concern of liability away, and that's a very real concern if you've got a small business. You don't want to be sued down the track by an employee for giving bad advice. Importantly, they do trust APRA to provide clear data in that regard.

In terms of advocates, almost everybody gets a bad trot as you might expect from highly stressed small business people. Fair Work Australia, the ATO, politicians, all get negative ratings. I didn't ask them what they thought of pollsters. But APRA is seen as the best placed to manage this. In terms of a number of funds, less is more, but the important thing is also that there should be some choice, to reflect a difference between a different appetite for risk, difference of age, different industries, that kind of thing. I would emphasise that I did ask for specific numbers and people were very reluctant to give them, perhaps a dozen, perhaps 15, but that's not a hard target, so I'd be very reluctant to put that as a concrete recommendation. There is much more light and shade that I can add from these - - -

MR WOODS: No, we can probably explore that in questions.

MR WRIGHT (FSC): Overall, as I said, I've summarised the mood as very supportive of these reforms and also it's important that it's got right because, as I think John mentioned, this is a once in a generation opportunity and there is a problem there that needs solving. Thank you.

MR WOODS: Thank you very much. With your indulgence, John, if we can ask a couple of questions of Nicholas first and then we can come back to your broader conceptual issues.

MR BROGDEN (FSC): Sure.

MR WOODS: Thanks for supplying the full document earlier which we've been through. The one thing I couldn't quite ascertain from the documentation we were

provided, I gathered that these were focus workshops in Parramatta, as I recall.

MR WRIGHT (FSC): Focus groups, yes.

MR WOODS: But I couldn't ascertain from that just what the numbers were and what the sample selection process was. Could you fill me in on that?

MR WRIGHT (FSC): Sure, absolutely. There was a dozen in each group. We had two groups. We specifically went for a location that would be a target-rich environment, I suppose, an area out towards western Sydney where we knew there were lots of small to medium-sized businesses. We stratified the sample by age, gender, other demographic information, which is standard pollster procedure, and then, as I say, the two groups are segmented. You can segment by any criterion you want; you could do, say, men first, women first, swing voters or whatever.

MR WOODS: Yes.

MR WRIGHT (FSC): We went for size of enterprise because we thought there would be different concerns depending on the size of the business and that turned out to be correct.

MR WOODS: Okay. So two focus groups of 12 each was the basis for this. That was just a little bit of the missing information, so that's helpful in that. The conclusions that employers want empowerment and freedom of choice and that they don't seek any further criteria to be overlain on MySuper, to some extent that goes contrary to advice of others such as COSBOA who come up with a perspective about - verballing Peter Strong, God bless him - but I think I could reasonably paraphrase it as saying, particularly at the micro and small, not necessarily the mediums, that this is way down on the list of things that employers want to be involved in and if there's some other process that takes this out of their hands, they're entirely happy with that. Now, is there a tension between what he is saying on behalf of his constituency and what was coming out of these focus groups?

MR BROGDEN (FSC): If I might answer that. First of all, that's in part why we did the research because we wanted to know the answer. You would have to be living in Antarctica not to know Peter Strong's view of these issues, so we are aware of what COSBOA's strong view was. So to that extent, the findings and the strength of those findings were, we believe, significant.

The second thing is I guess it's about how you interpret the answers we've been given, so I don't think anybody would agree that this is a low priority for businesses. They themselves want to get it done and leave it alone. The Financial Services Council represents the retail sector but as you can see from that research, it's as critical in the retail sector as it is in the industry sector in terms of biases about the

way the process works and people's engagement in the process. So from that perspective, it indicates that there is a level of cynicism about the way the options are presented to them at the moment.

The question then becomes what makes it easiest for small businesses to comply? We would say that a simple piece of public information most likely provided by APRA that allows some more businesses to choose on a series of simple criteria is better than option 3 and 4 which suggests a broadened but still finite list of pre-vetted funds. So I would say there isn't tension. What we're seeing is a different interpretation of the same issues flowing out of small business.

MR WRIGHT (FSC): I would just add to that; let's not make the mistake of seeing highly automated as being low priority. Because it is a highly automated system, once you tip the box, the machinery sort of takes over, that doesn't mean - - -

MR WOODS: They want to get the right decision but once the decision is made, they're then happy for it to be done.

MR WRIGHT (FSC): Exactly, but that decision is a very high priority.

MR WOODS: Yes, I understand that. They're two different aspects of the process.

MR WRIGHT (FSC): On an unrelated sort of topic, we did some polling of small and medium-sized enterprises and 90 per cent of the people we spoke to had nothing to do with COSBOA and certainly didn't feel they were represented by them, so I'd just be very cautious about taking that submission as representative.

MR WOODS: I'm sure you and Peter can debate that. I'm not going to get into that space.

MR BRAGG (FSC): Could I say briefly, we have a good understanding of COSBOA's policies in superannuation. Certainly COSBOA has a policy which will remove in effect the small business person from making superannuation contributions directly to a fund. Now, that's an argument around administration of superannuation. I think certainly this review has been around how do small business owners select a default fund; I think that's slightly in different territory. I know COSBOA traditionally has argued that the existing arrangements are not desirable and that their view has been - and I don't wish to verbal Peter or COSBOA - but it is undesirable to have industrial parties selecting service providers for those small businesses.

MR WOODS: All right. Peter can speak for COSBOA and he can do that directly on his own volition.

MS MacRAE: We do feel - and you're aware of it too - that the research on attitudes of business to these things is pretty thin on the ground, so we've really tried to just look at what's available and we appreciate the fact that you have also given us some extra research. But I think that your own comments in your report - and a sample of 24 people is pretty small - so we're really talking about quality rather than quantity research.

MR WRIGHT (FSC): Absolutely.

MS MacRAE: So we're still left with this issue of interpretation. Certainly when choice first came in and the expectations that there would be a rush and people would be enthused - and I think we thought then at the time that employers might welcome that, the idea that the initial proposal that any fund would be available - obviously in the absence of MySuper, but there seemed to be quite strong resistance from employers for that, so there's a little bit of history there as well. But coming back to some of your opening comments, can I just check, one of the things that you said, Nicholas, and it might have been more of an off-the-cuff thing, but you said that the people in these focus groups regarded themselves as numerically smart.

MR WRIGHT (FSC): Yes.

MS MacRAE: Now, one of the things that we hear - and it is also largely anecdotal and sometimes qualitative - is that people are saying, "We might be numerically smart but we don't regard ourselves as financial advisers and we don't want to be seen as one."

MR WRIGHT (FSC): That's right.

MS MacRAE: "But that decision for us is just too hard." So the other possible interpretation of this of, "I'm not trusting any of these people and I want it taken out of their hands but on the other hand, I don't really want the decision put back in my hands because I'm not a financial adviser and I don't want you to ask me to be, so I actually like the idea that someone else will do the work for me," I think some of the interpretation of the resistance to an overlay of another level of scrutiny, if you say to the employers clearly, "We're not asking you to do the scrutiny, we're saying someone else independent is going to do that," I think it's the idea that they're having to do the work that puts them off that idea. So I just caution that I think there's quite a lot around this information that could be interpreted a number of ways.

I guess the other thing is that you did say in your opening statement that you thought that there was significant differences between the two groups but there didn't seem to be a lot of discussion of that. I was expecting to see a bit more in terms of the write-up of the research, about what the significant difference was between the small and the mediums.

MR WRIGHT (FSC): Okay. Can I come back to that, because you've raised a number of points.

MS MacRAE: Sure.

MR WRIGHT (FSC): Firstly, in terms of qualitative over quantitative, we had a long discussion back and forth whether we should use an opinion poll here. An opinion poll is a very blunt instrument for telling you what people think. The purpose of focus groups is quite deliberately to get 12 expert witnesses, if you like, to tell you how and why this is interpreted, so it's very deliberately done in this way because, as you say, they are complicated issues and you can't simply ask, "Do you approve or disapprove?" You could do that, but it would be probably disingenuous to do so, so that's why we're talking focus groups rather than a quantitative poll.

In terms of how they see themselves, yes, absolutely they see themselves as numerically smart and able. The concern, and I think this is the critical point, is liability. They don't want to be held liable - and this also speaks to your question about the cleavage between the two groups, because there really was only one and it's primarily over liability, this question of, "I don't want to be held responsible." I own a small business myself and I don't want to be sued for suggesting that Australian Super is good or whatever. So this idea - and it does come back to your sort of two-tiered process, if you like - that the simplification and standardisation, as I said at the start, is an important context and that feeds into the specific recommendation that once certain benchmarks are met, ie, by the government - that's the government's job, to provide that security of MySuper - then that's your guarantee, if you like. That takes away the threat of increased liability, so therefore they would be able to choose on the basis of age, appetite for risk, whatever else, and that's where you get - - -

MR WOODS: It may be more directed to John to sort of pick up from that point, that one of the comments that came out of the research was less is more, so they want choice but a limited choice. Picking up on your option 1, when you look at the APRA authorisation of a MySuper product, it really isn't a performance rating, it just says, "Have you met these following legislative requirements?" So we could have 300 MySuper products, all of which legally - picking up your point of liability - meet that set of criteria, but it doesn't tell you anything about the relative performance. Now, there will be publication of a whole range of data which can help create some guidance and we've noted that in our draft report, but how do you marry the, "We want choice but we want it within a limited group," versus "All MySuper products provided they meet these legislative frameworks get authorised"? So you've got 300 there, you've got to ultimately come down to one there and the businesses are looking for, "Give me 10, 15," whatever to choose from. How in option 1 would you work your way through that issue?

MR BROGDEN (FSC): You're right. The sole role of the legislation is to create a new default product and it's silent, as it should be, on performance; you don't need mitigated performance to be a registered MySuper product. It is worth noting that the legislation will require an existing RSE holder to seek an amendment to their licence to deliver a MySuper product, so there is a higher standard that's required.

MR WOODS: It still could mean 300.

MR BROGDEN (FSC): Yes, of course, although there are only 200 players - - -

MR BRAGG (FSC): There are around 220 - - -

MR WOODS: Policy and legacy in some cases - - -

MR BRAGG (FSC): - - - which will reduce significantly over time.

MR BROGDEN (FSC): We're not talking thousands, we're not talking tens.

MR WOODS: No.

MR BROGDEN (FSC): So there is a gateway and that gateway is not based on performance or any other feature; member service, fees, any other requirement. The missing element I think that we're yet to see completed, let alone see in performance, is the role APRA will play. I mean, there will be a league tabling process that will take place. As you would know - Paul would particularly know - that will be based on two criterion, in particular, administration fees and investment fees. Linked to that we assume will be overall performance. So there will be some very simple, not simplistic but some very simple measures that APRA will deliver on a regular basis about performance.

We think that is the adequate information. We think that is adequate enough information, and indeed more appropriate than somebody else intervening between the employer and APRA's league table, we just have a concern about the proposal of having a player in between the two that's yet to be defined in full terms, but it's scoped, if you like, in the commission's interim report. We think that just adds a further layer of complication at a point where the government has created an enormous level of detail about a product called MySuper. We think it would be unhelpful to create another layer of bureaucracy to interpret which MySuper may be worthy of going on the list.

MR WOODS: Okay. But somebody is going to have to make the interpretation, particularly if the small/mediums are looking for a more bounded group. One option is to pick up the APRA reports and draw a line under the first 15 or so on those

things that they publish, but the issue then is of course what we've proposed in our draft is that there is a whole range of factors for consideration. We've said there are two that are most important and that's the investment strategy objectives are suitable to the demographic that that particular employer has of their employees and that there is the likelihood of them being able to achieve that. There's the whole debate about past performance and persistence and we can head in that direction to an extent.

There are other considerations. So what is the insurance offering? Are the fees within appropriate bounds, given what the investment strategy is? So we've identified a number of those. Would you be proposing that it be recommended to employers that they don't just take the two bits of published information from APRA and use that as their only guide as to how to get to at least the first 15 and then choose from there or would you say that's what's published, that's enough? Isn't it starting to require a level of sophistication of employers to then say, "But hang on, those two bits of information aren't sufficient in themselves, there are other considerations that you should take into account?" Would you then be requiring them to take those into account? Would you be putting out information sheets that says, "This is what you should be doing?" How do you move through that process?

MR BRAGG (FSC): The APRA tables which have never been tabled for employers - I mean, APRA currently produces fund-level data which is not useful for employers - when they commence publication next year, they will have information on risk, fees, asset allocation, performance, governance of the fund, insurance, all of the factors that any employer could conceivably want in order to make a decision, and that's assuming that they do want to pick from a complete range of approved funds.

We think that - given that we've never had the benefit of that information being provided by a public authority in a comparable way - that is, combined with the creation of the default product in legislation and approved by APRA, quite, if you like, a game-changing reform package that we haven't had the benefit of testing, but in other jurisdictions this has worked, in Hong Kong. I realise here we're reflecting on around 200 rather than 40 or 50, but in Hong Kong, employers are required to select a default fund which is relatively comparable to our system. They have 40 to choose from from a government-provided web site which has information about the schemes that are available. I just think we haven't had the opportunity to test that yet. Certainly from the research that Westfield Wright carried out, clearly the employer would prefer to have one fund, probably paid to the future fund, they would say, but given that there is choice, certainly the research bears out that once you have to make a choice as an employer, they would rather have the full suite to choose from.

MR BROGDEN (FSC): I guess what's interesting to ask is if you built a pure

system, a pure system based on what we have and MySuper, the new world, employers would have the opportunity to look at, in our view, the MySuper table published by APRA and choose from that, based on the criteria that Andrew outlined, which are more than just the two basic criteria to which you refer. They are a pretty good spread of criteria. For instance, insurance is quite a critical one and that can vary massively from workplace to workplace, even within the same industries.

MR WOODS: And it can vary under MySuper.

MR BROGDEN (FSC): Yes, but the expectations or demands of the workplace, the employees, the expectations of the employer for different insurance - indeed, just as a brief aside, we believe one of the quite new and distinctive features when MySuper is up and running will be insurance because there will be a lot of commoditisation. We think life insurance will be quite a feature from one product and one provider to the next.

So what we're challenged by and I guess it's what we're talking about in essence at the moment is how do we go from a system that we all broadly agree is dysfunctional and has flaws to a system that is pure, but - the asterisk is - makes the engagement by employers as, in our view, risk-free and I guess, in your view, as simple as possible.

MR WOODS: Simple and appropriate, yes. That's where we're trying to work through that middle space. If I can just pursue your option 1 a little further; isn't it possible, out of the full 300 or 250, or whatever we have of the MySuper products, to start to identify and make judgments about the performance of the various products and their appropriateness to various demographics of employees? The hospitality demographic is different from the construction industry demographic which is different from the aged care and community services demographic. So you could start to say, "This bundle of MySuper products is more akin to the needs of this group than that group."

MR BROGDEN (FSC): Or indeed this ageing workforce or - - -

MR WOODS: Yes, whichever way you want to cut it. In fact an employer may be in that industry group but have a different demographic because of their niche et cetera which is what we were trying to achieve with another recommendation we'll get to in a minute. But from our perspective, if there was some impartial process that produced a shorter list, then we think that's achieving what's required - which takes us back to where we see options 3 or 4 - an impartial entity to whom all funds have equal access, equal standing and can prosecute their proposals on their merit and be tested for those to come up with a number of funds that, in the opinion of a disinterested objective arm's length decision-maker, considers that this group best fit

this particular demographic compared to another group for another demographic. So given that option 1 needs some sort of process to create some short-listing, don't options 3 and 4 provide a process for doing that?

MR BROGDEN (FSC): We don't agree - - -

MR WOODS: I understand that, but I'm just trying to test why. Where is the fundamental flaw?

MR BROGDEN (FSC): We are in the process from 1 July next year of creating an entirely new default superannuation system which is - it might be going to far to say "radically", but is significantly different to what we have now and has built into it a series of safeguards that didn't exist before and then has APRA playing a new and significant role league tabling and also doing so on, as we indicated earlier, a series of criteria. We think that's enough. We think that delivers the outcome.

It also assumes that there will be hundreds of players. The reality is that there's a massive consolidation phase being undertaken in superannuation at the moment, particularly on the industry fund side. That will accelerate ironically as a consequence of MySuper and Super Stream reforms. So the sheer number of funds is going to reduce and we think that that means that the prospect that it is too daunting a task for a cafe owner next door to this facility to make a selection based off a list that APRA publishes, we don't agree that that's too daunting a task.

MR WOODS: Even though you agree from an employer's perspective, if they had a shorter list that that would help them then at least work through those numbers?

MR BROGDEN (FSC): I don't know that we do agree.

MR WOODS: The less is more did seem to be coming out of what the research was about. There seems to be a disjuncture here.

MR BROGDEN (FSC): There's no doubt there's some tension in the research which is, "We don't want to have the union and industry organisations pushing something on us, nor do we want some adviser who we think has got a hidden commission involved, so we feel we're being put upon by two organisations." We say, "Here is APRA." APRA has to be the single independent player.

MR BRAGG (FSC): I think the key point around the tension was that, as you say, less is more. "We don't really want to choose, so give us one, but if we have to choose, give us the full list. We don't want other people choosing for us," so the shortening therefore is not seen as desirable. I think the other way of looking at it is even in some awards today when you've got 18 or 20 different funds, employers are picking from 20 funds, as consolidation increases in the future and we've got a

designated default product with proper government-provided league tables, that's quite a different situation to today, where that information is available and we believe would allow an employer to make a decision if they wanted to.

MR BROGDEN (FSC): And non-award workplaces choose from the blue sky, so it's not like there aren't a large number of - - -

MR WOODS: In fact there are awards that don't have funds nominated; there are awards that refer to superannuation but don't refer to specific funds. There is a plethora of arrangements out there.

MR BROGDEN (FSC): Correct. There's another universe that exists presently and that universe exists, it would appear, competently.

MR BRAGG (FSC): If you want to use fees as a proxy, where there are the lowest fees is in the area where there are typically no award workplaces. Obviously there's a scale argument there to be made.

MS MacRAE: But I think the other thing to note about option 3 and option 4 is that given the issues around maybe a group of employers who do want to select from the unlimited list, we have proposed in our draft that there be a clause that employers would have an option to choose if they wanted. So I suppose in trying to come up with something that was going to satisfy all parties, because there does seem to be - you would expect across the full range of employers, there will be differences of view about how many want to make a choice and how many don't. It seems to be, from a very small end, which is where the numbers are, those people seem to be, as much as we can tell from what's available, very strongly of the view that they don't want to have to choose from a hundred or 200 or whatever, they really want a small list. So the idea of having five to 10 funds in an award satisfies those people who say, "Look, we really don't want to be given too much choice at all. If someone else has done the bidding for us and all that, that's great. We do still have" - I'm trying not to say "opt out" but I can't remember what we called it - "for employers who want to make a choice."

So I suppose my other question to you would be if we could get the architecture of that element of the draft report right, and I might say we are struggling to do that but if we could get that right, would that not then satisfy you and your concerns?

MR BROGDEN (FSC): We're just not comfortable with another body in effect being interpreted by employers as providing a level of financial advice. Whatever structure you put forward which will filter the full league table is inherently making a recommendation. We don't think that's appropriate. We don't know what that structure looks like; we think it's a highly risky structure because it puts an incredible

amount of responsibility on that structure.

MR BRAGG (FSC): Just to build on John's point a little bit, by shortening that list of MySuper from 1 July next year and setting out a better list, you've never really given the reform a chance to see whether it will work. It's never been given a pure opportunity. Your other point, Angela, around, as you say, the opt-out, certainly that would be a vast improvement on the existing system. It would take out the ability for an employer to pick a MySuper that wasn't listed. If there was to be a set list, it would take us back to where we were in many old state awards where an employer had a list of funds in an award but they could pick another compliant fund. In fact, another way of looking at that is pre-Fair Work, an employer could pick any super fund that had a licence from APRA. If you were to go with that approach in the future, you're not saying any fund, you're saying it's got to be in MySuper, so you put a certain criteria around that default fund that didn't exist pre-Fair Work. So we do think that would be obviously an improvement but we would prefer to see the MySuper reforms being given an opportunity rather than be cut down to a list for employers.

MR WOODS: Do you want to come in on this, Paul?

MR COSTELLO: Not on that issue.

MR WOODS: Okay. If I can wrap up, I think where we've got to is you remain steadfast on option 1; that's perfectly clear. To the extent that you could, in your submission, comment on, as you would see it, the imperfect options of 3 and 4, but would put them in an objective and neutral manner that would in your view meet the public policy considerations, that would be helpful to us.

As my colleague was saying, the option of providing employer discretion to go beyond the awards in terms of actually designing something that works is very problematic and so you'd actually have to, as we are, go through a questioning of who's actually seeking this. Where is the demand coming from amongst employers for such a proposal, how strong is that? What are the benefits and costs? What if it isn't covered by employee choice as well as having a number of funds from which employers can choose, as well as having an enterprise bargaining option which is always there which can include super? Does it actually have a niche anyway? Then if you add on to that if it was to exist that employers would want to have no legal liability of moving outside, that just adds another layer of complexity to that option, so it's wavering as an option in consideration but we will put all the factors together.

MR BROGDEN (FSC): We're happy to address those issues in our submission.

MR WOODS: You've foreshadowed them there but I understand the importance of them.

MR BROGDEN (FSC): What I would say is that unlike some of the other organisations that have presented, particularly employer and union organisations, today and yesterday, we have no direct guaranteed benefit in the changed system except that there is an opportunity for the members to get the best outcome. If, for whatever reason, our members were to perform poorly on any of these criteria or all of these criteria, that would weigh against them in terms of being chosen. So we would argue that one of the benefits we bring is that we are not arguing on behalf of interested parties in the sense of employers or unions who actually sit formally on some of these relevant funds.

