Australian Government
Productivity Commission

Default Superannuation Funds in Modern Awards

Productivity Commission Inquiry Report

No. 60, 5 October 2012

ISSN 978-1-74037-415-6
ISBN 1447-1329

Publications Inquiries:
Media and Publications
Productivity Commission
Locked Bag 2 Collins Street East
Melbourne VIC 8003

Tel: (03) 9653 2244
Fax: (03) 9653 2303
Email: maps@pc.gov.au

General Inquiries:
Tel: (03) 9653 2100 or (02) 6240 3200

An appropriate citation for this paper is:

Productivity Commission 2012, *Default Superannuation Funds in Modern Awards*, Report No. 60, Final Inquiry Report, Canberra.

JEL code J32, H55

The Productivity Commission

The Productivity Commission is the Australian Government's independent research and advisory body on a range of economic, social and environmental issues affecting the welfare of Australians. Its role, expressed most simply, is to help governments make better policies, in the long term interest of the Australian community.

The Commission's independence is underpinned by an Act of Parliament. Its processes and outputs are open to public scrutiny and are driven by concern for the wellbeing of the community as a whole.

Further information on the Productivity Commission can be obtained from the Commission's website (www.pc.gov.au) or by contacting Media and Publications on (03) 9653 2244 or email: maps@pc.gov.au

Australian Government
Productivity Commission

Melbourne Office
Level 12, 530 Collins Street
Melbourne VIC 3000
Locked Bag 2 Collins Street East
Melbourne VIC 8003
Telephone 03 9653 2100
Facsimile 03 9653 2199
Canberra Office
Telephone 02 6240 3200
www.pc.gov.au

5 October 2012

The Hon David Bradbury MP
Assistant Treasurer
Parliament House
CANBERRA ACT 2600

Dear Assistant Treasurer

In accordance with Section 11 of the *Productivity Commission Act 1998*, we have pleasure in submitting to you the Commission's final report into Default Superannuation Funds in Modern Awards.

Yours sincerely

Mike Woods Presiding Commissioner	Angela MacRae Commissioner	Paul Costello Associate Commissioner

Terms of reference

PROCESS FOR THE SELECTION AND ONGOING REVIEW OF SUPERANNUATION FUNDS TO BE INCLUDED IN MODERN AWARDS AS DEFAULT FUNDS

I, Mark Arbib, Assistant Treasurer, pursuant to Parts 2 and 3 of the *Productivity Commission Act 1998* hereby request that the Productivity Commission undertake an inquiry into the process for the selection and ongoing review of superannuation funds to be included in modern awards as default funds.

The Commission will commence its inquiry on receipt of the terms of reference and report to Government within eight months of commencement.

Background

In May 2009, the Government commissioned a comprehensive and independent review into the governance, efficiency, structure and operation of Australia's superannuation system (the Cooper Review). The Cooper Review provided its final report to Government on 30 June 2010 and made 177 recommendations.

A key finding of the Cooper Review was that many consumers do not have the interest, information or expertise required to make informed choices about their superannuation. These consumers rely heavily on the default superannuation system to act on their behalf.

Superannuation originated in the industrial relations system and awards determined the funds which applied for each industry. Modern awards now list 'default superannuation funds' which apply if an individual fails to exercise their right to choose their own fund. Enterprise agreements can also set the default superannuation fund or funds for a particular workplace. Enterprise agreements must be approved by a majority of employees and must be approved by Fair Work Australia who can only do so if satisfied employees are 'better off overall' than under the relevant modern award.

The Government believes that default funds should continue to be included in modern awards, but there should also be a transparent set of criteria that such funds can be assessed against. This is in line with the Cooper Review, which recommended that the processes by which default funds are nominated for inclusion in modern awards be reviewed in 2012 to assess whether they are sufficiently open and competitive.

This review delivers on the Government's election commitment to ask the Commission to design a process for the selection and ongoing assessment of superannuation funds for nomination as default funds in modern awards. It seeks to develop transparent and objective criteria against which funds wishing to be eligible for default fund status in modern awards can be assessed, on an ongoing basis, to ensure that the best interests of members are met if their superannuation contributions are allocated to a default fund under the modern award.

Scope of inquiry

The Commission is to design criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards by Fair Work Australia

The criteria designed by the Commission should be transparent and objective. In considering criteria for determining whether a superannuation fund is appropriate to be nominated as a default fund in a modern award the Commission could have regard to the following:

- The appropriateness of the investment strategy of the default investment option of the fund in terms of risk and expected return
- The medium to long term net-of-costs investment performance of the default investment option
- The level of fees incurred by members
- The scale of the fund and the level of services provided to fund members
- The suitability and cost of insurance provided by the fund
- The governance of the fund
- The fees incurred and other impacts on members if they cease employment with an employer.

While the Commission is to focus on factors that optimise outcomes for members, it should also consider the administrative and compliance impact of its recommendations on employers and their representatives, unions, superannuation funds and decisions of Fair Work Australia.

In undertaking its inquiry, the Commission should have regard to the following matters:

- the interaction with the design and implementation of MySuper, including that only funds offering a MySuper product will be eligible to be included in modern awards

- modern awards will continue to be made and varied by Fair Work Australia
- modern awards will be subject to a comprehensive public review by Fair Work Australia in 2014, following an interim review in 2012.

Process

The Commission is to undertake an appropriate public consultation process including holding hearings, inviting public submissions and releasing a draft report to the public.

The Government will consider the Commission's recommendations, and the Government's response will be announced as soon as possible after the receipt of the Commission's report.

Mark Arbib
Assistant Treasurer

[Received 6 February 2012]

Contents

Abbreviations

ACAC	Australian Conciliation and Arbitration Commission
ACCI	Australian Chamber of Commerce and Industry
ACTU	Australian Council of Trade Unions
AFP	*Administradoras de Fondos de Pensiones* (Chile)
Ai Group	Australian Industry Group
AIRC	Australian Industrial Relations Commission
AIST	Australian Institute of Superannuation Trustees
AMWU	Australian Manufacturing Workers' Union
ANAO	Australian National Audit Office
APRA	the Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	the Australian Securities and Investments Commission
ATO	Australian Taxation Office
Cooper Review	Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System
Corporations Act	*Corporations Act 2001* (Cwlth)
COSBOA	the Council of Small Business Organisations of Australia
CSSA	Corporate Super Specialist Alliance
DEEWR	Department of Education, Employment and Workplace Relations
EPSSS	exempt public sector superannuation scheme
ERF	eligible rollover fund
Fair Work Act	*Fair Work Act 2009* (Cwlth)
FOFA	Future of Financial Advice
FPA	Financial Planning Association of Australia
FSC	Financial Services Council

FWA	Fair Work Australia
IFF	Industry Funds Forum
ISN	Industry Super Network
Master Plumbers	Master Plumbers and Mechanical Services Association of Australia
MER	management expense ratio
MPF	Mandatory Provident Fund
NUW	National Union of Workers
PST	pooled superannuation trust
RSE	Registrable Superannuation Entity
SCT	Superannuation Complaints Tribunal
SDA	Shop Distributive and Allied Employees Association
SIS Act	*Superannuation Industry (Supervision) Act 1993* (Cwlth)
SMSF	self managed superannuation fund
SPA	Swedish Pensions Agency
TPD	total and permanent disability
UTS	University of Technology Sydney

OVERVIEW

Key points

- Default superannuation arrangements for those employees who derive their default superannuation product in accordance with modern awards have provided market stability, and net returns of default funds have generally exceeded those of non-default funds. However, the arrangements could be improved.
- The primary principle governing default superannuation arrangements for modern awards should be the promotion of the best interests of employees.
  - The selection of default products for awards should be merit rather than precedent based, and should encourage improved performance through competition.
- The criteria that the Australian Prudential Regulation Authority will use for MySuper product authorisation provide a first filter for the selection of products.
- The Commission recommends a set of non-prescriptive factors to be considered as a second stage 'quality filter' when selecting default products for modern awards.
  - The factors relate to: investment objectives and performance (as primary factors); fees and costs; governance practices (particularly mechanisms in place to deal with conflicts of interest); insurance; intra-fund advice; and administrative efficiency.
- The process for the selection and ongoing assessment of default products in modern awards should be reformed. Decisions on the listing of default products should be made by a new Default Superannuation Panel within Fair Work Australia (FWA).
  - The panel should consist of the FWA President (or delegate) and an equal number of full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services.
  - The part-time members should not be representatives of organisations or parties to awards, but should be appointed as independent members based on expertise.
- Superannuation funds should be given standing to apply to, and be directly heard by, the panel, in order to have their products assessed for listing in modern awards. The panel should transparently assess cases on their merits, using the factors identified by the Commission, and any other factors deemed relevant by the panel.
- The panel should list all MySuper products for each modern award that meet the factors for consideration (which may prove to be a long list). No express limit should be placed on the number of products that may be listed in any given modern award.
  - The panel should identify in each modern award, wherever possible, a small subset of those listed products judged as best meeting the interests of the relevant employees.
- The panel should conduct ongoing assessments and undertake a periodic wholesale reassessment of the products listed in modern awards.
- The process should apply at least for the medium term, given the uncertainty regarding the number, mix and quality of MySuper products to be offered from 2013.
  - The process should be reviewed in 2023 and this review should include consideration of the appropriateness of allowing employers to select any MySuper product as a default superannuation product.

Overview

Australia's three-pillar retirement income policy comprises a means-tested and government-funded age pension, supported by both voluntary saving and compulsory superannuation contributions.

Superannuation effectively became compulsory in 1992 with the introduction of the superannuation guarantee. This guarantee now requires employers to make superannuation contributions for most employees at the rate of 9 per cent of ordinary time earnings. This rate will progressively increase to 12 per cent by 2019-20. At June 2012, total superannuation assets reached $1.4 trillion, approximately equivalent to Australia's GDP in 2011-12. Assets are predicted to reach 150 per cent of Australia's GDP by around 2040.

In 2009, the Australian Government commissioned an independent review into the governance, efficiency, structure and operation of Australia's superannuation system (the Cooper Review). The Government accepted many of the Cooper Review's recommendations, including the establishment of a new simple and cost-effective default superannuation product, MySuper. Under new legislation, only defined contribution funds that offer a MySuper product, or exempt public sector superannuation schemes (EPSSSs), will be eligible to be listed as a default fund in modern awards (that is, the 122 industry and occupational awards that commenced on 1 January 2010).

Also arising from the Cooper Review, the Government has asked the Commission to design criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards by Fair Work Australia (FWA). Accordingly, this inquiry assesses a range of criteria that could be used and also examines the process by which the decision to list funds in modern awards is made.

Despite the growth of superannuation in Australia, most employees do not make an active choice about which fund, and/or which superannuation product in that fund, their superannuation contributions should be paid into. This can be due to a range of reasons, such as the complexity of investment decisions and apathy about superannuation given its compulsory nature (box 1). The failure of many employees to make an active choice is the primary rationale for having a default superannuation system.

Box 1 Difficulties faced in making retirement savings decisions

Individuals might encounter difficulty making retirement savings decisions that are in their own best interests for a number of reasons. These include:

- lack of financial literacy, which limits people's ability to make informed financial choices
- complexity of investment decisions and difficulty matching risk preferences with the right products
- high search costs in terms of time taken to research and understand what is often a large number of products
- the 'endowment effect' where people value money that is lost more highly than money gained, causing them to be unduly conservative in their investment decisions
- lack of price awareness, as compulsory contributions, fees and other costs do not come directly out of members' pockets
- information asymmetries between superannuation providers and individuals
- a long lag between the initial investment of contributions and the time when the benefits can be accessed
- an associated tendency toward procrastination and inertia in making retirement savings decisions
- mental rules or short cuts (heuristics) that people use when they have no clear preference, or where the cost of acquiring information is too high, which can lead to persistent biases in decision making
- framing effects, where people choose based on how the available options relate to one another, how they are explained and what other information is provided at the same time, rather than which option is in their best interests.

The recent Stronger Super reforms aim to promote a more effective and efficient superannuation system (box 2). The reforms will do this by better aligning the interests and incentives of agents (such as fund trustees) and their principals (such as members), and by promoting greater transparency and accountability in the conduct and governance of superannuation funds. In addition, the reforms will make it easier to compare the performance of default superannuation products through better information disclosure.

Box 2 **The Australian Government's Stronger Super reforms**

The Government has announced a range of reforms that include:

- a new default superannuation product — MySuper — authorised by the Australian Prudential Regulation Authority. Under new legislation, only defined contribution funds that offer a MySuper product or exempt public sector superannuation schemes will be eligible to be listed as default funds in modern awards
- requiring trustees to develop a single diversified investment strategy for their MySuper products specifying the investment return target (over a rolling 10 year period) and the level of risk appropriate to members of each MySuper product
- introducing rules governing fees which can be charged for MySuper products by:
  - limiting the types of fees that can be charged, restricting the circumstances in which performance fees may be charged, limiting certain fees to cost recovery and prohibiting the deduction of commissions from member accounts
  - requiring a fair allocation of costs between MySuper products and other products
  - requiring all fees to be disclosed to members
- requiring equal treatment of members by giving all members of a MySuper product:
  - access to the same options, benefits and facilities
  - equal attribution of gains, losses and beneficial interests
  - the same fees (with some limited exceptions)
  - protection against fee subsidisation (since one employee should not be favoured over another where they have the same employer)
  - protection against being unknowingly 'flipped' to a higher cost division of a fund (through a ban on transferring members unless their consent is received no more than 30 days before any such transfer)
  - at least a minimum default level of life and total and permanent disability insurance on an opt-out basis.

Governance and fund administration reforms are also being introduced, including:

- a requirement that the trustees promote the financial interests of the fund members
- mandatory governance, investment and insurance covenants
- a requirement that the trustees determine annually whether or not MySuper members are disadvantaged by the scale of the fund
- a product dashboard where funds must publish investment return targets and achievement of those targets, liquidity information, and fees charged per member
- capital requirements, which now cover operational risk
- a requirement that proxy voting policies be published
- new data and e-commerce standards that will include electronic transmission of linked financial and member data using standardised formats
- the use of a member's tax file number as the primary identifier.

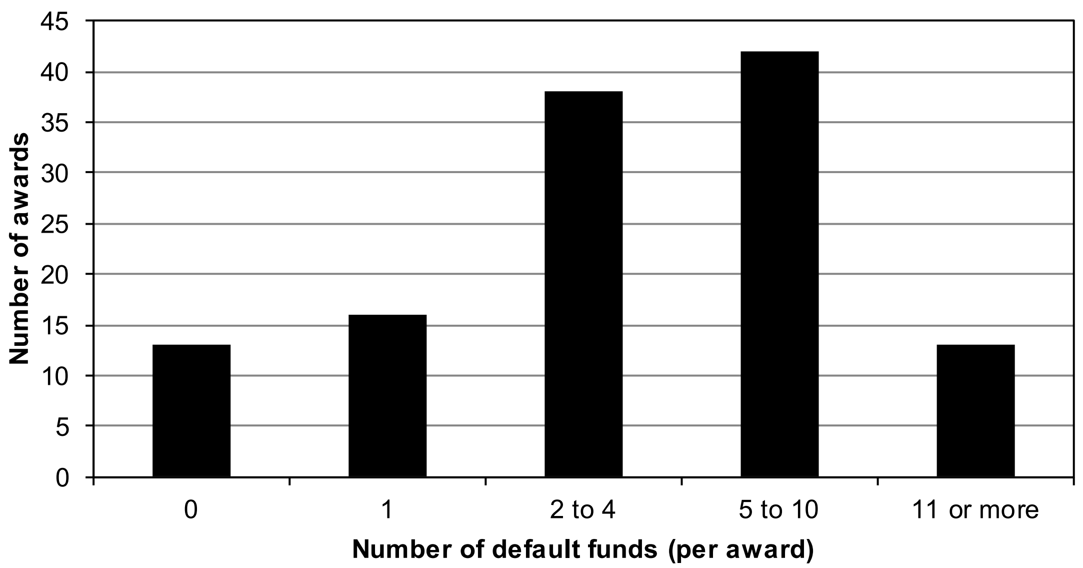
The current default superannuation system

Since 1 July 2005, most employees have been able to choose a superannuation fund and a specific superannuation product offered by that fund to which their superannuation contributions are made. This choice extends to employees who derive their default superannuation product in accordance with a modern award. This latter group of employees encompasses:

- award-reliant employees
- employees who receive above-award wages or conditions but derive their default superannuation product in accordance with a modern award
- employees covered by enterprise agreements that do not specify a default fund but refer to the modern award for superannuation purposes.

For employees who do not choose a superannuation fund or product, their employer is required to make superannuation contributions into a default fund and, where relevant, into a fund listed in an award. Of the 122 modern awards, 109 list at least one default fund, with some listing up to 18 funds (figure 1). For those modern awards that do not list a default fund, the employer may select any fund, provided it complies with the relevant superannuation legislation. Where there are grandfathering provisions in a modern award, employers can generally continue to make contributions to their previously selected default fund, even if it is no longer listed in the award.

Figure 1 **Number of default superannuation funds listed per modern award**

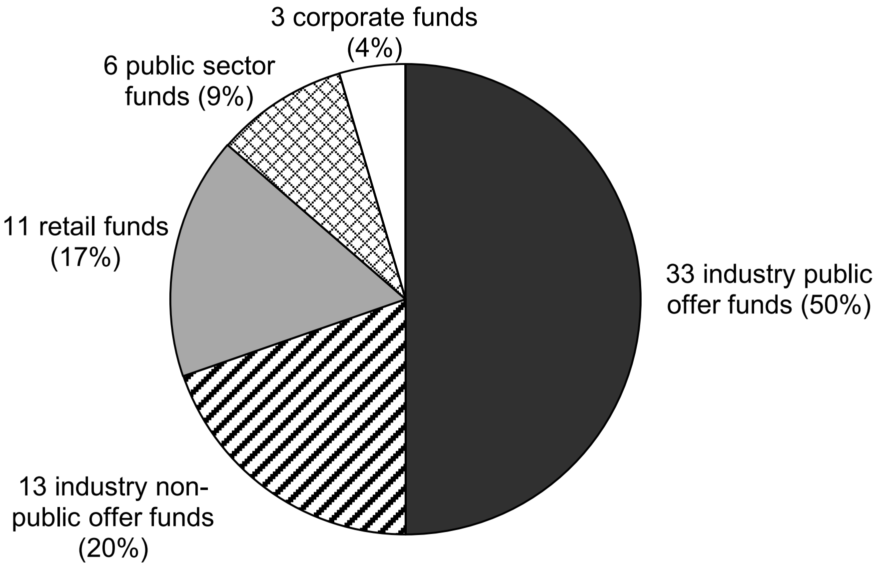


Default superannuation funds in Australia were included in awards when superannuation became an industrial matter in national wage bargaining in the 1980s. Many industry-based superannuation funds were established to cater for employees in specific industries, and a number of these have since become public offer funds — that is, funds that can be joined by members of the public by their own choosing.

Modern awards were developed during 2008 and 2009. Some modern awards cover a large and diverse range of industries and occupations, while others cover a smaller, more defined group. The superannuation funds that were selected for listing in the modern awards (mainly industry funds, along with some retail and corporate funds) were largely those that were already included in the relevant award-based transitional instruments. Most of the funds currently listed in modern awards have been classified by the Australian Prudential Regulation Authority (APRA) as industry funds (figure 2).

Figure 2 **Indicative types of funds listed as default funds in modern awards**

66 identifiable funds, by APRA classification



Since the commencement of modern awards on 1 January 2010, 30 applications have been made to list additional default funds in awards. Twenty of these applications were granted by FWA, on the basis that:

- the fund was listed as a default fund in an award-based transitional instrument relevant to the coverage of the modern award
- the representatives of the main parties covered by the award consented to the inclusion of the fund, or

- employers were making contributions to the fund for the benefit of employees covered by the modern award before 12 September 2008.

It is estimated that at least \$6 billion, and potentially more than \$9 billion, in superannuation contributions were made to default funds in modern awards in 2010 for employees who derive their default superannuation product in accordance with a modern award. Therefore, default listings in modern awards provide a relatively stable and predictable flow of new monies for many superannuation funds.

How well does the current default superannuation system perform?

The current default superannuation arrangements have resulted in net returns of default funds (that is, those listed in modern awards) generally exceeding those of non-default funds. Over the eight years to 2011, default funds in modern awards averaged an after-tax rate of return of 6.4 per cent, compared with 5.5 per cent for non-default funds.

While acknowledging this performance, the Commission considers that the current arrangements should be assessed in terms of their capacity to serve employees' best interests over time. A well-designed system should do the following:

- Place 'meeting the best interests of employees' as the explicit overarching objective in any criteria for the selection and ongoing assessment of superannuation products for listing as default products in modern awards.
  - The current process for listing default funds in awards is based largely on precedent and the consent of industrial parties.
- Promote contestability and competition — all funds that offer an eligible default product should have an equal opportunity to be assessed for listing in awards, and competition should provide an incentive for the ongoing innovation, efficiency, performance and consumer focus of superannuation funds.
  - The current system benefits funds that are supported by industrial parties.
- Promote transparency — relevant information should be made publicly available and actual, perceived or potential conflicts of interest should be declared.
  - The current system does not explicitly address actual, perceived or potential conflicts of interest.
- Be procedurally fair — all parties should have the right to put their case to an unbiased umpire.

- The current system does not provide for full procedural fairness, with some funds facing significant impediments to having their case to be listed as a default fund heard by FWA.

- Impose a minimum regulatory burden — each party involved should incur the minimum cost and inconvenience compatible with achieving the aims of the process.
  - The current system imposes minimal regulatory burdens.
- Promote stability and therefore stakeholder confidence in the superannuation market as a whole.
  - The current system promotes stability.
- Be consistent with other policies — including the Stronger Super and Future of Financial Advice reforms.
  - The current system is not always consistent with the reforms that place the best interests of employees as paramount, nor are decisions about where default money should be placed always made by professional advisers acting in the best interests of their clients.
- Have scope for regular assessment — all default funds must earn their product listing in a modern award on a regular basis.
  - Currently, there is no requirement for the funds and their products listed in modern awards to be regularly assessed and, if necessary, be delisted.

In these respects, the current system can be improved on because it:

- is based largely on precedent
- benefits funds that are supported by industrial parties
- is insufficiently transparent
- lacks important elements of procedural fairness
- is not always consistent with the recent reforms
- has inadequate mechanisms for the ongoing assessment of funds listed in modern awards.

In summary, employees who derive their default superannuation product in accordance with modern awards would benefit from a default superannuation system that ensures decisions are merit based rather than primarily precedent based.

Defining selection criteria for listing default products in modern awards

In considering potential criteria for the selection and ongoing assessment of default superannuation products for listing in modern awards, the Commission is mindful of the recent introduction of a significant number of reforms to the superannuation system. From July 2013, in addition to the introduction of MySuper products, there will be significant disclosure, governance and administrative reforms which are intended to make default superannuation products more transparent and comparable (box 2 above).

The Commission considers that the criteria for MySuper product authorisation, which will be administered by APRA, provide an appropriate starting point for the selection and ongoing assessment of superannuation products for listing in modern awards.

While the Commission does not consider there is a need for additional prescriptive criteria, there are several factors that should be taken into account when selecting products to be listed in awards. This is for two main reasons:

- The Stronger Super reforms serve largely to standardise features and promote disclosure to improve comparability between MySuper products, rather than filter out any products which may not represent the best interests of employees. Hence, there is a need for a 'quality filter' to distinguish between funds seeking listing of their products in modern awards.
- There is an administrative burden for employers — particularly new employers being required to choose from a potentially large number of diverse MySuper products. Aspects of superannuation compliance — particularly the complexity of the legislation, timing requirements for superannuation payments, and the administrative cost of paying small amounts for casual employees — are of concern to employers. Having all MySuper products listed as defaults in modern awards (or the practical equivalent, of not listing any default products or funds in any modern awards) might add to this compliance burden and create additional search costs for employers.

The Commission is proposing that the following factors be considered in the selection and ongoing assessment of superannuation products for listing as default products in modern awards.

Investment performance (primary factors for consideration)

- *The appropriateness of the MySuper product's long-term investment return target and risk profile for employees who derive their default superannuation* *product in accordance with a given modern award.* The Commission considers that the likely variability of MySuper product investment strategies is desirable, as it will result in a range of products that can meet the potentially diverse needs of employees who derive their default superannuation product in accordance with a given modern award. Accordingly, particular types of investment strategies should not be prescribed for default products. Instead, consideration should be given to the appropriateness of a product's long-term investment return target and risk profile for these employees.