MR WOODS: Yes, we understand that. Paul?

MR COSTELLO: It's a slight change of topic, and this is also moving from the small to medium workplaces to the larger ones. Irrespective of the path by which a larger workplace might get there, one feature of the Stronger Super reforms is that larger workplaces can have tailored solutions provided to them which go to structure and go to cost. One risk that we are conscious of and has been re-raised with us through this process is that while that might be very attractive to someone while they're working at that workplace, one needs to be conscious of what happens to them afterwards, this issue of flipping which has received a great deal of attention.

So if we can forget about how that workplace might be in that situation, I'm interested in your thoughts on when a decision is being made in respect of those people by an employer, by another party, how do you best see employees being protected from finding themselves in a fund which may turn out to be a less happy place for them post-employment than while they're currently in employment?

MR BRAGG (FSC): So predominantly you're referring to fees changing as a proxy?

MR COSTELLO: Fees, insurance - possibly insurance, cost of insurance, access to insurance - all those sorts of things.

MR BRAGG (FSC): The well-documented discussion around flipping which has been characterised most often in terms of fee changes - I think that would broadly be fair - may occur today in a part of the market that is very, very competitive for a number of reasons. It may be because an employer is able to choose from any number of funds and not encumbered by an award, for instance. They go to tender; fund A beats fund B. It's a very attractive product in terms of its services and features. The employee then leaves that workplace. Today that occurs in a circumstance where a member goes into a corporate division of a fund or a wholesale part of the fund. When they leave employment, they're moved into a personal division which is quite a different type of product.

In the new world when MySuper is in place, a member that goes into a MySuper - let's say it was very attractively priced and there was a high level of features - goes into that product, when they exit that workplace for whatever reason, they cannot be moved into a personal product. The legislation before parliament will only allow that member to be moved to a MySuper. So today you can go from wholesale to personal; in the new world, you can only go from MySuper to MySuper. Now, the fees might change.

MR BROGDEN (FSC): Unless you choose to opt out, of course.

MR BRAGG (FSC): Unless you choose to exercise your choice of fund. Now, the fees may change. One of the things we believe which will ensure that the fees - let's say fees as a proxy - will remain very competitive is the APRA league table. Now, if I'm fund A, the public officer division of the fund where I've been moved to following termination of employment will be up in lights on APRA's league tables as "Fund A, public offer fee rate by 100 basis points," let's say. There will be a market dynamic which will ensure that transparency which doesn't exist but will in the future will make it very commercially unattractive, on a market view, for a fund to have a very high fee relative to what we may see today in that circumstance.

MR COSTELLO: So to follow that up, we've suggested that the people making a decision about a default fund need to explicitly recognise the costs that the employee will incur post-employment. That's part of this, but it may not change, in which case it's easy; if it does change, they've got to consider it. Would you propose that that obligation exist under your preferred option 1, that that's a specific obligation on an employer as well, that in making this decision they have to think about the experience of this person post leaving them, or just that their responsibility exists simply while they're in that workplace?

MR BRAGG (FSC): We would not have a problem with that level of disclosure.

MR COSTELLO: But do you think that should be an obligation that the employer - - -

MR BRAGG (FSC): On the employer.

MR COSTELLO: Because we're suggesting it's an obligation on the decision-makers in option 3 or 4 because we think the reality is people have money long after they leave a workplace. I'm interested in your thoughts about the extent to which that should be a specific obligation that has to be factored into any decision about what's a good fund for employees.

MR BRAGG (FSC): To the extent that the employer seeks to engage on the range

of features that the fund offers, fees are certainly important, as is the asset allocation, in terms of being appropriate for that demographic profile of the workplace they're picking a fund for. In terms of making it a specific obligation, I imagine that would be a disclosure that the employer would have to make possibly.

MR COSTELLO: It's a question you might want to think about when you put in your submission.

MR BROGDEN (FSC): I think it's very hard, the task you've set yourself; anybody, an employer or an organisation - it's a challenging one, to give a post-employment - - -

MR COSTELLO: Have a think about that, because the issue of flipping remains alive to many people and it's something that we're conscious of making sure that we've thought about it thoroughly, so your thoughts on that would be welcome as a follow-up to this.

MR BRAGG (FSC): Yes.

MR BROGDEN (FSC): Can I be slightly challenging: is that a Productivity Commission consideration or is it more a legislative consideration with MySuper?

MR COSTELLO: We've identified it in part of our report as something that needs to be factored in in terms of value and cost and I think it forms part of one of the suggested criteria that we've made.

MS MacRAE: Yes.

MR WOODS: Yes. From our point of view, the best way to avoid egregious outcomes is that the public offer entity is the one that is assessed as being in or out of an award.

MR BROGDEN (FSC): I see.

MR WOODS: To the extent there's a discounting below that, that can be of benefit but that's the one that you judge as being what's included in the award, so it has to pass the merit test through all those factors for consideration. Given the time, are there any final questions that you wanted to ask?

MS MacRAE: I'd maybe say one more thing, just so I understand. I'm just thinking about how, in relation to Paul's question, suggesting that there might be a requirement on employers to look at particular factors when they make a choice, if I understand your preference for removing the legal liability for employers, I think if I understand you correctly that you're saying that in an ideal world, your first

preference would be as long as the employer chooses a MySuper fund - the government has done the work of selection - that's fine; as long as the employer chooses any MySuper fund, their legal liability stops there.

MR BROGDEN (FSC): Yes.

MS MacRAE: So we might then want to provide some guidance to employers about, "When you make a selection, these are the sort of factors you should take into account," but there would be no requirement on them to do so; that would be your proposition.

MR WRIGHT (FSC): That's right. That was expressed by SME owners and - - -

MS MacRAE: Okay. I just wanted to clarify that.

MR COSTELLO: You're right, so that point wouldn't exist.

MS MacRAE: You might want to include it as guidance but it wouldn't be a requirement.

MR WRIGHT (FSC): That's right.

MS MacRAE: Yes. One of the differences then between your proposals and our 3 and 4 is that we're saying that there's a requirement on the decision-maker to look at all these factors, taking members' best interests as the first requirement, whereas you're saying the members' best interests in your view are sufficiently taken account of by that MySuper filter, "We don't need to go beyond that."

MR BROGDEN (FSC): Correct.

MS MacRAE: Okay. That just clarifies that, thank you.

MR WOODS: Do you have anything that you want to raise that we haven't brought up?

MR BRAGG (FSC): I'll just add one point.

MR BROGDEN (FSC): Yes, go ahead.

MR BRAGG (FSC): You mentioned possibly wavering on the capacity for the employer to select a fund which is effectively a choice that employers had pre-MySuper. I'd just say that our view would be that if there was no capacity for an employer to select a default fund for their workplace, then we wouldn't be far from the status quo today which in our view, as we expressed today and in our

submissions, is highly undesirable.

MR WOODS: Except to the extent that you would have a transparently open access to a decision-maker who chooses a number of funds.

MR BRAGG (FSC): I'd say in the scheme of things, if an employer had a mandatory set of funds that they had to select as a default fund and they could not contract out of that unless they put in place an enterprise agreement, we would not see that as moving particularly far. So we will seek in our final submission to determine how your options 3 and 4 may be able to be achieved, and we certainly want to be as constructive as we can. But we wanted to restate today that we think that a lot of the complexity that comes with options 3 and 4 would be extinguished under our option 1.

MR COSTELLO: You might just wish, when you make that point, to explain - always referring back to this question that we've put - paramount, of how the members' best interests would be served, so as you talk about that, it's helpful to always frame it in that context, as opposed to simplicity, convenience or other factors which we recognise are important to an employer. It's always important to reference it back to that paramount criteria that we've identified.

MR BROGDEN (FSC): Thank you for the opportunity to present.

MR WOODS: It's been a pleasure. Thank you very much for your original submission and the constructive approach you've taken to assisting the commission.

MS MacRAE: First of all, I apologise, Mike Woods has had to go to another engagement for a couple of hours but will be back this afternoon. We have Unions New South Wales now at the table. If you would like to introduce yourself and the organisation you're representing for the purposes of the transcript and then if you have any opening statements.

MR LENNON (UNSW): Sure. Mark Lennon, secretary, Unions New South Wales which is the peak trade union body in the state of New South Wales.

MS MacRAE: Okay. Do you have an opening statement?

MR LENNON (UNSW): I do. As someone who has been involved in the superannuation industry for close to 20 years now and a trustee of super funds for almost 19 years myself, I think the problem with the system as it presently stands is the complexity of it for the average member. Clearly we're here talking about what's in the best interests of the member and I think part of the background to it is that the system itself, there are so many changes, so many different types of changes, be it governance, be it investments, be it the type of product offered or where the nature of default funds sit and how that is determined is just I think adding another level, to be quite frank, of complexity to the whole system.

I don't know that overall, when you put all that together - and that is probably not the remit of the Productivity Commission - that we are actually making the system simpler for people to understand. If you want to talk about the best interests of the member, I think the first and foremost thing we should be focusing on is let's try and make the system simpler, not just by such things as MySuper products - that's a great step - but the nature of it, the different elements of it, the different players in the system; if there's even more players in the system, it's making it more complex and more different for the average member of a fund to understand how it works and how it works in their best interests.

To that end, I suppose, that's an opening way of saying that I don't know necessarily therefore, putting aside clearly my views about the industrial nature of determining default funds, why there's a need to possibly go down this path with regard to deciding how a default fund should be determined in an award.

It seems to me, if the issue is about choice or about merit, then we already have that for the members through the changes back in 2005 where members could elect to choose which fund they should be in. If we're talking about the merit of relative funds, be it funds that members elect to go into, albeit they are default funds, then the members, if they're making a choice not to make a choice and therefore going to the default fund, it seems that they've made a decision on its merits. You come back to this clear principle that you're driving at: they're happy, as I see it, the way the default fund has been determined and how a decision has been reached about how

that fund comes to be in the award amongst other funds; in itself, they're looking into the merits of that themselves and making their decision.

I'm not quite sure if I was making myself clear then, but I think if we're saying that the focus here, as it should always be, is on the members and what fund they're in and how that's determined and whether there's been sufficient consideration given to their interests, and the merits of a particular fund against another, then it seems to me that the system that we've got, where they do have choice and therefore it's incumbent on them to either make a decision or make a decision not to make a decision and go into the default fund seems to me to bring all those factors into play. Whether we need, again as I say, to change the system of arriving at default funds, adding another level of complexity to the whole system, seems to me a path we don't necessarily have to take.

Having said that, then clearly going to the draft report itself, my point is, as I say, I'm not sure of the overall benefits of it. Clearly though we believe that the system as it has worked over the last 20 years has worked effectively and don't see, as I say, the necessity for change. However, if we are going down that path, if we focus on the issue with regard to how a decision may be made with regard to a default fund, then looking at the options that are in the Productivity paper, our preference would be clearly option 2, but if that's not the way the Commission seeks fit to go, then clearly we support option 3. I might leave my opening remarks at that and happy to answer any questions.

MS MacRAE: I guess one of the keys things when we started out on this journey of writing our report was looking at where we could transparently see that the members' best interests were being served and it was a requirement of the system that that be so. So, for example, if we looked at the history of funds in awards, there seem to be an awful lot of - well, history and precedent played a very large role and it wasn't easy to see, in the way that the awards are currently listed, that there was any requirement that those things be reviewed over time. So one of the things that didn't seem to be a feature of the system as a requirement at least was a regular review of those funds. That would be one of the factors where we felt that even if a fund at the time it was placed into an award was acting in the best interests of members, could we still say five, 10 years down the track that that was still the case, and if we were to do an open assessment of funds all over again, would that fund that's currently listed in that award be the one that we would choose again on its merits.

Those things might be happening behind the scenes but there's no legislative requirement that that currently happen and I think we have some concern that, particularly given that to a very large extent, it would appear that once a fund is in award, once it's in it's always in. It's pretty rare - there isn't much evidence at least at the surface level that these members' best interests are constantly sort of being reviewed and funds are being assessed against that sort of criteria. I don't know from

your experience as a trustee whether you would like to give me some idea about how often you might review those things and whether in fact, in relation to listing of awards, is there any process now that if we've got a range of funds in an award, who is looking out to see whether there's actually a better option that might go in or is there a better performing fund than one that's there now in terms of members' best interests?

MR LENNON (UNSW): Going back to the genesis of industry funds in the 80s was they were in fact that, industry funds. So talking about the interests of the members, they were decided on the basis of: what is the right sort of fund for our industry? So you look at the various funds and I suppose if we're perfectly blunt, in the first iteration, they were very similar and then over the years we've moved along to such things as member investment choice, where you may have seen some variety in the funds. It might have been with the insurance products that have been offered because of the nature of risks in certain industries. But on an ongoing basis, I think as trustees, most industry funds - speaking from my own personal experience - we factor in any changes we may make, particularly along the lines of insurance products but also the investment options that are offered to members.

What is the profile of our membership in our particular area? I'm presently a trustee of First State Super, predominantly in the New South Wales sector but a public offer fund, as you know, but now we've just recently merged with Health Super, so there's very common interests between the members but there's also some diversity there as well, so we're constantly reviewing that.

The other thing, in terms of whether a fund is appropriate to remain in an award or whether it's still delivering for members, we're constantly under review from APRA and that seemed to me to be the other thing, that it is ensuring that, yes, these funds deserve to remain as a default fund in an award because they're being supervised by the regulator and reviewed on a constant basis.

I think the other point is of course there's always peer review and we're constantly as super funds undertaking how we're performing against other funds of a similar membership. In some regards, necessarily you've got to look at what some would say is the business risk as opposed to investment risk or the risk against your own objectives and I think that's probably where we struggle, but that's not in the sense of who we are looking at. Are we looking at the members and making sure we're delivering for them or are we looking at how our alleged competitors are performing? That's a constant struggle I think for trustees but that's something that's probably not uncommon to the commercial world at large and the competitiveness of the commercial world at large.

MS MacRAE: I guess also given that history then and the acknowledgment that the funds initially came from designing something that best suited an industry and those

funds grew out of the industrial landscape, there is a concern among the players in the market that are not part of that industrial landscape that they feel that they're being excluded from that market in ways that gives them a non-level playing field. For example, some of our recommendations talking about opening up standing to those organisations where there might be a variation on an award to include a fund, would you have an objection to that sort of change?

MR LENNON (UNSW): In terms of opening it up to others in the marketplace in effect to - - -

MS MacRAE: To give others in the marketplace standing to be able to appear before Fair Work Australia, for example, if they wanted to apply. Currently for a retail fund to - - -

MR LENNON (UNSW): Yes, they would have to get special status to appear before the Commission - - -

MS MacRAE: Yes, to come via - if we were to say, as we've recommended in our options, that anyone with an interest should be allowed to put their case to Fair Work Australia, so a retail fund could appear directly rather than having to seek a sponsor through either an employment organisation or an employer to appear before - - -

MR LENNON (UNSW): Sure. My answer is, yes, I would be very concerned about allowing not just retail funds but any other people who aren't industrial practitioners to be appearing before any industrial tribunal for any reason, other than an industrial matter. It depends how we define - and it comes down I suppose to the crux of the question, how you define this whole superannuation issue. Is it an industrial issue or is it a commercial issue? We still say it is an industrial issue and therefore the parties that should argue the case about what should or shouldn't be in an award should be the industrial parties.

MS MacRAE: Okay.

MR COSTELLO: Your opening statement was along the lines of "the system ain't broke so why try and fix it" which was a view widely put when the government asked the commission to look at this review.

MR LENNON (UNSW): No, the system is broken because it's so complex, but let's not add another layer of complexity here for what I can see is a very limited return for the membership.

MR COSTELLO: I'm sorry if I misunderstood that.

MR LENNON (UNSW): No, that's my - - -

MR COSTELLO: But nevertheless, a number of people in their submissions to the Commission have recognised that while the system of nominating funds and awards and people having their contributions paid into those funds has, looking back, generally delivered above-average returns to those people, and therefore to that extent it's worked, they have as part of their submission recognised that there are aspects of the current process around transparency, around access and around contestability which could stand some scrutiny and perhaps some change. You have had a chance to look at some of the submissions from peak union bodies and from many of the industry superannuation funds that are currently nominated in awards and have often grown as a result of that, there has been a recognition that faith in the system would be improved if a greater degree of contestability and transparency were provided. I'm just checking your view. You're not really attracted to that position. You're essentially saying, as I understand it, that you don't see merit in opening up - I think you've just answered the question specifically - the opportunity for a wider range of funds to be considered on their merits as to whether they should be in an award. Is that correct?

MR LENNON (UNSW): No, my opening remarks are clearly employee choice rests with the employee. If they want to undertake those considerations themselves, they can do so.

MR COSTELLO: Okay.

MR LENNON (UNSW): That's where that ability presently rests and I can't see why changing this system with regard to establishing who was the default fund is going to improve from the membership's point of view, given the level of inertia that's already out there, how it's going to improve that in any way. What we need to do and what we've all been arguing about for 20 years is to get people more engaged with superannuation and more focused on it. I think people have been in the last few years because of the poor returns as a consequence of the GFC and therefore we need to let them understand they have the right to choice and they can make a selection and how they can do that. That would seem to be, in terms of trying to make the whole system more open and transparent, a better way to go.

MR COSTELLO: Sure. One of the criticisms that has been made of the system to date, whilst acknowledging the outcome, is that it can be quite blurred between the people making the decisions about which funds should be in awards, the fact that sometimes, but not always, those parties are shareholders in funds, and we get into that question as well about what priorities are determining outcomes. So one of the things we've said is that we think that the ultimate objective which you share with us is that what should matter more than anything else is improving the likelihood that a worker whose money is directed into a fund through the default system receives a good to very good outcome. We've suggested that providing some independence in

the way that the merits of different funds are reviewed and therefore funds are prioritised would be an improvement. You're not attracted to that idea, separating the people that make the decisions about which are the best funds or better funds for members should be separated from the interests of people who share an ownership interest in funds which presently is one of the criticisms of the system?

MR LENNON (UNSW): In terms of industry funds, no-one shares an ownership interest, do they?

MR COSTELLO: I'm sorry, say that again?

MR LENNON (UNSW): In terms of industry funds, how do you define ownership? No-one has an ownership interest as such.

MR COSTELLO: Let me clarify that.

MR LENNON (UNSW): Or a shareholder, where some are sponsoring entities that support particular funds and have certain rights in terms of appointment of directors to the corporate trustee, but we're not shareholders as such.

MR COSTELLO: It's not a point, but generally speaking, at least in my own experience, an owner is a shareholder of which there are a small number. That's the relationship, is it not? So I don't want to get caught up in owners and shareholders, but I would have thought for - - -

MR LENNON (UNSW): It's a not-for-profit fund. It's a mutual; most industry funds are mutuals, in effect.

MR COSTELLO: But as a matter of fact, the industrial parties that are - - -

MR LENNON (UNSW): I understand your point.

MR COSTELLO: Yes, all right.

MR LENNON (UNSW): I think your point is that we're, as a union, stepping up there, arguing the case for a certain industry fund to be in an award and we then also have an interest in appointing directors to that particular industry fund. That's your point?

MR COSTELLO: Broadly. What I'm saying is that there is criticism that that can or could interrupt the system of the best outcome for members being made.

MR LENNON (UNSW): Sure.

MR COSTELLO: So one of the things we've said - which is not to say that funds that presently enjoy status as default funds under an award don't deserve to be there - we're simply saying that that test should be reviewed by an independent body which would be not subject to that argument that a decision is made because of some other factor, that it should be an independent body and that the paramount interest should be that that independent body believes that this group of funds is expected to be better than the broader group in terms of advancing the interests of members. So I guess I'm just again pursuing your view that you don't find that principle and that process - notwithstanding your argument that it adds complication in the system and the system is already quite complicated - but I'm just canvassing - - -

MR LENNON (UNSW): I think I said at the outset, if I understand your question correctly, if you're going down that path, then option 3, where I understand it to be an expert panel within Fair Work Australia to look at that, might be the way to go. But having said that, from my experience in the industry, it's extremely difficult. You know, most funds do well. Most funds deliver. Industry funds deliver. It's extremely difficult, even for a panel of experts, to try and work out which funds should be or shouldn't be in an award for a particular group of members, given often in particular industries the diversity of the membership as well. So I still think the industrial parties, knowing the membership and the profile of certain industries, are in a pretty good position to work out what sort of funds should be in the awards.

MR COSTELLO: Okay, thanks.

MS MacRAE: Have you got anything else you would like to raise with us that we haven't covered?

MR LENNON (UNSW): No, I think I've covered most of them. I hope I was clear on my point at the start, that I think in terms of - can I just come back to the remark. To say the system is broken is probably not the right terminology; the system is very complex. My interest is to simplify the system for the people who use it, the members. I think one way it has been simplified already is for them to have choice and so if someone wants to talk about the merits of the fund, it rests with them, for them. If they want to make a decision on what they perceive is the merits of prospective funds, they can do so. To add another sort of complexity by others making decisions on merits about their default fund I think just at the present time adds another level of detail that we don't need at the present time.

MR COSTELLO: Sure.

MS MacRAE: Okay. Thank you very much.

MR LENNON (UNSW): Thank you very much.

MS MacRAE: We might break a little bit early for morning tea and we'll come back at 11 o'clock. Thank you.

MS MacRAE: I might open proceedings again. For those who have joined us since the break, I'm Angela MacRae, one of the commissioners on the study. I'm here with Paul Costello. The presiding commissioner, Mike Woods, won't be available until after lunch, so I make apologies again for him. I welcome to the table now United Voice. If you wouldn't mind just giving your name and your position for the transcript and then if you have any opening statement, that would also be welcome. Thank you.