- *The fund's expected ability to deliver on the MySuper product's long-term investment return target, given its risk profile*. Investment performance (returns after fees, taxes and charges) is central to meeting the best interests of members. Therefore, a fund's expected ability to deliver on its long-term investment return target, given its risk profile, should be taken into account in the selection of a default product. Acknowledging the widely held view that past performance is no guarantee of future performance, the Commission does not support the selection of products based on their relative past performance. However, the Commission acknowledges that a fund's track record is one factor in determining its future ability to deliver on its MySuper long-term investment return target, given its risk profile.

Fees charged to members

- *The appropriateness of the fees and costs associated with the MySuper product, given its stated long-term investment return target and risk profile, and the quality and timeliness of services*. The imposition of fee caps (beyond the Stronger Super cost recovery limits for some fees) is not recommended because of the distortions that would be introduced. However, fees and costs should be considered in the context of the stated long-term investment return target and risk profile, and the quality and timeliness of services associated with the MySuper product.

Governance and transparency

- *An assessment of whether governance practices are consistent with meeting the best interests of members.* The mechanisms put in place by fund trustees to deal with conflicts of interest, and the transparency associated with disclosure of those conflicts, should be an area of particular focus. Given APRA's recently enhanced role of developing and overseeing prudential standards relating to governance, it would be appropriate for the decision maker to be largely guided by APRA in assessing governance practices. Moreover, the Commission is broadly supportive of APRA's approach of not mandating any particular governance structure while also highlighting potential benefits of using independent directors.

Insurance, financial advice and administrative efficiency

- *The appropriateness of the MySuper product's insurance offerings for employees who derive their default superannuation product in accordance with a given modern award.* The Commission recognises that employees in different occupations and different awards have different characteristics and face varying risks, thus requiring different types of insurance. The Stronger Super reforms will impose a duty on trustees to manage insurance solely for the benefit of members, and allow trustees the flexibility to differentiate insurance offerings within MySuper products between different groups of members. While supporting these initiatives, the Commission recommends the consideration of the insurance needs of employees who derive their default superannuation product in accordance with a given modern award.
- *The quality of intra-fund advice.* The Commission considers that intra-fund advice (that is, advice relating to a member's existing interest in the fund and products offered by the fund) is important in equipping members with the skills and knowledge to make decisions about their superannuation.
- *The administrative efficiency of a fund.* Members and employers face transaction and time costs in interacting with funds. Therefore, it is the Commission's view that funds applying to have a default product listed in modern awards should be assessed on their administrative efficiency — in terms of their ability to minimise these costs to members and employers.

These factors that have been identified by the Commission for consideration when assessing whether a superannuation product should be listed as a default product in a modern award are not prescriptive, nor are they exhaustive. It is recommended that the decision maker be able to include other factors at their discretion, provided the reasons for doing so are fully disclosed. For the most part (with the notable exception of the factor relating to a fund's administrative efficiency), the factors for consideration apply filters to the MySuper authorisation criteria used by APRA. A decision on whether to list a fund will need to be made 'on balance' across the factors (noting the primacy of two) and include consideration of any other factors that are considered to be of particular importance in specific cases.

Applying the factors for consideration — an open, contestable and transparent process

Given the limitations of the current system for listing funds in awards outlined above, the Commission considers that the selection process itself needs to be reformed. To this end, the Commission canvassed and assessed four options in its draft report that were representative of the views put to it by participants.

The option of employers being able to choose any MySuper product received support from some stakeholders. However, given the timing of this inquiry, with the MySuper legislation not yet in force, the Commission is not in a position to observe the quality of products being offered by the market. Accordingly, the Commission is not currently able to be satisfied that the legislated MySuper authorisation process will operate as a sufficient filter to ensure that the best interests of employees who derive their default superannuation product in accordance with modern awards would be adequately protected simply by those employees being placed in any MySuper product.

Some inquiry participants supported essentially maintaining the status quo. The Commission has rejected this stance because current arrangements do not explicitly focus on the best interests of employees, and do not adequately address contestability and transparency concerns.

The Commission received many responses to its draft report proposal to provide an employer with the discretion to choose any MySuper product as their default product, as long as they could demonstrate, if called upon, that their employees would be no worse off than if a listed fund were chosen. Box 3 outlines the reasons why the Commission no longer supports the proposal for employer discretion, though providing some degree of employer flexibility remains a key consideration in the Commission's recommended approach (see below).

Box 3 **Employer discretion to choose a default superannuation product**

The draft report canvassed the possibility of providing employers with the discretion to choose any MySuper product as their default product, as long as they could demonstrate, if called upon, that their employees would be no worse off than if a listed fund were chosen.

The Commission does not support this discretion provision. The Commission was unable to design an appropriate test that would not place an undue burden on employers, while at the same time safeguarding the best interests of employees who derive their default superannuation product in accordance with modern awards.

Despite not recommending the employer discretion provision, the Commission acknowledges that some employers want flexibility to choose from outside the award list, and have the expertise to do so in a way that addresses the best interests of their employees. Accordingly, the Commission considers that some degree of flexibility for employers remains important.

The Commission is proposing a variation of one of the two options it supported in the draft report. The Commission recommends that a Default Superannuation Panel be established within FWA to make decisions about which superannuation products are listed in modern awards. The panel would consist of the FWA President (or delegate), and an equal number of full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services. The part-time members should not be representatives of particular organisations or parties to modern awards, but should be appointed as independent members based on their expertise.

The Commission recommends that an expert panel within FWA, rather than a new expert body independent of FWA, conduct the selection and ongoing assessment process. The Commission bases this on several reasons:

- The Commission considers that all funds that wish to have products listed as default products, and all other interested parties, should be heard directly by the decision maker (that is, a Default Superannuation Panel within FWA) as part of the one process, without there being a separate subsequent opportunity for industrial parties to make submissions to FWA.
- There are costs involved in setting up a new body and associated administrative processes. These costs could be incurred for little benefit, as the new body may not be needed in the longer term if the maturing of the market for MySuper products means that it is no longer necessary to list default products in modern awards.
- There is a risk of three 'regulators' potentially overlapping: APRA, FWA (while ever default superannuation arrangements remain in modern awards) and the proposed new body. The potential for overlap, conflict and confusion between three entities is a concern.

Under the Commission's proposal, all superannuation funds that offer an authorised MySuper product (and EPSSSs), including those funds currently listed in modern awards, would be required to apply to the Default Superannuation Panel if they want their default product(s) considered for listing in modern awards. Applicants would need to outline their case against the factors for consideration identified by the Commission, and any other factors deemed relevant by the panel. Applications would be made publicly available, and assessed by the Default Superannuation Panel on their merits.

The Commission recommends that all superannuation funds that offer an authorised MySuper product (and EPSSSs) be given 'standing' solely for the purpose of listing default superannuation products in modern awards. Giving these funds standing will require legislative change and will enable them to make applications to vary an award and be heard by the panel. Rights to judicial review of decisions should also be extended to these superannuation funds. This will promote contestability and transparency of the process.

Applicants that are not listed in the initial round should be allowed to apply/reapply to the panel at any time to have a MySuper product listed, subject to any limits that the panel places on how often an applicant with a product found to be unsuitable can reapply.

Any party with sufficient interest, including industrial parties, should be given the opportunity to submit their views on the applications received from funds by the Default Superannuation Panel. When doing so, they should be required to publicly disclose any conflicts of interest. These submissions should be publicly available, and the panel should determine the weight placed on them according to the merits of the arguments put forward.

The number of products listed in a given modern award should be at the discretion of the Default Superannuation Panel, rather than be a prescribed quota. The decision on whether or not to list a product should be based on an assessment of a fund's application against the factors for consideration proposed by the Commission, and any other factors at the panel's discretion.

Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing the product, which may result in a longer list. In the absence of grandfathering, a relatively long list has several advantages:

- It reduces the risk that an individual employee ends up worse off as a result of being moved into a product that is only marginally better than their current product and paying fees and insurance premiums on multiple accounts.
- There will be fewer movements of members between funds and therefore the risk of market instability is reduced.
- It decreases the administrative burden on existing employers as their current fund is more likely to be listed.
- It increases the opportunity for employers to choose a fund that it considers best meets the unique needs and characteristics of their employees (without the need to meet any other tests).

In addition, it is highly desirable that the panel, wherever possible, identify in each modern award a subset of those products found suitable for listing that, on transparent and publicly disclosed factors, it judges as best meeting the interests of employees who derive their default superannuation product in accordance with that modern award. Identifying a subset of products has several advantages:

- It makes it easier for new employers to choose a default product.

- It would be broadly consistent with the size of the lists currently in awards which appears to have been manageable for employers.
- It will drive competition between funds to achieve the status of being one of the subset when the subset of products is determined and reviewed and could lift standards throughout the industry.

As with decisions of the FWA Minimum Wage Panel, decisions of the Default Superannuation Panel should be final and not subject to appeal. Only judicial review on the grounds of jurisdictional errors should be permitted.

There should be an ongoing assessment of the list of superannuation products in modern awards by the Default Superannuation Panel to ensure that any unauthorised, non-existent or demonstrably unsuitable products are removed from modern awards as required. There should also be a periodic wholesale reassessment of the list of superannuation products in modern awards, and the subset of products best meeting the interests of employees who derive their default superannuation product in accordance with modern awards, every four to eight years.

Tailored MySuper products and MySuper authorised corporate funds should be required to apply to the Default Superannuation Panel for approval, in order to receive default contributions for employees who derive their default superannuation fund in accordance with modern awards. As with generic products, applications should be permitted at any time, and should be made and assessed on a transparent basis, against the factors for consideration proposed by the Commission (and any other relevant factors at the discretion of the panel).

These employer-specific products should not be listed in modern awards. Rather, modern awards that list superannuation products should specify that employers may pay into their employer-specific MySuper product provided that it has been assessed by the Default Superannuation Panel as being suitable. Tailored MySuper products and MySuper authorised corporate funds that have been approved by the panel would need to reapply on a periodic basis (at the discretion of the panel) to ensure that the product continues to meet the best interests of the relevant employees.

The Commission recommends that default contributions only be made to products that have been assessed as suitable by the panel (although contributions could continue to be paid into defined benefits funds without assessment given the advantages that defined benefit funds generally bestow on members).

Employers could continue to make contributions to a fund not listed in the modern award if it is included in an enterprise agreement, and the over-riding right of an employee to choose a fund would not change.

Box 4 summarises the Commission's recommended process for the selection and ongoing assessment of default products in modern awards.

Box 4 **The Commission's recommended selection process**

- A Default Superannuation Panel should be established within FWA.
- From 2014, the panel should consider applications from superannuation funds and funds should be given standing to apply to, and be directly heard by, the panel.
- All funds seeking to have their products listed in a modern award, including those already listed in modern awards, would need to apply to the panel in an initial round. Applications should be made publicly available.
- Any party with sufficient interest, including industrial parties, should be given the opportunity to submit their views on the applications received from funds by the Default Superannuation Panel. When doing so, they should be required to publicly disclose any conflicts of interest. Submissions to the panel should be made publicly available.
- The number of products listed in a given modern award should be at the discretion of the Default Superannuation Panel based on the applications received for that award and the panel's assessment of the applications against the Commission's factors for consideration, and any other factors deemed relevant by the panel.
- Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing the product, which may result in a longer list.
- The panel should, wherever possible, also identify in each modern award a small subset of the listed products that it judges as best meeting the interests of the relevant employees.
- Decisions of the panel should be clearly articulated and made easily and publicly accessible.
- Decisions of the Default Superannuation Panel should be final and not subject to appeal. Only judicial review on the grounds of jurisdictional error should be permitted.
- There should be an ongoing assessment of the list of superannuation products in modern awards by the panel to ensure that any unauthorised, non-existent or demonstrably unsuitable products are removed as required.
- There should also be a wholesale reassessment every four to eight years of the product lists in modern awards, and the subset of products best meeting the interests of employees who derive their default superannuation product in accordance with modern awards.

The Commission holds the view that all funds should be assessed, and then regularly reviewed, to ensure they are suitable to receive default contributions. The continuation of grandfathering arrangements relating to default superannuation would work against this principle. The Commission therefore recommends that, following an appropriate transition period, grandfathering provisions relating to default superannuation should be removed from all modern awards.

Implementation and transition

The Commission acknowledges the magnitude of the reforms already underway through Stronger Super, and that the industry is undergoing a period of significant transition to the new regime. Nonetheless, the Commission proposes that its reforms should ideally be legislated in full by 2014, so that the new process, together with the consideration of factors relevant to the selection of default products, can be held that year, potentially in conjunction with the review of modern awards that will take place in 2014.

From a community-wide perspective, the reforms will have the considerable net benefit of improving superannuation outcomes for employees who derive their default superannuation product in accordance with modern awards, and for fund members more broadly. It will do this by aligning the agents' (such as industrial parties and employers) interests with those of members and by encouraging improvement in the quality of superannuation products. The reforms will affect stakeholders in different ways:

- Employees who derive their default superannuation product in accordance with modern awards will benefit because their best interests will be the primary objective in the selection and ongoing assessment of default products, and there will be increased competition in the default superannuation market. However, some employees will find themselves in different funds, and will need to consolidate to avoid having multiple accounts. They will need accessible information from government agencies to help them make good decisions in response to any changes.
- In general, employers will benefit from the improved administrative capabilities of the funds they deal with. However, some employers will incur the cost of changing default funds, and will need to be promptly informed of changes to award listings. Employers will need to exercise judgement if they decide to swap between listed default products, to ensure their employees will not be worse off.
- The reforms will not affect all superannuation funds in the same way. All funds that wish to have their default products listed in awards (including funds that are currently listed) will need to submit an application for listing in 2014, and at least every eight years thereafter.
- The Default Superannuation Panel within FWA will have a range of responsibilities and functions, and will need to be resourced appropriately.

The Default Superannuation Panel will need a legislative basis for its operations. The Commission envisages that this could be modelled on current legislative arrangements for the Minimum Wage Panel that are contained within the *Fair Work Act 2009* (Cwlth). In developing the legislative framework, it will be important that:

- the factors for consideration are prescribed in the legislation
- principles of good process are followed
- all aspects of the default product selection process are provided for in (or permitted by) legislation, including that all eligible superannuation funds have standing solely for the purpose of listing default superannuation products in modern awards
- a legislative basis is provided to enable APRA to share data with the Default Superannuation Panel, and vice versa.

The Commission highlights the importance of sufficient resources being allocated to the Default Superannuation Panel to enable it to conduct all of its tasks in a professional and rigorous manner, and of clearly separating the panel's budget from that allocated to FWA's other functions.

The Commission recommends that there be an independent public review of the reforms after the first periodic reassessment of all awards has been completed, ideally in 2023. The review should examine whether the process and factors for consideration for default product selection remain useful and relevant, and consider the appropriateness of employers being able to use any MySuper product as a default superannuation product.

Recommendations and findings

Selection and ongoing assessment of default superannuation products in modern awards

FINDING 7.1

There is no case for the selection and ongoing assessment of default superannuation products for listing in modern awards to involve any prescriptive criteria over and above those used by the Australian Prudential Regulation Authority in authorising MySuper products.

RECOMMENDATIONS 4.1, 4.2, 4.3, 5.1, 6.1, 6.2, 6.3, 7.1

The selection and ongoing assessment of default superannuation products for listing in modern awards should have as their primary objective the best interests of employees who derive their default superannuation product in accordance with a modern award. The following factors should, at a minimum, be taken into consideration, but not as prescriptive criteria.

- ***The appropriateness of the MySuper product's long-term investment return target and risk profile for employees who derive their default superannuation product in accordance with a given modern award (as a primary factor) (4.1).***
- ***The fund's expected ability to deliver on the MySuper product's long-term investment return target, given its risk profile (as a primary factor) (4.2).***
- ***The appropriateness of the fees and costs associated with the MySuper product, given:***
  - ***its stated long-term investment return target and risk profile***
  - ***the quality and timeliness of services provided (4.3).***
- ***Whether fund governance practices are consistent with meeting the best interests of members, with particular focus on the mechanisms put in place by fund trustees to deal with conflicts of interest, and the transparency associated with disclosure of those conflicts (5.1).***
- ***The appropriateness of the MySuper product's insurance offerings for employees who derive their default superannuation product in accordance with a given modern award (6.1).***
- ***The quality of intra-fund advice (6.2).***

- ***The administrative efficiency of the fund (6.3).***

These factors for consideration should be enshrined in legislation. The legislation should also allow the decision maker to consider other factors that may be relevant, provided it clearly and publicly states its reasons for considering those factors (7.1).

RECOMMENDATION 4.4

The selection and ongoing assessment of default superannuation products for listing in modern awards should not include scale as a specific factor for consideration over and above the MySuper 'scale test'.

FINDING 7.2

The process currently used in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards has the following strengths. It:

- *has generally led to the listing of funds that have delivered relatively strong average net returns when compared to net returns of non-default funds*
- *has a measure of transparency*
- *imposes few regulatory burdens and fosters stability in the superannuation market.*

The process has the following shortcomings. It:

- *does not explicitly require decision makers to act in the best interests of employees who derive their default superannuation product in accordance with a modern award, or to consider the regulatory and administrative burden that may result from their decisions*
- *does not give equal access to all superannuation funds and therefore does not gain the advantages of contestability and competition*
- *is insufficiently transparent*
- *lacks important elements of procedural fairness*
- *has inadequate mechanisms for the ongoing assessment of funds.*

Principles for designing a selection process

RECOMMENDATION 7.2

The process used in the selection and ongoing assessment of superannuation products for listing as default products in modern awards should adhere to the following principles.

- ***Best interests — there is an explicit focus on meeting the best interests of employees who derive their default superannuation product in accordance with a modern award.***
- ***Contestability and competition — all default products have an equal opportunity to be assessed for listing in awards, and competition provides the incentive for the ongoing innovation, efficiency, performance and consumer focus of superannuation funds.***
- ***Transparency — relevant information is made publicly available and potential conflicts of interest are declared.***
- ***Procedural fairness — all parties have the right to put forward their case for consideration by an unbiased umpire.***
- ***Minimum regulatory burden — each party involved incurs the minimum cost and inconvenience compatible with achieving the aims of the process.***
- ***Market stability — the superannuation market is not destabilised.***
- ***Consistency with other policies — the process aligns with other relevant policy directions, including the Stronger Super and Future of Financial Advice reforms.***
- ***Regular assessment — all default products must earn their listing in an award on a regular basis.***

Reforming the selection process

RECOMMENDATION 8.1

A Default Superannuation Panel should be established within Fair Work Australia to make decisions about which products are listed in awards. The Default Superannuation Panel should be made up of the Fair Work Australia President (or delegate), and an equal number of full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services. The part-time members should not be representatives of particular organisations or parties to awards, but should be appointed as independent members based on their expertise.

RECOMMENDATION 8.2

Funds that are authorised to offer a MySuper product (and exempt public sector superannuation schemes) should be given standing solely for the purpose of listing default superannuation products in modern awards. This will allow those funds to make applications to have their products listed in modern awards, and be directly heard by the Default Superannuation Panel.

Applications should outline a case against the factors for consideration identified by the Commission (and any other factors at the Default Superannuation Panel's discretion), and be made publicly available.

Any party with sufficient interest, including industrial parties, should be given the opportunity to submit their views on the applications received by the Default Superannuation Panel. When doing so, they should be required to publicly disclose any conflicts of interest. All submissions should be publicly available, and the panel should determine the weight placed on the submissions it receives according to the merits of the arguments put forward.

RECOMMENDATION 8.3

After a transition period, grandfathering provisions relating to default superannuation should be removed from all modern awards.

RECOMMENDATION 8.4

The number of default products listed in a given modern award should be at the discretion of the Default Superannuation Panel. The decision about whether or not to list a product should be based on an assessment of a fund's application against the factors for consideration identified by the Commission, and any other factors at the panel's discretion.

Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing it even if this creates a longer list. Given the absence of grandfathering, a longer list will reduce the need for employers to change default funds. This will help ensure that the best interests of employees are not undermined by issues of market instability and the potential negative impact of having multiple accounts (unless employees exercise choice to consolidate their existing balances).

In addition, it is highly desirable that, where possible, the panel identify in each modern award a small subset of those products found suitable for listing that it judges best meet the interests of employees who derive their default superannuation product in accordance with that modern award. Identifying a small subset of products will assist employer choice and encourage competition.

The reasons for the panel's decisions about which products are found suitable for listing, and which are identified in the subset of products that best meet the factors for consideration, should be clearly articulated and made easily and publicly accessible.

RECOMMENDATION 8.5

The Default Superannuation Panel should undertake ongoing assessment of the list of superannuation products in modern awards to ensure that any unauthorised, non-existent or demonstrably unsuitable products are removed as required.

Once the initial process of listing funds in modern awards is complete, applications to the panel to add a MySuper product (or a product offered by an exempt public sector superannuation scheme) should be permitted at any time, subject to any limits the panel places on how often an applicant with a product that has been found to be unsuitable can reapply.

RECOMMENDATION 8.6

The Default Superannuation Panel should conduct a reassessment of the list of products in modern awards periodically, at which time the full selection process would be repeated and all funds that wish to have their default products listed in awards would need to apply or reapply.

The frequency of this reassessment should be at the discretion of the Default Superannuation Panel, but the reassessment should be conducted no more often than every four years and no less often than every eight years.

Should a product lose the status of being in the subset of products judged as best meeting the interests of employees who derive their default superannuation product in accordance with a modern award, contributions could continue to be made into that product, as long as it remains listed for that award. Default contributions to a product would only need to cease if the product was no longer listed.

RECOMMENDATION 8.7

In order to receive default contributions into a tailored MySuper product or a MySuper authorised corporate fund for employees who derive their default superannuation product in accordance with a modern award, funds should be required to apply to the Default Superannuation Panel for approval. As with generic products, applications should be permitted at any time, and should be made and assessed against the factors for consideration outlined by the Commission (and any other factors at the panel's discretion).

These employer-specific products should not be listed in modern awards. Rather, modern awards that list superannuation products should specify that employers may pay into their employer-specific MySuper product provided that it has been assessed by the Default Superannuation Panel as being suitable.

FINDING 8.1

The Commission notes that the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 makes provision for employers to continue to pay into a defined benefit fund for employees who derive their default superannuation product in accordance with modern awards. The Commission supports this approach and considers it appropriate that defined benefit funds be exempt from assessment by the Default Superannuation Panel.

RECOMMENDATION 8.8

Decisions of the Default Superannuation Panel should be final and reviewable only on the grounds of jurisdictional error.

Maximising the benefits of the reforms

RECOMMENDATION 9.1

The legislative and policy changes necessary to give effect to the Commission's recommended reforms should ideally be put in place in 2013 and 2014. This would allow the new process, together with the consideration of factors relevant to the selection and ongoing assessment of default superannuation products for listing in modern awards, to be applied during 2014, and potentially coincide with the review of modern awards that will take place that year.

RECOMMENDATION 9.2

The product names and identifiers and fund names used by the Australian Prudential Regulation Authority should be used by Fair Work Australia to list default superannuation products in modern awards.

RECOMMENDATION 9.3

An independent public review of the arrangements for the selection and ongoing assessment of default superannuation products for listing in modern awards should be conducted after the first periodic reassessment of products listed in awards has been completed, ideally in 2023. Amongst other things, the review should examine:

- ***whether the factors considered in selecting products for listing in modern awards remain useful and relevant***
- ***whether the selection process is working to deliver outcomes that are in the best interests of employees who derive their default superannuation product in accordance with a modern award***
- ***the appropriateness of employers being able to use any MySuper product as a default superannuation product.***

1 About the inquiry

The Australian Government has asked the Productivity Commission to design criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards by Fair Work Australia (FWA).

1.1 Background to the inquiry

Compulsory superannuation is a core element of Australia's retirement income system. Since the introduction of the superannuation guarantee legislation in 1992, employers have made compulsory superannuation contributions on behalf of most Australian employees. Employers must currently contribute 9 per cent of an employee's ordinary time earnings. This will rise to 12 per cent by 2019-20. Superannuation contributions, superannuation earnings, and withdrawals from the superannuation system receive concessional tax treatment.

In May 2009, the Australian Government commissioned the *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System* (the Cooper Review). The Cooper Review provided its final report to the Government on 30 June 2010. As a result of the Government's response to the Review, the superannuation industry is in the midst of implementing the Stronger Super reforms.

A key finding of the Cooper Review is that many consumers do not have the interest, information or expertise required to make informed choices about their superannuation. Therefore, consumers rely heavily on default superannuation arrangements. The Review recommended the establishment of a new default superannuation product, MySuper. The Government accepted this recommendation, and superannuation funds will begin offering MySuper products from July 2013.

The Cooper Review also recommended that the Productivity Commission conduct a review of the processes by which default funds are nominated in awards, to assess whether those processes are sufficiently open and competitive.

At present, there are two main ways in which superannuation funds are selected as defaults for those employees who do not choose a fund.

- Most of the 122 modern awards contain a list of default superannuation funds, selected primarily on precedent and the consent of industrial parties. Employers must use one of the listed funds as a default fund for employees who derive their default superannuation fund in accordance with modern awards. Where more than one fund is listed, employers choose among the listed funds. This means employers may need to choose different default funds for workers reliant on different awards. If no default fund is listed in an award, employers are free to choose a default fund, provided it complies with the relevant superannuation legislation.
- Many other industrial instruments, such as enterprise agreements and state awards, also list default funds. Depending on the industrial instrument, employers choose the default fund in consultation with employees, and industrial parties may also have a role.

The Government has stated in the terms of reference for this inquiry that it believes that default superannuation funds should continue to be included in modern awards.

1.2 What has the Commission been asked to do?

The Commission has been asked to design criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards by FWA. While the Commission has been asked to focus on factors that optimise the best interests of members, it is also to consider the impacts on other stakeholders.

The Government has asked the Commission to consider the interaction of this inquiry with the design and implementation of MySuper. Once MySuper is in place, which introduces a range of new standards for default superannuation products, only superannuation funds that offer a MySuper product will be eligible to accept default contributions, or be listed as a default fund in modern awards (though there are exceptions for certain public sector superannuation schemes).

Accordingly, the Commission has considered whether there is a net benefit to members, and to other stakeholders, in designing criteria for funds seeking to be listed in a modern award over and above those that will be required by the Australian Prudential Regulation Authority to authorise a MySuper product. It has also considered the process by which funds are selected to be listed in modern awards.

The Commission has taken into account that the Government believes default superannuation *funds* should continue to be included in modern awards. The Commission also notes that default contributions can generally only be made to MySuper *products* offered by funds. As appropriate to the context of each recommendation, some recommendations relate to the nature of MySuper products offered by funds, whereas others relate to the conduct and performance of a fund. Ultimately, the Commission considers that product names (and identifiers) should be used in conjunction with fund names to list default superannuation products in modern awards.

1.3 The Commission's approach to the inquiry

In keeping with the *Productivity Commission Act 1998* (Cwlth), the Commission has conducted this inquiry using open, transparent and public processes, with an overarching concern for the wellbeing of the Australian community as a whole.

The Commission published an issues paper in February 2012, a draft report in June 2012 and conducted public hearings in July 2012 in Melbourne and Sydney. The Commission has met with a range of interested parties, including: industry and union bodies; superannuation funds; academics and Government officials.

A total of 94 submissions have been received since this inquiry was announced. Appendix A provides details of the individuals and organisations who have participated in the inquiry, through submissions, visits and public hearings.

In conducting its analysis and proposing its recommendations, the Commission has given consideration to all submissions received during the inquiry, including responses to the draft report and feedback at the public hearings. The Commission has taken the best interests of employees who derive their default superannuation product in accordance with modern awards as the primary goal. The Commission has also been mindful of the administrative and compliance impact on employers and their representatives, unions, superannuation funds, FWA, the Australian Prudential Regulation Authority and other regulatory agencies.

2 Default superannuation funds in modern awards

Key points

- Australia's superannuation system managed $1.4 trillion in assets in June 2012 (which is approximately equivalent to Australia's GDP in 2011-12). The total pool of assets is predicted to grow to 150 per cent of Australia's GDP by around 2040.
- Between 1996 and 2012, the number of superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) decreased from 4747 to 352. Significant fund consolidation is expected to continue, but the rate at which this will take place is uncertain. Between 2000 and 2009, the number of self-managed funds doubled to over 400 000, and these funds now hold about 30 per cent of total superannuation assets.
- Employers' obligations to make superannuation contributions evolved as part of the industrial relations system. In 1992, employer contributions were extended to almost all employees by the superannuation guarantee legislation. Within this compulsory superannuation system, since 1 July 2005 most employees have had the right to choose a superannuation fund.
- Of the 122 modern awards, 109 list one or more funds as default superannuation funds. One of the listed funds must be used for employees who derive their default superannuation fund in accordance with a modern award (unless 'grandfathering' applies or employee choice has been exercised). Relevant employees include those who are award-reliant, above-award employees, and employees covered by enterprise agreements that do not specify a default fund but refer to the award for superannuation purposes.
- There are 104 default funds listed in awards, but some have merged, changed their name, or closed since they were first listed. Others are exempt public sector superannuation schemes or remain unable to be identified. Of the 66 remaining default funds, 46 are classified by APRA as industry funds, 11 are classified as retail, 6 are public sector and 3 are corporate funds.
- Around $6 billion, and potentially more than $9 billion, in superannuation contributions were made to default funds in awards in 2010 for employees who derive their superannuation fund in accordance with a modern award.
- Limited data and anecdotal evidence suggest that the superannuation funds listed in awards also influence the funds chosen in enterprise agreements.

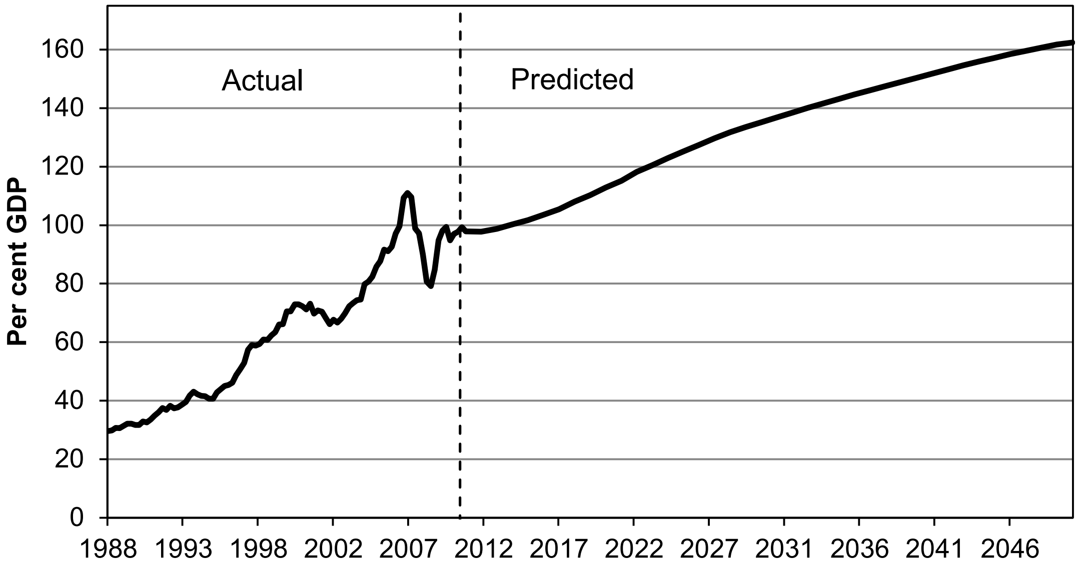
2.1 Default superannuation funds as part of Australia's superannuation system

Default funds are part of a large and growing compulsory system

Australia has a three-pillar retirement income system involving a government-funded and means-tested age pension, voluntary savings within the superannuation system, and compulsory superannuation (with tax concessions applying to the latter two). The focus of this report is the compulsory superannuation pillar, and in particular the default arrangements that are in place for 'employees who derive their default superannuation fund in accordance with a modern award' and who do not choose a fund into which their compulsory superannuation contributions are to be paid.

Assets in the superannuation industry have grown rapidly since 1992. In June 2012, total superannuation assets reached $1.4 trillion (APRA 2012f), which was approximately equivalent to Australia's GDP in 2011-12 (ABS 2012d). This growth is expected to continue, and it has been estimated by Treasury that superannuation assets will reach 150 per cent of GDP by around 2040 (figure 2.1).

Figure 2.1 **Predicted superannuation assets as a percentage of GDP**



Source: Gruen (2011).

Superannuation effectively became compulsory in 1992 with the introduction of the superannuation guarantee legislation (box 2.1). This guarantee now requires employers to make superannuation contributions for most employees at the rate of 9 per cent of ordinary time earnings. This rate will progressively increase to

12 per cent by 2019-20 (DEEWR 2012b). The superannuation guarantee applies to almost all employees, except for those earning less than $450 per month (or less than $350 per month in some industries); part-time employees under 18 years of age; and employees over 70 years of age (though this age limit will increase to 75 years of age by 1 July 2013) (ATO 2012a). A maximum contribution base ($43 820 per quarter in 2012) also applies (ATO 2012c).

Within the compulsory superannuation system, since 1 July 2005 most employees have had the right to choose their fund (the main exceptions being those employed under some enterprise agreements, or other specified pre-reform agreements). In the event that an employee does not choose a fund (box 2.2), an employer must make superannuation contributions for employees who derive their default superannuation fund in accordance with a modern award into one of the default funds listed in the award (unless 'grandfathering' applies — see below).

Box 2.1 **Features of the superannuation legislation**

Three pieces of legislation provide the main basis for regulation of the superannuation industry.

- *The Superannuation Guarantee (Administration) Act 1992* (Cwlth) determines whether or not employees have choice of fund. It also sets out the calculation of the superannuation guarantee shortfall, which accrues when an employer fails to pay superannuation.
- *The Superannuation Guarantee Charge Act 1992* (Cwlth) imposes a superannuation guarantee charge equal to the amount of the superannuation guarantee shortfall.
- *The Superannuation Industry (Supervision) Act 1993* (Cwlth) establishes the registration and licensing processes for superannuation funds and their trustees and contains rules on accounting, audit, reporting, governance, and board structure.

Where the award does not direct contributions to a particular fund, or funds, employers can make superannuation contributions to any complying fund under the *Superannuation Industry (Supervision) Act 1993* (Cwlth) (the SIS Act) (ATO 2011a).

Box 2.2 How many employees exercise choice of fund?

There are no data on the incidence of choice of fund by employees who derive their superannuation fund in accordance with a modern award. More broadly, there are a variety of estimates of how many employees (employed under a range of different industrial instruments, not just awards) actively choose their superannuation fund in any given year.

- 44 per cent of employees do not take any active role in determining the fund to which their contributions are made, and a further 26 per cent select the default fund offered by the employer, which means about 70 per cent of employees are members of the default fund selected by their employer (ABS 2007).
- 50 to 70 per cent of employees are members of their employer's default fund (Colmar Brunton 2010a).
- Just over 27 per cent of the 609 employees who participated in a survey commissioned by the Association of Superannuation Funds Australia actively chose their employer's default fund, 20 per cent did not exercise choice and were placed in the employer's default fund, and 23 per cent of employees did not have choice of fund, which means, in total, just over 70 per cent of the employees surveyed were members of the default fund selected by their employer (ASFA, sub. DR75).

Measures of whether or not a member is in the default investment option might also provide some indication of choice of fund, although a member who chooses a fund might also actively choose to be in the fund's default investment option.

- Of those who default into their employer's default fund, roughly 80 per cent are in the default investment option. Anecdotal evidence suggests that about 20 per cent of these employees actively chose to be there, meaning that about 60 per cent of members do not make active superannuation choices (Australian Government 2010a).
- 18 per cent of employees do not accept the default investment position within their fund (Super Ratings 2006; Gallery, Gallery and McDougall 2010).
- Just over 53 per cent of employees chose an investment option other than the default. This includes employees who had chosen a fund, and some of the employees who were in the default fund (ASFA, sub. DR75).

Regulation of the superannuation industry

The Australian superannuation industry is highly regulated, with a number of agencies having a role (box 2.3). The Australian Prudential Regulation Authority (APRA) has the primary regulatory role, as it regulates industry, retail, corporate and some public sector funds (APRA 2005). The characteristics of each of these types of funds are, briefly:

- *industry funds* — they have traditionally drawn members from the employees of a range of employers across a single industry, and were generally established under an agreement between parties to an industrial award. The boards of these funds have an equal number of employer and employee representatives, and sometimes one or more independent directors. However, industry funds are increasingly public offer and can be joined by members of the public by their own choosing
- *retail funds* — they offer superannuation products to the public on a commercial public offer basis and are usually run by large financial institutions
- *corporate funds* — they are sponsored by one or more employers
- *public sector funds* — they have a government agency or government-owned corporation as their sponsoring entity. Although some are regulated by APRA, a number are exempt from APRA regulation. Exempt public sector superannuation schemes (EPSSSs) are subject to a heads of government agreement between the Commonwealth and State Governments under which the schemes are operated (to the extent practicable) in accordance with core legislative requirements.

Trustees of APRA-regulated funds must be licensed under the SIS Act. Each licensed trustee must comply with a number of ongoing requirements, including proper and prudent performance of their duties, compliance with fit and proper standards, and registration with APRA of each superannuation fund for which the trustee is a licensed trustee (APRA 2004). In addition, the SIS Act requires equal numbers of employer and employee representatives on the boards of corporate funds and industry funds that are not public offer. There is also a requirement that default products offered by superannuation funds include a minimum level of life insurance.

Box 2.3 Regulatory arrangements for superannuation

The Australian Prudential Regulation Authority administers and enforces a range of prudential standards. There are several other agencies that also have responsibilities for superannuation regulation.

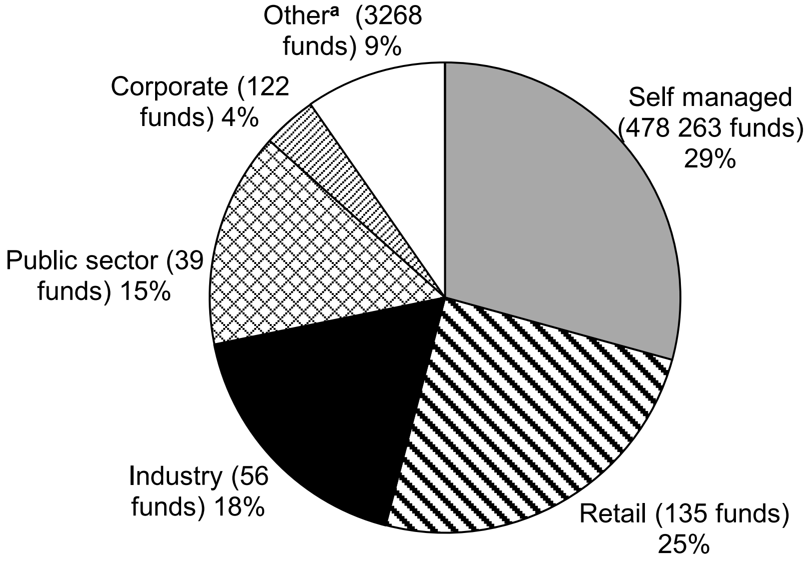
- The Superannuation Complaints Tribunal hears complaints relating to the decisions of trustees of superannuation funds.
- Fair Work Australia regulates the industrial relations system and the listing of default funds in awards.
- Failure to make compulsory superannuation contributions results in the employer being liable for a superannuation guarantee charge. This is enforced by the Australian Taxation Office (ATO). The ATO also regulates self managed superannuation funds.
- Although the Fair Work Ombudsman (FWO) is responsible for the enforcement of industrial relations laws, it does not enforce the payment of superannuation. Complaints received by the FWO about non-payment of superannuation are referred to the ATO. However, an employer's failure to pay into a default fund listed in a modern award would in theory be dealt with by the FWO, although complaints about this are rarely made.
- The Australian Securities and Investments Commission licenses financial advisers, regulates corporate disclosure and has a general consumer protection role in the financial services industry, including in relation to superannuation and insurance. For example, the Australian Securities and Investments Commission is responsible for the regulation of intra-fund advice provided by superannuation funds.
- The Australian Competition and Consumer Commission has a general role in ensuring competition in markets. It regulates anti-competitive conduct such as price-fixing, cartels, anti-competitive agreements and misuse of market power. It is also responsible for reviewing mergers that could substantially lessen competition.

Sources: ACCC (2008, 2012); ASIC (2012a); ATO (2011a, 2011b); FWO (2011a); SCT (2009).

Other than EPSSSs, self managed superannuation funds (SMSFs) are the main type of superannuation fund not regulated by APRA. SMSFs have fewer than five members, and are the largest and fastest-growing superannuation sector. From 2000 to 2009, the number of SMSFs doubled to over 400 000 funds (about 30 000 new SMSFs were established each year between 2007 and 2011, and during this period, SMSF assets grew at twice the rate of total superannuation assets). As at September 2010, the sector held over $400 billion in assets, which is about 30 per cent of assets in the entire superannuation industry (figure 2.2) (ATO 2011c, 2012e; Australian Government 2009).

Figure 2.2 **Superannuation industry profile**

(Number of funds, per cent share of assets), June 2012



[a] Other funds, which are not regulated by APRA, comprise pooled superannuation trusts, small funds, and balance of life office statutory funds. Retirement savings providers have not been included in this figure, as they accounted for 0.1 per cent of assets, as at June 2012. Single-member approved deposit funds have also been excluded.

Sources: APRA (2012f) performance results based on quarterly data for superannuation funds including APRA-reporting exempt public sector superannuation schemes, pooled superannuation trusts, and retirement savings accounts.

In contrast, between 1996 and 2012, the number of APRA-regulated superannuation funds decreased from 4747 to 352. This consolidation is expected to continue in coming years, although the rate at which this will take place is uncertain. Estimates for the Cooper Review indicate that there are likely to be around 74 APRA-regulated funds by 2035 (Australian Government 2010a).

Superannuation fund mergers can be discouraged by an unfavourable capital gains tax outcome (Towers Watson 2010) (although capital gains tax relief for superannuation funds has recently been announced — chapter 4) and encouraged by economies of scale in their operating and investment costs (Higgs and Worthington 2010; Sy and Liu 2010). However, the impact of the Stronger Super reforms (discussed later) on the economies of scale of superannuation funds and therefore on their rates of consolidation is uncertain (Deloitte 2010; Rice Warner 2010).

Although the superannuation industry has consolidated rapidly to date, total assets have generally continued to grow, increasing from $245 billion to $1.4 trillion between 1996 and 2012 (APRA 2007, 2012f).

Despite the overall size of the industry, average member balances are relatively low, and since most individuals holds multiple accounts, average account balances are even smaller (table 2.1). Many of these accounts are a consequence of changes of workplaces and are unintended — for example, the individual has not actively chosen to hold multiple accounts for the benefit of multiple insurance policies or investment diversification. The Australian Government has announced its intention to automatically consolidate some small and inactive accounts in 2014 (chapter 9).

Table 2.1 **Average member superannuation assets in APRA-regulated funds**

By fund type, 2009

Type of fund	*Average member balance*	*Average account balance*
	$	$
Corporate	133 492	98 493
Industry	32 895	21 895
Public sector	100 302	62 456
Retail	46 710	24 526

Source: Estimates for the Cooper Review (Australian Government 2010b).

Employers' role in superannuation

In June 2011, there were more than 800 000 employers in Australia, and almost 90 per cent of these were small businesses (ABS 2012a). Excluding working proprietors,[1] employees of small businesses (employing less than 20 employees) accounted for just under 30 per cent of private sector employment (ABS 2011a, 2012a; Farmarkis-Gamboni, Rozenbes and Yuen 2012). Small employers are more likely to rely on awards or individual arrangements, while larger employers are more likely to use collective agreements (ABS 2011b). Around 45 per cent of award-reliant employees are employed in small businesses, 35 per cent are employed in businesses with 20 to 100 employees, and large businesses with more than 100 employees employ around 25 per cent of award-reliant employees (FWA 2012b).

Employer compliance with the superannuation guarantee is difficult to determine as the available data are limited and unreliable. The Inspector-General of Taxation has estimated that, in 2000, about five per cent of employees did not receive any of their superannuation guarantee entitlement (that is, their employers did not make the

[1] Employers are required to pay superannuation for most of their employees. This includes directors of a business, and family members employed by a family company or trust. However, sole traders and partners in a partnership do not have to make contributions to a superannuation fund for themselves (ATO 2011a).

superannuation contributions they were required to make by law). Employees of small businesses, casual employees, and employees aged between 18 and 25 years were at higher risk of receiving no or insufficient superannuation contributions. This was particularly the case for employees in certain industries (arts and recreation; accommodation and food; agriculture, forestry, and fishing; and transport, postal and warehousing) (IGT 2010).

Superannuation compliance is of concern to employers due to the complexity of the legislation, the costs of administering employee choice of fund, the challenge of timing requirements for superannuation payments, and the cost of paying small amounts for casual employees (Australian Government 2006). The Council of Small Business Organisations of Australia submitted that the Stronger Super reforms 'will not decrease costs for employers and … will increase costs in time and money for individuals who are also employers and also increase non-compliance' (sub. 7, p. 4).

The availability of clearing houses can help reduce compliance costs for employers. The Small Business Superannuation Clearing House, administered by Medicare Australia, was introduced on 1 July 2010 for small businesses with less than 20 employees. It aims to reduce costs by allowing superannuation contributions to be paid to a single location and then distributed electronically (Treasury 2008). At the end of November 2011, over 14 000 small employers (less than 2 per cent) had signed up to the clearing house, and over $100 million in contributions had been made for just over 79 000 employees (Department of Human Services 2011). There are also private clearing houses which are used by large employers.

> Clearing houses themselves are a critical component of efficient superannuation administration across larger employers. With large numbers of employees and many of these entitled to exercise choice of fund, the number of default funds which are required can be significant. Without the use of clearing houses, larger employers would be overwhelmed. (REST Industry Super, sub. 47, p. 10)

2.2 Australia's industrial relations system

Awards, agreements and individual arrangements

Currently, default superannuation fund arrangements in Australia are part of industrial awards and hence part of Australia's industrial relations system. Understanding the nature and scope of industrial awards is therefore critical to understanding the close interaction between superannuation and the industrial relations system.

Australia's industrial relations system has both a federal and a state jurisdiction, though it moved to a predominantly national system when the *Fair Work Act 2009* (Cwlth) reforms were introduced. In May 2010, 87 per cent of all employees were in the federal system (7.8 million employees) (ABS 2012c).

Coverage of the federal industrial relations system differs between states. The Northern Territory and the ACT have always been part of the federal system, and Victoria referred its industrial relations powers to the Commonwealth in 1996 (Business Victoria 2011). Although businesses in Queensland, New South Wales and South Australia are covered by the federal system, state and local government sector employers in these states are covered by state industrial relations legislation (FWO 2011b). In Tasmania, only local government sector employers are covered by the state industrial relations system. In Western Australia, only employees of constitutional corporations (foreign, trading or financial corporations) are covered by the federal system. All other employees in Western Australia — including state and local governments, sole traders, partnerships and trusts — are covered by the state legislation (Department of Commerce 2012). For employees not covered by the federal system, default funds could also be listed in these state industrial instruments.

Industrial instruments can be broadly grouped into three categories: awards, individual arrangements and collective agreements.

- Awards set minimum pay and conditions for employees in a particular industry or occupation. The 122 new federal awards — called 'modern awards' — are part of the national industrial relations system and commenced on 1 January 2010. Some entitlements from state awards are still being transitioned into the national system, and a number of federal awards made prior to 1 January 2010 covering individual enterprises and public sector employees are yet to be modernised.
- The individual arrangements allowed by the new national industrial relations system are common law contracts, above-award payments and individual flexibility arrangements. These arrangements are not registered with Fair Work Australia (FWA), but still subject to regulation under the Fair Work Act. Some individual agreements implemented under the previous industrial relations system (such as Australian workplace agreements) are still in force but are being gradually phased out.
- Collective agreements under the new national industrial relations system are known as enterprise agreements. However, collective agreements from the previous industrial relations system (such as certified agreements) are still in force until they are replaced by a new agreement made under the Fair Work Act.

Of all the industrial instruments in force, only the new agreements introduced by the Fair Work Act (enterprise agreements and individual flexibility arrangements) are subject to the 'better off overall' test. This test requires that each of the employees that were covered by an award are better off overall under the new agreement than they would be under the relevant award (FWA 2012a).

Employees who derive their superannuation fund in accordance with a modern award

The Fair Work Act makes a distinction between employees who are covered by an award, and employees who are award reliant. An employee is covered by the award if they are in a group of employees expressed to be within the scope of the award. In contrast, an employee will only be award reliant if their pay and conditions are solely determined by the award, and not some other industrial instrument (Preston et al. 2012).

However, in this inquiry, the Commission is primarily concerned with employees who are subject to the default funds listed in modern awards, and refers to them as being 'employees who derive their default superannuation fund in accordance with a modern award'. This encompasses three categories of employees.

- Award-reliant employees, who have all the terms and conditions of their employment, including their default superannuation fund, determined by the award.
- Employees who receive some above-award wages or conditions through an individual arrangement, but have the other terms and conditions of their employment, including their default superannuation fund, determined by the award. Although around 37 per cent of employees were employed under different types of individual arrangements in May 2010, it is uncertain how many of these were above-award arrangements (under which employees still rely on the award for their other terms and conditions of employment, such as superannuation) (ABS 2011b).
- Employees covered by enterprise agreements that do not specify a default fund but refer to the terms of the award for superannuation purposes. There were an estimated 115 000 collective agreements in force in May 2010, covering about 43 per cent of employees (ABS 2011b; DEEWR 2012a), but it is uncertain how many of these specified a default fund. (Employees covered by enterprise agreements that specify a default fund do not derive their superannuation provisions from an award.)