MR DALEY (UV): I'm Brian Daley, I'm national officer for superannuation, United Voice.

MR BURTON (UV): Troy Burton, national assistant secretary, United Voice.

MS STARK (UV): Rebecca Stark, head of responsible investment and engagement, United Voice.

MR DALEY (UV): If it pleases the commission, we provided a submission yesterday which we'd like to take the commission through and speak to.

MS MacRAE: Sure.

MR DALEY (UV): We also provided the commission this morning a copy of a report which is essentially a report written to Mr David Elia, the chief executive officer of HOSTPLUS. United Voice is a 50 per cent owner of a company called HOSTPLUS Pty Ltd and we have been working collaboratively with HOSTPLUS on the preparation of this report and obtained the appropriate permissions from Mr Elia to release that report to the Commission.

MS MacRAE: Thank you.

MR DALEY (UV): Just initially talking on a couple of background issues and the summary of key points, United Voice is in an interesting position, it says, to make commentary to the position and essentially to put this perspective on it, United Voice is a union which represents a wide range of workers who are often characterised as low paid but who are generally service sector workers. We talk about some of the industries that the union covers in point 2.

It's an interesting perspective for United Voice in this, in that the membership of United Voice are people who were significantly impacted by the implementation of award superannuation and then universal superannuation in the 1980s and the 1990s. In particular, you would say that when award superannuation came along in 1985, it's a widely reported number that about 40 per cent of the workforce had access to superannuation, of which 20 per cent of those or half of those people were public servants and traditionally, in the private sector only, something like a third of

the workforce actually had access to superannuation. The sort of people who were excluded from superannuation were generally the lower paid, the blue collar workers, women, casualised workers, which characterised much of the membership profile of United Voice at that time and still do. So with a number of other unions, we've played a significant role in providing superannuation across the workforce and are keenly interested in what a review of the system might do at the moment.

We wish to say two or three key things to the Commission today. One of them is we wish to point out that we believe that the recommendations as they're framed will have a disadvantageous effect on low-paid workers, and we particularly take the commission to aspects of the Rice Warner report which deals with a particular aspect of that. I appreciate that other people have put submissions about what the impact would be in other areas such as investment performance and the like, but we say we concentrate on one particular issue and that is the issue of distribution costs, in our report.

In addition to that, we want to address the Commission on some aspects of I suppose the appropriateness of the selection processes and some issues which we think are thrown up by the selection model, that they differ from both the flavour and the structure of the way in which the system which has worked so successfully now operates and indeed have some particular issues about it which we think are both unforeseen and have disadvantageous effects.

In points 4 and 5 of our report, we do talk about, in particular at point 5, the selection of default funds being an industrial issue. Clearly that flavour underpins much of what we'll see later in our submission about this, that in the mid-1980s, the High Court, through a number of cases, determined that superannuation was an industrial issue. It went further to determine that the choice of fund was an issue, and it then created an issue for the then Australian Industrial Relations Commission to deal with how we could resolve superannuation and choice of fund as an industrial issue. Substantially to that, we say that what it did do is that it arbitrated the issue of choice of fund on approximately 50 occasions. Unions probably would have been involved in at least 20 of those arbitrations and it established a rationale for how funds were selected for each industry sector.

We disagree with the Commission when it says that that isn't a transparent finding; in fact we say it's very much a clear and on-the-record process for how funds were determined as being an appropriate fund. In many cases, a wide range of issues were discussed and determined as being the rationale for which fund applied to which award sector. It went very much to issues that were consistent with traditional industrial doctrines, about how representatives of the employees would be involved in the selection of funds, again that's an issue we'll talk about, but it went to a lot of other evidentiary issues such as issues like mobility of labour, patterns of labour movement, patterns of employment, the need to provide a low-cost model which was

significantly untested in those days. So we actually do so that there was a reasonably significant rationale behind the determinant of super and many of those principles in our submission are still very relevant, the way in which super should be looked at in today's context.

In particular, we wanted to talk about the points that we start to raise at point 6 and we believe that the review of the default system should be based on a number of considerations if the model is to be changed. That is, firstly, whether the principle of having a regulated system is still appropriate, given those employment patterns, mobility issues and levels of benefits, and we think that there's a strong case in favour of there being a regulated distribution system. I think it's fair to say that hasn't been a contested point at the moment. It's just in a sense been an issue of what does a regulated distribution system look like, and that becomes a point of a need to go further into some evidence and some factual consideration of some of the issues that are thrown up.

We say at 6(b) that if the current distribution is still efficient in its operation and cost, whether any alternate model of greater contestability would be advantageous or disadvantageous to the recipients, and that's a key issue for us. Representing our people, we want to make sure that their benefits are maximised in this system and that if there is an issue whereby greater contestability comes along and is disadvantageous particularly for low-paid people, then it's a significant issue for us.

So in addressing points 7 to 10 of this submission, we then I think want to take the commission to aspects of the report that's been prepared for HOSTPLUS and which we tabled. It is headed The Default Superannuation Funds in Modern Awards. Perhaps I should preface this by saying this at this stage: what this report tends to do or it does is it looks at the impact on the existing industry fund model of introducing essentially a new distribution system. Perhaps to clarify that, currently the distribution system at the moment is substantially through the award system, and the award system works closely with the industrial parties to the award. The funds work closely with those parties in a systematic manner to ensure that people within the industry know what the default system arrangement is and enrolled in the fund, and essentially it's a cost-effective distribution model.

What we're looking at is potentially the impact of that changing if an individual employer is faced with a much broader selection of funds than they are at the moment. What is the impact on the providers of having to change their distribution system? So other than relying on going through the current processes of there being some sort of funnelling through the employer and the union association to the default fund process, instead essentially the eight to 10 to 12 to the unlimited number of funds that might be in the system would all require a model of making employers aware of their brand and essentially trying to put a value proposition to the employer

to say, "Pick our brand over one of the brands." It's the cost impact on the industry funds of having to import that sort of system to its current model.

We don't touch very much on the impact of what might happen with the retail funds. I think that there's this potential argument out there that says if you import this competitive model in there, then won't it automatically mean that the market price for administration for super will move in some way to a lower-cost model? We dispute that for a number of reasons. We dispute that with particular reference to what's happening in the marketplace at the moment. The Rice Warner report talks about this. We say that the average costs for the operation of the superannuation fund - and I'll take you to this in some detail in a second - is about $218 for a large industry superannuation fund where you take the administration and investment expenses into account. So essentially the cost to a worker to have their superannuation in an industry fund is about $218 a year.

The current MySuper offerings out there, a number of retail providers are coming in, and they have a slightly different model for how they establish a cost basis for it, but the cost basis for those alternative models are somewhere in the range of, say, 400 to a thousand dollars. If you take one of the examples that's in here of what does a person with an $80,000 pay to a typical fund which has a dollar a week administration charge and, say, a .7 basis points charge, the cost to them for getting their superannuation through a model like that is currently about $660 a year. So already those models out there, and as the market matures and balances grow, are significantly higher than the costs of the current industry funds. Now, we don't do any analysis that says, "What's the actual cost impact of moving a person from $218 to, say, an average of $600?" because that cost impact is huge, but we also say that it's not a realistic proposition to expect that the funds who recast themselves into the MySuper market at, say, an average of five to six hundred dollars are going to come back and say, "Look, we think we can effectively compete at $220." That's not going to happen. In fact what the whole market expects is that the distribution costs for those funds may rise slightly but they're expecting the distribution costs for the industry funds to rise significantly towards that, and that's the way in which competition is most likely to play out; in fact rather than a new market, a competitive price being set, it's simply going to add distribution costs into the system.

So having explained that, I'll take you through the Rice Warner report because I think that is probably the clearest way of explaining that point to people. Rice Warner, on this first page under Background, talks initially about the Productivity Commission just as a background report to say that this is partially in response to the report that's there and that they have been asked to estimate the potential impact on the operating expenses of superannuation funds which ultimately will affect the retirement benefits.

It then talks about how the distribution models work at the moment and I don't

take the Commission in any great detail on to that first point, but it does make the point at the bottom that given that default funds would no longer be covered by the AIRC, that there would be new options and criteria would need to establish the process for determining default funds. As it says there, the Commission has determined, in its initial report, listed between five and 10 funds. On page 2, it makes the point that:

> The measures proposed in the report would effectively increase competition between the funds and all things being equal, we would expect that that competition would directly impact on the distribution costs within the industry.

It then makes two points in this. It says:

> In the first instance, the measures are likely to add cost pressures to many small industry funds. They have limited distribution models and as a result of that, the industry fund segment is likely to consolidate quickly.

On its own, that is going to have a positive impact on the industry funds and they will actually get a slightly reduced cost through the impact of scale because a number of the smaller funds will be pushed into a merger or an amalgamation situation. Then in the last paragraph of that, about halfway down page 2:

> Moreover, the large industry funds remaining after the consolidation process would need to invest heavily in business-developed models to maintain their market share. Contrast most of the commercial corporate master trusts competing directly with industry funds are owned by the major banks and have direct ownership of the marketing and banking relationships with both the superannuation fund members and their employers which would give them a competitive advantage.

Essentially, whilst the report doesn't give any numbers on this, I think the implication from there is there's not expected to be the same impact on distribution costs on them. We say that doesn't matter, given where they potentially are in comparison to industry funds.

The impact of consolidation, it repeats some of those numbers that I gave the commission earlier. It says that the average industry fund is estimated to be $218 per week after consolidation compared to the $248 before consolidation, so a reduction of about $30 a week is expected in consolidation. But when you look at the next paragraph which says that the largest industry funds are expected to be the beneficiary of those consolidations and that they're already somewhere around $226 a week, the impact of consolidation is really a relatively small amount, about $8 a week. There are a couple of graphs that demonstrate that on page 3.

On page 4, the impact of distribution costs is discussed. Rice Warner say that again this issue of distribution costs is a factor that the funds currently do not have within their current structure and would need to import. In the third paragraph it talks about adopting a proxy measure for this which is how some of the wealth management subsidiaries of the banks operate. It goes on to make the point that marketing is normally done through salaried teams and professional development staff and talks about distribution costs of the order of .5 per cent of assets. Taking a conservative model, it thinks that this is likely to be an impact of somewhere in the order of about .35, which is an impact of $75 per year on the average person in a fund.

So essentially the point that we make in this and the point that we've worked with both HOSTPLUS and then Rice Warner about is that a recommendation to move away from the current model of, we'll call it, an orderly and well-structured distribution model to a model which imports distribution costs because people need to have professional distribution staff adds $75 a year to the lowest-cost operators in the fund and essentially will add $1.50 to the administration charges that people bear. That is then summarised in the overall costs tables at the bottom. You will see in there that there's potentially an increase in the benefit of consolidation. I take the Commission to the right-hand side of the table; an $8 reduction, $75 increase, a net increase of about $67 a year for the average person.

We've then asked Rice Warner to estimate what that means on end benefits and they've done two examples. If it would suit the Commission or the Commission wanted more, we could obtain some more modelling on this. But it looks at the two models; I will take them in reverse order here. It looks at a person who is aged 45 with a current balance of about $80,000, been in the system for a long time and not expected to be in the system for more than, say, 20 years, is likely to have their end benefits reduced somewhere in the order of about $17,000 or 4 per cent. A person who is younger and just joined the system is likely to suffer a reduction of something in the order of $27,000 or 8 per cent.

Essentially the point that we say is made by the Rice Warner report is that a change to the model away from a system which has an already established rationale for determining how a fund works to essentially a more competitive one has a deleterious and disadvantageous effect on people in the fund, particularly low-paid people. It adds costs of the order of $1.50 a week and then benefit costs of up to 8 per cent to people in the system.

We think they are serious implications, the change, and a change should only be made if it's going to add benefits to the system, so it shouldn't be made if it's going to clearly disadvantage the people who have been brought into the system in the mid-80s and who are important recipients of what the system should deliver. So I

don't go to points 7 to 10 of our submission any more than that to say that the points we make in there, that essentially a collective approach to the management - and that is a retention of the style of distribution system is there - is clearly in our submission the most advantageous to low-paid people. We do wish to make a couple of other points in the time remaining, if that suits the Commission.

MS MacRAE: Sure.

MR DALEY (UV): That goes to the issue of essentially other issues that are associated with the way in which a rationale is determined for selecting funds. Point 11 I think I've already dealt with essentially to say that the Commission said that the original selection had been done without transparency, and we're happy to refer the Commission to the 50 decisions which have actually determined this. There's been an enormous amount of transparency on the factors that have been taken into account that have reached the current process.

We say at point 12 we don't believe the process needs to fundamentally change. Essentially it reiterates the points that if the current system, both in cost numbers and effective distribution and coverage of the workforce is working in a systematic fashion, then there is no need to fundamentally change the system. We say in point 13 the opening up of default arrangements, increasing contestability essentially goes to this issue of what happens to the impact on long-term returns in the fund.

Having reached that point, I might hand to Mr Burton who is going to deal particularly with those other aspects of what we say are changes to the issues of the rationale behind determining choice.

MR BURTON (UV): Thank you, Brian. Thanks to the commission for the opportunity. I just want to talk a little bit about some underlying concerns we have about I guess the fundamental basis for injecting competition at the employer choice level into the sector. Brian has gone to the fact that we don't believe that there's a compelling rationale around better investment outcomes or an improvement to the fee structure. We would say that there's a fundamental flaw in a process that attempts to encourage or even institutionalise competition playing out at the employer choice level. Principally, that's for the obvious reason that an employer is divorced, both in time and in place of incidence, from the repercussions of the choices that they make on behalf of their employees. A simple process, whatever the motivations of the employer, the direct self-interest motivation of the employer, is not going to be primarily to achieve better retirement outcomes and I think that gives rise to a whole range of potentially disadvantageous outcomes from the process. It's just fundamentally flawed to think the system will be improved by introducing competition with decision-makers who do not bear the brunt of the decisions that they make.

I'll come back to some of the outcomes of that shortly. What we would say is that whilst it's become somewhat unfashionable to consider worker representatives as a legitimate role within decision-making bodies, we would say that in the absence of employees exercising individual choice - and they have the option to do that now, competition can play out at the retail level - that this is an issue about their superannuation, it is an issue about their retirement outcomes where there needs to be an employee voice in the process and to effectively remove that or allow that process for that employee voice to be removed runs some real risks of decisions being made for other reasons rather than leading to an effective competition.

We also think from an employer's point of view that it runs the risk of increasing the burden and the perception of costs associated with superannuation. How is an employer to make an informed decision even with all of the best motivation? How do they inform themselves? What criteria do they use and how do they avoid being burdened with a very costly structure of analysing superannuation fee and return analytics?

We think that there's some real dangers with the distribution model in terms of the funds' relationships with an employer. One of the issues that we face already is the issue of soft arrears, where an employer falls behind in their contributions to a superannuation fund, whilst ultimately the ATO bears the burden of pursuing those. In reality, that's a situation that needs to be managed by a fund. If an employer can unilaterally change the default fund if put under any pressure to make those contributions, we think that that will inevitably lead to a reluctance on behalf of funds to robustly pursue even a discussion about those arrears.

I guess just a couple of things in relation to potential impacts on investment decisions as well and investment outcomes in the medium to long term: I think one of the outworkings of institutionalising competition at the employer level is essentially you institutionalise competition at a wholesale distribution level which means the movement of money in and out of funds and between funds is at least likely to increase. What that does for a fund in terms of investment decision-making is that you have to reassess your liquidity assumptions and that means you have to surrender some of the illiquidity premium and some of the other benefits that go with a much longer-term investment horizon. I think they're probably the key points that we want to make.

MS MacRAE: All right. Thank you very much for that. Can I just ask a few questions - and we have only just received the information about the distribution networks - but I would just be interested to know, in terms of the cost impacts, what assumptions Rice Warner made in relation to the take-up of choice by employers and the likely turnover in funds. So while we're saying in our proposal that we think that awards should have been five and 10 funds listed in an award - and I'm sure you

know at least as well as I do that most awards currently have between five and 10 in them - so it just seems, on the face of it, without having gone into the numbers any more, that the assumptions here seem to be that there would either be a lot more take-up of employer choice and/or the turnover in the funds that are listed in awards would be substantially different than what we have today and I guess maybe we wouldn't see that much shift because I think you would also concur that if you're looking at the characteristics of funds that are currently listed that it would seem at first blush that many of those funds would continue to be listed, it's just that we're reviewing them to make sure that they are the best that's there. So just given the size of the numbers there, the impacts on the distribution system seem to be implying that there would be a big shift from the current funds that are currently listed.

MR DALEY (UV): The short answer on the immediate part of the question is that we don't have that information about what Rice Warner assumed.

MS MacRAE: Sure.

MR DALEY (UV): However, we can gather that information and put it in our final report.

MS MacRAE: Okay. That would be helpful.

MR DALEY (UV): But my suspicion is that they haven't allowed for a specific factor in that area. I think the way the report reads or the way the report is structured is that they have simply said that if there is now going to be a broader panel where there is active competition going on, then the response is, irrespective of what the take-up rate is going to be, that you are going to have to have a field staff that now actively deals with the choice issue employment site by employment site; that if an employer has 10 live choices in front of them - and I'll come back to this issue because you said it before - then ultimately that is a much different competition system than the system where the award system operates at the moment. In a sense, it means that the only way in which you deal with that is to establish a full-blown distribution system that deals with that.

It goes back to this point of how many funds are named in awards. This is a function of some of the issues that happened with award consolidation after the modernising of awards in 2008-2009 where up until then, the general case was for one fund per industry covered by an award. So if an award was the national hospitality industry, then HOSTPLUS was the nominated fund and sole fund. There were examples where two funds were named or more than one fund in a award or a fund covered a class of employees but substantially that was the case.

MS MacRAE: Yes.

MR DALEY (UV): When the modernisation of awards came on, it tended to basically add a multiplicity of funds but essentially the operation of those funds continuing to represent the class of employees that they already represented. The hospitality award would be an example of that. For instance, I can think of three hospitality funds that were added to the award, Club Plus New South Wales, Club Plus Queensland, InTrust Queensland. Now, they were very sector-specific awards which basically have continued to see their position and operation being sector specific, so that they operate in Queensland hotels for InTrust, Queensland clubs for Club Plus, New South Wales clubs for Club Plus. Generally the industry doesn't operate in a fashion and the selection of choice doesn't operate - even though the award might nominate five or 10 funds - that an employer in another state might have a presentation or an offer made by funds which are by and large regional based funds and who are inserted in the award for regional reasons.

The issue with the widening of this fund is if a number of the retail funds which have MySuper offerings are added to the selection panel; then what you do is you actively enliven choice across the whole country where it's not enlivened at the moment. So if three retail funds are named alongside HOSTPLUS in an award and an employer then is faced with an active retailing component that says to them, "Here is our retail offering, it's terrific, it's got all these bells and whistles, pick our fund," fund B comes along and says that, fund C comes along and says that, the employer then actually has to make a decision, and HOSTPLUS needs to burden itself with extra costs to be able to provide an additional range of information above what it does at the moment to facilitate that choice process, to re-establish its brand recognition, to put a value proposition to people, and that's what's involved.

My understanding or my belief would be that Rice Warner haven't needed to assume what the turnover might be; it's simply said if that's what competition means, and it means live competition where five to 10 isn't live competition at the moment, then it means a distribution system such as this.

MS MacRAE: Okay. I think I just need a bit more time to absorb all that, so I hope that's okay. Do you have any more questions on that, Paul?

MR COSTELLO: No, that was helpful, because it was really a question along the same lines that, as you would recall from the report, there were four options canvassed and one really was - which some of the submissions supported - that it should be opened up completely so there was full and complete competition between all funds, and I can see how in that sort of scenario, you could imagine what it would take for every fund to have its voice heard and how much that would cost. I found myself thinking, "I wonder if Rice Warner have assumed that we're in that sort of situation," where everyone is struggling to have their voice heard, so everyone needs a large distribution and marketing team and that adds a lot of cost, whereas of course the Commission has come down with an option which is similar in structure to what

currently exists, that there's 10 or less funds nominated in an award, which bears a lot of similarity at least in structure to that.

You made the point that there's a sort of gentlemen's agreement that exists at the moment - appreciate I said that, not you - but you said an orderly distribution mechanism where people stick to their territory or industry or whatever, so therefore you don't have people spending money to be heard over the others, although I must say just in passing, I was looking at Michael Rice making a comment in The Australian not so long ago, a discussion about some competition between industry funds struggling to be nominated in awards and he does make the point that it was part of a trend away from a collegiate approach, as industry funds had competed more fiercely to recruit new members and build the scale.

> Whereas there used to be demarcations, they are now starting to fight for different territories -

he said.

> Scale is definitely an advantage in super. You get higher competencies if you have a bigger fund with more resources. Everyone is trying to get in on an industry award at the moment because they offer monopoly rent.

So I think your argument is that funds don't have to spend a lot of money at the moment because even though there might be 10, for argument's sake, in an award, they're not openly struggling or competing to have their voice heard. So again it goes to Angela's point, trying to understand exactly what assumptions have been made, whether it's the kind of free-for-all environment that option 1 would envisage or just some more spiced-up competition as you outlined.