- Some employees in each of these groups may not receive superannuation because they earn less than the required minimum.

Profiling award-reliant employees

In May 2010, 15 per cent of employees had their pay solely determined by an award (table 2.2). This award-only category is broader than the FWA definition of award-reliant employees, since it includes instruments other than modern awards, such as award-based transitional instruments. However, the data for award-only employees are the best available proxy for award-reliant employees. These employees received, on average, 7.8 per cent of wages paid in that year (ABS 2011b).

Table 2.2 **Methods of setting pay**
May 2010

	Number of employees	*Share of total*
	'000	%
Award only	1 361	15.2
Collective agreement[a]	3 892	43.4
Individual arrangement[b]	3 346	37.3
Owner manager of incorporated enterprise	368	4.1
All methods of setting pay	**8 968**	**100**

[a] Includes registered and unregistered agreements. [b] Includes registered and unregistered arrangements.
Source: ABS (2011b).

Award reliance varies by industry, and tends to be lower in more highly skilled industries (Rozenbes 2010) (table 2.3).

> … the distribution of award reliance for setting pay is quite focused. Over 70% of employees who are award-reliant for pay are employed in five of the 18 ANZSIC industry divisions. In descending order of importance these are accommodation and food services, retail trade, health care and social assistance, administrative and support services and manufacturing, which in May 2010 employed over 970,000 of the 1.36 million award-reliant employees identified in the survey. (ACCI, sub. 37, p. 15)

Industries that have a high proportion of award-reliant employees also tend to have a high proportion of part-time and casual employees.

> The hospitality industry workforce is characterised by a higher proportion of younger employees and people working on either a casual or part time basis (such as parents with young children, people earning a second income, etc.) (Australian Hotels Association, sub. 10, p. 8)

In 2008, a casual employee was four times as likely to be award reliant compared to a permanent or fixed-term employee (Rozenbes 2010). Casual employees often work simultaneously for several employers and experience high job turnover (this might also pose a constraint to superannuation account consolidation) (Rice Warner 2007). Further, women are more likely to be award reliant than men, and typically have lower superannuation balances (Clare 2008).

Table 2.3 **Percentage of award-only employees, by industry**
May 2010

	Number of employees	*Share of total*
	’000	%
Accommodation and food services	291.6	21.4
Retail trade	204.9	15.0
Health care and social assistance	193.6	14.2
Administrative and support services	161.0	11.8
Manufacturing	120.8	8.9
Other services	88.2	6.5
Construction	53.2	3.9
Wholesale trade	45.9	3.4
Education and training	43.1	3.2
Rental, hiring and real estate services	40.3	3.0
Transport, postal and warehousing	32.9	2.4
Professional, scientific and technical services	26.2	1.9
Arts and recreation services	24.1	1.8
Public administration and safety	12.8	0.9
Information media and telecommunications	9.2	0.7
Financial and insurance services	7.9	0.6
Electricity, gas, water and waste services	3.0	0.2
Mining	2.6	0.2

Source: ABS (2011b).

The coverage of modern awards does not correspond to the industry classifications in table 2.3 (since modern awards can cover more than one industry, or cover one or more occupations rather than a single industry). As noted by the Australian Chamber of Commerce and Industry:

> The demographics of award coverage are not easy to determine and identifying coverage is made more difficult by the cross-cutting effect of occupational awards which reach across industries but do not necessarily uniquely provide award coverage for the occupations they cover … It is clear that modern awards were not made with industry coverage rules in mind, in fact, rather the reverse. (sub. DR83, pp. 5−6)

Some awards (such as the Social, Community, Home Care and Disability Services Industry Award 2010) cover a large and diverse range of industries and occupations, while others (such as the Poultry Processing Award 2010) cover a smaller, more defined group. Accordingly, the data on award-only employees by industry can only provide some indication of the distribution of award-reliant employees by industry. FWA has recently released draft mapping documents comparing modern award coverage with the industry classifications in table 2.3 as part of a long-term research project which will attempt to resolve these problems (FWA 2012c).

2.3 Superannuation in awards

A brief history

Employer superannuation began in 1862 with the establishment of a defined benefit pension fund for the employees of the Bank of New South Wales. Superannuation followed this model for the next 100 years: defined benefit pension funds were established for a minority of employees, who were generally higher-paid white-collar employees in the private sector or civil servants in the public sector (APRA 2007; Sy 2008).

Although superannuation started to become more widely available from the 1970s as a result of claims brought under industrial relations laws, two related developments in the mid-1980s resulted in superannuation clauses being included in awards.

- The first was the 1985 Prices and Incomes Accord, where an agreement was reached between the Australian Government and the Australian Council of Trade Unions (ACTU) that a 3 per cent wage increase deemed due on productivity grounds would instead be paid as superannuation.
- The second was the June 1986 National Wage Case. The ACTU gained approval from the Australian Conciliation and Arbitration Commission (ACAC) (a predecessor of FWA) for an agreement to contribute wage increases of up to 3 per cent into superannuation funds. The jurisdiction of the ACAC to make this ruling was challenged by the Australian Chamber of Manufactures and the Victorian Employers Federation. However, the High Court (1986) held that the ACAC had jurisdiction to hear this case (and cases relating to superannuation more generally) because superannuation benefits for employees was an 'industrial matter' as defined in the *Conciliation and Arbitration Act 1904* (Cwlth).

As a result of these developments, superannuation clauses were gradually incorporated into industrial awards as they were renegotiated. This saw superannuation coverage expand from about 40 per cent of employees in 1986 to

79 per cent in 1990 (APRA 2007). Under this system, superannuation payments could only be enforced by bringing a case before the ACAC (APRA 2007).

A significant body of case law was subsequently developed around the inclusion of default funds in pre-modern awards. For example, in the 1994 Superannuation Test Case*,* the Australian Industrial Relations Commission (AIRC) (a predecessor of FWA) held it would have regard to its previous decisions about the specification of default funds in awards. In the 1999 Building and Plumbing Award Simplification decision, it was determined that if the AIRC had jurisdiction (which it was later found to have), then the claim would be decided on its merits which may include the history of any superannuation provisions in the award, the circumstances of the industry covered by the award, the decisions of the AIRC relating to specification of the fund, and many of the matters referred to in the evidence of the witnesses. These matters were portability of superannuation balances, mobility of the workforce, no entry or exit fees, no commissions paid to agents of financial planners, equal representation of employer and employee representatives on the trustee board, low administration costs, member investment choice, and automatic insurance cover (United Voice, sub. DR88).

It was not until the *Workplace Relations Act 1996* (Cwlth) was introduced that legislation expressly included superannuation as an allowable matter in awards. Superannuation in awards has been affected by subsequent changes in the industrial relations regime, as noted by MLC Ltd–NAB Wealth:

> … the Howard Coalition Government committed to the removal of superannuation as an ‘allowable matter’ in industrial award provisions from 2008. This would have enabled employers to choose ‘any complying fund’ with minimum insurance coverage. However, the excision of superannuation as an ‘allowable matter’ was overturned when the Rudd Labor Government came to power in 2007 instituting the Fair Work Act which expressly included superannuation as an ‘allowable matter’. (sub. 44, p. 4)

Award modernisation and superannuation

The 122 modern awards were developed by the AIRC in the course of the most recent industrial relations reforms which resulted in the Fair Work Act. In the course of this reform process, more than 1500 pre-modern federal and state awards were combined and ‘modernised’ to create the 122 modern awards. This award modernisation process involved around six months of consultation for each of the four tranches of pre-modern federal awards in order to develop the modern awards (AIRC 2009c).

Modern awards commenced on 1 January 2010. The process by which default funds were, and continue to be chosen for listing in modern awards is discussed in detail in chapter 7. Briefly, an application to vary a modern award by listing an additional default fund will be granted if:

- the fund was nominated as a default fund in an award-based transitional instrument relevant to the coverage of the modern award
- the representatives of the main parties covered by the award consent to the inclusion of the fund, or
- employers were making contributions to the fund before 12 September 2008 on behalf of employees who are now covered by the modern award.

FWA is conducting a review of modern awards in 2012, and 18 submissions to that review have requested an additional superannuation fund be listed as a default fund in a modern award (FWA 2012f) (chapter 7). FWA has indicated that applications in relation to superannuation will be dealt with between April and May 2013 (FWA 2012g).

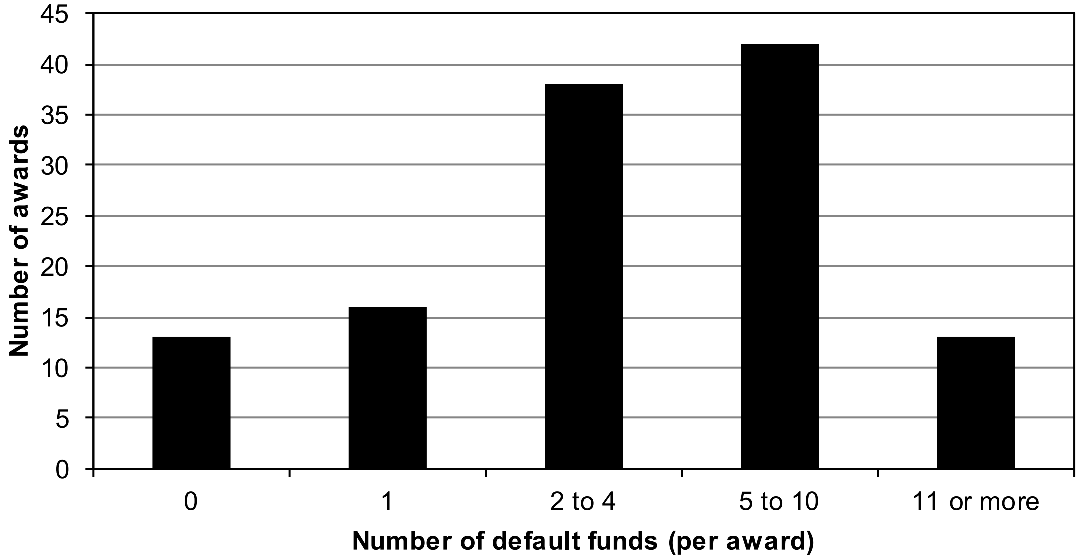
Default funds in modern awards

Of the 122 modern awards, 109 list a default superannuation fund or funds (figure 2.3). A list of the funds in each award was prepared by FWA in February 2012 (Parliament of Australia 2012).

The remaining 13 awards do not list a default superannuation fund — these awards cover a wide range of industries, including fire fighting, shipping, labour market services and mining. In eight of the awards that do not list a default fund, there is no reference to superannuation, although this may not necessarily mean employers covered by these awards can choose any fund — the Industry Super Network suggested these industries might be substantially covered by enterprise agreements or other statutory arrangements (sub. DR62, p. 25).

In total, there are 104 superannuation funds named as default funds in at least one modern award. Of these 104 funds, 43 are named in only one award, 47 are named in between two and nine awards, and 14 are named in ten or more awards. The fund listed most often is AustralianSuper (which appears in 69 awards).

Figure 2.3 **Number of default superannuation funds listed per modern award**



Source: Modern awards published by FWA (2012e).

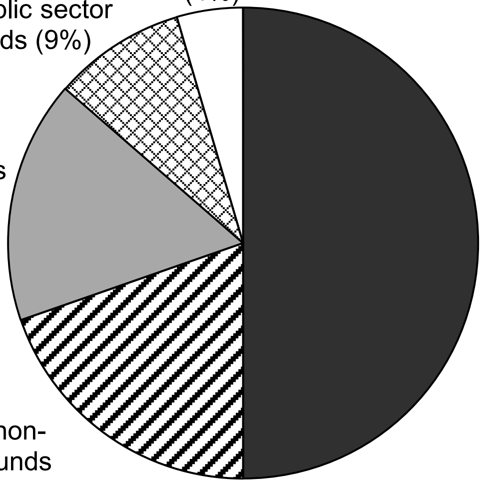
Although there are 104 funds named in awards, there are now only 66 distinct funds that can be identified on APRA's list of current funds, as some have merged, changed their name, or closed since they were first listed. Others are EPSSSs or remain unable to be identified (APRA 2012f). Of these 66 default funds (which are about 17 per cent of the total funds regulated by APRA), APRA has classified them as follows:

- 46 industry funds (of which 13 are non-public offer funds)
- 11 retail funds (including one eligible rollover fund)
- 6 public sector funds
- 3 corporate funds.

Most of the funds listed in awards have been classified by APRA as industry funds (figure 2.4). However some funds can have characteristics of two fund types, and the emergence of new superannuation products and industry consolidation makes classification of funds into their appropriate fund types more difficult. In these circumstances, APRA classifies the fund into the type it considers most appropriate (APRA 2005).

Figure 2.4 **Indicative types of funds listed as default funds in modern awards**

66 identifiable funds[a], by APRA classification



[a] Based on APRA-regulated superannuation funds for which data are available for 2011.

Sources: Productivity Commission estimates based on APRA fund-level profiles and financial performance data (APRA 2012h); Modern awards published by FWA (2012e).

Despite the lesser presence of retail funds in awards, they can still have a significant default business. For instance, AMP noted that it:

> … is responsible for the management of over $60 billion in retirement and superannuation assets on behalf of nearly 4 million customers. Of these funds, approximately $20 billion in superannuation assets are directly attributable to approximately 500,000 members of a number of employer default superannuation plans. (sub. 52, p. 3)

The greater prevalence of industry funds as default funds in awards could explain why they have a higher proportion of assets in their default investment strategy, since employees who do not actively choose a superannuation fund could be expected to be less likely to actively choose an investment strategy (table 2.4).

Table 2.4 **Indicative profiles of funds listed as default funds in modern awards**

66 identifiable funds[a], by APRA classification

	Members (default and non-default) (average)	*Proportion of assets in the default investment strategy (average)*	*Assets in the default investment strategy*
	no.	%	$m
Corporate	13 177	43	605
Industry	244 188	72	3 586
Public sector	282 296	49	7 779
Retail	392 977	47	1 612

[a] Based on APRA-regulated superannuation funds for which data were available for 2011.

Sources: Productivity Commission estimates based on APRA fund-level profiles and financial performance data based on annual data for superannuation funds (APRA 2012a, 2012h); Modern awards published by FWA (2012e).

However, not all superannuation contributions made under awards are made to default funds listed in awards, because of the 'grandfathering' clauses in all modern awards which contain superannuation provisions. These grandfathering clauses allow employers to continue to contribute to funds to which they were contributing before 12 September 2008, even though the funds in question are not listed as default funds in the modern award. Though some funds are heavily reliant on grandfathering (Transport Industry Superannuation Fund, sub. DR91), and some have been grandfathered since the late 1980s (Ai Group, sub. DR79), the reach and impact of grandfathering is unclear (chapter 7).

Effect of default funds listed in awards on the flow of employer superannuation contributions

Default superannuation provisions in modern awards directly affect employees who derive their default superannuation fund in accordance with a modern award. As discussed earlier, this includes award-reliant employees, those who receive some above-award wages or conditions, and those covered by enterprise agreements that do not specify a default fund but refer to the award for superannuation purposes. It is estimated that at least $6 billion, and potentially more than $9 billion, in superannuation contributions were made to default funds in modern awards in 2010 for employees who derive their default superannuation fund in accordance with a modern award, as explained below.

Contributions for employees who derive their default superannuation fund in accordance with a modern award

There is no precise measure of the number of employees who derive their default superannuation fund in accordance with a modern award. The Australian Superannuation Funds Association estimated that 'between 20 per cent and 30 per cent of employees are directly subject to award provisions relating to superannuation' (sub. 31, p. 4), although Tasplan placed this figure as high as 65 per cent (sub. 6). REST Industry Super commented that '45 per cent of REST's membership are party to an industrial award' (sub. 47, p. 6).

APRA (2012a) reported that total superannuation contributions by employers were $72 billion in 2010, of which an estimated $50 billion was attributable to the 9 per cent superannuation guarantee (Clare 2010). Since the superannuation guarantee is a constant 9 per cent of ordinary time earnings received, and award-only employees received 7.8 per cent of total average wages paid in 2010 (ABS 2011b) then, making assumptions about ordinary time earnings of these employees, they received approximately $3.9 billion in superannuation guarantee contributions in 2010 (if award-only employees are used as a proxy for award-reliant employees). Assuming that award-reliant employees are as likely to make choices about their superannuation fund as are other employees (box 2.1), this would imply that around 75 per cent are in the default fund, which means around $3 billion in superannuation contributions were made to default funds on their behalf in 2010.

A number of employees receive above-award wages through an unregistered individual arrangement, but rely on the award for the other terms and conditions of their employment. Existing estimates suggest that roughly 15 to 30 per cent of employees are employed under above-award arrangements (Australian Fair Pay Commission 2006; Buchanan and Considine 2008). Though there are insufficient data on wages received by above-award employees to conclude how much superannuation was paid on their behalf, a lower bound can be estimated by assuming that above-award employees (who are estimated to comprise between 15 to 30 per cent of the workforce) received at least award wages. This implies around $3 billion, and possibly up to $6 billion, was paid into default superannuation funds on their behalf.

Influence of award default funds on enterprise agreements

Employees covered by enterprise agreements are only considered to be employees who derive their default superannuation fund in accordance with a modern award where the enterprise agreement does not specify a default fund but refers to the award for superannuation purposes.

Although the Department of Education, Employment and Workplace Relations maintains a database on some of the terms of enterprise agreements, data on the superannuation provisions of these agreements are not collected.

Further, although employees covered by enterprise agreements that specify a default fund are not employees who derive their default superannuation fund in accordance with a modern award, funds listed in awards might influence the funds chosen for inclusion in enterprise agreements.

There are no data on how funds listed in awards influence funds listed in agreements, but several inquiry participants suggested that awards can be used as a referential framework for negotiating enterprise agreements.

> We consider that employers and employees would use their experience of award conditions as a basis when negotiating an enterprise agreement ... Some agreements reproduce provisions from awards, either by including relevant clauses or by cross-reference to award provisions. Single purpose agreements dealing only with superannuation are no longer allowed, but it is possible to include existing award provisions in agreements. (Asset Super, sub. 32, pp. 1−2)

> While there are no records available to the AHA, within the hotel industry it is believed the majority of enterprise agreements in the hospitality industry list Hostplus [one of the default funds listed in the relevant award]. (Australian Hotels Association, sub. 10, p. 6)

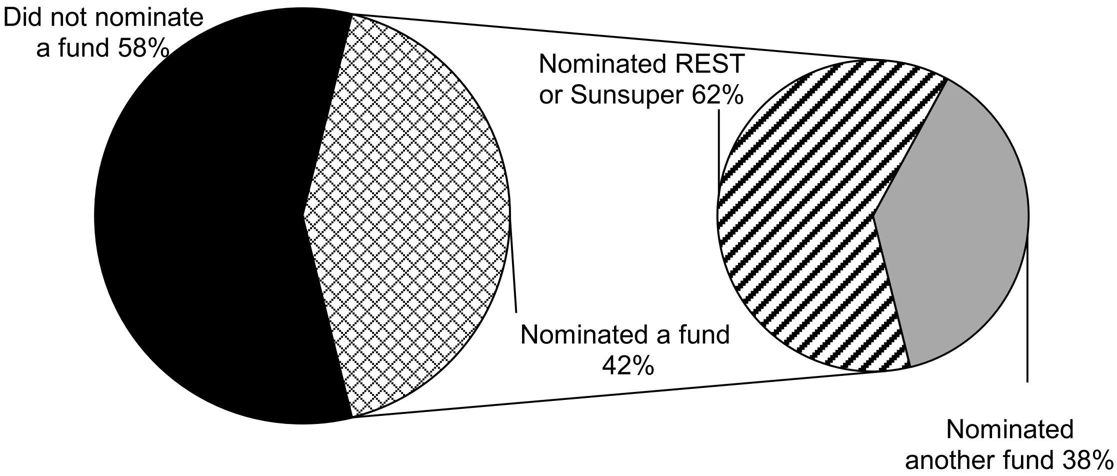
The extent to which this occurs is likely to vary across industries.

> Internal research undertaken by industry super funds indicates that over 43% of enterprise agreements leave the selection of default superannuation fund to the employer. This data was collected across Australia from a range of industries. The treatment of superannuation within industrial agreements is inconsistent across industries … The limited available evidence indicates that where funds are named, at least three quarters are industry funds and the superannuation clauses found in enterprise agreements, more or less, reflect the arrangements within the underpinning award or awards. (ISN, sub. 27, p. 37)

Given the limited data available, the Commission reviewed enterprise and collective agreements in the fast food industry in order to obtain a broad indication of the influence of default funds listed in awards on the superannuation provisions contained in enterprise agreements in one sample industry. The fast food industry was chosen because the modern award covers one industry, rather than one occupation across several industries.

Of the 42 per cent of agreements that listed a default fund, more than 60 per cent listed REST Industry Super or Sunsuper — the only two default funds that are listed in the relevant award for the sector. This example suggests that default funds listed in awards are quite influential in the listing of funds in enterprise agreements, at least in this sector. However, at least for this sector, a majority of agreements do not specify any default fund at all (figure 2.5).

Figure 2.5 **Superannuation funds listed in enterprise agreements in the fast food industry**



Source: Productivity Commission analysis based on enterprise agreements published by FWA (2012b).

The Stronger Super reforms

While the Australian superannuation industry is undergoing a significant period of fund mergers and consolidation, which is expected to continue, the regulatory environment is also rapidly changing. This inquiry is occurring in the context of the staged introduction of a significant number of reforms to the superannuation system. From July 2013, there will be a new default superannuation product, MySuper, together with disclosure, governance and administrative reforms which are intended to make default superannuation more transparent and comparable.

MySuper

Following the Cooper Review (Australian Government 2010b), the Australian Government (2011a) is introducing reforms to the superannuation system that will, amongst other things:

- introduce MySuper, a new superannuation product authorised by APRA. Only funds that offer MySuper products (or EPSSSs) will be eligible to be listed as default funds in modern awards and enterprise agreements
- require trustees to develop a single diversified investment strategy for their MySuper product that specifies the investment return target over a rolling 10-year period and the level of risk deemed appropriate (chapter 4)
- introduce rules governing the fees that can be charged for MySuper products (chapter 4)
- require equal treatment of members by giving all MySuper members:
  – protection against fee subsidisation (since one employee should not be favoured over another where they have the same employer)
  – the assurance that, unless they have consented no more than 30 days before the transfer occurs, MySuper members cannot have their interest replaced with another class of interest in the fund
- require all MySuper products to offer at least a minimum default level of life and total and permanent disability insurance on an opt-out basis. Superannuation funds are able to vary insurance terms and conditions between groups of members within the same default product (chapter 6)
- allow trustees to offer a ‘tailored’ MySuper product for a large employer that has more than 500 employees who will contribute to that product.

SuperStream

The SuperStream reforms will introduce new data and e-commerce standards for superannuation transactions (Australian Government 2010c). This will include electronic transmission of linked financial and member data using standardised formats, and the use of tax file numbers as the primary member identifier. These reforms will be phased in between July 2011 and July 2015. The Cooper Review estimated that SuperStream will save the superannuation industry about $1 billion annually (Australian Government 2010b).

Governance

A range of governance reforms are also being introduced as a result of the Cooper Review's recommendations. These include requirements that trustees of a MySuper product:

- promote the financial interests of the fund members
- determine annually whether or not MySuper members are disadvantaged by the scale of the fund
- discharge their personal duties to act honestly, exercise the care, skill and diligence of a 'prudent superannuation director', and exercise their duties and powers in the best interests of beneficiaries.

Further, a dashboard (for both MySuper, and other superannuation products) will be developed to disclose the investment return target and the number of times the target has been achieved, average fees, and liquidity information.

APRA (2012g) is being given the power to draft binding prudential standards for the superannuation industry for the first time. The standards will cover governance, fit and proper persons, risk management, business continuity management, outsourcing, auditing, conflicts of interest, investment governance, insurance, solvency and capital requirements. These standards will commence on 1 July 2013 to coincide with the introduction of MySuper.

Additionally, improvements to governance frameworks are being developed by bodies representing various types of superannuation funds (chapter 5).

3 Conceptual framework

Key points

- In a well-functioning market for superannuation, individuals would be well informed and have the expertise and motivation to choose a fund that meets their best interests.
- In reality, many do not have the interest or ability to make decisions that are in their best interests and do not actively choose a superannuation fund. Although the proportion of individuals who actively make a choice is expected to increase over time, a default superannuation system will be required for the foreseeable future.
- A default system can improve outcomes for individuals. However, there are some potential impediments to maximising outcomes through the use of a default system that need to be addressed.
  - Where a third party is making decisions for an individual (a principal–agent relationship), the interests of these parties will not necessarily be totally aligned and the decisions made by the third party might not always be in the best interests of the individual.
  - A lack of demand-side competition can reduce the incentives for funds to compete on price and performance to deliver good outcomes for members.
  - Any one default product cannot be optimal for all members as it is a homogeneous product, but people have heterogeneous attributes. This means that the optimal choice will differ between individuals.
  - Regulatory barriers can restrict contestability between superannuation funds.
- With a focus on default funds listed in modern awards, this inquiry examines what impediments there are to meeting the best interests of employees who derive their default superannuation product in accordance with modern awards, the extent to which the Stronger Super reforms are expected to address these impediments, and whether there is a net benefit to introducing criteria beyond those required of funds to be authorised to offer a MySuper product.
- Good outcomes, particularly for individuals, depend not only on the criteria by which default funds are selected, but also on the process by which those criteria are applied. Therefore, the net benefits of reforming the process for listing default superannuation funds in modern awards will also be examined.

In 1992, the Australian Government made superannuation compulsory. The Government's decision largely stemmed from:

- the fiscal imperative to reduce reliance on the aged pension
- the desire to increase national savings and economic growth, and achieve better retirement outcomes for the community (Kingston 2004).

In a well-functioning superannuation market, individuals would be well informed and have the expertise and motivation to choose a fund that meets their best interests. However, as explained in a wide body of literature, many individuals lack the interest or ability to make retirement savings decisions that are in their best interests (box 3.1).

Box 3.1 **Difficulties faced in making retirement savings decisions**

Individuals might encounter difficulty making retirement savings decisions in their own best interests for a number of reasons.

- Lack of financial literacy, which limits people's ability to make informed financial choices (Australian Government 2010a).
- Complexity of investment decisions and difficulty matching risk preferences with the right products (Brown, Farrell and Weisbenner 2011; Ingles and Fear 2009).
- High search costs, in terms of time taken to research and understand what is often a large number of products (Impavido, Lasagabaster and García-Huitrón 2010).
- The 'endowment effect', where people value money that is lost more highly than money gained, causing them to be unduly conservative in their investment decisions (Ingles and Fear 2009; ISN 2010).
- Lack of price awareness, as compulsory contributions, fees and other costs do not come directly out of members' pockets (Australian Government 2010a).
- Information asymmetries between superannuation providers and individuals (Brown, Farrell and Weisbenner 2011).
- A long lag between the purchasing decision and the time when the benefits can be accessed (Fear and Pace 2008).
- An associated tendency toward procrastination and inertia in making retirement savings decisions (Gallery, Gallery and Brown 2004).
- Mental rules or short cuts (heuristics) that people use when they have no clear preference, or where the cost of acquiring information is too high, which can lead to persistent biases in decision making (Fear and Pace 2008).
- Framing effects, where people choose based on how the available options relate to one another, how they are explained and what other information is provided at the same time, rather than which option is in their best interests (Fear and Pace 2008).

One policy option for addressing the tendency for individuals to make sub-optimal retirement savings decisions is to provide information and implement financial literacy programs to assist them (Bernartzi and Thaler 2007; Brown, Farrell and Weisbenner 2011).

Another option is to introduce a default superannuation system, whereby a third party effectively makes a choice of superannuation fund on behalf of the individual. Under a default superannuation system, an individual can be given the option of choosing for themselves, as has been the case in Australia since Choice of Fund legislation was passed in 2005 (chapter 2), or individual choice can be restricted.

While there is a substantial body of evidence that a default system improves outcomes (for example, Thaler and Sunstein 2009; Bashears et al. 2006), its success in doing so is contingent on the appropriate design and application of the system. Otherwise, unintended and sub-optimal outcomes can readily materialise (Gallery, Gallery and Brown 2004).

3.1 Potential impediments to meeting the best interests of members

There are several potential impediments to meeting the best interests of members under a default superannuation system, some of which are unique to the Australian system. A well-designed default superannuation system needs to take these impediments into account and minimise the effects that they have on outcomes.

Principal–agent relationships and information gaps

Principal–agent relationships are inherent in any default superannuation system. A principal–agent relationship is one where an individual engages (or relies on) a third party to make decisions and take action on their behalf (Drew and Stanford 2003). Having an agent might be optimal if that agent acts in the best interests of an individual lacking the expertise to make decisions in their own best interests. However, issues can arise when the agent does not face adequate incentives to act in the best interests of the individual, and that individual does not have the information or means to monitor the actions of their agent.

In Australia's default superannuation system, there are several principal–agent relationships that can be cause for concern, and any negative effects from these need to be addressed in the design of the system.

Employees and employers

In the Australian default superannuation system, employers choose a default fund (either from a list contained in the relevant award, in negotiation with employees such as through an enterprise agreement, or unilaterally) for employees who do not choose themselves.[1] Where an employer is free to choose any default fund for employees (that is, where an award does not require them to make a contribution to a particular fund, or an enterprise agreement does not specify a default fund and does not refer to the terms of the award for superannuation purposes), or where an award lists many funds, there are reasons why employers might not have the incentive to make a decision that is in the best interests of their employees.

Employers:

- receive none of the direct benefits of a fund's high performance, and therefore might have little incentive to invest time and effort into making choices that are in the best interests of their employees
- could choose a fund solely on the basis that it has the least onerous administrative requirements
- might face high search costs when trying to make an optimal choice, especially when choosing from a large pool of potential funds, and especially when they themselves lack information and expertise
- could choose a fund that has additional benefits specific to them, such as access to financial products for their organisation
- might be driven by concerns about any legal repercussions of choices they make, rather than the best interests of their employees.

Employees and industrial parties

In Australia, industrial parties have played a central role in determining which superannuation funds are listed in awards (chapter 2). In choosing a default fund, they might bring their own incentives and biases to that task. For example, there is potential for conflict of interest given that the industrial parties have an ownership stake in the relevant industry fund (Drew and Stanford 2003). There might also be asymmetric interests at the workplace level where trade unions might have an interest in allocating contributions to an industry fund, whereas individual employers might be more equivocal about the choice of default fund.

1 In some countries, this is not the case. For example, in Sweden, the Government operates and manages a single national default fund. In New Zealand, the Government selects a number of default funds, amongst which employers may then choose (appendix B).

Fund members and fund trustees

Trustees of funds manage and invest the contributions of members. In doing so, trustees might not always act in the best interests of their members unless explicitly required to do so (chapter 5). According to the Australian Government (2010b, p. 5), trustees are 'not always focussed on acting for the benefit of members and maximising members' retirement incomes in an efficient and cost-effective way'. (To deal with these concerns, the Government has proceeded with a number of governance-related reforms — see chapter 5.)

If funds are not disclosing information in an open, transparent and easy to understand manner, members may find it difficult to assess how well funds are performing on their behalf. Members may also have difficulty making this assessment if they do not have the expertise to do so.

Financial advisers and their clients

In the default system, employers or employees might use a financial adviser to help them choose the right fund. Due to the way that some advisers have been remunerated (based on commissions rather than fee-for-advice), they might be conflicted in the advice they give to their clients (Vidley 2004). These potential conflicts have been dealt with in the Future of Financial Advice legislation (chapters 5 and 6). Where independent advisory firms focus on running corporate tenders, conflicts are much less likely to exist.

The Australian Government and the private superannuation sector

Principal–agent relationships also exist at the aggregate level. The Australian Government has made superannuation savings mandatory, with a view to reducing reliance on the aged pension and improving retirement outcomes, and it uses the private (not-for-profit and for profit) sector as its agent to manage those savings. The superannuation sector overall is not necessarily driven by the same objectives as the Government.

Lack of demand-side competitive pressure

While default superannuation systems can improve outcomes, they do not alter the underlying attitude of indifference by individuals towards making retirement savings decisions (ISN 2010). In fact, by providing a default system, indifference can grow, as some of those who may otherwise have chosen to engage might feel that a default chosen by a third party is a signal or endorsement of the best choice (Brown, Farrell and Weisbenner 2011).

The tendency for individuals not to make active choices means that, once placed in a fund, they tend to stay there. According to the Cooper Review (Australian Government 2010a), since the introduction of Choice of Fund legislation in Australia, switching rates between funds have declined from an initial rate of around 5 per cent in 2005 to 2 per cent in 2009 (and most switching takes place due to people changing jobs).

Given the growth in the self managed super fund sector (chapter 2), it might also be the case that active participants are increasingly choosing to manage their own retirement savings rather than choosing amongst existing funds.

A lack of active participation means that members will tend not to respond to price signals (that is, demand is price inelastic) and little demand-side pressure will be placed on funds both within and outside the default system to compete on price and performance (Fear and Pace 2008). According to the Australian Government (2010a):

> In superannuation, competition in the market for super at the consumer level (ie between funds competing for the business of a new member) has so far been relatively weak. This is because superannuation is different … the model of member-driven competition through 'choice of fund' (in the form of SG Act choice and consequent portability) has struggled to deliver a competitive market that reduces costs for members. (Australian Government 2010a, pp. 7–8)

Instead of being driven by individuals, demand-side competition could be driven by those making decisions on behalf of members, such as employers, financial advisers and industrial parties. However, for this mechanism to operate, these third parties need to have the incentive to actively participate on behalf of members and not be subject to inertia themselves. And, as discussed above, such incentives might not always be present, given the inherent nature of principal–agent relationships.

A lack of demand-side pressure can lead to:

- administrative inefficiencies within funds, including difficulties for employers dealing with funds
- price distortions
- non-price competition around marketing, distribution and product differentiation, which is costly and of little benefit to those members in default funds not making active decisions (Impavido, Lasagabaster and García-Huitrón 2010). (This is what occurred in Chile in the 1980s and 1990s — appendix B.)

Moral hazard

Government involvement in the default system can raise the issue of moral hazard. If a major fund is performing poorly or has the potential to collapse, the government might feel obliged to take action to protect the interests of members of that fund, particularly if the fund is seen as 'too big to fail'. This can encourage funds to engage in riskier behaviour than they would have otherwise, and distort the efficient operation of the market.

Heterogeneity of member preferences

Any one default superannuation product is a homogeneous product in most aspects. However, people have heterogeneous attributes, such as risk preferences and demographic characteristics, which means that the optimal choice will differ between individuals (Carroll et al. 2009). This problem is compounded if the product is not adjusted to suit the changing nature of individuals' preferences over time (Brown, Farrell and Weisbenner 2011). The more closely aligned the preferences of members within a default fund, the better the potential outcomes for those members.

Regulatory impediments

Regulatory impediments can create barriers to entry for funds wishing to participate in the default system. For example, the process by which funds are listed in modern awards could be acting as a regulatory barrier to entry (chapter 7).

Barriers to entry impede contestability and provide scope for incumbent funds to underperform and/or drive up costs (Impavido, Lasagabaster and García-Huitrón 2010). This can exacerbate the problems caused by a lack of demand-side competition.

3.2 The Stronger Super reforms

The Cooper Review and the Government's response through the Stronger Super reform package were aimed at addressing some of the impediments to meeting the best interests of members mentioned above. According to the Cooper Review:

> The current superannuation system assumes that all members want to make choices about their superannuation and are interested in receiving a variety of superannuation-related services. 'Default' members are not adequately protected and

> can find themselves paying for services that they do not need or request and, on some occasions that they do not receive. (Australian Government 2010b, p. 5)

The focus of the Cooper recommendations is on member outcomes. They are based on the idea that, as superannuation contributions are mandatory, members should not have to be 'interested, financially literate, or investment experts to get the most out of their super … If members are not interested, then the system should still work to provide optimal outcomes for them' (Australian Government 2010a, p. 1).

More specifically, MySuper is aimed at enabling:

> … members, employers and market analysts to compare funds more easily based on a few key differences. It will also ensure members do not pay for any unnecessary 'bells and whistles' they do not need or use. (Shorten 2011b, p. 3)

MySuper will provide information in a manner that will allow easier comparison between products. In this sense, the MySuper regime is primarily about increased disclosure and equips individuals, to a degree, with information to make choices for themselves. Other factors might also contribute to an increasing trend in self-choice (box 3.2).

Box 3.2 **Reasons why self-choice might increase over time**

- MySuper will provide a filter for consumers, reducing the number of options from which a choice needs to be made (though the option of choosing from outside MySuper would remain). Consolidation will also reduce the number of funds to choose from (chapter 2).
- The information available to make a choice will be more comparable because of the MySuper reforms.
- The informal sources of information about superannuation have grown as the compulsory system matures.
- Access to information about savings choices is easier and cheaper as the internet becomes increasingly easy to use and access.
- There is a greater focus on financial literacy in schools and the community (ASIC 2011a), meaning that savers are likely to be more sophisticated in their knowledge than in the past.
- There may be a greater understanding by upcoming generations that the capacity of government to provide for retirement incomes may be reduced, resulting in greater appreciation that individual savings choices matter.

However, there is still a question of whether individuals will have the interest or ability to use the information from MySuper to make quality decisions about their retirement savings. There is likely to be a long way to go before the vast majority of Australians are actively choosing a superannuation fund, and thus a robust default system is likely to be necessary for the foreseeable future.

There is also a question of whether employers will have the expertise to use the information from MySuper to make quality decisions on behalf of their employees without incurring excessive search costs.

3.3 Framework for assessing the case for further reform

This inquiry assesses whether there is an overall net benefit to introducing criteria beyond those required for the authorisation of a MySuper product, for a product to be listed in modern awards.

In doing so, the Commission focuses on whether the Stronger Super reforms are expected to do enough to address any impediments to meeting the best interests of employees who derive their default superannuation product in accordance with modern awards, or whether there is scope to improve outcomes by using additional criteria.

Chapters 4 to 6 assess the net benefits of introducing criteria over and above those that will apply under Stronger Super. These chapters cover:

- the current requirements for superannuation funds
- what additional requirements are contained in the Stronger Super reform package and what impediments to meeting the best interests of members they are seeking to address
- whether the Stronger Super reforms go far enough, or whether there are any remaining impediments to meeting the best interests of employees who derive their default superannuation product in accordance with modern awards
- whether there is a case for additional eligibility criteria, by weighing up the benefits (such as increasing members' retirement savings) and costs (such as administrative, transaction, compliance and monitoring costs) of introducing any additional criteria
- if a case for additional criteria is established, what those criteria should be.

The overarching objective of the inquiry is to assess, and propose any necessary reforms to, the system such that it meets the best interests of employees who derive their default superannuation product in accordance with modern awards. However, the effects on other employees, employers, industrial parties, superannuation funds and the Government are also taken into account.

While the focus of this inquiry is on default funds listed in awards, the Commission also considers whether its findings and recommendations have any implications for awards that do not currently contain a list of funds.

Minimising the impediments to achieving the best interests of employees who derive their default superannuation product in accordance with modern awards, such as the potential principal–agent and contestability issues, might depend not only on the criteria that the default fund must meet, but also on the process by which those criteria are implemented and funds are selected. Therefore, in addition to looking at designing a set of criteria, the Commission examines in chapter 7 whether there is scope to enhance the best interests of employees who derive their default superannuation product in accordance with modern awards by reforming the process for listing funds in awards. A principles-based approach is used to assess the appropriateness of the current process and the potential reform options.

Chapter 8 assesses the options for implementing any additional criteria and reforming the process, while chapter 9 examines how the reforms can be implemented in a way that maximises the overall net benefits.

4 Investment performance

Key points

- Retirement outcomes for superannuation fund members depend in large part on the long-term investment performance of superannuation funds. Small improvements in annual net returns (returns after the deduction of fees, costs and taxes) can lead to significant increases in accumulated returns upon retirement.
- The Stronger Super reforms prescribe new disclosure requirements for investment strategy, risk, performance, fees and costs, and scale for all MySuper products. These disclosures will enhance comparability between products and are expected to improve the consumer demand response to superannuation product offerings.
  - Each MySuper product will be required to have a single, diversified investment strategy (which may be a lifecycle approach), including a clearly articulated investment return target and level of risk.
  - No minimum investment performance criteria will be required for MySuper products.
  - Only particular types of fees will be allowable for MySuper products. Some categories of fees will be limited to cost recovery, though investment and administration fees will not be capped.
  - Trustees of funds that offer a MySuper product will be required to consider whether the scale of the fund negatively affects their ability to promote the best interests of their members.
- When determining if a MySuper product should be listed in an award:
  - The appropriateness of the MySuper product's long-term investment return target and risk profile (for employees who derive their default superannuation product in accordance with a given modern award) should be a consideration, as a primary factor.
  - The expected ability to deliver on its MySuper long-term investment return target, given its risk profile, should be a consideration, as a primary factor. The appropriateness of the investment strategy and previous success against its objectives are relevant. No threshold investment return target or risk profile should be set.
  - The appropriateness of the MySuper product's fees and costs should be a consideration, in terms of the product's long-term investment return target and risk profile, and the services provided.
- The MySuper scale requirement is appropriate, and no greater prescription with regard to scale is required to list default products in modern awards.

This chapter includes analysis on the scope for additional prescriptive criteria relating to investment performance (that is, net returns to members) to be considered in the selection and ongoing assessment of superannuation products for listing in modern awards. The chapter considers these in the context of the Stronger Super reforms.

The chapter covers the case for an additional criterion relating directly to investment performance, and in particular, the ability to deliver on investment objectives. It also includes consideration of criteria that relate indirectly to investment performance, namely: investment strategies and objectives; fees and costs; and economies of scale. Investment strategies and objectives largely determine the path to investment performance. Fees and costs influence net returns to members, though their actual effect will depend on the value for money they provide, and economies of scale can lead to higher net returns to members.

4.1 Investment strategies and objectives

An investment strategy guides the allocation of assets among various investment options to meet the investment objective (such as the investment return target), or objectives of the fund, taking into account the fund's risk tolerance. A defensive investment strategy allocates assets to minimise the risk of losing value, and in contrast, an aggressive investment strategy allocates assets to achieve maximum return, usually taking on additional risk. A balanced investment strategy portfolio falls between these two extremes.

When formulating, documenting and giving effect to an investment strategy, trustees are required to consider the likely return and risk, diversification, and liquidity of investments. Trustees must consider the risk tolerance of members when setting the risk profile for the fund (Jones 2011).

Stronger Super reforms

Though MySuper trustees will be required to formulate, give effect to, and publish a single, diversified investment strategy, MySuper products will not be required to employ any particular investment strategy, pursue any particular investment return target, adopt any particular risk profile, or include any particular asset class. This reflects the view that trustees are best placed to make these decisions, and that if trustees were required to make particular investments, this would limit their capacity to pursue investment opportunities in the best interests of members (Treasury nda).

As a result, investment strategies are likely to vary among MySuper products, though this will be tempered by the overarching focus of MySuper products — 'low cost and simple' (Australian Government 2010d).

Trustees will be required to clearly articulate the investment return target (over a rolling 10 year period) and the level of risk being taken to achieve this return, and justify why these are appropriate for the membership of their MySuper product. They will also be required to outline the investment strategy they have adopted to deliver on these objectives and to regularly review the investment strategy. Trustees will also be required to have regard to additional factors when developing an investment strategy, including: the availability of valuation information; the expected taxation consequences; the expected costs of the strategy (such as brokerage); and the appropriate due diligence in the selection and monitoring of investment options made available to members (Shorten 2012d).

Lifecycle investment approach

Trustees will be able to choose a lifecycle investment strategy as the single investment strategy for the MySuper product (Australian Government 2011a). A lifecycle investment strategy is a tool designed to reduce risk as members get closer to retirement age. Where a lifecycle investment strategy is adopted, trustees would automatically move members into a different investment mix, based on their age.

Scope for additional criteria relating to investment strategy and objectives

Participants' views

Inquiry participants did not support prescribing a single specific type of investment strategy, or investment return target and level of risk as a criterion for listing default superannuation products in modern awards. However, one inquiry participant contended that all listed superannuation products should have a risk profile *no greater* than that found in a balanced investment strategy (Unions NSW, sub. 13). In contrast, Mercer contended that superannuation products listed in modern awards should not all be similar in terms of their investment strategies and services, preferring a diverse range (sub. DR68). The Corporate Super Specialist Alliance (CSSA) commented that it was 'difficult to conceive' (sub. DR56, p. 3) that the same investment strategy would suit every person employed under an award.

A small number of participants argued that the *appropriateness* of the investment strategy, or the investment return target and level of risk, should be considered when listing default superannuation products in modern awards. The Australian Hotels Association contended that decision makers should consider the appropriateness of the investment strategy for the industry workforce (sub. 10). CPA Australia considered that the appropriateness of the investment strategy for the employees covered by the award should be taken into account (sub. 39). The CSSA indicated that the appropriateness of the MySuper product's investment return target and risk profile for employees who derive their superannuation product in accordance with a modern award, should be a primary factor when listing default superannuation products (sub. DR56).

Another participant pointed out that, regardless, decision makers need investment strategy information that is clear and complete to allow them to make informed decisions (Centre for the Study of Choice, UTS, sub. 22).

On the other hand, some inquiry participants did not support 'investment strategy' as a consideration when listing default superannuation products, often on the grounds that MySuper was adequate in this area. For example, Tasplan contended that due to the MySuper authorisation process, investment strategy, or investment return target and level of risk factors, should not be considered in the listing of superannuation products (sub. 6). Other participants considered that the focus should instead be on long-term returns (for example, the Australian Institute of Superannuation Trustees, sub. 20). The diversity of views on this matter is illustrated in box 4.1.

Views were expressed about the appropriateness of offering a lifecycle investment option in default products. For example, the Australian Institute of Superannuation Trustees (sub. 20) considered that the presence or not of a lifecycle option should have no bearing on default listing. DFA Australia (sub. 21) considered that a lifecycle strategy can limit investor outcomes, unless it takes into account factors other than age, such as personal retirement income objectives.

Box 4.1 Investment strategy and objectives as criteria for selecting default products — some perspectives

Should be considered

> On a broad scale, Fair Work Australia should assess the appropriateness of the default investment option of the fund in terms of risk and expected return. This would include an analysis of medium and long term asset allocation, the manager selection and review process, the overall investment philosophy … (NGS Super, sub. 18, p. 2)

> ISN proposes a process for the selection of default funds within awards that will require Fair Work Australia to consider the relevance of … fund strategies and services to each award … with reference to the demographic within the jurisdiction of the award. (ISN, sub. 27, p. 43)

Should not be considered beyond MySuper requirements

Some participants regarded that the MySuper requirements alone were sufficient, so that a separate investment strategy, or investment return target and level of risk, criterion was unnecessary. For example:

> … these factors will be covered in the fund's successful completion of the MySuper licensing process with APRA. (REI Super, sub. 26, p. 3)

Some participants regarded that the focus should be on long-term returns. For example:

> … investment strategy is important but it is the long term outcome that matters most … There is sufficient new regulation of investment strategy requirements for superannuation funds generally and for MySuper offerings … including new investment strategy covenants applying to trustees. (AustralianSuper, sub. 36, p. 9)

The Commission's view

The Commission does not believe that a specific type of investment strategy, or specific investment return target and level of risk, should be prescribed for the selection and ongoing assessment of superannuation products for listing in modern awards. Indeed, the Commission considers that the likely variability of MySuper investment strategies is desirable as it will result in a range of products that can meet the potentially diverse needs of superannuation members. It follows that listing a range of default products in modern awards is desirable as it will facilitate employers selecting products that meet the needs of their employees (chapter 8).

Though the Commission sees no case for additional prescriptive criteria to be applied in this area, the Commission regards the investment return target and level of risk, and the investment strategy employed to deliver on these objectives, as important factors for consideration because they largely determine the path to delivering long-term investment performance (section 4.2).

The Commission recognises that the Stronger Super reforms already require MySuper trustees to set an investment return target and level of risk (and the investment strategy to deliver these) that is appropriate for the entire product's demographic. The Commission considers that the selection and ongoing assessment of superannuation products for listing in modern awards should go one step further, and consider if the investment return target and risk profile are appropriate for the employees who derive their default superannuation product in accordance with a modern award. The Commission recognises that there will be challenges in gathering adequate data to understand the characteristics of these employees (chapter 9), but, notwithstanding this, an assessment of the broad appropriateness of a MySuper product's long-term investment return target and risk profile should be given primary consideration among a range of factors.

The Commission notes that the Stronger Super reforms give trustees the option of offering a MySuper product that employs a lifecycle investment strategy. The Commission believes that where a lifecycle strategy is offered that product should be evaluated on the same basis as other products, that is — according to the appropriateness of its long-term investment return target and risk profile.

RECOMMENDATION 4.1

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the appropriateness of the MySuper product's long-term investment return target and risk profile for employees who derive their default superannuation product in accordance with a given modern award (as a primary factor).