MR DALEY (UV): Just a couple of comments on that, if I might. It would be wrong to say that there's never any competition between the five to 10 funds in an award, and you do highlight the point that Michael Rice made. I think it tends to operate at the margins rather than in the mainstream and sometimes that's the way in which these issues are reported; that if you have a celebrated coverage battle on the waterfront or a Qantas or something like that, which I think that article referred to, there's then a flavour that that's what's happening in the larger marketplace. It's generally not the flavour of what happens in the larger marketplace but again it's not to say that there aren't places where there is some competition. Not all industry sectors are clearly and openly delineated in the coverage of each industry fund and there will always be some funds where there's an arguable case for one or more funds having a say for that coverage. So there is some competition that exists but it's very limited competition at the moment.

MR COSTELLO: Right.

MR DALEY (UV): But I just make the point about competition to this extent: the point is made, and I think it's assumed that there's five or 10 funds in most awards, there are many awards where it's not the case. For instance, the contract cleaning industry, one of the largest industry that the union covers has one fund named in it. Now, if it's to have five or 10 funds named in it, then there has to be a process and a rationale for who determines what other four to nine funds should be named in this industry when no rationale has existed up until the moment. So that's not clear in the Commission's finding as to cases where there's been good, clear and very stable outworkings of the system at the moment which is I guess covered in a broad change process to add a number of competitive funds to it.

MS MacRAE: I think the view that you've just expressed that there is competition at the margin, I don't know whether you would think that's a good thing in the system, but if you did and assuming you did, what we're looking at is to increase that competition to some extent and if we felt there was no benefits from competition at all, then the corollary of, "Let's just get the distribution costs down," is, "Why don't we just have one big fund for everybody." Just put everybody in one, then there's no competition, we don't have to worry about distribution costs because if there's no benefits from competition, then we just have one fund. So while I take your point about the distribution costs being one factor and an important one, it's not the only one because if this was really our key issue, then we would just say, "If distribution is all, we'll just have one fund,: and there's no competition.

MR DALEY (UV): I think Rice Warner addressed that point by essentially saying that the marginal benefit that you get from being large is not significant above a certain size. So if you have five funds each with a million members, they operate at about the same cost that one fund with five million members would operate in. The marginal cost is very low once you reach a certain level. Then because that marginal cost is low, it allows you to basically draw into other factors of representation, mobility in industry, the sort of factors that were relevant to the original selection processes.

MS MacRAE: Again though if we just accepted that argument, we would be putting a lot of weight on scale and saying there's a lot of small funds out there that probably wouldn't make the cut if we were going to say scale and distribution cost is all as well. Anyway, I'm just trying to make the point that I think you've given us some good food for thought but I think, as in all things in this area, there's balances to be made between various factors and I think you've given us some food for thought on the distribution side. I guess I'm just indicating I wouldn't want you to go away today thinking that the Commission is likely to accept this as a really - I mean, I've got to think about it a bit more, I suppose, in terms of the relative weight I put on that evidence compared to the sort of weight you've put on for your members. I appreciate that you are looking at a particular side of the market and we'd certainly

want to look at that. So it's very helpful that you've provided it and, as I say, it's certainly provoked a few thoughts in my head, so thank you for that.

The other thing I should say is if you've got those 50 decisions and the history - you talked about the history - that would be really helpful to us as well. That would be terrific.

MR DALEY (UV): Sure.

MS MacRAE: It sounds like you've got that at your fingertips, so I fully appreciate it. I think that's information either we did have and we didn't publish it or I wasn't aware that we had gone away and looked at those things, so that would be helpful to us as well. I'm just conscious we are due for our next participant. Did you have other things?

MR COSTELLO: No, you go ahead.

MS MacRAE: You had some things around giving the employer choice and not being attracted to that notion at all and one of your comments said that you had concerns about the employee voice being removed from the process and that's certainly not in our proposition, that the employees would no longer have a voice. The industrial parties would still be able to make submissions in our options 3 and 4 which are sort of the ones we're choosing between as a result of the draft. So I just wanted to make sure that there wasn't any misunderstanding in terms of what we were proposing there.

MR BURTON (UV): I guess what we were pointing to was when you move away from decision-making predicated on process and structure to one with a primacy of criteria around the investment product, you weaken that employee voice and you weaken the considerations in it. I guess it goes to the heart of the fact that we do believe this is an industrial matter and that it's best determined between the industrial parties and that reducing them to the role of making submissions and giving opinions is dangerous, we think. It really goes to the heart of the fundamental assumption - and you said you assumed we think a little bit of competition is good and so therefore more would be better at the employer level - - -

MS MacRAE: Sorry, no, I didn't say you would necessarily think more would be better, but I was assuming that that level of - - -

MR BURTON (UV): That we think a little bit is good. I think there's a real danger or we think that there's a real danger when you start to institutionalise the idea that that competition plays out best at an employer decision-making level and any steps in that direction we think are fundamentally flawed, just because what you're doing is giving the decision to people who are not impacted by that decision directly.

MS MacRAE: I understand.

MR BURTON (UV): So that's really the basis of that comment.

MR COSTELLO: Just to clarify, which is why the option that suggested that there should be an entirely employer based decision was not supported, and the concept of keeping it manageable, to your point, but putting central an outcome which was assessed as driving the best outcome for an employee from the range of options, sorting the vast range of options into a manageable number of options, but the only test applied being that they would be likely to have their interests best advanced. You make the point that that may increase costs and that may go against their interests. We make the point that cost is important but not the only factor that determines outcome, and there's a bunch of other criteria as well and it's a case of balancing all of those things.

So it is important I think to reinforce the point that the interests of the employee is paramount. One of the difficult things in this industry is that everyone purports to speak to the member but represents some part of the puzzle of serving them and so this report from the Commission distances itself from that. It just simply says trying to balance all of those things, does it increase cost or not, and that was helpful; is it genuinely in the best interests of the contract cleaners to have a fund nominated some time ago, no real provision for that to be checked against others, no real review of whether that's an optimal fund for them that's convenient and it's low cost and it's easy at the workplace, the point is taken. I guess what the review tries to say is that optimal for the interests of those employees, is it certain that that's optimal or would some change to that, always with the interests of those employees at heart, be appropriate to consider, and that's the balancing job that this review tries to do.

MR BURTON (UV): With contract cleaning, I suppose what we would say is this: it is not a process that is removed from the potential for review, that what you have to do is look behind the fund that's there. The employees have a constant voice on that fund in terms of employee representatives sitting on the fund and reviewing it and if there's a belief that it's not performing or that there's some problems with it, then it's quite open for that to be raised and addressed, whereas if there was one fund and it was removed from employee interaction and evidence and the only choice was to exercise individual choice of the superannuation fund, we think that would be a bad outcome. But in that particular instance, we think, particularly in the contract cleaning, security and industries where there are reasonably small employers with high employment costs, it would be a disaster to have a form of competition put into that because we would have no confidence that, given any choice in that industry, an employer would be in a position to make a good choice of default fund and would be able to immunise themselves against undue or even perceived employer benefits

from exercising choice in that domain.

MR DALEY (UV): And essentially has to almost take up a financial services licence to be able to give the advice as to which fund they have chosen.

MS MacRAE: Okay. Thank you. That's been very enlightening and we look forward to receiving your submission in due course. I understand you'll be providing us with one. Is that right?

MR DALEY (UV): Yes.

MS MacRAE: Thank you.

MS MacRAE: If I could now invite the Law Council of Australia to the table. Thank you very much. If I could just invite you to give your name and the organisation that you're representing today and then if you have an opening statement, that would be very welcome. Thank you.

MR GIRGIS (LCA): My name is Maged Girgis. I'm a partner at Minter Ellison and I'm here representing the Law Council of Australia superannuation committee today. I apologise for not previously circulating a bullet-point list of the points I was going to raise but I understand you might have them now, so if you'd like to take a moment to read them or I can start, it's fine by me either way.

MS MacRAE: It's only a page, so I'd be happy for you to read them, if you like then they go into the record and it gives us a bit of a chance to absorb them. We're happy to do that.

MR GIRGIS (LCA): Basically we divide our submission into five points. The points can be basically summarised as follows: out of the four options discussed in the draft report, we believe option 1 is still the best option. In particular, we have concerns with options 3 and 4 as to their practical outworkings. That's probably not a surprise from some of the discussions I've heard you talk about that you had earlier today. One of the main drivers for that is the significant financial impact it will have on any given fund if they are excluded. I will go into more detail into each of these points shortly.

The second point we would raise is that we question whether Fair Work Australia or an expert panel would be able to accurately assess the criteria that had been set out in the draft report given the sheer number of funds that would want to be involved, the amount of information they are likely to give and the amount of information really that would be required to accurately assess any fund against those criteria, in particular, the criteria that would tend to be on the high-level side and almost open up a can of worms on each criteria to some extent if I can put it as bluntly as that.

The other question we have is whether it is even appropriate for Fair Work Australia or an expert panel to make a commercial assessment of superannuation fund in this way. This is a role that's normally restricted to rating agencies and financial planners and financial advisers. They will look at the appropriateness of a particular product, given the particular characteristics of the person or of the employer group and advise. In effect what is being asked of Fair Work Australia or the expert panel under options 3 and 4 is effectively a very similar exercise. We are concerned that if it does go down that road that it would need immunity from suit. If, for example, it was to basically assess a number of funds, five to 10, put them on basically an approved MySuper list effectively, and members, employees, employers were to lose money, say, by investing in a fund, it would be very easy to take the

criteria around the appropriateness of the investment objectives and the risk profile.

Now, if Fair Work Australia or the expert panel got that wrong - and it would be very easy to get it wrong given the volume of material it would have to get through within presumably a short period of time - the question of who would pay for that loss, even if Fair Work Australia or the expert panel were protected from suit, would it create a moral hazard for the government to step in anyway, because effectively it was a government agency that was endorsing or approving these products. This doesn't currently exist because the government through its agencies, through Fair Work Australia or the Industrial Relations Commission as it previously was when the awards were drafted doesn't in any way endorse any of the super funds on that list, but here an independent review would be done on the quality of those funds as against certain criteria, so we're concerned that that may be another angle.

We're also concerned, having regard to the significant impact it will have on any fund that's excluded, effectively they will be shut off to 70 to 90 per cent of SG moneys, if you take the statistic that 70 to 90 per cent of people don't exercise choice and that they fall into the default category. Given the significant financial impact it's likely to have on that fund, I think it's fair to say that the funds that are excluded will seek review of the decision that's made, somehow, some way, and they will seek to impugn that decision in some way. So we question whether it is appropriate for Fair Work Australia or an expert panel's resources to be used up in defending itself and in this sort of analysis.

The third point is what is currently proposed in the draft report is that an employer can come of the list, if you like, but they would need to demonstrate that employees will not be worse off. We don't believe that is necessary and also believe that an employer should be able to come off the list without having to demonstrate that. But if the Commission was minded to still apply a test along those lines that the test would need to be recast. In particular, what needs to be made clear is whether that is a test that's applied before or at the time that the employer comes off the list or after. So is it a retrospective test or is it a test that's applied beforehand?

If it's applied beforehand, which is the way it currently seems to be drafted, then the employer is saying, "You will not be better off." In other words, "I'm also guaranteeing" - the words are quite strong in terms of - "you will not be worse off." If it's after the effect, then the question is really: is it a test of whether the person is worse off or it's a test of whether the employer had a reasonable basis for believing it. We believe that it should be based on a reasonable basis test. Employers aren't gifted with foresight any more than any of us. The Commission should then also prescribe what sort of documentation an employer could use to satisfy that test; some sort of standard documentation would be ideal. A certificate from an actuary or from an accountant or from a financial adviser should be what's required.

Thirdly, if an employer does get it wrong, there should be no impunity for that employer, except where they've acted in bad faith. An example of that might be some benefit that the employer received which was inappropriate for making the decision to superannuate its employees in that particular fund. We believe these changes are required because without those changes, the fear that an employer could have their decision second-guessed to justify the decision to an employee, a union, Fair Work Australia, is enough to dissuade employers from taking the decision in the first place. It simply isn't important enough to most employers to want to get a better deal for their employees if the cost of that will be tying up company resources or litigation or some sort of penalty of some description. So to encourage employees to get that better deal, we need to free up the consequences and only pick up with consequences those employers who have acted in bad faith.

We believe the grandfathering, or grandparenting, I should say, provisions should not be removed. To do that effectively means that members will end up with multiple accounts. It may mean that they lose their insurance benefits because that fund is no longer their primary fund. It's not clear from the report what would happen once a fund comes off the list whether the amounts would have to follow, the account balance would have to follow. Presumably the report doesn't deal with that, but with the government's auto-consolidation regime, the amounts would follow at some point down the track.

This would happen at a time not of the employee's choosing. It may happen during a downturn in the economy which means they're crystallising investment losses at a time the employee didn't want to do it. It would particularly affect employees if they had had an illness and their insurance was cut off. They wouldn't be picked up by the old insurance policy in the old fund, and in the new fund it would be a pre-existing injury, so it wouldn't be picked up there. So we believe grandfathering is vital.

It also would create a cost burden for employers, an administrative burden. If one looks at a multi-industry employer, someone like a BHP, that have coalminers, electricians, secretaries, truck drivers, and it goes on, covered by multiple awards. At the moment they satisfy that by contributing to one fund, the grandfathered fund. The removal of grandfathering would effectively mean they would have to comply with a potentially different fund for each of their awards. So you've actually taken one fund and turned it into 20 funds or however number of awards they're picked up by. So that actually adds to the industry burden of employers. It doesn't even need a big employer; even a small employer operating out of a city like Parramatta, for example, would still have a secretary picked up by the Clerks Award. They would still have other people picked up by other awards. You could be picked up by other awards even if you're a small employer.

Lastly, a period of eight years is suggested in the draft report for basically a

total review to be conducted. As I mentioned, one of the underpinning things of our position is taking the fund off an award will basically ruin their liability. The smaller the fund, the worse it gets obviously. This will impact on the investments that funds make. If they know that they have got an eight-year window where they could be taken off, there's no guarantee they will still be on there, I question how many funds will make the 10-year, 20-year, 30-year investments. So I think what we'll see is only the very large funds making those sort of long-term investments because they're probably going to be a bit more confident that they will make it through the eight years. Smaller funds probably won't, and they won't necessarily syndicate their investments either because they're going to have to have some fall-back position in eight years' time if they don't make it onto the award.

That's the general thrust of it. I can go into more detail into any of those or I can answer questions; I'm happy to do either for the Commission.

MS MacRAE: I think we might come to questions, if that's okay, because you've raised a lot of material and I've got quite a few questions, some of which is, I have to say, extremely helpful. This might be a question that you would prefer or that you haven't really given thought to, but option 1 does have some attractions to it but we went through with the FSC this morning in some detail, that we've seen that many employers, particularly the micro and small end, are very concerned that they don't want to have to choose from, say, 300 funds. Even if you accept the sort of proposal that maybe it's not going to be 300, it's going to be 200, I don't think anyone is suggesting it's going to be much less than that.

MR GIRGIS (LCA): Yes.

MS MacRAE: So in some ways with option 1, the difficulty you have with it is somehow or other for practical purposes for an employer, from the employer perspective, we need to somehow be able to narrow down that range of options. I guess at the end of the day, where we've come to is to say: what's the existing structure that we have for how we select funds for awards? Can we adapt that in some way that would meet the overarching requirements that we think should apply for the best interests of members that gives us a short list of what would otherwise be a very large list? I'd ask you do you see that as a reasonable problem that we're trying to address in terms of the amount of choice for employers, and would the Law Council have any idea about how they think we should best address that issue?

MR GIRGIS (LCA): Sure. There's probably three comments I'd make in relation to that. The first one is the number; I think the lowest figure I've seen is 172 and that was the Rice Warner report. No-one knows what it's going to come down to. What we do know though as lawyers who are working on mergers constantly and have been working on mergers for the last 10 years, I suppose, is that numbers are coming down dramatically.

I gave a talk recently on a completely unrelated matter but it was a snapshot of what life was like in 1996 and what life was like in 2006 in the super world. In 1996, the ISC in those days was lamenting that funds had fallen from 17,000 down to 8000 - the sort of funds we're talking about now, we're not talking about self-managed, these are the ones we're just talking about now - and how employers found a way of picking funds in those days. By 2006 the figure had fallen down to roughly 1500 and it's now down to 340, I think, all up, excluding small APRA funds which realistically aren't going to move to MySuper, so they're going to be excluded naturally anyway. So we're seeing a constant decline. That's the first point. I think we are going to end up with sub-200s, realistically.

The MySuper regime is geared up to reduce that number. Inherently built into it is a scale test which means that the smallest funds, the bottom of the list in terms of size, we'll always need to be heavily reassessing whether they need to be in existence. So you've got a constant sort of built-in culling mechanism; that's the first point I'd make.

The second point I'd make is there are different ways we can get around the difficulties of finding a fund. One might be, for example, to list funds in an award but not make it mandatory, so employers that feel strongly about coming off the list can come off the list, either because they've got an existing arrangement, grandfather arrangement, or because there's a particular benefit that might come outside of the fund offered by the institution. For example, there may be salary continuance insurance offered outside of the fund for staff, for example.

The real issue that we see with option 2 is that it's locked - options 2, 3 and 4 actually - you're locked into that list and the way to come off that list is to somehow demonstrate that someone will not be worse off. The worse-off test is actually in itself problematical. You've got 10 funds worse off than which fund, worse off and which way? How do you assess if someone is worse off? Is it just on fees? Is it on investment returns, and so on and so forth. It's such a nebulous concept that it would be difficult to apply and it leaves employers going, "You know what? I don't really care that much about it. It's not my core business. I'm an iron and steelmaker," or, "I'm a car manufacturer," or whatever.

MS MacRAE: Yes.

MR GIRGIS (LCA): So it's the locking-in part that we think is the real detriment to options 2, 3 and 4 as opposed to 1.

MS MacRAE: So just in relation to the suggestions you've made, and we certainly did ask for feedback on how that mechanism might be recast because we did appreciate that it was one of those things that we were sort of working on as we were

getting to the finalisation of the draft and we certainly didn't feel entirely comfortable with what we were proposing but we were hoping to give enough substance that we could get feedback, as you've provided.

MR GIRGIS (LCA): Sure.

MS MacRAE: Would you think that out of your three points, points 3(a), (b) and (c), where you're talking about the way we could recast that sort of test, that we could get something workable that the Law Council would feel we could make work if we went for an option 3 or 4 that had a test more akin to the sort of proposal you've got here?

MR GIRGIS (LCA): There's two parts I suppose to the recast that we're suggesting. One is that by itself, it's got so many issues associated with the test that's currently cast; what does it mean, how is it applied, and so on. The second part is while you can clean all that out and clarify what that means, does it still in effect act as a discouraging agent? We think it does, because it basically makes the employer justifiable in an area which employers generally don't want to be justifiable. What I mean by that, and I want to clarify what I mean by that specifically, it's not so much that they won't stand by their decision, what we're concerned about is there is a feeling among many employers that they don't necessarily want to engage in industrial relations unless they have to. So if they're answerable to a union or to employees on a particular decision, they're engaging in an area that really they want to reserve for renegotiation of industrial instruments, not on a more ongoing basis.

If we're trying to avoid creating administrative burdens for employers, then this sort of thing is going to create the potential for a burden or you just simply don't do it. You don't want your HR department having to write letters to people explaining why you picked - you're just not going to do it. So that's what we're concerned about and there's two aspects: one is clarification and one is it must be done in a way where justification can be done very simply. Now, to the extent an employer is relying on external advice, whether it's for an actuary, an accountant or a financial adviser, then evidence of the professional advice they receive should be sufficient. If that professional advice is sound - at the end of the day what we're talking about is a reasonable basis, so if the advice is not sound, if it's something written on a scrap of paper or the back of an envelope, it really doesn't give the employer a reasonable basis for believing that members will not be worse off or employees won't be worse off, so it has to be a sound piece of advice, but that should be sufficient.

MS MacRAE: Okay. Then you're saying that in relation to the penalty that an employer might face, the worst that they should face, if they have met that previous test of having a reasonable basis is that FWA might direct them that all future contributions had to be made to a listed fund.

MR GIRGIS (LCA): Exactly. At the end of the day, what we're worried about is the employer being effectively punished, either through some penalty or some other mechanism, for the way in which it delivers a benefit. It's important to note here, this is not an employer that has not provided super or anything like that, it's just the way they're providing that benefit. They believe it's a better way to do it this way. They do it that way; it comes out that at the end of the day they're incorrect. They've done so on a reasonable basis. Do we really want to be punishing the employer for that?

MS MacRAE: I can't tell you how helpful that is. We've been playing around with ideas and we do actually have some staff who are lawyers but it has been a very difficult issue and we'll think about that very closely, so thank you, that's very helpful.

MR GIRGIS (LCA): The only other points I would make - or would you prefer to continue on - - -

MS MacRAE: No, that's fine.

MR COSTELLO: It's a point that comes up constantly really but people approach it from a different perspective. Question 2, you've clearly articulated, for a range of reasons, a preference for option 1 that we outline. Do you believe that the long-term net financial interests of the workers who are default members covered under awards - which is not all workers, it's a large subset of them by number, it would seem limited by the amount of capital in the system but large by number - do you believe that option 1 would be expected to produce a better financial outcome for those people? Leaving aside risks to employers, leaving aside how it affects funds and leaving aside their investment program and whether they're short or long term, do you think that where employers are choosing from a larger group of funds but unencumbered by interference in the system, that that would produce a better outcome for people than some version of three or four where you've got some expertise coming in, trying to kind of refine that group and make that decision on their behalf?

MR GIRGIS (LCA): It's a really good question. If you had asked that question of me in 1996 when there were 8000 funds, I would have answered no. But what underpins also this point is that since then, we've got a much smaller number of funds. They are generally all major players now. Out of that 300, there are very few small funds that really shouldn't be around. MySuper is going to basically apply a pretty heavy filter through that group as well. So what you're going to end up with is very much some very good quality funds, and almost all of them will be a certain calibre which I would accept as being a very good level.