4.2 Investment performance

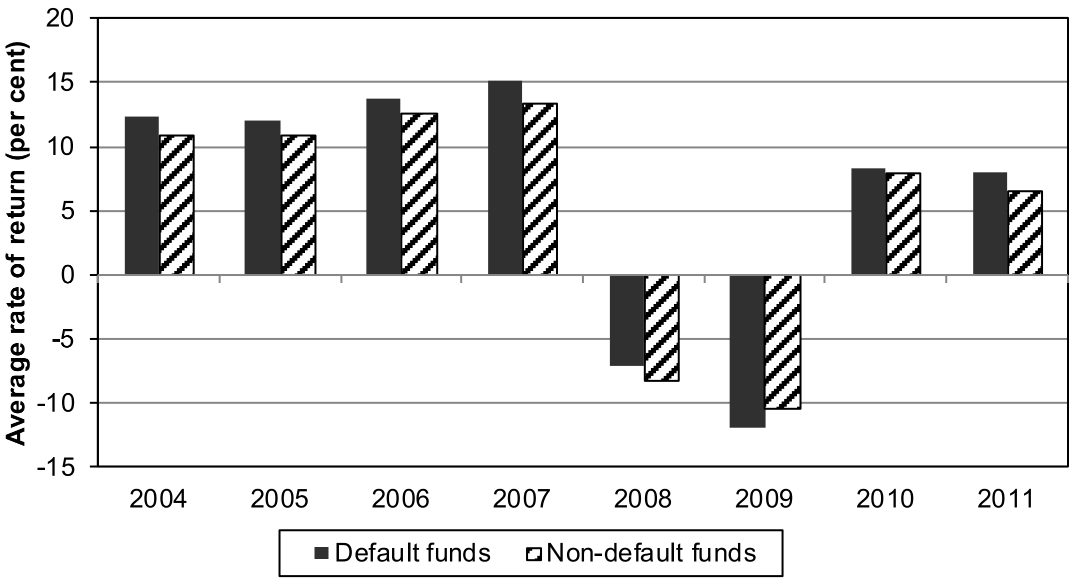
The importance of investment performance

The success of a superannuation fund's investment strategy is determined by its long-term investment performance. Net returns — that is, returns after the deduction of fees, costs and taxes — can be highly uncertain and variable over time, and are influenced by factors such as asset allocation and the level of expenses. Small improvements in the annual net return of a superannuation fund or product can lead to a significant increase in accumulated returns for members, given the long time frames over which superannuation assets are typically accumulated.

Though the industry itself often focuses on the relative net return of different types of funds, for the purposes of this inquiry, it is useful to look at the relative net return of current default funds (that is, those listed in modern awards) and non-default funds (that is, those not listed in modern awards).

The investment performance of default funds listed in modern awards has been relatively strong when compared to non-default funds. Over the eight years to 30 June 2011, default funds averaged an annual (after tax) rate of return of 6.4 per cent, compared with 5.5 per cent for non-default funds, and default funds collectively outperformed non-default funds in each year except 2009 (figure 4.1).[1]

Figure 4.1 **Superannuation fund performance**[a, b, c, d]
Default funds versus non-default funds



[a] Based on APRA-regulated superannuation funds for which return data are available for all years 2004–2011. [b] Excludes pooled superannuation trusts, exempt public sector superannuation schemes, small APRA-regulated funds and single-member approved deposit funds. Self managed superannuation funds regulated by the Australian Taxation Office are excluded. [c] Includes Eligible Rollover Funds. [d] Default fund data based on superannuation funds listed in modern awards (as at September 2012), for which return data are available for all years 2004–2011.

Sources: Productivity Commission estimates based on APRA fund-level profiles and financial performance data 2011 (APRA 2012j); FWA (2012e).

1 The rate of return is the ratio of money gained or lost on an investment, to the amount of money invested. This analysis compares the performance of current default funds to non-default funds. It is based on average performance of groups of funds and gives no indication of dispersion around the average.

Stronger Super reforms

Current regulatory arrangements do not prescribe return targets for superannuation funds. However, MySuper trustees will be required to promote the financial interests of members, and deliver value for money over the long term. This focus reflects that most members would be expected to remain in superannuation for a considerable period, and therefore it will be generally appropriate to manage returns over the long term (Shorten 2012d).

In promoting the financial interests of members of a MySuper product, trustees will be required to focus on net returns to members. Returns to members are described as 'those amounts placed into member accounts through an increase in their unit price or credited to their account, which are a result of investing the member's balance' (Shorten 2012d, p. 13).

The Stronger Super reforms will enhance comparability between MySuper products (and choice investment options), and make performance more transparent. Funds regulated by the Australian Prudential Regulation Authority (APRA) will be required to calculate (gross and net) returns in a standardised way for MySuper products and choice investment options. Under legislation currently before Parliament, APRA will be required to publish quarterly information on net returns for MySuper products (Shorten 2012a), and trustees will be required to disclose the information regarding choice products (Australian Government 2010d). APRA is currently in consultation on the new reporting standards for superannuation, which are due for release in the first half of 2013 (APRA 2012g).

Further, all APRA-regulated funds will be required to disclose the investment return target (over a rolling 10 year period), and the number of times the target has been achieved, together with other information — including the average fees charged in relation to the product on a per member basis and liquidity information — for their MySuper and choice investment options, on a product 'dashboard' (Shorten 2012a).

Scope for additional criteria relating to past performance

One key question is the extent to which past investment performance (net returns) should be taken into account when selecting default products for listing in modern awards, including whether a particular absolute or relative level of past performance should be met before a MySuper product could be considered for inclusion.

Participants' views

Some inquiry participants suggested that overall past investment performance is an important criterion for listing MySuper products in modern awards — either as the prime consideration or in conjunction with others. For example, the Industry Super Network (ISN) proposed that past performance should be the prime criterion:

> Recognising that the principal objective of superannuation is improvement in retirement outcomes, long term net returns must, therefore, be the prime criteria on which the suitability of superannuation funds to be named as defaults is judged. (sub. 27, p. vi)

Cbus considered that funds with default status should have 'a history of strong investment returns in its default product' (sub. 15, p. 4), and AustralianSuper considered that:

> … the medium to long term net-of-costs investment performance of the default investment option [is] the single most important criterion to include. This more than any other aspect has the largest impact on a member's retirement outcome. (sub. 36, p. 5)

The Actuaries Institute argued that past investment performance should be one of a number of considerations:

> Past investment performance (net of investment fees, costs and investment taxes) is one of the many factors that should be considered when assessing the investment capabilities of a fund. (sub. 45, p. 3)

Some participants stated that default funds should be selected from a list of the highest relative performing funds, with selection, therefore, based on investment performance relative to industry peers. For example, the Australian Council of Trade Unions (ACTU) recommended that:

> … only those MySuper compliant products that APRA report as being among the top 100 best performing in terms of net returns to members over an extended period (such as 10 years) can be eligible for inclusion as a default in an award. (sub. 29, p. 11)

Along similar lines, ISN recommended that persistently low relative net returns be used to exclude products (albeit as their second preference to setting a performance benchmark for including products) (sub. DR62). Other participants expressed concern with such an approach. The Law Council of Australia noted that the resulting list may require frequent updating as a 'position in a "league table" in terms of [performance] may vary widely over even relatively short periods' (sub. 23, p. 3). However, ISN argued that updating should not be required more than annually (sub. DR 62).

Another approach is to use a minimum return threshold. ISN contended that an appropriate minimum performance benchmark should be set to ensure:

> … that only those funds which have demonstrated a capacity to deliver superior returns to members over the long-term should be considered for inclusion as default funds within modern awards. (sub. 27, p. 6)

Similarly, Eldercare was of the view that:

> Only those funds that meet a minimum performance threshold should be able to apply to be named as default funds in awards … (sub. DR57, p. 1)

One participant pointed out that an understanding of the drivers of past performance is necessary if past investment performance is to guide fund selection. The Association of Financial Advisors stated that:

> What is essential is an understanding of the reasons for historical out-performance and whether this is genuine and whether it is sustainable and risk effective. (sub. DR73, p. 3)

A number of participants considered that past performance is no indicator of future performance, and did not support its use as a criterion for listing in modern awards (Association of Financial Advisors, sub. DR73; CSSA, sub. 35; FSC, sub. 30; Tasplan, sub. 6). For example, CSSA stated that past performance is 'a very dangerous thing to base any sort of recommendation on' (trans., p. 141), and that:

> … history shows us that a fund which outperforms in one year may not do so in the next … (sub. 35, appendix C, p. 5)

One participant considered that published return data may be unreliable, resulting in erroneous and unfair ranking of funds. Rural and Regional Promotions stated that:

> Whilst ASIC for example publish reports of fund performance these reports are usually provided to ASIC by the individual funds, also it does not appear to address the issue of published returns versus crediting rates. (DR86, p. 1)

If a past performance threshold was implemented, trustees might adapt their investment return target to maximise the chance of their MySuper product being listed. This may have unintended consequences. The Actuaries Institute noted:

> … the imposition of a target level of investment performance would likely constrain the level of risk that a fund would then be prepared to accept, which would potentially lead to lower investment returns over the long term. (sub. 45, p. 3)

Past performance in the context of meeting investment objectives

Some participants took the view that past performance should be taken into account, but in the context of a fund's stated investment objectives, so that an assessment of the ability of fund trustees to meet their objectives, albeit in the past, could be made. The Australian Institute of Superannuation Trustees considered that products with default status should be selected on the basis of:

> … past performance based on 10 year rolling net returns, assessed against each fund's investment objectives and target returns. (sub. 20, p. 4)

Similar views were put by REST Industry Super, which stated that:

> The primary focus should be on the long-term performance of funds against their stated investment objectives. Relative performance can also be a useful tool for assessing historical performance but should only be a secondary consideration. (sub. 47, p. 36)

A long term view of performance

Participants regarded the period over which past performance is measured to be important. The Actuaries Institute argued that the past performance measure adopted should be 'aimed at reducing scope for trends in relative performance to be distorted by … performance in recent years' (sub. 45, p. 3). In the context of past performance, Rural and Regional Promotions stated that:

> [s]uperannuation is a long term investment and quarterly performance reports can lead to short term speculative investing by fund managers … (sub. DR86, p. 3)

In this vein, ISN contended that they support 'the inclusion in awards of funds that can demonstrate high net returns over the *long-term*' (sub. DR62, p. 17, emphasis added). legalsuper contended that:

> … long-term investment performance should be considered over 10 years. (sub. 19, p. 4)

The past performance evidence base: the question of persistence

Several participants argued that research supports the use of past performance as an indicator of future returns. The ACTU contended that there is '… a statistically significant level of persistence in fund returns' (though they noted that past performance does not guarantee similar future performance) (sub. DR77, p. 5). ISN stated that a range of research (including work commissioned by them) found that:

> … persistence in relative returns has been a feature of the Australian superannuation market. Most relatively strong performers in one period are relatively strong performers in subsequent periods. (sub. DR62, p. 11)

Cbus argued that the performance persistence evidence provides an adequate basis for using past performance as a stand-alone factor in selecting default funds (sub. DR81).

The Commission's view

The Commission recognises that using past investment performance as a prescriptive criterion when listing default products in awards is intuitively appealing, but has concerns about using past performance as a stand-alone basis for selection.

Regulators globally have recognised the risks to investors of using past performance as a predictor of future performance. This is reflected in the ASIC requirement that a declaration to this effect is included in promotional material for financial products and services (ASIC 2003). The nature of past performance as an 'unreliable predictor' was reflected in practice by the Australian Industrial Relations Commission in deciding which default funds to list in modern awards (chapter 7). This conclusion is supported by an extensive body of research literature revealing a lack of consensus on performance persistence among both highly and poorly performing funds. Although some studies do find persistence among some fund categories (for example, Delaney, Watson and Wickramanayake 2011), many studies do not (box 4.2).

The different results between and within studies may be explained by different approaches to the research question. Specifically, results vary according to methodology, performance measurement metrics, and time periods used for analysis (for example, Delaney, Watson and Wickramanayake 2011). In many studies, results differ depending on whether raw or risk-adjusted returns are used (for example, Hallahan 1999). ASIC consider that investment return metrics are more meaningful if adjusted for risk (ASIC 2002, and confirmed pers. comm., 28 September 2012).

Box 4.2 **Performance persistence in superannuation funds**

An extensive body of research reveals a lack of consensus on performance persistence. Where evidence of persistence is found, it is often identified in a category with particular characteristics, rather than in support of persistence for all categories of funds. This limits the extent to which past performance can be relied upon.

Recent Australian research

- In one recent study, some performance persistence was evident. Of formerly top−ranked funds, 43 per cent were subsequently top−ranked, 37 per cent mid−ranked, and 20 per cent in the lowest rank. The results were similar for funds formerly in the bottom rank. Persistence was more pronounced for large funds (with more than $1 billion in assets), though this may be limited to large not-for-profit funds. The performance measure was not risk-adjusted (Deloitte Access Economics 2012).
- Another recent study found no *general* support for ratings predicting future performance, though some persistence was found among certain categories. Some fund types among higher-rated funds significantly outperformed in subsequent periods. Funds with the lowest rating severely underperformed in subsequent periods. The study used risk-adjusted fund ratings (Delaney, Watson and Wickramanayake 2011).
- In another study, some performance persistence was evident. Of formerly top performing firms (that is, where the aggregate of all their investment options perform in the top rank), 50 per cent had a probability of being top-ranked from one period to the next, and of firms formerly in the lowest rank, 57 per cent had a probability of being bottom-ranked from one period to the next. The results show a decline in rank persistence among Australian superannuation firms over time. The performance measure was risk-adjusted (Sy and Liu 2009).

Other Australian research

Various studies found:

- no support for the predictive power of (risk-adjusted) fund ratings (Gerrans 2006)
- no support for performance persistence, once adjustment for risk was applied (Bilson, Frino and Heaney 2005)
- no support for persistence using a risk-adjusted performance measure (Drew, Stanford and Veeraraghavan 2002)

past performance is an unreliable guide to future performance. The study employs several methodologies. Some short term (risk-adjusted) performance persistence was evident for fixed interest eligible rollover funds, and there were ambiguous results for multi-sector funds. Ranking persistence (risk-adjusted) was evident for fixed interest eligible rollover funds among top performing funds (Hallahan 1999).

Several factors would make the practical application of a relative performance measure challenging, and some of these may lead to undesirable outcomes:

- Conscious of the risk of producing an outcome that is relatively poor compared to other funds or products, funds may be less responsive to changing market conditions. This could be detrimental to market-wide performance.
- At the practical level, there are numerous ways to measure performance and apply performance criteria. It would be difficult to find a measure that would be seen by all as accurate, consistent and that allowed for full comparability between funds.
- Minimum return targets or 'league table' approaches would require updating, which could be disruptive to funds (and their members) that are around the cut-off point (chapter 8).
- Other issues include:
  - how to value, and how often to value, unlisted assets that are not traded on an open exchange
  - how to account for new funds or products with no performance history.

Due to the lack of consensus in the performance persistence literature, the regulatory guidance and the practical difficulties of applying a performance measure, the Commission is not attracted to using relative investment performance as a prescriptive criterion per se.

Though the Commission sees no case for an additional prescriptive criterion to be applied to past performance in default superannuation products, the Commission accepts that in assessing a fund's ability to deliver on its MySuper investment objectives, both the appropriateness of the investment strategy and the track record of the product should be factors in the evaluation mechanism. The 'track record appraisal' should include an assessment of the past performance of the product against its objectives, and against the market more broadly. The Commission recognises that, as a consequence, decision makers will need to assess close substitutes to understand 'past' investment performance of new products.

Further, the Commission considers that where performance is taken into account in making that judgement, decisions should be weighted heavily in favour of long-term performance. That said, short-term information may 'flag' a pending change in long-term performance and should not be ignored, but instead form part of the overall monitoring of fund performance.

In the Commission's view, therefore, a fund's past long-term investment performance should not be used in the selection and ongoing assessment of superannuation products for listing in modern awards per se. Instead, it should be used to provide some guidance on a fund's expected ability to deliver on its MySuper product's long-term investment return target, given its risk profile. The latter is a valid factor to consider, and should be given primary consideration among a range of factors.

RECOMMENDATION 4.2

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the fund's expected ability to deliver on the MySuper product's long-term investment return target, given its risk profile (as a primary factor).

4.3 Fees and costs

Superannuation funds incur investment and operating costs. Investment costs are related to the asset allocation and approach to risk taken by the fund, and whether the assets are managed actively or passively. Operating costs are those that are not directly linked to the investment portfolio, such as administration and compliance costs. The level of overall costs can make a significant difference to the ultimate retirement benefit received by fund members.

Understanding fees and costs

The investment and operating costs of a superannuation fund can be passed on to members directly in the form of fees. In contrast, some costs are not charged as fees to members and are not always disclosed to members. For example, some costs are allocated against all the assets of the fund (or product), paid out of reserves, or deducted from investment returns. In particular, payments to third parties are not always disclosed to members.

Typically, investment costs are distinguished from operating costs. This assists comparability between funds or products. It also assists members in understanding whether they are obtaining value for money, such as whether the operating costs reflect the quality and timeliness of the services they receive.

Stronger Super reforms

Stronger Super reforms seek to ensure that MySuper members are charged for costs that are representative of those associated with their account, as well as to aid comparison between MySuper products.

Under the Stronger Super reforms, trustees of MySuper products must disclose all fees to members and may only charge the following fees:

- Administration fee — relating to the administration or operation of the fund (including intra-fund advice).
- Investment fee (including performance-based fees, subject to limitations).
- A buy–sell spread (limited to cost recovery) — relating to transaction costs incurred in relation to the sale and purchase of assets.
- A switching fee (limited to cost recovery) — relating to costs of switching in and out of a MySuper product and from one choice product to another choice product.
- An exit fee (limited to cost recovery).
- An activity fee (fees for member-specific costs, limited to cost recovery).

Trustees will also be able to charge an advice fee for some additional forms of financial advice, and an insurance fee (chapter 6). Charging an entry fee for MySuper products is prohibited. Trustees will also be prohibited from deducting any amount from a MySuper product that relates to making a commission payment to a financial advisor (Shorten 2012a).

There must be equal treatment of members by giving all members of a MySuper product:

- the same fees (except: where a discounted administration fee is offered to employees of particular employers; for lifecycle investment strategies where investment fees can be charged according to age cohort; or for financial advice and insurance fees)
- protection against fee subsidisation (since one employee should not be favoured over another where they have the same employer).

In addition, trustees must attribute costs fairly and reasonably across all MySuper products and choice products offered by the fund. This is intended to prevent MySuper members from cross-subsidising other members (Shorten 2012a, 2012b).

A range of Stronger Super reforms are expected to reduce costs, ultimately benefiting members. For example, over the longer term, SuperStream is intended to reduce administration costs for funds. Further, trustee duties will include promoting the financial interests of MySuper beneficiaries, with a particular focus on returns after the deduction of fees, costs and taxes (Shorten 2012d).

Improving transparency

Comprehensive data on costs, including fees, are not currently available, though this will change under Stronger Super. All APRA-regulated funds will be required to calculate fees in a standardised way. APRA will be required to publish quarterly information on fees and costs (and net returns) for MySuper products, and trustees will be required to disclose the information regarding choice products. APRA will have additional powers to collect information on a ‘look-through’ basis. This will enable APRA to obtain more complete and comparable data — particularly in relation to costs — including payments to third parties that are otherwise undisclosed to members (Australian Government 2010d; Shorten 2012a).

The new reporting standards (section 4.2), yet to be released, will provide the exact details of APRA reporting requirements for superannuation entities, including those related to fees and costs. The APRA discussion paper on the reporting standards for superannuation indicates what is currently preferred. It includes the separate reporting of investment and operating cost categories, and a number of sub-categories within them. It also includes payments to third parties, so that investment costs are captured whether or not they are charged explicitly (APRA 2012g).

The exact data that will be published by APRA — from the data that will be ultimately collected under the new reporting standards — are not yet clear, and have not as yet been the subject of consultation.

Scope for additional criteria relating to fees and costs

The Stronger Super reforms will limit some fee categories to cost recovery (that is, to the underlying costs that relate to the fee) and, therefore, protect the interests of MySuper members by restricting the size of the fee imposed. However, the Stronger Super reforms will not place limits on investment and administration fees, providing trustees with some flexibility.

The requirement that trustees allocate costs fairly between MySuper and choice products, and the Stronger Super transparency measures, including the ‘look-through’ reporting of investment payments to third parties (above), will support the fee-related reforms. However, the exact details of these requirements will remain unclear until early 2013, and the resulting data 'completeness' and product comparability is likely to remain uncertain for some time beyond their implementation in July 2013.

Participants' views

Many participants recognised the centrality of fees and costs to the ultimate net returns to members. For example, the Department of Education, Employment and Workplace Relations and the Treasury jointly commented, in the context of the appropriateness of fees and costs charged to members, that:

> Net returns (that is, returns after the deduction of fees, costs and taxes) … must be the core criteria used to assess fund performance. (sub. DR89, p. 6)

Only a small number of inquiry participants argued that a fee limit should apply for products to be listed as default products in modern awards, though the benefits of low-cost options are recognised (for example, Employment Law Committee of the Law Society of NSW, sub. 11). In contrast, REI Super stated that imposing an investment fee limit ignores that '… there may be a case … for higher investment fees if active investment management produces higher net performance to members' (sub. 26, p. 3). In addition, imposing a fee cap may have the unintended consequence of '… providers pricing their products at the maximum amount' (FSC, sub. 30, p. 21).

Other participants believe that the fee rules prescribed for MySuper products are sufficient. The Financial Services Council pointed out that pro-market competition reform has benefited consumers, suggesting that if competition were increased among default products in modern awards, no fee limit would be required (sub. DR80).

Other participants recognised that fees should be one consideration in the selection and ongoing assessment of default products, but fell short of suggesting a limit should be imposed (for example, CPA Australia, sub. 39).

The Actuaries Institute pointed out that when considering this issue, it is 'vital' that all costs, and not just fees, are taken into account so that those that are paid indirectly by members, as well as those that are paid directly, are taken into account (sub. 45). Another participant voiced concerns about costs that are paid indirectly by members as a result of third-party transactions:

> … investment structures can allow [costs] and profits to be moved down a chain of entities, rather than being reflected in headline fees. Accordingly if fee comparisons are to be made they should, if possible, adjust for these variations. (DEEWR/Treasury, sub. DR89, p. 7)

In supporting fees and costs as a consideration in listing default products in modern awards, the Actuaries Institute also contended that fees and costs associated with investments should be considered separately from those associated with the fund's operation. Some participants also emphasised the importance of understanding value for money. In this vein, the Actuaries Institute contended that the appropriateness of the fees and costs associated with investments should be considered in terms of the investment return target and risk profile, and that operating fees and costs should be considered in terms of the services provided (sub. DR60) (box 4.3).

Box 4.3 **Fees and costs as a criterion for selecting default products — some perspectives**

Should be considered

Fees should only be a consideration when a fund is demonstrably charging an unreasonably high fee for administration, or where investment fees are unreasonably high on a like-for-like basis. (AIST, sub. 20, p.12)

CPA Australia believes [the] level of fees … should be considered when determining the suitability of a default fund … All criteria should have equal weighting. Importantly, the focus should be on the overall value or benefit provided to members. (CPA Australia, sub. 39, p. 2)

Fees and costs need to be one of the factors considered when choosing a default fund in an Award or agreement. (Actuaries Institute, sub. 45, p. 4)

Should not be considered beyond MySuper requirements

… the process for authorisation of a MySuper product factors in fees. (Tasplan, sub. 6, p. 4)

Fees should not be a factor beyond the standards set by MySuper. It is the net return to members and services provided which are important. (Unions NSW, sub. 13, p. 5)

Other comments

Low or no cost options should be considered in any review for younger workers. (Employment Law Committee of the Law Society of NSW, sub. 11, p. 1)

In looking at products, it is not possible to look at fees alone. (Association of Financial Advisors, sub. DR73, p. 3)

A maximum fee limit should apply to all superannuation products listed in awards. The decision about whether the member would benefit from a higher-fee fund should be made by each individual member, not by anyone else on his/her behalf. (Australian Hotels Association, sub. 10. p. 8)

The Commission's view

The Commission sees no case for additional prescriptive criteria in relation to fees and costs. In relation to fees, a blanket cap on fees could impede optimal investment performance outcomes. In terms of investment fees, setting a fee cap risks decision makers and trustees focussing on costs to the detriment of investment performance. The imposition of such a cap could prevent funds offering a MySuper product that delivers better outcomes for members, such as one with a highly diversified investment strategy and a higher return target, with the same (or lower) risk profile. As trustees become reluctant to increase their expenses, including investment management expenses, this could lead to a 'race to the bottom' in terms of performance.

Though the Commission does not support a blanket cap on fees, it supports the cost recovery limits prescribed for MySuper products that apply to some fee types (such as for switching and exit fees). This is because a cap on these fee types will lower overall costs to members, emulating the outcomes of competitive market forces.