The problem that we have with options 3 and 4 is you are then saying, "Okay,

out of this group I'm going to somehow pick the best of the best," in a way, because the best have already just made it through MySuper. There's some problems with some of the criteria, but as a group, our question is: how would you be able to assess the best of the best, because inherently these are all snapshot analyses. If we were to apply the same snapshot, say, four years ago, the funds that would have succeeded under those analyses four years ago you would see are not the best funds today four years down the track, because four years ago their investment returns were fantastic and so on. With the GFC, we've now realised some things that we didn't realise at that point of time. So in a way, I don't know whether members would be better off applying that analysis, but that's my point, that no-one will ever know.

MR COSTELLO: Sure. So the point you make about the difficulty of making a decision going forward about a financial outcome is recognised by anyone who's been - - -

MR GIRGIS (LCA): My point is actually more than that though.

MR COSTELLO: But my question is, if we accept that it's difficult to make a decision which would not be regretted in time, I'm interested in your view that you think that employers on balance would be better making that decision alone from a wider group than with some guidance - which our option 3 would suggest it's guidance, "It's there if you want it, if you don't want it" - and you've made some comments about what would happen if you don't, but our suggestion is that there's guidance for the many that say that they would value it, and we're talking about how to create flexibility that say that they don't, putting on - and we think this is important - that whoever is making that decision, the employer in the workplace or the specialists outside it, need to be thinking about little else but what's likely to be in the best interests of those people. I'm just interested in your view that you think, I think you said before, they would be at least as good, if not better by making that decision alone from a wider group than in our proposed - - -

MR GIRGIS (LCA): There's a couple of things I'd say about that. My point is it's more than simply it is a difficult task. My point is it is a difficult task, but also that realistically, an assessment like that is a fluid assessment. I don't mean eight years, I'm talking about it can change literally from year to year. You often see funds that are in the top quartile suddenly dropping down to the bottom quartile because the style of the manager they're using doesn't suit the market conditions, because the market conditions are constantly changing and you can jump from the top to the bottom very quickly.

So generally the assessment, apart from assessments like governance and so on which tend to be a lot less fluid, those sorts of assessments are inherently fraught with danger. That's my point, that it's not just difficult but actually you could be giving the wrong impression about the quality of a fund by endorsing it, because it is

a snapshot analysis on something that's constantly changing.

The other thing I'd say about this is that this needs to be looked at in terms of practically how things occur. Giving employers choice doesn't mean that employers will all make a choice. The majority of them will simply default to the funds that are listed. So if you said, for the sake of argument, "Here are a bunch of funds which we think are very good, you can contribute to these funds or any other fund that you choose," the far bulk of people would just simply go to that list and will probably go in alphabetical order to the top one. We always joke about funds doing that, changing their names. The funds that will realistically go to the "any other fund" category will be those that can make decisions - the larger employer groups, and we do see them. We act for employers in my particular practice and we do see them dropping funds because their investment returns aren't as good. We see them dropping funds because their fees are not as good. A lot of employers also subsidise fees, so they're keen on that. They also see superannuation as an employee retention strategy as well, so lesser funds do get dropped by the wayside.

I'm involved in a fund at the moment, a corporate fund that's being closed down. It's a very large multinational fund. It's one of the largest corporate funds around. The employer went to tender for an alternative and they went through all of these same analyses. So they do have the resources. Their HR departments do have the resources when they're larger, and they're the ones realistically that will be doing it. But if there was any sense that they have to justify their decision or they're accountable in a pecuniary sense, they simply would not go to the trouble of doing it.

MR COSTELLO: Would you be able to clarify something that I see as an inconsistency between two things you've said; one is the diligence with which employers are prepared to look at their decision and review it, and if they conclude that a decision made some time ago is no longer optimal going forward - I mean, I understand the motivations for that - but you did point out if that the system as a whole were to build in the same flexibility to say a decision made eight years ago is not optimal today, you saw that as a weakness, in that it would interfere with the decision-making of the fund. So I guess I'm just pointing out what I see as an inconsistency there between the necessity and the benefit of review versus the - - -

MR GIRGIS (LCA): What I would though is that there a difference between an employer moving his staff and a fund being dropped off an entire industry. One will devastate the fund and by necessity, they won't be investing in those things. We're talking about a fluid situation as opposed to a guillotine execution of - - -

MR COSTELLO: So short of option 1, where there is no nomination of awards, how would you suggest this question of a fund that struggled on some criteria, on a reasonably informed review of criteria, struggle to retain the position that it was in a number of years ago? Do you have any thoughts on how that question might be

managed? To the extent that a decision that looked fine eight years ago is no longer - you've suggested that there would be a guillotine effect and that it would be problematic if it were to be removed, I guess the only conclusion there, if you think it's better that it stays, even if - I'm asking you how you think that might be managed to deal with that situation because for someone new turning up at a workplace the next day whose contributions may well find themselves going into that fund - - -

MR GIRGIS (LCA): So we're looking at a scenario where a fund has invested properly, those returns are now coming home to roost, if you like, and roughly an eight-year period has lapsed and they are now up for review. One option, as you say, is they simply don't make the review grade and they are axed from the list. What I'm suggesting though under option 1 is what will happen if there was a leakage of employers as those returns become worse and worse and worse, so it would start to happen as it's getting worse, not necessarily on a drop-dead line. The fund will generally start to react by the time it starts to lose funds under management, starts to see leakages. Most funds at board meetings have an inflow and outflow analysis done, so they will start picking it up very early. They won't be waiting until the end of the eight-year period. So in some ways I think it's healthier for funds to actually start to feel that pain, if you like, as it's increasing rather than, in a way, being able to survive till the end of the eight-year period and then the guillotine cuts, not to mention also the flow-on effects of cutting off the fund and so on.

The other problem is that once a fund is effectively cut because of its resources, its cash flows and so on are affected, there's a good chance it probably even make it on that list ever again, depending on the grandfathering of course. If it means automatically that account balances will have to move out of that fund - I suppose there's two dynamics. One is inflows and the other one is funds under management. Inflows are enough to really hurt the fund. Funds under management will bring the fund effectively down the scale and effectively wind up the fund.

Underpinning all that, implicit in all that is that we believe that competition is a better thing and that if you end up with five funds, then you're effectively not much different to the Australian banking system with four major players. I think there's a general view in the marketplace that that's not necessarily a good thing to only have four players, and I think the government is now starting to introduce competition in that regard. So we're looking at five funds on an award potentially; there's not a lot of incentive to really make life a lot better for your members if you are guaranteed a spot effectively because you're one of the major players and there's only five of you on there. So we would say having 200 funds nipping at your heels is not necessarily a bad thing. There is a cost to that. I agree with the comment made earlier on about distribution costs, but the upside I think is worth it.

MS MacRAE: All right. We are due to break for lunch. I'd like to thank you very much. Will you be making a written submission?

MR GIRGIS (LCA): We will be. It is a draft at the moment.

MS MacRAE: Great, okay. We'll look forward to that. Thank you.

MR GIRGIS (LCA): Thank you.

MS MacRAE: We will reconvene at 12.45. Thank you.

(Luncheon adjournment)

MS MacRAE: We might get started again. Just to apologise again, Mike Woods has another commitment but should be with us within the next 10 minutes or so but he did ask that we get started without him to make sure we fit in all of our schedule today. If you wouldn't mind introducing yourself with your name, the organisation you represent for our transcript and then if you have an opening statement, we would be pleased to hear it. Thank you.

MR WATTS (ISN): Richard Watts, external relations manager and legal counsel for Industry Super Network.

MR VIDLER (ISN): I'm Sacha Vidler, the chief economist of the Industry Super Network.

MR WATTS (ISN): Thanks for the opportunity to address at least two of you. We welcome the opportunity to make some comments in relation to the draft report. We welcome the draft report and the work that has gone into it and in particular we recognise and welcome the conceptual framework adopted by the commission. The work that is detailed in section 3 of the draft report, in particular the placement of the best interests of members as an explicit overarching objective in the process and we think that is something we should not lose sight of throughout the process. So we welcome that as a fundamental direction which this exercise is being taken and we recognise that that is in fact the case.

I think it is worth making just one observation though. We recognise that there are some comments in the draft report where the commission has inferred that the existing process of selection is wanting and wanting on the basis that - I think the inference is that it has built in conflicts of interest and there are allegations, I guess, of bias in that process. Some of the tone of those observations are surprising given that we're talking about a statutory body with members appointed by the governor-general and working within the Fair Work Australia Act. They are surprising. We don't necessarily agree with the inferences that are there.

In relation to MySuper and the relationship with the process of MySuper, we recognise the Commission's observation that there needs to be a filter process beyond the MySuper authorisation process, that there will be many varied of MySuper funds operating and that there is a need to have a filter to ensure that MySuper funds are appropriate for the relevant award and the demographic that is covered by that award and we concur with that view. In terms of the default fund selection criteria, there are a number of views that have been put forward by the Commission in relation to that. We have to say that in our original submissions we proposed that there be a prescriptive criteria, recognise that the commission is of a view that there not be a prescriptive criteria other than factors to be considered.

It's a subtle difference in part but we believe that there are at least a couple of issues where we are still of the view that it would be appropriate that there be a prescriptive criteria, in particular long-term net returns and the behavioural issue of flipping that we address in our original submissions and will go to further in our follow-up submissions in the next days.

We will come to the issue of net returns in a moment in a little more detail. But we think the draft report lacks some clarity in terms of how to deal with the issue of net returns. We believe that a proper reading of the report would indicate that in fact the Commission is discussing the need to look at what people in fact get in their pockets, net returns - or rather in their accounts. I'm not entirely sure that a casual reading would leave one with that interpretation and I think it needs to be a little clearer in a final report as to what the Commission's views are on net returns.

The selection criteria and the processes and the factors that the Commission has put forward for consideration, we welcome all of those. We think they're worthy. We will, in our follow-up submissions, make some comments in relation to some of the criteria or recommendations as to how they interact with the proposed MySuper changes, Stronger Super changes and the APRA prudential standards that have been introduced. Whilst we think they are important considerations and they do warrant consideration through this process, there was also a separate process that has been undertaken, in particular the APRA prudential standards that go to issues of governance, the conflicts of interest, that those are matters that are probably left in the hands of one body rather than two and they are important issues and we think they need to be addressed.

We think the governance issue needs to be addressed in a holistic sense as well, not just through what the legislative or legalistic requirements are, whether in fact, we would believe, a fund that is operated for and in the best interests of a member and the structure of the funds, whether it is in fact providing representatives rights for representatives and employees is an important consideration in terms of governance. However, those matters are all probably matters that are largely dealt with through separate processes.

In relation to governance, recommendation 5.2 calling for government inquiry into governance structures, I am really not sure what the motivation is behind that, how it ties in with other initiatives that are taking place, in particular the Stronger Super, MySuper changes, the APRA prudential guidelines and standards that have been worked on at the moment. We think that it is not necessarily something that we would think would be appropriate, given that there is a process of change and investigation taking place elsewhere.

Recommendation 5.3, Mechanisms for Dealing with Conflicts of Interest, as I said, we welcome that and we believe that the APRA draft standard 5.2.1 is probably

the process that that would be dealt with, it would be through industry consultation and APRA has some firm views in relation to how those processes should be undertaken. We concur with the proposed prudential standards. 5.4, we welcome that recommendation very much. It is a recommendation that when looking at the selection process for a fund the consideration be given on the likelihood of an employee's interest being transferred, that is, flipping being considered. We agree that that is an important issue and needs to be looked at.

On that issue on pages 92 and 93 of the commission's draft report, there are some comments regarding employee discounting which we think probably need to be looked at in the context of the flipping issue. Whilst we not opposed to employer discounting of a product to ensure that it might be appropriate for the workplace, the important point is how the employee is treated and what happens to that employee once they leave the employer. The exercise of flipping is one where more often than not a discount is applied to an employer that that then - that discount no longer applies to an employee when the employee leaves the workforce. Now, with 20 per cent of the workforce on average changing jobs every year and that ratio being higher amongst minimum wage employees, which are largely award dependent, then we have a large percentage of the population having their interest in their fund being altered as a result of these arrangements.

So if in fact there is a discount and the discount is provided on a loss leading basis where subsequently the cost is incurred by the employee when they leave the employer, then we have some concerns. So discounting per se there's nothing wrong with discounting, it's in fact to be encouraged, in some respects. But it's the basis on which the discount is provided, whether in fact the employee is being treated fairly, so flipping should be looked at in holistic context.

Recommendation 6.1, The Issue of Compatibility of Insurance for the Demographic Covered by the Award is an important issue, one we raised in our earlier submissions. As we pointed out many industry funds have tailored their insurance over a period of time to reflect their particular industry that they've historically covered, and we think it's an important consideration, as is recommendation 6.2, The Quality of Member and Intra-fund Advice, we welcome that. It's not just the quality of the intra-fund advice and intra-fund advice that's offered but the availability of it. That goes to the scope of the fund and the ability of the fund to provide intra-fund advice to its members no matter where they happen to be found.

Recommendation 6.3, Considerations of Administrative Efficiency, whilst it's welcome, we probably suspect that it's more an issue for the Stronger Super reforms; not sure how delivery of bodies to look at the administrative efficiency issues in itself - it might be an issue that is beyond the level of expertise, unless of course the administrative inefficiency is probably patently obvious.

I'd like now, if we can, to address some of the issues about past performance and the persistence of returns. It might be a good time to take that break given we've been joined by Commissioner Woods. I'll hand over to Dr Vidler to deal with this particular issues.

DR VIDLER (ISN): Thanks, Richard. I've brought along a little bundle of extra research to table. Can I hand these to you?

MS MacRAE: Is this what we've already got? No?

DR VIDLER (ISN): No.

MS MacRAE: Something different? Okay, thank you. Sorry, I just wanted to save you the trouble if we had them already.

DR VIDLER (ISN): There's a few copies there.

MS MacRAE: Thank you.

DR VIDLER (ISN): It's quite a bundle, but I'm going to talk to it quite quickly. They're fundamentally there for reference. So as Richard said, my comments are just going to go to one issue, and that's the value of consideration of historical returns. The value of these returns and historical performance are questioned in the draft report. The only statistical exploration of this issue that I could see was table 4.1 page 67 of the draft report which just uses a handful of funds and it appears that that example was selected to illustrate a lack of persistence. The Commission's view is summarised on page 68 where it says:

> The Commission's view, therefore, is that a fund's past performance should not be used in the selection and ongoing assessment of superannuation funds.

So I'd just like to spend a few minutes going over why I think this is problematic. In fact, net returns in superannuation do show persistence. This has been shown by three different researchers using different techniques, different data and for different periods. Sy and Liu, who are APRA researchers - and they're in the bundle at tab D. APRA in 2009 had a significant appendix to a report on returns, that's at tab E, and they identified persistence in returns as well. What you'll see there is just an extract with the key charts. Most recently, Deloitte Access Economics, we submitted previously, has also found evidence of persistence in raw returns between 2003 and 2011. This is not a surprising result. It's entirely consistent with a decade of research that shows that returns are directly influenced by profit orientation and governance.

So since 2003 APRA have released research on numerous occasions showing that retail funds underperform not-for-profits. There's a number of articles in that bundle, tabs H, I, J and F - go to that very question. APRA researchers have also looked into why this is the case, besides noting differences in fees and asset allocation, which are perhaps the most obvious sources of difference in returns. They have also found that retail funds on average overpay suppliers who are related parties by a multiple of 2.6 on average, so very significant overpayments to related party suppliers, whereas not-for-profit funds who also use suppliers who are related parties tend to pay market rates. That research is at tab C.

They've also found in research released this year, Cummings 2012 at tab F, that retail funds do not pass on economies of scale, whereas not-for-profit funds do. Cummings has made the breakthrough - he's demonstrated the economies of scale exist, he can identify them and the administration costs - but those economies don't flow through to the members of funds in the case of retail funds.

APRA have also found that there are difference in characteristics of directors of retail funds and not-for-profit funds. At tab G the research shows that a majority of retail fund trustee board members work for the fund or suppliers, whereas the reverse it true for not-for-profit funds. They've also shown that only a small minority of retail fund directors have a personal stake in the fund, whereas the reverse is true for not-for-profits. Most not-for-profit directors have a stake in the fund that they manage.

I'd just like to emphasise the reason I've tabled this research is that it goes to an issue raised by the Commission, which is the importance of agency costs in financial services and particularly superannuation. The historical record and this research goes directly to this question. It shows that retail funds historically have underperformed, they've done so persistently and that they've done so for reasons which are related to governance and profit orientation. We know that in retail funds there are three sets of interests competing: shareholders, members and management. All of this evidence goes to the fact that of the three it's always members who come last.

This treatment, the treatment of members, is reflected quite clearly in persistence in performance and we believe it to be quite inappropriate therefore for decision-makers making the call on what an appropriate default fund for a workplace is to ignore that record. Similarly, it would be inappropriate for those designing a structure in which those decision-makers operate to also ignore that record.

MR WATTS (ISN): Thank you. If we could just briefly move on to the selection process options themselves. We've welcomed the Commission's findings that - I guess the options it has put up itself as available options. It has rejected option 1 and

2 and probably concentrated on option 3 and 4. Clearly option 3 is our preference. It's an option that we proposed in our earlier submissions. I won't reiterate our views on that other than to say that we believe that a process that is open and transparent where any MySuper fund can apply to be listed in the award is an appropriate process, one where funds are judged on their merits, their primary merit being long-term net returns and, of course, their treatment of their members, including whether they flip and whether they have appropriate products for the industry that they seek to represent or work within.

Option 4 of course being put by the Commission as, I guess, a de-industrialised version of option 3. We believe that option 3 is appropriate where Fair Work Australia continues to determine these matters. It determines it in an industrial context, it's part of the way to assist and we believe it's appropriate that it remain in that context. We also believe it's appropriate that Fair Work Australia, as it does with the minimum wage system, avail itself of outside expertise as it sees fit. In the process of making this decision, both in terms of resources and expertise.

The issue with option 4, we think that there are number of logistical issues, apart from the fact that it does take out representatives of employer and employees in the process when these are the - everyone has a stake in this industry but I think the key stakeholders are the people who pay and receive, it takes out the representatives of those parties. But the issue of option 4 is if there's going to be an appeal process, if there's going to be a consideration of the merits of decision, option 4 is problematic. We believe that there is going to be a process where you will need to have an appeal process built in; there will need to be an appeal process. We agree that that should be in place.

The Commission's draft report says that's appropriate. I just, for the life of us, can't see how option 4 can accommodate that process. Fair Work Australia will be implementing a decision by another body and the appeal process will not be through Fair Work Australia, that process will be implementing, not making a decision. The need to set up another regulatory or tribunal-type body - and it will be one that will not have long-term standing, it will be an ad hoc process. So how those two things work together, we're not entirely sure. We believe it's a duplication which is unwarranted. It's an exercise probably driven by a philosophical need rather than a practical need and we don't believe that it is going to warrant setting up of additional bodies. So we think it is problematic on those grounds, we just can't see how that would work.

The other big recommendation that we take exception to is what we would call - and I'm sure that the Commission doesn't call it this - the employer opt-out proposal. We have and intend in our submissions to go through a number reasons and we have forwarded to the Commission some information as to what our views are on this. It is a proposal which we think is completely contrary to the framework

in which the Commission has based its recommendations on elsewhere, that there be a process that is open and testable, a process that is reviewable, a process that ensures that there is a filter through the MySuper authorisation process. Notwithstanding that, an employer can exercise their discretion to go outside the system. Quite frankly I think we would have to say the Commission has to make up its mind in its final report whether it agrees that there has to be a laissez-faire approach or whether there should be a system of filtering of MySuper authorisation acting in the best interests of the members of funds and we don't think you can do both.

We looked at the reasoning behind the proposal and we don't believe the reasoning is sound and there are four main reasons which are given for the employer proposals: to allow an employer to exercise their discretion to go outside the award system which is a unique idea in itself. Of course, it could be interesting to have an award safety net system, a minimum wage and condition safety net proposal where, as a minimum, employers have to abide by those conditions but notwithstanding that an employer, if they believe they have the expertise or knowledge can move outside and choose something else. It's an interesting proposal.

Very quickly, there are four reasons given - very brief reasons I must say - in a page and a half for the proposal. The first is that 45 per cent of pre-modern awards do not list a default fund. We actually contest that. 45 per cent of pre-modern awards, the only way that that figure could possibly have come about is if all the various types of awards have been pre-reform awards, state awards, MX awards which are awards in settlement of dispute, awards that are made in isolation of holistic conditions, all put together - that may or may not be the case. There are awards that are made in the past for particular circumstances that we would not expect to list for default fund. What we say is that the evidence is that the vast majority of employees that are award dependent were covered by awards that listed a default fund. There were certainly awards that did not list a default fund but the vast majority did.

The second reason and probably the most important reason given by the commission is that allowing an employer to choose would add to contestability. Part of the reasons for that, as we discussed earlier that we necessarily agree with, and that is the view that the current process is biased. We also have to say that the existing evidence that is available, some of which we through in our original submissions that employers do not have the skill, expertise, resources and by and large in the vast majority of employers are not seeking to choose their own default fund, they're looking for guidance. We are surprised the commission is of the view that individual employers being able to chose their own fund would add to contestability.