Though the Commission does not support additional prescriptive criteria in relation to fees and costs, it regards them as valid factors for consideration in the assessment of products to be listed in modern awards. Firstly, the Commission recognises the benefit of taking into account all the costs, as well as the fees, associated with a MySuper product, as a focus on fees alone may ignore costs that are indirectly attributed to members and ultimately reduce net returns to members. All the costs and fees should be taken into account, to the extent that this information is available. Secondly, in doing this, consideration should be given to the value for money to members, given the MySuper product's long-term investment return target and risk profile, and the services provided to those members.

The Commission acknowledges the benefit of distinguishing between investment and operating costs in understanding delivery of value for money to members, and of taking into account payments to third parties. However, until the new reporting standards are bedded down, and the public availability of the data collected under these arrangements is clear, the extent to which this will be possible remains uncertain.

RECOMMENDATION 4.3

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the appropriateness of the fees and costs associated with the MySuper product, given:

- ***its stated long-term investment return target and risk profile***
- ***the quality and timeliness of services provided.***

4.4 Scale

Scale refers to both the number of members and value of assets in a superannuation fund. Economies of scale will result if there are fixed costs that are distributed across a greater number of members/value of assets, and these reduced costs (per member or dollar of assets) may benefit members in the form of lower fees and costs and improved net performance. In the case of superannuation funds, economies relating to size of membership can be achieved in such areas as the collection of contributions, record keeping and marketing (Impavido, Lasagabaster, and García-Huitrón 2010). Economies relating to the size of the assets can be achieved through lower investment-related transaction costs. Economies associated with size of membership and assets are interrelated to the extent that additional members will add to the asset base.

The scale of superannuation funds

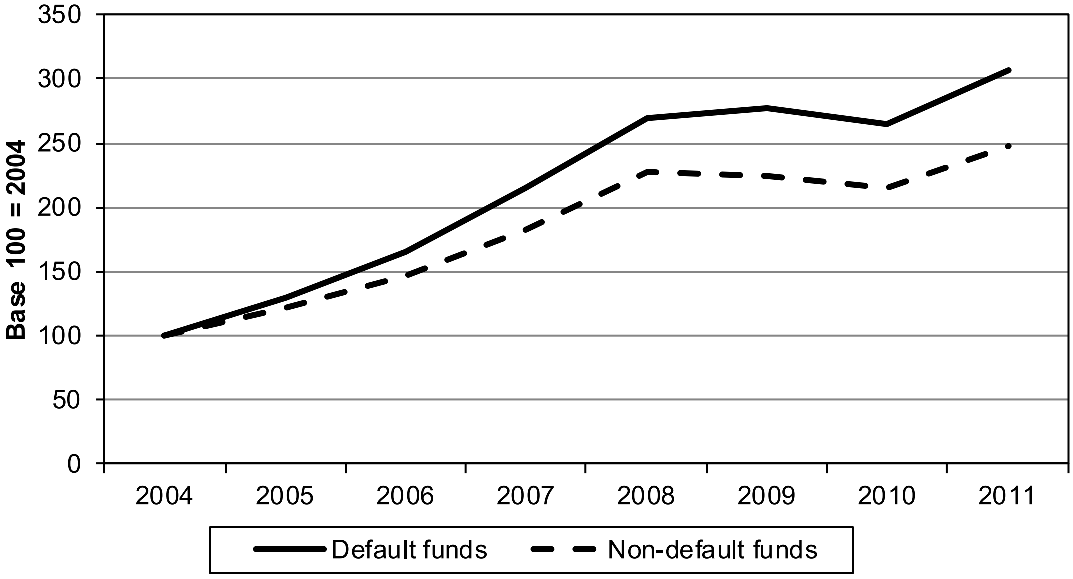
The scale of superannuation funds by asset size increased over the period 2004 to 2007 for all fund types, before the effects of the global financial crisis took their toll. Assets increased again between 2010 and 2011 (figure 4.2). The scale of superannuation funds has increased over the same period that expenses have trended downward, suggesting that falling expenses may be a result of increased scale economies (for example, Deloitte 2010).

Stronger Super reforms

Current regulatory arrangements do not include a scale test for superannuation funds. Though Stronger Super reforms will not prescribe scale requirements for funds that offer MySuper products, trustees will be required to consider scale.

In the process of seeking MySuper authorisation, a trustee will have to demonstrate to APRA that the product has access to 'sufficient scale' to provide net returns that are in the best interests of members (or, for a new entrant, that they have a credible path to achieving sufficient scale). MySuper trustees must implement the 'scale test' on an annual basis. Where trustees determine that assets or members are insufficient to meet the scale test, they must take appropriate action to meet their obligations. APRA will provide prudential guidance on relevant considerations for trustees in rectifying insufficient scale (Shorten 2011b, 2012d). APRA have indicated that in this regard, their concern will be long-term performance, and there would be 'no concerns with a small fund that was performing well' (APRA 2012d, p. 3).

Figure 4.2 **Scale of superannuation funds by asset size[a, b, c, d, e]**
Default funds versus non-default funds, indexed



[a] Based on APRA-regulated superannuation funds for which return data are available for all years 2004–2011. [b] Excludes pooled superannuation trusts, exempt public sector superannuation schemes, small APRA-regulated funds and single-member approved deposit funds. Self managed superannuation funds regulated by the Australian Taxation Office are excluded. [c] Includes Eligible Rollover Funds. [d] Default fund data based on superannuation funds listed in modern awards (as at September 2012), for which return data are available for all years 2004–2011.[e] Based on cash flow adjusted net assets.

Sources: Productivity Commission estimates based on APRA fund-level profiles and financial performance data 2011 (APRA 2012j); FWA (2012e).

Further, other Stronger Super reforms are expected to increase the scale of superannuation funds. New operational risk financial requirements will require APRA-regulated funds to hold a minimum level of operational risk reserves (APRA 2012b). These higher capital standards may accelerate merger activity. This will complement the ongoing restructure of the superannuation industry that has already seen a significant number of fund consolidations in recent years (AMP, sub. 52) (chapter 2). Ongoing consolidation will be supported by the recently announced capital gains tax relief provisions for superannuation funds (Shorten 2012h), regarded by some as a prerequisite for ongoing merger activity (Asset Super, sub. 32).

Scope for additional criteria relating to scale

Participants' views

Few inquiry participants believe that scale should be considered when listing superannuation products in modern awards, but some recognised scale benefits. For example, REST Industry Super contended that scale facilitates the development of business capabilities, and may result in a broader range of investments and improved overall rates of return (sub. 47). Further, where scale exists, it may be used to reduce costs.

> Scale allows a trustee to negotiate better rates with service providers such as investment managers, administrators and custodians. (AMP, sub. 52, p. 6)

Most participants believe that the MySuper scale requirements are sufficient, and that no additional scale requirements should apply (box 4.4). One participant indicated that scale economies could be accessed, even by small funds.

Box 4.4 **Scale as a criterion for selecting default products — some perspectives**

Should be considered

> Entry to awards after 2013 [should] be conditional on funds being able to prove to APRA that they have operated [on] an equivalent of a scale … that would make it appropriate for award inclusion. (ACTU, sub. 29, pp. 11–12)

Should not be considered beyond MySuper requirements

> Funds will be required to make their own assessment of scale to ensure that they are able to offer a MySuper product that is in their members' best financial interests. As this process is a threshold MySuper criteria, it should not be a criteria that is duplicated in the selection of funds in awards. (AIST, sub. 20, p. 16)

> We believe [scale] is adequately addressed in the MySuper licensing process and ongoing 'scale test'. (REI Super, sub. 26, p. 5)

> There is no ideal fund size in assessing member value. Regardless, the MySuper framework contains a requirement that a MySuper trustee annually makes an assessment of scale. (FSC, sub. 30, p. 24)

> We do not believe that scale should be a deciding factor as smaller or specialised funds may provide the necessary value to employees in a particular industry or achieve scale through pooling administration or investment resources. (CPA Australia, sub. 39, p. 2)

> … it is not the case that … returns [always] increase in sync with fund size increase. (Tasplan, sub. 6, p. 5).

> Lower costs are irrelevant if the benefits are not passed on as lower fees and better returns for members. Large retail funds benefit from scale, but the data show their cost savings go to profit for shareholders and not to benefit for members. (Wilson Sy, sub. DR58, p. 1)

The Transport Industry Superannuation Fund pointed out that:

> 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 [administration] and promotion. (trans., p. 147–8)

One participant spoke out more strongly against using scale as a criterion, contending that there is 'no generally valid relationship between scale and the cost of running superannuation funds' (Wilson Sy, sub. DR58, p. 1).

The Commission's view

Imposing a prescriptive scale criterion that requires a minimum fund size would ignore the possibility that superannuation funds can access 'scale advantages' in a number of ways other than through internal growth or merger activity. The outsourcing of administrative or investment components can realise similar benefits (such as by using organisations that offer a 'one-stop-shop' investment capability) (Deloitte 2010).

The imposition of a prescriptive scale criterion that requires a minimum fund size could also penalise small well-performing funds, and might have the unintended consequence of shutting out new and smaller players, preventing competition.

Further, a prescriptive scale requirement would ignore that scale is just *one* factor among many that influence fund investment performance. Such a requirement would risk introducing 'false security' for decision makers, and may divert focus from other important considerations.

The MySuper 'scale test' is a flexible approach without the disadvantages outlined above, though its success will depend on the thoroughness with which APRA reviews each MySuper application, and the extent to which it monitors the annual 'scale test' review.

The Commission considers that the MySuper requirement for trustees to consider scale is appropriate, and that no greater prescription of scale is required.

RECOMMENDATION 4.4

The selection and ongoing assessment of default superannuation products for listing in modern awards should not include scale as a specific factor for consideration over and above the MySuper 'scale test'.

5 Governance and transparency

Key points

- Default superannuation arrangements are subject to significant principal–agent relationships. Good governance arrangements are therefore critical to ensure the security of monies held in the form of superannuation, and to ensure superannuation funds operate in the best interests of members.
- The Cooper Review found no significant evidence of systemic trustee governance failure, but found a number of areas in which governance arrangements needed to be improved. Conflicts of interest, and conflicts of duty, were seen as commonplace.
- In response, as part of Stronger Super, the Australian Government is introducing a number of reforms including: new duties for trustees; stronger requirements with regard to conflicts of interest; increases in the standard of care, skill and diligence required of trustees; and an expansion of the covenants for which trustees must have regard.
- Submissions to this inquiry supported the need to consider governance arrangements in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards, though there were different views about what constitutes good governance.
- Considering that many of the Stronger Super reforms relating to governance have only recently been announced, and given the broad nature of these reforms, the Commission is not persuaded that additional prescriptive criteria are warranted.
- The Commission considers, however, that governance practices — particularly the mechanisms put in place by fund trustees to deal with conflicts of interest — should be taken into account in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards.

This chapter discusses the scope for additional criteria relating to governance and transparency to be applied in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards. It begins with a discussion of the importance of having good governance arrangements in place. It then analyses, in the context of the Stronger Super reforms, the case for additional criteria relating to the key governance and transparency issues identified by inquiry participants.

5.1 The importance of good governance

In a system of compulsory superannuation — where people are unable to opt out of investing — it is especially important to ensure the security of monies held, and that the interests of fund members are paramount. Good governance arrangements are critical in this regard. The Cooper Review highlighted the importance of good governance in the context of compulsory superannuation:

> It is sometimes overlooked that the superannuation industry is quite different from other businesses. It owes its existence to government policy and is underpinned by a social purpose that runs alongside many other economic and stakeholder considerations. Recognising this special purpose, the Panel believes that all those involved in the system need to have — and be seen to have — high standards of governance. In superannuation, just as in other areas of corporate activity, good governance plays a major role in promoting better decisions, greater accountability and in reducing unintended operational and investment risks. (Australian Government 2010b, p. 44)

Participants have similarly referred to the importance of good governance. The Australian Institute of Superannuation Trustees (AIST) said:

> The links between improved governance and higher performance is well documented and we expect that with the improved level of governance come improved returns. (sub. 20, p. 15)

The Industry Super Network (ISN) stated:

> Analysis of superfund performance suggests that governance affects performance, but that the loyalties and perceived role of directors are the crucial factors. (sub. 27, p. 25)

Default superannuation arrangements are subject to significant principal–agent relationships (chapter 3). The role of governance arrangements is to limit the ability of agents to act in a manner contrary to the interests of the principals, to ensure the interests of principals override other interests, and to promote overall transparency and confidence in the compulsory superannuation system. Studies have suggested good governance arrangements can increase annual returns by between one and two percentage points (Ambachtsheer, Capelle and Lum 2006).

The term 'governance' relates to how authority is exercised and controlled within superannuation funds, and how accountability is maintained. Governance practices include:

- procedures for dealing with conflicts of interest or duty
- ensuring trustees exercise care, skill and diligence
- procedures regarding related party transactions

- accountability and reporting to members
- prudential and risk management procedures
- performance monitoring
- board tenure policies
- remuneration policies (including links to risk management)
- procedures to ensure fair treatment of members
- use of committees.

Until recently, regulatory arrangements for the superannuation industry were contained in the *Superannuation Industry (Supervision) Act 1993* (Cwlth) (SIS Act), regulations under the SIS Act, the *Corporations Act 2001* (Cwlth) and were also based on other licensing requirements for superannuation entities. There were also a number of non-binding guidelines produced by the Australian Prudential Regulation Authority (APRA). The Cooper Review found that a lack of coordination between these regimes led to a range of governance problems.

5.2 The Government's response to the Cooper Review's governance recommendations

In response to the Cooper Review, the Australian Government has proceeded with a number of reforms in the area of governance, including:

- introducing a duty for trustees and directors to give priority to the interests of fund members when that duty conflicts with other duties
- strengthening the requirements on individual directors in relation to managing conflicts of interest
- increasing the standard of care, skill and diligence required of trustees and directors of corporate trustees to that of a 'prudent superannuation trustee'
- clarifying the duties applying to individual directors of corporate trustees to act honestly and to exercise independent judgement
- introducing a requirement for trustees to devise and implement an insurance strategy, and imposing a statutory duty on trustees to manage insurance with the sole aim of benefiting members (chapter 6)
- expanding the covenants to which APRA-regulated fund trustees must have regard to include expected costs, expected taxation consequences, and the availability of valuation information (Australian Government 2011a).

The Government will also require superannuation funds to publish on their websites information including:

- details of asset holdings to be updated every six months (with up to a three month lag)
- details of director and executive remuneration
- a product dashboard as proposed by the Cooper Review, with information on target returns, past performance, investment risk, liquidity and fees (chapter 4) (Shorten 2012a, 2012d, 2012f).

Further, the Government has foreshadowed that regulations will require other documents to be published on fund websites. These documents include:

- performance information for the past ten years
- trust deeds
- annual reports, and other financial and actuarial reports
- names of outsourced providers
- names and biographies of directors, trustees and people involved in the trusteeship of funds
- details of board meeting attendance by directors
- the proxy voting policies and procedures of funds, and their voting behaviour (Shorten 2012a).

APRA has been given the power to draft binding prudential standards for the superannuation industry for the first time, and has provided the industry with a draft version of these standards.[1] Where possible, APRA is seeking to align them with the prudential standards applying to other financial institutions subject to APRA oversight (in line with APRA's objective for greater regulatory convergence).

The Government has also, through the Australian Securities and Investments Commission, developed a new, centralised superannuation website, www.moneysmart.gov.au.

Not all of the governance-related recommendations of the Cooper Review were adopted by the Government. For example, it rejected the recommendation to remove the mandatory requirements for trustee boards of employer-sponsored funds

[1] APRA's draft prudential standards cover governance, conflicts of interest, fitness and propriety, risk management, outsourcing, investment governance, operational risk requirements, audit requirements, business continuity management, insurance and matters specifically relating to defined benefit funds.

to have equal representation between employer and employee representatives. Recommendations that boards be required to have a 'critical mass' of independent (or 'non-associated') trustee directors were also rejected (Australian Government 2010d). These issues are discussed further in section 5.3.

Future of Financial Advice reforms

The Government has also introduced new Future of Financial Advice (or FOFA) laws which are designed to improve governance arrangements and transparency in all fields of financial advice. The reforms include:

- bans on conflicted remuneration structures, including commissions and volume payments, in relation to the distribution and advice of retail investment products including managed investments, superannuation and margin loans
- bans on up-front and trailing commissions and like payments for both individual and group risk insurance within superannuation
- a ban on soft-dollar benefits (monetary and non-monetary benefits) received by financial planning firms, representatives and associates in relation to both retail investment products and insurance within superannuation, where a benefit is $300 or more
- requirements for advisers to request retail clients to opt in (or renew) their advice agreement every two years, with the Australian Securities and Investments Commission being given the power to exempt advisers from the opt-in obligation where it is satisfied that the adviser is signed up to a professional code which obviates the need for opt in
- the introduction of a best interests duty so that advisers must act in the best interests of their clients, subject to a 'reasonable steps' qualification, and place the best interests of their clients ahead of their own when providing personal advice to retail clients.

Industry initiatives

In addition to these government initiatives, other bodies have also moved to improve disclosure. For example, AIST has announced new disclosure guidelines for its not-for-profit member funds. Under these guidelines, information that funds will be expected to disclose includes:

- remuneration for trustees and key senior executives
- details of each director, including their names, experience, who appointed them and who they represent

- trustee attendance at board and committee meetings
- a listing of 'material' service providers
- proxy voting policies
- a list of fund assets updated every six months with a three month lag (AIST and IFF 2012, AIST pers. comm. 17 September 2012).

The Financial Services Council (FSC) (an industry association representing retail funds) has also drafted a new *Superannuation Governance Policy*, which has been released for industry consultation. Key elements include:

- requirements for the Chair and the majority of directors to be independent
- preclusions on directors holding multiple and conflicting board positions
- disclosure of environmental and social risk policies
- requirements to publish proxy voting records (FSC 2012).

A previous proposed requirement to disclose remuneration has been superseded by the Government's requirements in this area.

Scope for additional criteria relating to governance and transparency

The Commission is supportive of the direction of the governance reforms contained in the Stronger Super package, and is also conscious that the reforms have only recently been announced. Therefore the Commission does not see it as appropriate to place additional governance and transparency criteria on funds beyond those envisaged under Stronger Super. In some areas, however, the Commission considers further consideration is justified in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards.

5.3 Superannuation board governance

A number of participants raised issues relating to the structure and practices of boards. There were, however, diverse views regarding what constitutes best practice governance. For example, many participants expressed a preference for boards which comprised equal representation of employer and employee representatives (the 'equal representation' model) while others suggested that the presence of independent directors on boards would lead to better governance. Others saw issues relating to board structure as being relatively unimportant.

The equal representation model is required by the SIS Act for non-public offer employer-sponsored funds — that is, corporate funds and a significant proportion of industry funds — with allowance for one additional independent trustee or director who is unable to exercise a casting vote.[2] APRA can also approve additional independent directors through a licence variation.

The Cooper Review put forward a number of reasons to consider moving away from the equal representation model.

- The introduction of fund choice, and a move away from defined benefit funds, reduces the close relationship between employers and superannuation funds.
- Many employer and employee representatives on boards are appointed by third parties rather than being elected by employers and members. As a consequence, the democratic principle that equal representation was meant to reflect is not always observed in reality.
- The potential for perceptions that individual trustee-directors are dictated to by the organisations that appointed them.
- The large number of employers, employer organisations and employee organisations related to a fund can sometimes lead to larger boards than would be ideal.
- Equal representation can leave some groups 'unrepresented', such as members who are pensioners and members who have joined the fund because they exercised fund choice.

In summary, the equal representation model was seen by the Cooper Review to impose rigidity on fund governance practices and reduce accountability, without ensuring the representation objective on which it was predicated.

Further, the Cooper Review saw best practice in corporate governance as involving the presence of independent directors. The Cooper Review therefore recommended that a minimum number of independent trustee-directors should be on the boards of all funds, representing a 'critical mass' to ensure board decisions could be genuinely influenced.

---

2 Under the SIS Act, public offer funds can either be bound by the equal representation requirements or have an 'independent trustee'. Non-public offer employer-sponsored funds are bound by the equal representation requirements.

Scope for additional criteria relating to superannuation board governance

Participants' views

The Commission, in its 2001 Review of the SIS Act (and other legislation), supported equal representation on boards:

> The equal representation rules for trustee boards of standard employer-sponsored funds provide balanced representation of employer and employee interests. They are conducive to active member interest in the prudent management of these funds. This benefit exceeds the cost of finding and appointing members who are capable of undertaking trustee duties. (PC 2001, p. 113)

The Industry Funds Forum highlighted the advantages of the equal representation model:

> Industry funds developed the current governance structure, which applies to regulated superannuation funds. Industry funds have from virtually the beginning had equal representation and a two-thirds majority for decision-making. This representative governance structure helps ensure that member interests come first, at the same time allowing key stakeholders [to] have a say in how the fund is run, with no one stakeholder or group of stakeholders having a controlling interest. (sub. 51, p. 9)

The Australian Council of Trade Unions (ACTU) also stated that the equal representation model — with representatives of fund members represented on boards — was consistent with the OECD's governance guidelines for pension funds (sub. DR77). The relevant guideline relating to accountability states:

> The governing body should be accountable to the pension plan members and beneficiaries, its supervisory board (where relevant) and the competent authorities. Accountability to plan members and beneficiaries can be promoted via the appointment of members of the governing body by pension plan members and beneficiaries or their representative organisations. The governing body may also be accountable to the plan sponsor to an extent commensurate with its responsibility as benefit provider. In order to guarantee the accountability of the governing body, it should be legally liable for its actions which fail to be consistent with the obligations imposed on it, including prudence. In defined contribution plans, accountability calls for safe harbour rules that clarify the responsibilities and liabilities of the governing body. (OECD 2009, p. 2)

Some participants, including industry funds that have independent representation on their boards, supported broadening the structure of boards to include independent directors. Unions NSW said 'a fund should have an equal representation of employer and employee representatives with an agreed independent chair' (sub. 13, p. 6).

HOSTPLUS similarly stated:

> HOSTPLUS … is now overseen by a Board made up of three representatives from the [Australian Hotels Association], three from United Voice and three independent Directors. The structure ensures the interests of employers and workers are met and provides the fund with a strong understanding of the intricacies and employment nuances of our sectors. (sub. 8, p. 2)

Jeremy Cooper highlighted the importance of having directors who could bring independent judgement to boards:

> The key thing about looking after large amounts of other people's money is that you have the necessary skills to do so. You particularly need to be able to bring independent judgment to the role, asking the right questions where necessary. You need to be able to act without fear or favour. It's at this point where the super industry often gets caught up in arguments around terminology; whether or not someone is 'independent' or, alternatively, querying the need for independence in the first place. The desirability of independence in corporate governance is well established to the point of being beyond serious question. (sub. DR94, p. 1)

BT Financial Group noted that, outside of superannuation, there were requirements for financial services entities to have independent board members:

> With the exception of superannuation, APRA currently requires that regulated entities have both an independent Chair and that the majority of directors are also independent. The Australian Stock Exchange also believes that independence of the majority of directors and the Chair is best practice. (sub. 46, p. 3)

The FSC saw independence as critical:

> We believe that in keeping with contemporary governance standards and with the significance of the superannuation industry to Australians and the economy, independence is critical … We believe that moving to a model which enshrines independence in the board [would represent] the most appropriate governance structure for the superannuation industry as the trustees safeguarding Australia's retirement savings. (sub. DR80, p. 31)

However, the ACTU questioned whether the case for independent directors was particularly strong:

> We noted [the Cooper Review's recommendation for independent board members] flowed from the review panel's assertion that such a reform reflected 'contemporary best practice in corporate governance.' It did not arise on the basis of actual evidence that the equal representation model in Australia was failing and therefore required this particular reform. Nor did the panel's report consider any of the evidence and debate generated by researchers in corporate governance which questions the extent to which non-associated or independent directors actually deliver better performance and governance in practice. In short, the panel opted for speculative assertion rather than evidence-based policy analysis. We therefore welcomed the government's rejection of

> the Cooper panel's recommendation and its view that the equal representation model worked well and should continue. (sub. 29, p. 7)

Cbus noted that independence can mean different things to different people:

> 'Independent directors' are supported by interest groups who variously consider 'independent' as independent of management, independent of sponsoring organisations, and subject matter experts. This creates an appearance of many voices in support of a concept, whereas in fact there is little consensus. (sub. DR81, p. 4)

Jeremy Cooper noted the potential governance benefits of bringing in directors from outside the superannuation industry:

> It remains my view that the super industry would benefit from an increased participation by talented business people not directly connected to super, but with relevant skills. Such people bring the value of their reputations and have the option of resigning if they feel that they are not adding value or are not happy with the way things are going. This reflects the legal notion of the 'disinterested' director. (sub. DR94, p. 2)

In response to the Commission's draft report, ISN disagreed with suggestions that the equal representation model becomes less attractive when industry funds begin taking members from outside their original industry:

> Industry SuperFunds believe that the equal representation model has delivered superior performance and relevant products that meet the needs of both employers and employees. This view is supported by a significant body of independent research. We do not accept the views expressed in the draft report that representative arrangements become inappropriate when a fund accepts members from the public at large. (sub. DR62, p. 29)

A number of participants suggested board structure was an inappropriate criterion for assessment. For example, Cbus — suggesting governance practices were more important than structures — said:

> Cbus submits that in applying this factor, [Fair Work Australia] should not focus on the composition of the Trustee Board. Nor should it artificially rate a fund as superior simply because it has a certain proportion of its Board independent of its sponsoring organisations. Rather than focus [on] Board composition … Cbus submits that the focus should be upon whether the governance structures, (including but not limited to Board composition) reflect an orientation towards a member-only focus. (sub. DR81, p. 4)

The Commission's view

The Commission agrees that the equal representation model has generally operated well to date, and this is reflected in the performance of many of the funds operating under this model. However, some arguments for an equal representation structure become less compelling as funds actively broaden their membership beyond their traditional base. In particular, it is less certain that the 'outside' members would necessarily find the trustees under the 'equal representation' structure to be representative of their interests.