Where employers have - and this is the third reason given - the interest and expertise, the view is that they should be allowed to exercise their own discretion,

knowledge and skills. In the absence of any valid contestable process, we would say valid contestable process, that they have gone through that filter, the Commission says, is important; that is the filter beyond the MySuper authorisation. We think it is a difficult exercise when an employer is go outside and have the ability to chose their own fund and yet what's being argued that it is in fact something that can be contested. We have some issues about who, how and what and how that actually works in terms of how an individual employee, particularly a minimum wage employee, is going to contest to that selection.

I will come back to that briefly because the last point that was given as the reasoning behind the proposal is that it allows for the tailoring of products to suit employers, employees, and to the benefit of employees at a workplace. We would suggest that probably the more likely effect is that it will allow for a tailoring of product to suit an employer rather than employee; that they will be tailored towards the needs of employers who in fact will be the customers that will be directly approached and discussed.

We went again to some of these issues in terms of the flipping issue and the issue of tailoring of products to the needs of employers in our earlier submissions and I won't labour the point, but we do have concerns. We believe that the process allows employers to act unilaterally. It's based on an assumption most employers have the skills or expertise or it should be based on the assumption that most employers have the skills and expertise and I think the Commission recognises that they don't. But we believe that it will encourage flipping, not restrict it; that an individual employee is not in a position to challenge an employer's choice of super fund, particularly if in doing so they're challenging the employer's knowledge, expertise and their choice. It just doesn't recognise the power relations at workplace level. There is no body that we can see that is being proposed where an employer's choice could be challenged. Not sure how that challenge would occur other than through the civil courts.

So if in fact the proposal is that a minimum wage employee covered by an award is in a position to challenge an employer's choice of fund, take civil action against them, we would say that it's perverse. The no worse off test that has been proposed by the commission - who would exercise or look at that test we're unclear but if there was a body to look at that test it's in fact less than the better off overall test that is applied by Fair Work Australia in looking at the relative merits of enterprise agreements.

We also believe that the proposal would result in compliance issues in the sense that there would not be necessarily any register or reference point in terms of what funds an employer should be paying into. One would think if an employer is exercising its discretion no reason why you would limit that discretion and the employer would not be able to change their choice of default fund on a regular basis.

Compliance bodies keeping up with that process we would think would be very difficult. So we have some fundamental difficulties with that and reiterate our basic position. The commission needs to make, I think, a clear position. It either believes a filter beyond the MySuper authorisation process is required or it's not. If it is, then we don't think the opt-out process is satisfactory.

There's just a couple of minor points. There's one on grandfathering. We think that there might be issues that arise out of grandfathering. Happy to discuss those with you but essentially our point - if there is a fund that is to change as part of this process - the fund no longer meets the criteria - we would think that it's a process that would need to be discussed further. It really depends on the model that's adopted in the end as to what the grandfather arrangements would be. It might be appropriate that on an individual basis, as opposed to a whole of employer basis, grandfathering continue. That is, that the employer would be required to change the default fund but the individual would have the option of remaining in the - allowing the employee to continue to pay into that fund. Given that's a default fund and the employee hasn't actively chosen we would expect that that would require notification to the employee that their fund is no longer found in the award but they can opt in or out.

DR VIDLER (ISN): I might just add that that's obviously an important question but it's not an isolated question. It's a question that this structure, whatever it might be, would share with the MySuper arrangements. If you can imagine a fund being an authorised MySuper fund and for some reason subsequently that authorisation is revoked, then these grandfathering questions will come up in that context and will have to be resolved in one way or another. I would say that whatever solution is applied there would be at least benchmark for how this problem is dealt with in the case of awards.

MR WATTS (ISN): The assessment period suggested by the Commission with an eight-year review period and a light touch review, the intervening four-year period - whilst we don't have any fundamental objection to it our preference would be that it be done on a more regular basis. Our concern is if there's an underperforming fund for a period of eight years that an employee is in that that could be a significant impact on their retirement income. It may be, as an alternative position, that there is a full review every eight years and that in the four-year period whilst funds may not be added, underperforming funds could be removed and those funds which are subject to consolidation, name change, there will be tidying-up exercise during that period.

On the issue of underperforming funds, we have proposed in our original submissions, and we stand by those, that we believe there should be a performance criteria, a hurdle, if you like, that funds would have to jump that only the best performing funds would be eligible to be selected as default funds within modern awards. An alternative to that, should that not be accepted, is that the bottom

performing funds be removed during that four-year or the eight-year - every four years they be reviewed and so the bottom quartile funds, if they've remained consistently in the bottom quartile for that four-year period - only a few funds would fit into that but they'd be the worst performing funds and clear evidence of long-term poor performance - that they would lose that special status. Whilst they still might eligible to be MySuper funds I guess it emphasises the important difference and the need to have an additional filter for what are essentially Australia's lowest-paid employees. I think that ends our lengthy comments. Thank you.

MR WOODS: Apologies for missing your first bit but I assume you were dealing with the factors for consideration and the standing - - -

MR WATTS (ISN): We were dealing with the factors and we essentially agreed with the nine factors. We raised the issue of relationship with MySuper and other regulatory change with some of them, but that was essentially - - -

MR WOODS: Consistent with the notes that we have available to us?

MR WATTS (ISN): That's correct.

MR WOODS: Do you want to start then, Angela?

MS MacRAE: Well, I think maybe if we just talk about flipping again. This has obviously, and you'd be very well aware, been a very long-running issue, long before we started our process. I know it has been very much discussed as part of the MySuper as well. We did sweat over it long and hard about whether it should be a hard - or a prescription. But we were concerned that if we made it that that we might be counting employees out of the opportunities for more preferential benefits through discounted fees and maybe access to insurance and things like that. So we've tried to phrase our criteria in a way that gives some flexibility so we don't preclude that opportunity for someone to be better off. That was our main concern in not going for something that was as - hard line is too long, but as said, as what you've been proposing. I guess I'd ask you do you think that if we went - would you agree that if we go for a sort of harder test as you've proposed that would necessarily mean that we might be counting employees out but that in your view that would be worth it because we would be ensuring that no-one would be worse off, or do you think that a hard line test would not have the outcome of cutting off those discounted opportunities?

MR WATTS (ISN): I think there's a difference between discounting - and there are employers, large employers with significant scale, that we see genuine discounts that have not - those discounts continue on when the employees leave the employer. There is a model, a commercial model, where those discounts are in fact paid for by the employees who subsequently leave, where their insurance is significantly

reduced, much more expensive, assumptions have changed. All of a sudden they become from a 22-year-old female they become a 45-year-old male smoker and their insurance costs go up and the cost of the fund go up generally. The discount is removed. In this context, in a MySuper context, they go to the standard MySuper product which may not be a commercially attractive product, rather a capture product.

Now, that model is possible under MySuper and we think that it's problematic. We had no difficulty with discounting, and in fact, there's no reason why that discounting wouldn't continue, particularly if the member is - the moneys are sitting there in the fund. There's no reason why that discount wouldn't generally be available to an employee when they leave the employer and remain in the fund. We don't have any difficulty with that. The issue is encouraging a model that actually allows - is based on an assumption that someone is going to be charged more at some stage. Superannuation should be judged over a long period of time, not just the period that they're with a single employer. If you're going to judge the worthiness of a product based on the period that they're with employment and ignore the other period once they leave the employer then we think it's not the appropriate period.

DR VIDLER (ISN): I'm not sure whether that goes to the question of a hard or a soft rule, but the - - -

MS MacRAE: I suppose what I'm saying is we recognise the problem too and we've tried to come up with something that gives enough flexibility to ensure the upside but hopefully is good enough to cut off the downside, and you're obviously saying, "We don't think it does sufficiently address the potential for downside," but our concern in doing something as hardline as you're suggesting is that we might then be cutting off the upside as well.

MR WATTS (ISN): There's an easy way to deal with it, I think, and that is to allow discounting, to allow that to occur but you're simply saying there's no reason why that wouldn't continue when you leave an employer. So the consideration may simply be that to be eligible to be selected as the default fund in a modern award, the fund cannot unilaterally transfer the interests of the employee to another MySuper product. It's as simple as that.

DR VIDLER (ISN): The element of the practice which is so odious is that the cost of the member to the fund generally goes down because they have left the workplace. A significant fraction of those members will become inactive members and the money will be sitting out there without contribution, processing costs and all that. The transfer of them without express consent is the problem. If you explain, "This is what we're doing. If you sign here and approve it" - and we'd also like to draw a distinction between situations where the employer is actively paying for some portion of the costs which is quite acceptable and there is no reason why X employee

should qualify for those benefits, versus a benefit delivered by the fund on the basis of a long-term strategy that they will be able to migrate that member from a low-cost product to a high-cost product, and what better way to migrate than by default without any express consent? I mean, that's the practice we're looking at. As long as it's listed as an important consideration, that should be enough, but I guess the devil is in the detail and that's an implementation question.

MR WOODS: I think there's common agreement on (a) the problem and (b) the need to resolve it, but if the fund that is being nominated in an award in fact is a specified product of the fund and that product ranks in the top 10, so that's the product that's identified, and then if there are discounts from that product during a period, then terrific. But the worst than can happen to an employee then is that where they revert to, the reversionary product is the one that in itself has been ranked as being the top 10, then I don't see a problem.

DR VIDLER (ISN): I am not sure that that's a situation that ISN would have a problem with. That's not what we observe in the marketplace now.

MR WOODS: No, I understand current practice but I'm just trying to work out if it was possible to nominate the reversionary products and that they were the ones that were assessed and you picked the best 10 of those and they were nominated in the award, then any discount below that has an upside, but there is no downside.

MR WATTS (ISN): I think that's worthy of consideration because what it's really looking at is where people are going to end up looking at in a holistic sense and that's exactly what we're proposing.

MR WOODS: Precisely.

MR COSTELLO: Okay.

MR WOODS: Does that make sense?

MR COSTELLO: It's clear, sure.

MR WOODS: So if we got to that end, then we've solved most of that problem. Do we want to deal with persistence? Can I do that briefly?

MS MacRAE: Yes.

MR WOODS: I was hoping, as I looked through earlier information that you had provided on Deloittes et cetera, to find that persistence was more pronounced at the bottom end than the top end and only if I sort of turn sideways and squint can I just get that solution. It doesn't come through strongly; it would have been nice if it had.

DR VIDLER (ISN): Could I just say on that, there might well be tests that reveal that. The structure of this test, it lends itself to symmetry.

MR WOODS: Yes.

DR VIDLER (ISN): If you leave one bucket, you end up in another bucket.

MR WOODS: No, I understand how they have been constructed and I accept what the results are. But two things come from that; one is that irrespective of the statistical significance of the persistence that is found, there is still a very wide dispersion of behaviours from one period to the next. So there are still significant numbers who move from the first to third or less so, from the third, move up to the first. So there's not a correlation that gives you a high degree of certainty but it does give you a statistically significant outcome.

DR VIDLER (ISN): There is a lot of noise but there is a very strong signal.

MR WOODS: Yes, so we can agree on all of that. That says that to the extent that we've expressed our second factor, a fund's expected ability to deliver, the degree of persistence is an important contribution to coming up with a view based on that factor but that you do need a whole range of other factors. You can't just use that as a single indicator.

DR VIDLER (ISN): We wouldn't contest that.

MR WOODS: No.

DR VIDLER (ISN): I mean, my earlier comments went to the statement that it couldn't be used per se.

MR WOODS: Okay. Be assured that the tablet we did put in was not our only analysis of that issue but it did demonstrate a point I think somewhat powerfully, but our analysis does go beyond that. In our final report, we will cover the topic more completely. You spent some time then on drawing distinctions between industry funds and retail funds. I have to say from our perspective that's sort of an irrelevancy. What's important is what are the factors for consideration and which products nominated by funds do or don't meet those criteria and we're agnostic as to who owns them. What's the ultimate criteria for the benefit of members; that is of significance to us. That's the overriding concern here.

DR VIDLER (ISN): I accept that.

MS MacRAE: If I understand your argument - I'm not trying to put words in your

mouth, so you can tell me if I don't get it right - but I understood you to be saying by the structure that retail funds have, they incur costs - they have to incur a level of costs or do incur a level of costs - and industry funds won't and that helps to bolster the persistence of - - -

DR VIDLER (ISN): Sure. The draft report cited ASIC saying that there's no historical significant - that past performance doesn't necessarily give a guide, and my point was that there's a lot of research out there going to the question of performance and persistence and the relationship with governance. Now, I accept that when you're considering a structure for determination, the causes of performance might not matter but it goes to the question of whether there is persistence and that's why I was discussing it.

MR COSTELLO: Could I just pick a point up there, because this issue has generated quite a lot of heat and some light, and you take to task the simple, quite bald statement which you found in the report which says there is no link and you've substantially demonstrated that there is a link. It's not perfect all the time but it certainly counters the statement that there is no link. So that's fine, and thank you for all that. The question remains what to do about that. I guess we've always implicitly understood that and those of us who have been in financial services constantly wrestle with this question about the past and the future and we would expect that an expert panel would similarly wrestle with it, focused on the future but clearly being cognisant of the past.

I guess the question I have is it's a kind of "so what" question, and I'd love to understand from you, are you suggesting that, acknowledging your research and perhaps improving the statement that's made in the report around linkages and adding more colour and texture to that, would you therefore acknowledge that armed with all of that information and all of that insight, a judgment about the expected ability of a fund to perform in the future is what matters and it should be left to those judging, with all of the skill and experience they have accumulated, to try and do that, or are you suggesting that some highly prescriptive cut-off, "If you're above this line, you're in. If you're below that line, you're out? So I just want to understand where you stand on the balancing versus the prescriptive.

MR VIDLER (ISN): You have suggested two extremes there.

MR COSTELLO: I've not really and if I can just clarify, it's either a judgment or it's a rule and I don't know whether you've to say that what we have said around making a judgment is inadequate or imperfect, in which case I think you have been heard, or are you saying that it should be a rule.

MR VIDLER (ISN): This is, as you say, the challenge of investment. You're making decisions today to try and get returns in the future and the future is

unknowable and all we have is past evidence and the first question is, is that useful?

MR COSTELLO: Sure.

MR VIDLER (ISN): There are some efficient market hypothesis that suggests it's not. All of the information that is available is already in current asset prices and we shouldn't take it into account. Now, that's a wider debate in financial markets generally but we have 10 years of evidence in relation to super particularly which shows that there is persistence. I think that is an important first point and then there's a secondary question - and I accept that they're different - as to how that information is used by a decision-maker. I think the threshold issue is should it be used as one, and an important factor among many, and I think that is true. I think it should be used and, of course, you look at the other factor, you look at the structure, you look at the asset allocation, you look at the demography, you look at a range of factors. But the threshold issue is whether you take historical - - -

MR WOODS: You haven't come up with a rule.

MR WATTS (ISN): I think you do but recognising, of course, your recommendation is that it should be between five and 10 funds listed with an award and to go beyond that is going to be difficult for employers and add search costs and other costs to employers and we accept that. We were proposing a minimum of two and six and we had no real objection to five and 10. There has to be some filtering. There has to be a process that provides some guidance and at the very least - and this is why we propose the alternative - if you have a long-term, poor performing fund it may well be that any sensible people, any sensible bodies sitting around a table will say, "Well, we're not going to consider those." There's probably little harm and it's probably an exercise in efficiency to say, "Well, the system won't consider those."

That in itself, we would think, reduces the playing field but might only reduce it by 10 per cent but they're 10 per cent of the worst performers out there and at that at the very least is heading in the right direction. That is a rule then. You're looking at a rule rather than just some sort general guidance. Whether you set that rule there or whether you set it higher is a debate.

MR VIDLER (ISN): There is almost a holistic question about - we have had four or five years of reviews in superannuation and some key issues should be addressed and one of them is flipping and we are heartened that you have taken that on board. The other is that there are segments of the workplace-controlled funds which are certainly underperformers. They're quite expensive relatively and whether they're industry funds or retail funds, if that issue isn't dealt with going forward, then that's five years of reviews that have been wasted.

MR COSTELLO: That's is great. That has really helped to clarify your view

there.

MR WATTS (ISN): I think going back to your earlier question in terms of governance and the like, our proposal would be clear and it is that the system should be opened up, it should be open and transparent and only the best performing funds should be available to be listed as modern awards. If an industry fund or not-for-profit fund or a retail fund doesn't meet the grade, our view is that that is in the best interest of members.

MR WOODS: Did we deal with standing?

MS MacRAE: Just to be sure in relation to your position in opening that up and the process that might be followed, you have indicated that you prefer our option 3 to option 4. In relation to the process that you would follow, we have recommended at this stage that anyone that has an interest in the matter would have standing before the tribunal. Are you happy with that?

MR WATTS (ISN): No, we don't have any objection to that. I think the issue is a practical one more than anything else in terms of appeal rights and I think this has to be dealt with evenly and equally for everybody otherwise it's an unfair system. We are proposing a fair and open system. But, of course, if someone has a commercial incentive to go through an appeal process and finances aren't an issue, we could find ourselves with extensive litigation in the area. So I think there needs to be some attention drawn to grounds for appeal and limiting of those grounds.

But in terms of standing, our view is that the system should be open to anyone who has a product, a MySuper product and they wish to put it forth and put it forward. The criteria should be the process that those people are filtered out, not the individual whims or interests of others. However, we do have a view that the views of the industrial parties, that is, the employer and employee representatives, they should be given, whilst not formally greater weight, there should be a process, we think where their views are expressly addressed by, in our view, Fair Work Australia. So whether Fair Work Australia rejects or accepts them, they should at least be required in their reasoning and their written decision to give reasons as to why they have accepted or rejected.

The reason we say that's appropriate is that they are the bodies that are representing the people who are paying and receiving the moneys, not necessarily the shareholders of other interest groups and whether they be not-for-profit or profit funds and we're not saying their views be determinative, other than they be expressly considered, no more than that.

MR COSTELLO: I know time is running out but I wanted to ask one question about this employer opt-out as it is increasingly been used. Is that okay?

MR WATTS (ISN): Yes.

MR COSTELLO: You have made quite a strong point about the risks with this as it's presently described and again a little like past performance it's often shorthand for a much broader discussion. I just wanted to get your view - and your may wish to consider this rather answer today - it's easy, I would have thought, on the one hand to say an employer acting unilaterally, making a decision, non-transparency et cetera et cetera has problems. At the other end of a situation it's acknowledged that employers and employees can come together to debate this and many other issues and record their agreement and that then prevails under an enterprise agreement. But I think we're aware that it is an easy sentence to roll off but it's quite a complicate process to enshrine; many at least believe it's a complicated process to enshrine.

So I guess the question I would ask you consider is, leaving aside the first example and going much more towards the latter where it's a consensual decision that's made often with - an organisation might even bring in some expertise to help them review options and come up with a decision and so it's a widely view about what would be a good default arrangement for that workplace and there was all those features those. I am interested to understand whether this is an issue of principle that one shouldn't be allowed to say, "Thank you, but no thank you," to the shortlisted funds if what would generally be regarded as a pretty thoughtful and rigorous process was undergone or is it really that when that starts to get diluted more towards a unilateral action without transparency that bothers you. So I am interested to know whether it's a hard line or whether you see this as a scale.

MR VIDLER (ISN): That situation you described with an enlightened employer hosting a process, if you like, to come up with the best result for their employees does happen currently and, by the same token, there are many hundreds of thousands of workplaces where the employer has other things to do and other focuses. Superannuation is essentially an administrative hassle and that's their priority and that's their incentive is to reduce the admin burden. The question is how you allow an opt-out for employers which doesn't prevent the enlightened employer conducting a tender for the advantage of their employees where - - -

MR WOODS: It has collective agreement and things but not necessarily exhibited in a collective - - -

MR VIDLER (ISN): It is even conceivable in a circumstance where there isn't an enterprise agreement would you would expect that this is a larger employer with some resources to throw at this task. That is not the problem in the market currently. The small corporate master trust area, 35 billion, 600,000 employees is where the employees means it's largely outside the award system just in practice because probably they don't know what award is in place and they have had a historical

legacy fund, that is the issue you have to deal with. This seems to enshrine that as a continuing issue in the industry.

MR WOODS: What is the mechanism? We have explored whether you can actually have a formal enterprise agreement that is a single item agreement and that seems to bring with it a whole lot of other issues because it then prevents bargaining on other things if there is an enterprise agreement in operation et cetera. But is there a mechanism whereby the enlightened employer goes through a process and that they employees - - -

MR VIDLER (ISN): Enterprise flexibility arrangements are open. It would require an internal process and it would require employer and employees to make applications to Fair Work Australia. However, it would not necessarily be one where there would be enterprise agreement limitations that are there. We don't have any objection to a genuine agreement being processed - it being a process and changes in place, whether it be to readily accommodate a genuine agreement between a workforce that doesn't interfere with other arrangements, it's non-complex. The proposal itself is problematic when it's standing there by itself in the sense that there are no restitution rights if you get it wrong.

I'm not sure how an individual or collective challenges an employer's decision, how an employer codifies their decision to show that they have in fact considered the criteria, whether in fact bound in any way to really legally consider the criteria anyway is another matter. We just don't think that the process as it is proposed is going to be enforceable. There would need to be built into it a whole regulatory body of protection which we think are probably unjustified. But if it could in fact be accommodated through another process and a process that is already in place, whether it be Fair Work Australia or another process, where you don't have to replicate appeal rights, you don't have to replicate a whole process where people do have genuine rights, we would think that might be worth considering. That is the fundamental problem.

MR WOODS: But what you're being invited to do is to say, "We're trying to achieve a certain thing through this process, if there are fundamental flaws with this" - and we will come to our own view on that - "but you're invited to put forward an alternative process" - as are all participants, this isn't just an exclusive invite for ISN.

MR VIDLER (ISN): That's unfortunate.

MR WOODS: But, yes, you are being expressly to look at mechanisms that can achieve the underlying objective that you consider maybe a more satisfactory way of dealing with it than we have currently proposed.

MR VIDLER (ISN): We will give that some consideration.

MR WOODS: You have leniency to go beyond Friday in terms of lodging your submission if you can solve that one.

MR WATTS (ISN): Thank you for that. I think in doing so we will put the problem in the context of what the demands for such a solution are.

MR WOODS: Yes, entirely happy for you to do that. I'm conscious of the time but that was very valuable. Are there things that you want to raise?

MR WATTS (ISN): No, thank you very much.

MR VIDLER (ISN): Thank you.

MR WOODS: Can I thank you (a) for your original submission but also all of the supplementary information and in anticipation your final submission.

MR WATTS (ISN): Thank you very much.

MR VIDLER (ISN): Thank you very much.

MR WOODS: If I can ask the Association of Financial Advisers and the Corporate Super Specialist Alliance to start coming forward, please. Thank you, could each of you please for the record individually state your names and the organisation you are representing and the position you hold.

MR KLIPIN (AFA): Richard Klipin, the CEO of the Association of Financial Advisers.

MR ANDERSON (AFA): Phil Anderson, chief operating officer, Association of Financial Advisers.

MR HALL (CSSA): Gareth Hall, I'm the treasurer of the Corporate Superannuation Specialist Alliance.

MR WOODS: Thank you very much. Do you have opening statements that you wish to make.

MR KLIPIN (AFA): Indeed we do, thank you. Thanks for the opportunity to appear at this hearing. As you heard, my name is Richard Klipin, I'm the CEO of the AFA. I'm here with my two colleagues who you've met. Gareth, in addition to being the treasurer, is an AFA member and a practising financial adviser who specialises in corporate super and Phil Anderson is a CPA and has spent 15 years in financial services with a focus on advice and advisers. His speciality is policy development, risk management and ensuring that policy is practical so that clients and advisers can work effectively.

I will just give you a very brief introduction to the AFA. The AFA is Australian's oldest professional financial advisory association. We were founded in 1946 and we are celebrating our 66th birthday in 2012. It is an association of, by and for advisers. We have a membership of 2000 individual members and through our licensee partners represent just under 7500 advisers spread across the country with chapters in all major cities. Our individual members are in essence mainly small businesses who serve their clients and their communities with distinction. Our view is that the role of financial adviser is to build, to manage and to protect the wealth of Australians. Our members today provide a broad range of holistic advice to all Australians and our members have a strong heritage in insurance but now provide broad advice, including corporate superannuation.

Of course we're here today to talk about and provide input into the Productivity Commission's review of default super within modern awards, however, we would also like to talk in terms of the value of advice and the importance of encouraging Australians to seek advice. To the AFA's view, at the outset I'd like to express our broad support for the direction that the draft report suggests the Productivity

Commission is heading. It is important to express, however, our serious concerns about the current model which your report has so clearly spelt out. The current model for selection of default super funds is not based on merit, we believe it is not that transparent and, as you have highlighted, needs to lead to equitable outcomes rather than inequitable ones and it's very much biased in favour of industry funds.

The lack of necessary competition in this area is an important issue that needs to be solved quickly for the benefit of employers, for members of employee superannuation funds. I would also like to make the point that with the recent FoFA changes and the pending MySuper reforms the arguments that the industry funds have put forward on the key points of difference around price, cost, fees and returns in many cases no longer exist due to competition in the marketplace. The AFA has expressed concerns with respect to FoFA and MySuper, however, we have been supportive of the removal of commissions on superannuation investment accounts. This policy direction has already led to significant changes in the marketplace. We now have a number of retail products that are extremely cost competitive. Any review in this area obviously needs to take into account the current competitive reality.

In addition, at a philosophical level, one of our major concerns with MySuper is that it seems to accept and almost support a lack of engagement by members in the superannuation investments. On the other hand, we also have the regulator, ASIC, who are interested in confident and informed consumers. It seems that disengagement in super is definitely at odds with this idea. It's important to appreciate that superannuation is often the second largest asset that most Australians hold and a model that's based on an autopilot is, from our point of view, unacceptable. We also seek a policy setting where people are encouraged to seek financial advice, not just with respect to superannuation, but their broader financial position. Without financial advice people typically lack the necessary financial strategies and often inadequate insurance. Therefore, we make the point that their policy settings need to actively encourage people to obtain financial advice.

In terms of some of the specific recommendations, the previous AFA submission to the Productivity Commission recommended the complete removal of super from modern awards so that employers would have the flexibility to appoint the most appropriate default super fund. We acknowledge that this was not part of your scope and not what you have recommended. You have set out four options. We believe that option 1 where all MySuper products will be available to all employers is a workable model. We also recognise that there may be desire to make this process of selection of a default super fund a more manageable exercise for employers by limiting the number that are available to select from.

In this context we believe that option 4 would be most appropriate as this enables the decision-making to be placed in the hands of an independent body. We

oppose option 3 and we are very conscious of the recent criticism of Fair Work Australia with respect to their handling of a recent high profile matter. Giving the employer the option to appoint a fund that is not listed in the award where the member is no worse off makes strong sense. This introduces some level of flexibility and has been removed from the system under the Fair Work Act. In addition, for this mechanism to work and actually be used, it will be critical that there are objective measures set for what is meant by no worse off. If the bar is too high and involves too much risk, then it is unlikely that many employers will take on this option.

We believe that advisers are well positioned to support employers in this decision - and you will hear that from my colleague in a moment - where the rules are very clear. It is also important to recognise that this decision is one that is made at a point in time and cannot be subject to review based upon the benefit of hindsight. To support advisers in this, all the information that is provided for selection to be included in a modern award would need to be publicly available information.

With respect to a recommended criteria for the selection of default funds, the AFA would like to make the following points: when it comes to investment performance, it's important to appreciate - notwithstanding the previous conversation - that past performance is no indicator of future performance. What is essential is an understanding of the reasons for historical outperformance and whether this is genuine, whether it's sustainable and risk effective. Over recent years we've seen one high profile industry fund go from top of the list to the bottom of the list in a very short space of time.

In looking at products it is not possible to look at fees alone, there are a range of other qualitative factors that need to be taken into consideration, for example, service standards in terms of processing payments or rollovers are important indicators of funds that lacked adequate capability. Secondly, and equally importantly, is the issue of daily unit pricing. Crediting rates are less costly but the lack of the same level of equity between new, remaining and leaving members needs to be addressed.

When it comes to corporate governance we support enhancements in this area but it's not just about controls, it's also about disclosure. One area of disclosure that we would like to see enhanced is the related-party transactions. The AFA strongly supports the move towards independent directors. One issue of scale that needs to be considered is the capital backing in order to address and resolve events of significance that potentially might impact on the viability of the fund. Sufficient capital to overcome any operational risk eventuality is important. Whilst we note your recommendation with respect to intra-fund advice, it is important to recognise that advice for members might come from both the fund via intra-fund advice or from an adviser. Some funds will operate a model that supports intra-fund advice while others will favour a greater reliance on financial advisers. We would not like

to see an outcome that works to the disadvantage of one over another.

We would also like to express a concern about the frequency of reviewing the funds in the award and the inability to add new fund in between formal reviews. If a new and improved product appears in the marketplace, then employees would largely be prevented from accessing this. There needs to be a mechanism to add a new fund without adding significantly to the complexity and the bureaucracy of this process.

In terms of the time frame for moving forward, we would make the point that 2014 is a long way off. This time frame means that the current structural competitive advantage available to some funds over others will remain in place for a significant further period. We believe that the government should be capable of moving sooner, even if this is limited to the ability of employers to nominate a default fund that is not listed in the award.

We are optimistic about the future for superannuation and see the outcome of this review as a critical part of ensuring that we have the most appropriate structures and a genuine level playing field. On behalf of the members of the AFA and their clients they look after, we thank you for your efforts in this area and your commitment to addressing this important issue in such a constructive manner. I would now like to hand over to Gareth Hall to talk in terms of what actually happens with corporate super advisers to give some more detailed understanding in supporting the employers and members that they serve. Thanks very much.

MR WOODS: Thank you very much.

MR HALL (CSSA): Thank you once again for the opportunity to present to the commission hearing. As I said, I'm Gareth Hall, I'm here representing the Corporate Super Specialist Alliance. I'm not going to recover the same ground that Richard has just spoken about, I will just elaborate on a few things that are probably more important to us. The Corporate Super Specialist Alliance is an association that is probably, as opposed to the oldest, is probably the youngest association in the financial planning industry. We were formed a few years ago to represent the interests of corporate superannuation specialists, particularly around the Cooper Review and FoFA and MySuper and now, of course, this Productivity Commission review. We wanted to ensure that we could continue to provide proactive services to hundreds of thousands of members of superannuation funds that we currently look after.

While I am here today in my capacity as treasurer of the CSSA, I am also a financial planner of 22 years. I run my own business and my business employs 10 people. We see that superannuation is a key pillar of Australia's retirement income system. For many Australians it will actually be their only substantial source of retirement funding and private saving for retirement. We do not believe that

removing services and advice from the workplace will do anything to improve retirement outcomes for members of super funds.

In many cases the adviser linked to a company superannuation fund is the only financial adviser working people will come into contact with. I can share many stories with you as to how people's lives have been improved by the contact we have had with them. One case comes to mind of organising disability and income insurance for a young father of three who not long after had a stroke and was permanently disabled. He is now able to live a financially-independent life because of that contact.

The CSSA is completely supportive of the Commission's recommendation to reform the process around the selection and ongoing assessment of super funds for listing as default funds in modern awards. Of the four options for reform that the Commission outlined, we are of the opinion that option 1 would be the least complicated and would involve the least red tape. You would certainly have no problems as to choosing methods by which funds were to be included or excluded or whatever and I would believe that the economic forces on superannuation funds would sort the good from the bad, as is currently happening in the market.

The number of superannuation funds is shrinking, as you would know. The number of platforms is shrinking and there is a lot of consolidation going on so naturally we think that that would occur. We do understand that this option could make the decision process more complex for employers. However, employers are pretty adept at making those sorts of decisions, they are faced with them every day. If option 1 ends up being ruled out, then we're of the view that the only other viable option is option 4.

In addition to the points raised by the AFA, we would like to specifically discuss a couple of things that we feel are important to our clients. Let me start by saying in my 22 years I have never seen a superannuation fund that has been established for employees to benefit the employer - ever. I just don't think that ever happens. Maybe an employer might look at administration efficiencies and things like that but generally that's one of a suite of things that they look at and from my experience an employer always acts in the best interest of their employees. I have never not experienced that outcome.

I would also suggest that in MySuper flipping is not an issue. I think you encapsulated that in the last conversation that you had that if you select a fund, if it's a MySuper fund, really the fees in that fund are going to be quite low anyway because of competitive forces. If we can negotiate or an employer can negotiate a discount, then isn't that a wonderful thing for the employees? I think that should be encouraged. If they're flipped out of that into the standard product at the standard fee, fantastic. Where is the problem? Again, I'm really concerned that we have to

encourage people to be aware of their own circumstance and make some decisions for themselves. If they feel that their fee is too high, then they can obviously choose another option.

One thing that we think is wonderful is the ability for employers to under any circumstance choose their own default fund because while the awards encapsulate potentially a certain group of people, an award may cover a million employees. An employer that is based in the city, with a white-collar workforce, could potentially be under the same award as an employer that's working in the bush with a totally blue-collar workforce. So for the employer to be able choose what they believe is best for their employees we think is fantastic. It's really quite essential. Guidance in the award is a wonderful thing but for them to have the financial decision I think makes a lot of sense.

Our concern around this is the proviso that nobody should be any worse off as a result of that choice. Obviously my concern in thinking about that is how do we know when somebody is going to be worse off? Generally it's only with the benefit of hindsight, so we really can only make those sorts of decisions with the information that we have to hand at the time. I think that if the commission follows this path that really we need a set of criteria that we can use to look at say whether this fund is not going to have the members being any worse off over a period of time. Of course, hindsight is usually 20/20 and it would be a horrible situation if an employer or even worse, the financial adviser to an employer found themselves in court five years down the track because of a decision that was made and was justified at the time, but with hindsight turned out not to be the right one.

The CSSA would also suggest that new super funds should be able to be added to awards more regularly than every eight years on review. MySuper is a brand new concept and I can tell you from my conversations that I am having with all of the product providers, all of the designers of superannuation products, that they're thinking very innovatively about how they're going to deal with MySuper and what they're going to provide for employees. It would be a real shame for somebody to come out with an innovative great product and then for that to have to sit on the shelf for eight years until it could be considered for inclusion in an award and I think also if you have a product that has a known tenure of eight years, they're probably much less likely to innovate within that product and to do things that are going to improve the outcome for investors. Historically in our industry a three-year time frame has been pretty much the time frame for review of super funds and insurance contracts and those sorts of things.

There has also been some discussion around default funds should be selected on the basis of past performance and on the basis of fees. I was very pleased to hear you say in your last conversation that that is not really the issue because it doesn't make a lot of sense to me. I think in MySuper it is an entirely new environment, the

fee structures will be completely new. The past performance of funds is a very dangerous - as a financial adviser it's a very dangerous thing to base any sort of recommendation on. It has been spectacularly demonstrated, as you know, in a few instances that some funds that perform very well have not been so good of recent years.

Fees can also be a very misleading indicator. Some funds may charge a higher fee in order to be able to provide features and services and benefits that other funds don't provide. If you have an index based approach to investing it's very, very cheap, whereas if you have an active base for investing then that can be significantly more expensive but can give the member a better return in the long run. We would also observe that in a number of instances the fees charged by current industry default funds are in fact higher than fees charged by wholesale public offer funds and master trusts and I take particular exception to the constant reference between industry funds and retail funds. I mean, retail funds are a thing of the past. They're illegal of 1 July next year so I really don't think that is a relevant reference.

Our observation on fees is backed up by recent research that was conducted by Rice Warner on behalf of the Financial Services Council. In fact the trend appears to be that the fee gap, if anything, is widening. A lot of the retail, if you like, wholesale and master trust funds are getting cheaper whereas some of the industry funds have actually become more expensive. Thank you very much.

MR WOODS: Thank you for that. In both cases that's fairly comprehensive views. I just have one question and that is given your expertise in the area of evaluating funds, we have identified a number of criteria that would be used as guidance in a selection process. Do you have views on whether those are the right criteria? I know in your introductory comments you made reference to a number of things, some of which did line up with the criteria that we have identified and in other cases there wasn't a perfect alignment. But is there some way and either today and in a follow-up piece of work where you could give us your views on those criteria?

MR HALL (CSSA): Yes, certainly. I would probably prefer to take it on notice.

MR WOODS: Yes. That would be quite helpful and whether it's through AFA or CSSA is entirely up to yourselves. We are grateful for the very detailed information that you provided by way of original submissions to us. That was my only particular concern.

MR COSTELLO: I have a question. What do you see as being - you expressed your clear preference for option 1. Why do you see option 4 as materially better than option 3 or, put the other way, what is the disadvantage or what don't you like about option 3 that makes you attracted to option 4?

MR HALL (CSSA): I don't see much employer representation in option 3.

MR COSTELLO: Just to make sure we're on the same page. So in both cases a group of specialists would be asked to assist in the process of evaluating funds?

MR HALL (CSSA): Yes.

MR COSTELLO: I appreciate this is where you would not prefer it to be. The question is do they sit completely outside the industrial process, outside Fair Work Australia and their report or recommendations is somehow involved or sit - especially brought in for that expertise and within but one would imagine a little on the edge of Fair Work Australia. So you clearly prefer them outside rather than within and on the edge and I'm just interested to understand what you see as the disadvantage or advantage or relative disadvantage of those two just to be clear on that would be helpful.

MR ANDERSON (AFA): I just say a few things on that: that we do have reservations about Fair Work Australia in the context of recent discussions that have been broadly covered in the media. The other thing is about getting access to the expertise. If it is in a separate body and one of the options that was raised was APRA, you will have expertise in that and expertise with respect to superannuation is core to what they do rather than being incidental to what Fair Work Australia does.

MR COSTELLO: Although I think it's fair to say that one thing that Fair Work Australia does is it manages industrial awards, so this is a feature of it which we've suggested requires some specialist - and Fair Work Australia themselves would be the first to say, "This is not really an area where we feel especially competent." I mean, there's a number of statements on the record from them that this is not an area of professed expertise by them. So I think either way, to the extent that it's in an award, it's going to end up with Fair Work Australia being the final port of call.

I'm just keen to pursue this question, whether you think the outcome would be somehow diminished or less than optimal if it were in rather than out, given in both cases you've got specialists and both cases Fair Work Australia signs it off. It's sort of what happens in that middle part; I'm keen to understand why you think option 4 is better than option 3 because they are very similar.

MR KLIPIN (AFA): Yes, and we'll be frank and candid obviously. The current structure has kind of meant that the retail market is essentially cut out of this segment and by having an arm's length review into it - that's outside of Fair Work Australia and made up of independent experts if we head down option 4 - I think then gives the transparency, the expertise and the arm's-length nature of actually addressing the issue. There's obviously comment from some in the marketplace around unbundling superannuation from the award process. I'm not sure whether that's going to happen

or not but I do think with the size of flows that are going into superannuation, the size of the pool that's there now, the more transparency and the more arm's length and the less it can be called into question absolutely the better for the long-term nature of it because we don't want to be sitting here in five or eight years' time, the pool being now $3 trillion and this kind of sectional sparring between the retail world and the not-for-profit world.

We've been on record, and there's obviously a large body of discussion around FoFA now, we would far rather that the retail world and the not-for-profit world actually collaborate and start to focus on how do we actually get more Australians more engaged in their wealth, in their superannuation, in risk, in risk management, rather than in a sense fighting over the spoils and who's got the right or the best product. I think that's the place where we would want to see it and in that context, option 4 is a better option than option 3.

MR ANDERSON (AFA): I guess the other point is it reflects the history that the responsibility has been with Fair Work Australia to this point and we've expressed the view that we're not happy with the way the model is working, so we believe it's appropriate for there to be a change to achieve better outcomes.

MS MacRAE: I suppose I have two quick comments. One was in relation to the employer discretion sort of clause that we had in there and you will note that we welcome comment on that and I'm wondering if you've had an opportunity to think more about how we might be able to modify that. We did have a proposal from the Law Council of Australia earlier today and they have indicated they will put in a submission, so in the same way that Mike invited the previous people to make a comment on something particular, if you're able to have a look at what the Law Council put forward, that might be helpful to us.

MR ANDERSON (AFA): Sure.

MS MacRAE: One of the points you raised was the issue of, "We don't really want to look back with 20/20 vision and say, 'That now doesn't look like a reasonable position,'" and one of the things that they have picked up in their amendment would be to say that, you know, at the time it was a reasonable decision and that's an example; that seemed like a good chance in the way that we had phrased our test, so that's one thing.

The other thing that the Law Council mentioned, and I'd just be interested in your views on this, was a concern that super funds might have a shorter time horizon for their investments if they were concerned that if, in eight years' time, the guillotine might fall on them and they're no longer listed in a fund, whether you think that's a problem and how we might overcome it because on the other hand, you were saying, "Wouldn't it be nice if we could let a few funds in on the way," so that if you had a

good new product that was suddenly available, waiting eight years is a long time and you might stifle innovation in that period. On the other hand, having an eight-year period and then having this guillotine fall seems to present some issues as well. So I guess on both of those points but particularly about whether you see any risks in terms of time horizons for fund investments if you have this eight-year review and the possibility of delisting at that point.

MR ANDERSON (AFA): I guess the core asset class that gets to the core of that issue is infrastructure, so unlisted assets. Now, I think there's a few issues there. It's how you actually go about valuing unlisted assets and the timeliness with which you can reflect changes in the value of unlisted assets. I think we've seen some cases in that particular area.

I think the other thing is it's the percentage of the portfolio that's devoted to unlisted assets. If you've got a very high percentage, then the point that you raise is absolutely valid, the risk of being removed from an award may be particularly challenging, but if you've got a manageable level of unlisted assets, then that's something that you can manage in the context of you might be dropped from one award, you might be dropped from a few but you'll be still on others and you will still source fund flow from other areas of the market. It's probably a little overstated and it's really only relevant in the context of unlisted assets.

MR WOODS: Just that lack of liquidity and trying to unload something of that magnitude into the market.

MR ANDERSON (AFA): Yes, but if you have got a manageable proportion of your portfolio and you remain attractive to a broad cross-section of the marketplace, then it isn't going to be a problem - - -

MS MacRAE: Okay.

MR ANDERSON (ALC): And if you've got it too high, then maybe you've got your balance wrong in the first place.

MS MacRAE: I guess that was my main concern because we don't want the regulatory rule to be determining what the best investment for the structure is. Fine, if on market fundamentals, you've got that balance wrong, but if we're saying we've now imposed a new regulatory rule that's changing your time horizons for your investments because of that rule, that would be something that we wouldn't see as desirable.

MR HALL (CSSA): Sorry, can I add to that?

MS MacRAE: Yes.

MR HALL (CSSA): As a financial planner, let me tell you, most people don't have an eight-year time horizon. Most people have a very, very much shorter time horizon when they're looking at the performance. It's usually from statement to statement.

MS MacRAE: Yes, sure. No, I was thinking more in terms of the view from the fund.

MR HALL (CSSA): I understand that, but I guess the point that I would make is that with MySuper and my understanding of part of the logic behind having a product such as MySuper, it's very easily comparable, one product to the other. Fees are comparable, everything else is comparable. So I would be very surprised if fund managers actually do have very large exposures to unlisted products in MySuper because those unlisted assets are only valued potentially every year or so and they can't really publish a unit price that's comparable with other MySuper funds. I might be wrong, but I think the process of introducing MySuper will probably restrict those issues to a certain extent.

MS MacRAE: Okay, thank you.

MR ANDERSON (AFA): If we can go back to your first question which was about the ability for an employer to select someone who is not currently on the award, one of the points that Richard made in his presentation is we have to move to an environment where there's full disclosure of information. So the information that's submitted to the body that is reviewing applications to be on awards, that information needs to become publicly available so that employers have access to that information and financial advisers who assist employers to make decisions on recommended default funds for employers. If they have got that, then that's going to be particularly advantageous.

There's a range of service providers now who do fund comparisons. There's a number that are highly regarded in the marketplace, so there's that as a vehicle as well. Gareth makes the point that it has to be an objective measure; you don't want to have so much uncertainty that no-one is willing to make the call. But there are number of mechanisms that are out there now. We just have to make sure that in looking at this issue, there's not too much focus on the long-term history because MySuper is new and we need to recognise that the world has significantly changed in the last 12 months in terms of the products that will be made available. So all of the issues that there's been a big focus on about things like flipping, higher fees in retail funds, become much less relevant going forward. So we've just got to get that balance right.

MR WOODS: Thank you very much. We appreciate your contributions today and

look forward to your final submission.

MR WOODS: Could I ask the Transport Industry Super Fund to come forward, please. Thank you very much. For the record, could each of you separate state your name, the organisation you represent and the position you hold.

MS CALDWELL-SMITH (TISF): My name is Di Caldwell-Smith. We represent the Transport Industry Super Fund on behalf of its administrator, Diversa Superannuation Services.

MR DE VRIES (TISF): My name is Andrew De Vries, with Diversa Superannuation Services. As Di was saying, we represent Transport Industry Super on behalf of the trustees. I'm head of superannuation.

MR WOODS: Thank you very much. Do you have an opening statement you wish to make?

MS CALDWELL-SMITH (TISF): Yes, and some discussion around certain of the points.

MR WOODS: Thank you.

MS CALDWELL-SMITH (TISF): I believe you've already got our submission.

MR WOODS: Thank you, we do.

MS CALDWELL-SMITH (TISF): Thanks for the opportunity of appearing in front of the hearing. The Transport Industry Super Fund felt it was extremely important to have the views of the trustees of an actual super fund put to the hearing and also on behalf of their sponsoring employers and members, in particular because we are a specialised non-profit volunteer fund. So we have a volunteer board, trustees and directors, who are elected every three years of equal numbers of employers and employees. No director receives fees, it's totally voluntary, and we are small but beautiful, as I call it.

TIS, as I call it - it's called the TIS Fund, as an acronym - was formed in 1989. It was formed by the Australian Federation of National Transport and it was formed to provide a choice for those employers and members who were ideologically unsuited to other funds such as the Transport Workers Union Fund. So it specifically provided a choice for philosophical reasons, that they could place employer-sponsored superannuation guaranteed payments.

Since September 2008 it has been operating via a system of choice by members or through grandfathered arrangements with an excess of 3800 employers, so quite considerable. The way the fund works due to its small size is to outsource for

expertise and to achieve scale and efficiencies and they do that in the areas of corporate governance, investment and administrative and promotion. All of those parties provide advice and services to the board.

We have four areas of variance to the draft recommendations that have been put forward. We would like to recommend a modified option 4, and we're calling it 4(a) for the purposes of this. We don't believe that there needs to be an artificial limit on the number of default funds under the award. We believe rather that there should be a clause within the award that simply refers to a default super fund list and that that list of default super funds be assessed, selected and maintained by APRA.

The reason for this, which is basically a combination of option 1 and 4, is consistent with the Productivity Commission's reform principles; it's consistent with meeting the interests of members. APRA is already the superannuation body. They already ensure that criteria and the SIS legislation standards and the law is met. It will improve contestability, transparency, procedural fairness and member interests being looked after.

There were comments in the previous discussion about whether it should stay with Fair Work Australia. We don't believe that it should. That is based on the current awards which have been in place since 2008 which basically have shanghaied all the previous award processes and arrangements that were in place. That has affected the Transport Industry Super Fund greatly. We believe it will minimise cost and regulatory burden, and I haven't heard a lot spoken about that today. There doesn't need to be a new system. There doesn't need to be extra panels. APRA is already doing significant work on corporate governance and improving trustee boards. APRA have taken an active interest in the Transport Industry Super Fund so we have an ongoing positive relationship with them. Stronger Super reforms are geared to strengthen the regulatory system. This combination 4(a) is also consistent with the Competition and Consumer Act of openness and competitiveness.

The other aspect of this, by running a register of default super funds in APRA, there's no need to review them every eight years. It is an open system and available to be applied to at any time. We agree with the criteria identified by the Productivity Commission for selection and assessments of default superannuation funds with one extra criteria. We recommend that the fund's industry history and employee characteristics should be taken into account so this should assist in having a register of default super funds with specific areas covering different areas.

I use the example: we went to considerable trouble in the fund to achieve life insurance for long-distance operators and drivers, not an easy achievement with life companies. You wouldn't get that in all super funds because they wouldn't have the interest or the understanding of the particular area. Employers are well placed to understand what their employees need. They already do their HR, they do their

people management, they do occupational health, family-friendly workplaces, flexibility. Super is one criteria of this. We are challenged because we submit that the bulk of employers are both interested and financially literate. We don't understand where the assumption of disinterest and disengagement has come from. Most are concerned that their employees get the best options.

Superannuation has been around a long time. Financial literacy continues to improve and I think we have to understand that financial literacy and disengagement are not the same thing. Disengagement particularly post GFC, I can understand everyone would feel the same way about that. We all wonder. However, interest, concern, making sure the employees get the right deal, that's a different thing. In 20 years, neither of us have seen a situation where you can walk out to any employer and underrate their sophistication and their knowledge.

The area we're most concerned about is over 50 per cent of our members are long-distance drivers. We want to make sure that their interests are taken into account. We also want to make sure that all superannuation factors and comparisons through choice for employees is taken into account: ethical, philosophical, ideological. For example, consider a MySuper fund with a sharia overlay; I don't think we're considering those aspects.

The other aspects in MySuper - and I'd ask Andrew if he could speak to this - the TIS Fund submits the investment criteria regarding investment performance is just not needed. There is plenty of structure already. The short-form product disclosure statements that are just coming out now, the areas around investment strategy and performance and the eight-year time line are well covered.

MR DE VRIES (TISF): Just to add to that, if we consider APRA's guidance on construction of investment strategies and the classification of risk, for example, these are areas that continue to develop. So, for example, having the same description of what low risk means or medium risk or whatever and having that backed into statistical analysis and actuarial analysis is actually very important because then with MySuper, which we think is a great development for default members, that consistency of description, that ability to compare is heightened.

So from an investment perspective, if you are following these guidelines that are being developed and you're looking at an investment objective and you're constructing a portfolio, essentially they're all going to go through the same process which is looking at: what's the investment objective? Is it a margin above inflation? What would be the core asset allocation that would be required? They're all going to run statistical models that say, "Okay, for these asset classes, these are the historical returns. Based on that, when we project them forward, there's a high probability of return out of these asset classes going forward." They're all doing efficient frontier. They will all go through the same statistical and actuarial process to construct the

portfolio bases, ie, in asset allocation and ranges around asset allocation. They're also all going to be boxed into a quantifiable risk description being an incidence of negative return within a particular period of time.

So to put another overlay on top of that, given the professional portfolio construction process is largely the same for all of them we think is unnecessary. We think professional portfolio construction and the existing regime that's in place and where the future of that is going in terms of the APRA guidance that's out at the moment is adequate.

MS CALDWELL-SMITH (TISF): We recommend that APRA be the body to assess board governance, transparency and to set the list of default super funds in place based on criteria set as part of this inquiry. There is no need for a separate panel. APRA is already doing this. It has the necessary expertise and it also is enforcing under Stronger Super reforms improved corporate governance.

We do not believe, even in outsourcing to an expert panel, that Fair Work Australia would have the required skill or impartiality required to assess these funds and would have to assemble and structure that panel. This would also include a cost, and we're very concerned about this. We believe it could be incorporated into current APRA due diligence without a significant increase in cost. However, as soon as you mention a separate panel, that strikes me as being a separate department et cetera, and who is going to pay that? I would suspect a levy to the funds and its members, so I don't see that as being in the best interests of members.

There also needs to be a system to police employer decision-making if they elect to operate outside that. If an employer elects to search out their own fund, who is going to police that? How will that be done? The list of funds within APRA, taking into account individual aspects of industries - and bear in mind we only really are looking at four awards when it comes to transport because we have a definition within our trustee, we are not a public-offer fund - so if you had a list of funds that the employers could go to, they would not face liability or contestability issues. We don't - and you did ask the question how this would be handled - see that as an issue because people like ourselves will provide the information to assist them to make that decision because that is in our interests to do so, the same as other funds who work in that space.

As far as the review of the system is concerned, we recommend it should be within a five-year period of time. In the history of Australia, eight years is an incredibly long time. It's two rounds of government. It's eight budgets. It's enormous change, if you consider the last eight years. A lot can happen in eight years. It's two sets of investment around the trade club. We believe five years is suitable. It brings this into line with MySuper in 2017. It prevents the consolidation of a bad system and outcomes that are not in the spirit of the

legislation. It also means that if you didn't become a default fund in the initial phase that you might not be even able to apply for eight years and there doesn't appear to have been thought put around that.

We also believe that any review could be conducted using modified existing standards, leverage of what we've already got. We already have APRA prudential standards, we already have ASIC guidance notes and class orders. We're already operating within the Corporations Law. There are significant regulatory boundaries there that could be leveraged off. That would provide the ability to interpret and modify legislation going forward.

MR WOODS: Thank you very much. We appreciate the time and effort you've put in to giving us copies ahead of today - they have proved useful - so that we could go through them. Can I pick up your first significant point and that is your 4(a), as you describe it, and that this would be a list maintained by APRA. Presumably it's a subset of all MySuper and it uses the criteria that you identified but adding the fund's history in the industry, and I'd like to get to that bit in a moment. But would you see APRA as basically going through the process that we've identified there, so rather than be Fair Work Australia with an expert panel or an expert panel in itself, that you would be keeping the process, albeit with the addition of another criteria, but it being done by APRA and them calling forward parties and testing them and the like?

MS CALDWELL-SMITH (TISF): Andrew can make a comment on the MySuper process, and I think that's quite important because we're going through that right now.

MR DE VRIES (TISF): Yes, it is important. The simple answer is yes, so your experts within APRA. If you consider the MySuper licence application process that's just about kicking off, APRA, through their relationship management, are already very well positioned and in fact it's incumbent on them to make a subjective judgment about whether a trustee is able to or will comply with its requirements under MySuper, including enhanced prudential standards, including fees and putting the product offers, including their ability to assess scale and the impact of scale; having a program in place to do that, an insurance program. So APRA in its RSE licence variation process, they're going through all this with a fine toothcomb and they are making a subjective decision. It's not an objective, "If you have filled in this part of the form, tick; go to the next." That's out, as we know. It's subjective, so they're applying their professional judgment already.

So if we consider that, we already have this really quite robust filter at the top end when all of this group of people who eat, sleep and breathe super every single day of their lives - yes, when they're asleep as well - so it's an incremental addition, if you like, to what they're currently doing. Their background is huge already. They already will have formed views on trustees and the ability for them to implement, so

the next step of saying, "Get some objective criteria. Do these things stack up against this objective criteria?" is a small step. So part of this is just a logical conciliation. Part of it is about efficiency, part of it is about having an unbiased umpire out there. It's about leveraging off what we've currently got. Also, you will recall that APRA are funded by various levies which are already imposed on superannuation funds. The levy has gone up again, so they have already got a funding mechanism in place, so why reinvent the wheel when you've got 85 per cent of it there? Just add 15 to what you've already got.

MR WOODS: Without taking it too much further but you do talk about not having an artificial limit. But if you're using a set of criteria you are creating a subset?

MS CALDWELL-SMITH (TISF): Yes.

MR WOODS: So is that a subset - - -

MS CALDWELL-SMITH (TISF): But you're not creating a - you could have between five and 10 funds. You're having the suitable funds for that particular part of the industry in place.

MR WOODS: Which might be - half the funds might be only 10 of the funds but - - -

MS CALDWELL-SMITH (TISF): That's right.

MR WOODS: You're saying that that in itself would be a judgment as to how many of them meet those criteria?

MS CALDWELL-SMITH (TISF): That's right. But it won't be one fund, as it currently is in the Long Distance Operators Award.

MR DE VRIES (TISF): Which is the artificial limit, if you know what I mean, because there are others that are suitable or may be suitable, so they should be available for consideration. Remember as well you're going to have enhanced reporting in terms of product dashboards and all of this stuff already coming into existence as a result of MySuper. So a lot of the outcomes that are suggested here, the tracks are already being laid.

MS MacRAE: Can I just ask, am I right in understanding that you've currently got a couple of applications in to be listed in an award?

MS CALDWELL-SMITH (TISF): Yes, we do.

MS MacRAE: Okay. So in that - - -

MS CALDWELL-SMITH (TISF): That will be heard between now and 29 September.

MS MacRAE: Right, okay. Can you just tell us a bit more, because this is an area we've had a lot of trouble getting much evidence on, about how hard or how relatively hard or easy that has been, the process. For example, we've had it put to us that look, you know, why are people complaining about not having standing? All they have to get is the support of one employer and they can be heard. It's that easy. Why aren't more people doing it? Why can't they just bring it forward? So we would be very pleased if you could tell us a little bit more about your actual experience, because we've heard a lot of anecdotals but we haven't had a lot - - -

MS CALDWELL-SMITH (TISF): It is a very difficult process, but we - because of the nature of our existence are very lucky to have probably one of the pre-eminent bodies in Australia, an organisation of standing, who have gone forward on our behalf. Can I just tell you a little bit of history? It might help.

MS MacRAE: Yes, sure.

MS CALDWELL-SMITH (TISF): Formed in 89. In 1995 a federally based award came into being that overtook all the state awards. That federal award is the only respondent award in existence. That means that approximately 350 employers signed that award saying that this was the award they would use for long-distance operators and transport in Australia so that they didn't have to constantly be in and out of the states worrying about what award they were under. It made sense. At that time those employers philosophically indicated that they would support the Transport Industry Super Fund. However, they didn't see the need to put within that award a default super fund. They said, "This is what we're going to do, it doesn't need to be that."

MR WOODS: So does that mean the award at that point didn't name TIS or didn't include super as an item in the award?

MS CALDWELL-SMITH (TISF): No, it didn't. The only award going back - - -

MR COSTELLO: It didn't what?

MR WOODS: Both, didn't both? Didn't include your fund but also - - -

MS CALDWELL-SMITH (TISF): I'm not sure if it included the TWU or not. I can't comment on that.

MR WOODS: Okay, so it may have dealt with super but - okay, but it didn't

include - - -

MS CALDWELL-SMITH (TISF): I don't think it included any, but we can confirm that for you.

MR WOODS: Yes, thank you.

MS CALDWELL-SMITH (TISF): The early 80s, the TWU super fund, which is one of our main competitors obviously, did at that stage when superannuation first came into being - had itself went through that default super fund process when it was the Industrial Relations Commission. Now, that has flowed through with a couple of minor changes. 2008 came along and modern awards came in and that combination of all of the awards. At that time the grandfathering clause came in and the TWU super fund along with a couple of other three, four funds was nominated in the award for road distribution and transport. The TWU super fund was the default super fund at that time, so it was put into the Long Distance Operators Award.

Now, since that time any enterprise agreement that has been negotiated, any default superannuation arrangements through employers it basically has to be through that mechanism unless the member chooses or they were already grandfathered. In going to Fair Work Australia earlier this year - - -

MR WOODS: Sorry, on enterprise agreements, presumably they can name any fund if it's collectively agreed.

MS CALDWELL-SMITH (TSIF): They can name whoever they please, however, whether they're able to negotiate that through is another question.

MR WOODS: Yes.

MS CALDWELL-SMITH (TSIF): We can only provide anecdotal evidence on that and there is plenty of that.

MR WOODS: That's all right. I understand that.

MS CALDWELL-SMITH (TSIF): In March this year the review came up of modern awards and like many other people, the discussion was held as to whether to try to get this to review. I'm sure you know the four rationales, the ways that you can - (1) you have to have an organisation of standing, and there are a couple of other pieces, and the really good one is that all current parties to the award must agree and that's probably the biggest sticking point. NatRoad, National Australian Roads Transport Association which represents about 1500 employers around the country, has indicated that they were prepared, as an organisation of standing, to assist us to vary the award, to put in an application to vary the award. So that was passed by

their board and the applications for the two respective awards were put into place.

They are a large enough group and represent enough employers around the country to have the standing to do this. So you would need someone like an ATA, a NatRoad, a Logistics Council to do it. They're the only bodies big enough to be able to say they represent the number of people. A bit of a long-winded way of getting there but it might explain their interest in it. Their interest is ensuring their employers and the members get choice. That is what they want, just choice and an opening playing field.

MR COSTELLO: So would you mind explaining then what has happened. So the application has gone in?

MS CALDWELL-SMITH (TSIF): Yes, and we have decisions - - -

MR COSTELLO: Have you been asked for further information?

MS CALDWELL-SMITH (TSIF): Yes, decisions hearing last Wednesday and it is going before a full bench some time between now and 29 September for the hearing. We don't know the outcome.

MR DE VRIES (TSIF): You asking of experience and what have you. What we're seeing is that it is a very tight closed little shop and set of criteria to be able to get the thin end of the wedge in there to be able to argue your case. Then once you're in there and you can actually argue your case, all of the incumbents are actually making the decisions. Let's just consider the Transport Industry Super Fund for a moment, our appointment to assist the trustees is recent. We've only been on board for 12 months. The investment managers, UVS, have been on board for about two years. So the fund or the product, as we would call it, has seen a bit of change in terms of making things different to make it more competitive and better. When we do any form of competitor analysis, which is what we do and we present that, we can actually show in a number of areas where we're as good or better.

The most telling one is obviously investment performance. If we look at investment performance for the last year in particular, trying times, they're actually significantly better than any of that competition. Then when we talk about changes that we have made to insurance for the members and covering more people, a whole stack of things in a relatively short space of time, all that actually counts for nought. The quality of the fund counts for nought because you have all these incumbents in there who have many different vested interests and they're all webs woven into there who are not looking at it going, "Well, gee, you've got a better definition on total and permanent disability and arson, that will be good for a whole bunch of drivers," and, "You've got long haul covered, have you? Wow, how did you do that?" That's not the discussion, it's, "No, well, that will encroach on what we're doing and we're

trying to stitch up some sort of EBA over here with some other larger group and that's not a bargaining chip we can use."

So when you ask about experience, it's all these things going on the background which are, it is strongly arguable, not in the best interests of the members. These decisions that are being made are not in the best interests of the members, they're in the interests of these other incumbent organisations trying to keep competition out and that is probably the single - Di has obviously been very close to this, I've played a support role. But is probably the biggest single thing, it's not in the spirit of transparency, it's not open, it's not contestable. Many of the principles that you're talking about are just simply not at work.

MS CALDWELL-SMITH (TSIF): You may think we're cynical about this but it's hard to imagine Fair Work Australia, even with an expert panel in the future, having the procedural fairness going forward and being able to take the politics out. I would ask the Commission in your considerations over the next few weeks to follow us through Fair Work Australia. It would be a very good exercise to see how they treat this.

MS MacRAE: Once you have made your application and you have presented material to them that you would like them to consider, what is made public of all of that? Sorry about my ignorance - - -

MS CALDWELL-SMITH (TSIF): You haven't really seen a lot.

MS MacRAE: No.

MS CALDWELL-SMITH (TSIF): It's on the Fair Work Australia web site if you choose to look at it.

MR WOODS: No, we will go and look at that.

MR DE VRIES (TSIF): It is also an interesting process to go through. It is not simple. It is not simple at all. The amount of work that we have had to do in our office to dig through and dig through and dig through to find out, "What are the criteria and are they really it?" and then, "There's something else that fits in the background." It's not like you can pick up a two-pager that just goes bang, there it is, here is what you have to do, here is how it's nice and simple. It is a very complex set of arrangements and then once you are actually in there again, as we have discussed - - -

MS CALDWELL-SMITH (TSIF): You discover it's a club.

MR DE VRIES (TSIF): Yes.

MR WOODS: Are there any other matters that you want to bring before us?

MS CALDWELL-SMITH (TSIF): No, I think that covers it.

MR WOODS: You have put in a submission but if you were feeling so inclined to supplement that with a more clearly documented set of steps that you have had to proceed to having your application heard to this point, recognising it would on the record, that would be exceedingly helpful. We can use today's transcript but quite often you might want to put it into a clearly structured and consecutive set of issues. If that could come within a week or so, that would be very helpful to us.

MS CALDWELL-SMITH (TSIF): A week or so would be great.

MR WOODS: I understand your point but you've got to understand the value to us in having that document.

MS CALDWELL-SMITH (TSIF): Yes, I do.

MR WOODS: In which case thank you very much for your attendance and your contribution to this inquiry.

MS CALDWELL-SMITH (TSIF): Thank you.

MR DE VRIES (TSIF): Thank you.

MR WOODS: That completes the list of scheduled participants. Is there anyone present who wishes to make an unscheduled statement? That being the case, I will adjourn the hearings.

AT 3.03 PM THE INQUIRY WAS ADJOURNED ACCORDINGLY