Although recent debate has centred around the governance of industry funds, arguments in favour of having a critical mass of independent directors apply to both retail and industry funds, albeit for different reasons. As highlighted by the Cooper Review, it is important for retail funds to have directors that are independent from management, while there are likely to be benefits from having independent directors of industry funds to introduce an 'outsider's perspective', and to ensure the interests of those members who have exercised fund choice are taken into account.

For both retail and industry funds, there is the potential for independent directors to bring increased knowledge and expertise to superannuation boards. The Commission has previously noted the benefits of non-aligned expert members in several of its other reports (such as the Commission's 2005 Health Workforce Report).

The Deputy Chairman of APRA, Ross Jones, has expressed support for independent directors in media interviews, citing the additional expertise they can bring, and stating that their presence has added value in those financial industries where having independent directors is compulsory. Media reports have also suggested APRA is likely to recommend that funds have independent directors, seeing this as representing good governance, but that APRA will not require funds to have independent directors by law (possibly addressing the issue through the guidance notes to its prudential standards for superannuation) (Patten 2012a, Korporaal 2012).

Some calls for increases in the number of independent directors also stem from concerns that equal representation boards might find it difficult to remove unworthy directors. For example, experts such as Jeremy Cooper have highlighted that giving boards the power to dismiss directors could be quite problematic,[3] and have suggested that having more independents would assist in encouraging unworthy directors to leave (Patten 2012b). That said, directors do not need to be independent to exert pressure on their poorly performing counterparts, and the Commission

3 As it stands under Australian corporate law, it is up to shareholders to determine the composition of boards, and boards have no legal authority to remove individual directors even where there is a strong case for doing so. A concern with giving boards such authority is that it could lead to individual directors feeling they were unable to freely express their views at board meetings without fear of retribution in the form of dismissal.

notes that recent issues surrounding controversial board members have been resolved without the presence of independent directors.

The Commission considers that issues relating to board structure are important. However, overall, there is a lack of compelling evidence to suggest that any one model of board structure should be viewed as clearly preferable in all cases. Therefore, the Commission does not consider it appropriate at this time for a particular structure to be mandated. Further, the Commission would not want to see restrictions placed on board structures without such restrictions having a sufficient evidentiary basis, particularly given the potential impact they could have on competition for default listing.

Rather, the Commission is broadly supportive of APRA's approach of not mandating any particular structure for superannuation fund boards, while also highlighting potential benefits of having independent directors in cases where this is appropriate. The Commission anticipates that APRA would be likely to facilitate requests from industry funds for licence variations to allow additional independent directors, and the Commission would be supportive of this.

In relation to what constitutes an independent director, APRA has published guidelines that state that an independent director would be one who is not, and in recent years has not been:

- in an executive role with an employer–sponsor
- an official or representative of a body that has the right under the governing rules to nominate or appoint directors (or individual trustees) to represent either member or employer interests
- a director, employee or shareholder of a company related to either a standard employer-sponsor or to the fund licensee (other than in the case of a wholly-owned subsidiary of the licensee)
- a director, employee or shareholder of a material service provider, whether related or not (APRA 2011).

The Commission considers that funds which intend to appoint independent directors should draw on this guidance.

While the Commission does not support mandating particular board structures, it considers that issues relating to board governance are highly important. However, as the Stronger Super reforms have dealt with many of the most pressing governance issues (such as those relating to conflicted loyalties, remuneration and the competence of trustees), there is no need to revisit many of these at this time.

In summary, the Commission considers that governance practices of trustees should be assessed in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards to ensure they are consistent with meeting the best interests of employees who derive their default superannuation product in accordance with modern awards. Given APRA's recently enhanced role of developing and overseeing prudential standards relating to governance, it would be appropriate for the decision maker to be largely guided by APRA in this process.

In its draft report, the Commission suggested it could be timely to set up a panel of corporate governance experts to assess the appropriateness of board structures of default superannuation funds. However, in view of the lack of definitive evidence in favour of any particular board structure, it does not consider that this exercise would provide net benefits at this time. The Commission prefers that the impact of the Stronger Super reforms on governance be observed before recommending such a review.

5.4 Board tenure and renewal policy

One issue brought to the Commission's attention is an area of contention under the Stronger Super reforms — the requirement for funds to develop a board tenure and renewal policy. The argument supporting this requirement is a perceived need to ensure that boards continue to remain open to new ideas and independent thinking.

APRA has not proposed specific tenure limits for directors or individual trustees, but rather that each fund have a renewal policy incorporating an explicit statement as to the maximum term the fund licensee considers appropriate for its directors. APRA states that funds can choose to develop policies that allow for flexibility for term extensions of individual directors 'where appropriate and justifiable' (APRA 2012h, p. 13).

Participants' views

REST Industry Super considered tenure to be an inappropriate criterion for judging directors:

> REST … holds the view that it is important to strongly advocate the benefits of long-standing directors and what this brings to a fund's board and its members. REST's view is that tenure, by itself, is a poor measure to assess the appropriateness of a director. It is the contributions made to the Board through their collective skills, education, experience and participation that are more relevant. The REST Board is made up of individuals who have a wealth of retail industry and commercial experience in a corporate environment. Their long standing in-depth knowledge of the fund which

> can only be gained over a long tenure, together with their understanding of the industry adds huge value not only to the operation of the fund but also to the members and employers. (sub. 47, p. 24)

APRA's current position is that directors should only be reappointed in relatively rare circumstances:

> APRA considers that … licensees should have a clear approach for assessing, prior to the cessation of the term of an individual director, what would make it appropriate, at that time, to step outside their tenure policy. The presumption would continue to be that a director would leave office at the end of their term unless the RSE licensee could appropriately form a view on why that director should remain. (APRA 2012h, p. 13)

The Commission's view

The Commission considers that there are important trade-offs between the benefits of renewal and the benefits of having experienced board members. On balance, it supports APRA's policy, in that the policy allows for sufficient flexibility, while recognising that the status quo has seen some very long board appointments that might not have always been in the best interests of members. Accordingly, it would not be necessary to consider this issue in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards.

5.5 Managing conflicts of interest

The management of conflicts of interest is particularly important within the default superannuation system given the inescapable reliance on principal–agent relationships. This is not only to ensure agents' interests can be aligned with those of members, but also to promote overall transparency and confidence in the system.

Stronger Super reforms relating to managing conflicts of interest

As detailed above, the Stronger Super reforms seek to deal with conflicts of interest and make it clear that members are owed the highest duty by fund directors and trustees. APRA has proposed a new prudential standard SPS 521 to deal with this issue.

APRA (2011) notes that conflicts of interest can be actual, perceived or potential in nature. The new APRA standard does not seek to eliminate conflicts, but rather to ensure that funds are aware of them, and have measures in place to deal with them. This includes proposed requirements to have two registers: one that outlines all duties of the licensee and duties of each individual director; and the other that lists all material interests of individual directors and senior management (where interests include matters such as gifts, emoluments and benefits). APRA's expectation is that conflict management frameworks should be appropriate to the size, business mix and complexity of a licensee's operations.

Scope for additional criteria relating to managing conflicts of interest

Participants' views

NGS Super highlighted the importance of ensuring that members' interests were paramount:

> The introduction of MySuper brings with it increased fiduciary responsibilities for fund trustees … they will have to give priority to the interests of members in the case of a conflict or potential conflict of interest … it is clear that strong corporate governance focussing on the promotion of members' best interests … is a priority. (sub. 18, p. 5)

The ACTU (sub. 29) and the Australian Manufacturing Workers' Union (sub. 49) expressed particular concern about conflicts of interest among retail funds. The ACTU stated:

> To many financial institutions our superannuation system is primarily an opportunity to accumulate private profit. The existence of a large number of customers who are compelled to participate in a market they often do not understand and are unable to influence has provided financial institutions with many opportunities to apply a raft of fees, charges and commissions at the expense of member benefits. This is evidenced by the fact that while retail funds have on average underperformed relative to most not-for-profit funds in terms of net returns to members, they continue to charge significantly higher fees. This indicates that a major inefficiency in the Australian superannuation system … is the retail super sector. (sub. 29, p. 3)

ISN pointed to past performance to suggest that the governance structure of industry funds was best placed to deal with conflict of interest concerns:

> Eliminating the pernicious effects of conflicts of interest — namely, the effects of conflicts of interest that undermine performance and otherwise undercut the ability of the fund to maximise retirement outcomes — is a critical part of [producing superior returns to members]. Accordingly, any consideration of governance in connection with naming default funds in modern awards should be tied to the available research, which demonstrates that the representative trustee model employed by not-for-profit funds has best served the public interest and member interests. (sub. 27, p. 26)

In response to the draft report, ISN expressed support for the Commission's approach, seeing APRA's draft prudential standard as largely addressing the issue:

> ISN supports [the Commission's] draft recommendation … which requires a consideration of the mechanisms put in place by trustees to deal with conflicts of

> interest and the transparency in disclosing those conflicts. These considerations apply to all large fund types and are addressed in detail within the proposed APRA prudential standard SPS 521 Conflicts of Interest. (sub. DR62, p. 29)

AustralianSuper also saw APRA as dealing adequately with conflict of interest issues:

> Australian Super is of the view that [issues of scale, governance, conflicts and administrative efficiency] are being dealt with extensively under the Stronger Super reforms … or in the consultation stage. In addition, APRA has advanced its development of Draft Prudential Standards … APRA's draft Standards deal extensively and substantively with issues relating to governance … and conflicts management. We are confident that … APRA will be appropriately equipped to deal with these issues. (sub. DR74, p. 3)

The Commission's view

Many potential conflicts of interest are inherent in the superannuation industry, but it is important that funds and trustees seek to minimise their impact. When selecting and assessing superannuation funds for listing as default funds on an ongoing basis, conflicts of interest associated with superannuation and the mechanisms put in place by fund trustees in dealing with these conflicts should be considered. These decisions should be made on a 'fund-by-fund' basis rather than being based on any inherent assumption that particular governance structures deal best with conflict of interest issues. APRA's prudential standard relating to conflicts of interest should be used to guide this process.

RECOMMENDATION 5.1

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of whether fund governance practices are consistent with meeting the best interests of members. In particular, consideration should be given to the mechanisms put in place by fund trustees to deal with conflicts of interest, and the transparency associated with disclosure of those conflicts.

5.6 Flipping of members

A large number of participants raised the issue of 'flipping'. Flipping was defined in the Cooper Review as the practice of fund members 'being automatically moved from one division of a fund to another … on cessation by the member of the particular employment to which the original fund division related' (Australian Government 2010b, p. 24). Concerns about flipping emerge when members are transferred to a higher cost division of a fund, often without their knowledge or understanding of the consequences for their superannuation balance. This highlights potential principal–agent problems when the interests of members and fund managers do not align.

Flipping measures under Stronger Super

Under the initial MySuper legislation, it was proposed that a core criterion for MySuper products would be that a member's interest could not be transferred without the member's consent *except* to another MySuper product within the fund (Shorten 2011b). Given the Government's intention that MySuper products are 'low cost and simple' (Australian Government 2010d), this requirement would have made it much less likely that members would have been moved to a significantly higher cost product (but it would not have entirely eliminated the possibility). Almost all of the submissions to this inquiry were based on the initial version of the MySuper bill.

In the third reading version of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 that passed the House of Representatives in August 2012, an amendment was included that should eliminate the possibility of members being flipped without their knowledge. This amendment, which is discussed in more detail below, has changed the Commission's conclusions since the draft report.

Scope for additional criteria related to flipping of members

Participants' views

A number of participants considered that the practice of flipping should be addressed when considering the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards. For example, HOSTPLUS (sub. 8) stated that only funds that demonstrate no (past) evidence of flipping should be eligible for nomination. ISN considered that 'funds that actively flip their members into a higher priced MySuper product should not be eligible to be named as a default fund' (sub. 27, p. vi), and AustralianSuper suggested that eligible MySuper products should be 'prohibited from engaging in fund flipping' (sub. 36, p. 5).

Some participants (including the ACTU, sub. 29, AustralianSuper, sub. 36, and ISN, sub. 27), expressed concern that the initial legislation before parliament left room for flipping to occur. For example, some employers (subject to having more than 500 employees) with award employees may negotiate a tailored MySuper product with the fund nominated in the relevant award. In these circumstances, an individual MySuper member, when they cease employment with the employer that negotiated the tailored product, could have been moved to the 'mainstream' MySuper product within the same fund. The concern predominantly related to the (potential) practice of a fund providing artificially low prices in its tailored products, with a view to recouping its losses and making additional profits when employees left their employer (and were 'flipped' to the fund's non-tailored MySuper product).

The key concern here was that some funds could have adopted a business model targeting industries that had high employee turnover, for tailored products with discounted fees (potentially below cost). As the ACTU put it:

> Retail funds will be able to offer 'loss leading' versions of their MySuper products to particular large employers on the basis that employee turnover will mean such losses are recouped over time. (sub. 29, p. 10)

Cbus stated:

> Regrettably the incentives to create opportunities to engage in 'sharp practice' of flipping are high. High labour mobility and short job tenure in the construction industry expose workers to being unknowingly moved into funds with a high cost structure. (sub. 15, p. 6)

The Commission's view

In the draft report, the Commission proposed including the likelihood of flipping as one of the factors to be considered in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards. Funds with a reputation for flipping would therefore have been at a competitive disadvantage when seeking future inclusion as default funds.

A number of participants supported the Commission's draft proposal. For example, Cbus said:

> We welcome the draft finding that [Fair Work Australia] should address the likelihood of flipping, and that this would count against a fund being chosen as a default fund. Cbus accepts that there may be instances where the withdrawal of a fee-discount that is based upon an employee's ongoing membership of a particular employment class is valid. However Cbus strongly believes that [Fair Work Australia] needs to be empowered to vigilantly guard against the possibility of price gouging, and we welcome the Commission's draft findings in this regard. (sub. DR81, pp. 2-3)

Others still saw opportunities for poor practices. For example, in calling for funds that engage in flipping to be ineligible for selection as a default fund in a modern award, ISN stated:

> [The Commission's draft recommendation] will allow a continuation of current practice among retail funds, under which product providers will offer discounts to employers on a loss leader basis. When an employee leaves the employer there is nothing to stop their assets being transferred without approval to a more profitable product … As many members in default products are disengaged, the product the employee is transferred into need not be price competitive … Flipping is a significant issue in high turnover industries, many of which are heavily award dependent. (sub. DR62, p. 8)

The ACTU expressed a similar view:

> While one option [for dealing with flipping] could be to mandate consideration of the likely 'total costs' to employees should they change employment and remain disengaged, the most effective way to tackle this problem is to prohibit flipping in the context of award default selection. This will remove uncertainty, build public trust in the new system, and send a clear signal to the industry that member disengagement in a compulsory system is not a legitimate source of private profit. (sub. DR77, p. 6)

Since the draft report, an amendment moved by Greens MP Adam Bandt was incorporated into the version of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 that passed the House of Representatives. The effect of the amendment is to require the contemporary express agreement of a member before they can be flipped:

> A beneficial interest of that class in the fund cannot be replaced with a beneficial interest of another class in the fund, unless the person who holds the interest consents in writing to that replacement no more than 30 days before it occurs. (s. 29TC(1)(g))

In view of this amendment — assuming it is passed by both Houses of Parliament — the Commission no longer considers it is necessary to include the likelihood of flipping as a factor to be considered in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards. The practice of flipping people without their knowledge will be prohibited with regard to MySuper products.

While the Commission agrees that flipping is a highly undesirable practice, in seeking to prevent flipping it is not desirable to dissuade funds from offering members attractive discounted tailored MySuper products where an employer can negotiate a good long-term outcome for their employees. If funds are prevented from shifting people into higher fee divisions of funds, they have a diminished incentive to offer discounted fee divisions. To the extent this removes the incentive to offer 'loss leader' products with the intention of shifting members to much higher-cost products without their knowledge (leaving them significantly worse off in the long run than they would have been in other products), this is a desirable outcome.

However if, when an employee changes jobs, the fees they subsequently face are no higher than those applying for the standard product *and* the fees or other features remain comparable with other similar MySuper products, then this should not be considered a problem.

In response to the draft report, a number of participants agreed with the Commission on this point. For example, the Corporate Super Specialist Alliance said:

> Some minor fee differentials may occur if an employee leaves the employment of a firm that has negotiated discounts on behalf of their staff and that this is an acceptable practice if the exiting member reverts back to a fee that is no higher than the standard fee for the MySuper product. (sub. DR56, p. 3)

The Commission therefore considers that the Government should monitor whether the ban on flipping has the unintended consequence of discouraging discounting of MySuper products. In the event that it does, the Government should consider dealing with flipping in another way (for example, by permitting funds to shift members from one division of a fund to another upon their changing jobs provided the fees applying were no higher than those applying for the standard product *and* the fees or other features remained comparable with other similar MySuper products).

6 Other potential criteria

Key points

- As part of the process for selecting default products in modern awards, consideration should be given to the appropriateness of a fund's insurance offerings for employees who derive their default superannuation product in accordance with a given modern award. The extent to which a fund designs a range of insurance offerings under its default product, and the way these offerings are allocated to members, should be taken into account.
- However, no prescriptive criteria should be applied to insurance as a requirement for eligibility for selection in modern awards because:
  – the Commission found no systemic issues that are likely to remain that would require further prescriptive criteria after the implementation of the Stronger Super reforms
  – there is potential for any additional regulation to have unforseen and adverse consequences, due to the complex nature of insurance.
- Intra-fund advice improves the ability of members to make informed decisions about their superannuation. In the selection and ongoing assessment of superannuation products for listing as default products in modern awards, the adequacy of intra-fund advice should be considered.
- However, given that the Stronger Super and Future of Financial Advice reforms adequately address concerns about financial advice in superannuation, further prescriptive criteria should not be applied in this area.
- Where funds are 'connected' to a particular industry, there might be components of their products that are highly suited to employees in that industry. However, it is the appropriateness of those components, rather than industry connectedness per se, that should form part of the consideration for the selection and ongoing assessment of superannuation products for listing as default products in modern awards.
- Some employers and members face significant administrative costs in dealing with certain superannuation funds. The SuperStream reforms will address this issue to some degree. However, some differences between funds are expected to remain.
- Therefore, the selection and ongoing assessment of superannuation products for listing as default products in modern awards should include consideration of the administrative efficiency of the fund.

This chapter looks at potential criteria relating to insurance, financial advice, industry connectedness and administrative efficiency in the selection and ongoing assessment of superannuation products for listing as default products in modern awards. The Stronger Super and Future of Financial Advice (FOFA) reforms are taken into account in this assessment.

6.1 Insurance

Superannuation is a major distribution channel for insurance in Australia. Types of insurance currently offered with superannuation products include life, total and permanent disability (TPD), income protection and trauma insurance (box 6.1). Research suggests that more than 80 per cent of life and TPD insurance policies in Australia are held through individual superannuation accounts (AIST and IFF 2008).[1]

> Box 6.1 **Types of insurance offered with superannuation**
>
> **Life** insurance provides a benefit to beneficiaries of the policy holder in the event of the policy holder's death.
>
> **Total and permanent disability (TPD)** insurance provides a benefit to the policy holder in the event they suffer mental or physical injury and are permanently unable to return to their normal occupation as a result.
>
> **Income protection** insurance provides a benefit to the policy holder when they are temporarily unable to earn income due to illness or injury.
>
> **Trauma** insurance provides a lump sum benefit to the policy holder if they are diagnosed with an injury or illness covered by the policy. Under the Stronger Super reforms, trauma insurance can no longer be offered with superannuation products.

There is currently a requirement under section 32C of the *Superannuation Guarantee (Administration) Act 1992* (Cwlth) for default funds to offer, as a minimum, a level of life insurance that is defined in terms of a premium of $0.50 per week, or a level of cover that is dependent on the member's age.

Funds generally set a higher level of life insurance than the legislated minimum in their default products. In addition to life insurance, members are typically allocated a default level of TPD insurance on joining a superannuation fund. They can usually opt out or vary the level of insurance if they wish. Underwriting procedures for members wishing to increase their cover vary by fund.

[1] Pension systems in other countries, such as New Zealand, do not include insurance (appendix B).

There are two arguments commonly made for bundling insurance with superannuation products. First, the sole purpose test, provided under section 62 of the *Superannuation Industry (Supervision) Act 1993* (Cwlth) (SIS Act), requires that the sole purpose of a superannuation fund is to provide financial benefits when members retire, become disabled and are unable to work, or die. Second, obtaining insurance through superannuation can provide members with a range of benefits, including:

- lower premiums (the financial cost to members of the cover they receive) than those in the retail insurance market as a result of wholesale insurance contracts
- premiums being paid from pre-tax contributions
- automatic acceptance.

Insurance differs across several dimensions, including:

- the types of insurance on offer (such as life, TPD and income protection)
- default levels of cover
- maximum levels of cover
- ability to opt in or out
- automatic acceptance levels
- waiting periods
- continuity of insurance between jobs
- other terms and conditions.

Superannuation funds may vary insurance terms and conditions between groups of members within the same default product, depending on their circumstances. For example, a fund may differentiate offerings based on occupation, with a higher level of cover for members in a white collar industry, and a lower level of cover for members in a blue collar industry at the same premium, reflecting different occupational risks (box 6.2). Funds may also differentiate offerings between workplaces, or according to age and other demographic factors. However, the terms of the group insurance contract, as negotiated between the fund and the insurer, may restrict the fund's ability to vary the terms between groups of members.

Box 6.2 Variation in insurance across superannuation funds

All default superannuation funds are currently required to offer life insurance under section 32C of the *Superannuation Guarantee (Administration) Act 1992* (Cwlth). Some offer income protection cover as well. A small number of funds offer trauma insurance, although this will be prohibited by the Stronger Super reforms.

Most funds allocate a default level of life and total and permanent disability insurance, which typically varies with age. The level of cover usually rises until members reach their 30s, then declines to a small amount of cover at retirement age.

Some funds offer one insurance schedule for 'blue collar' employees, and another for 'white collar' employees with the latter having higher levels of cover for the same premium. This recognises the increased risks of injury faced by employees in blue collar industries. Members are sometimes allocated to the blue collar schedule initially, but may change to the white collar schedule on application if they are eligible.

Some funds also differentiate premiums and levels of cover based on other factors, such as the member's gender and whether or not they smoke.

Members allocated to a fund through their employer's default arrangements are usually allowed to cancel or increase their insurance on joining without having to provide health information or undergo medical examination, within automatic acceptance limits. These limits vary between funds.

In many policies, members can also increase their cover when significant life events occur, such as getting married or having a child. The life events which allow a change in cover vary between policies.

If a member wishes to increase their cover at other times, they will usually be required to provide evidence about their health. The exact requirements will ordinarily be determined by the fund's insurance provider. Industry funds generally acquire insurance through large insurers, although retail funds might be able to acquire insurance through a related party.

Other policy conditions, such as exclusions for certain events, also vary between funds, as does the treatment of members when employer contributions are no longer being made on their behalf (box 8.6).

Stronger Super reforms

The Cooper Review argued that the provision of life and TPD cover aligns with the purpose of superannuation (that is, to provide members with benefits when they no longer work) and recommended that, in addition to life insurance, funds should be required to offer a default level of TPD insurance. Income protection was considered to be less clearly linked to the purpose of superannuation. Other types of insurance were considered insufficiently linked to the purpose of superannuation. As a result, the Stronger Super reforms:

- require that life and TPD cover must be included with MySuper products on an opt-out basis
- allow for income protection insurance to be included on an opt-out or opt-in basis, or not at all in MySuper products
- require that no types of insurance other than life, TPD and income protection are paid for by members through their superannuation in MySuper products.

Funds are currently afforded flexibility to differentiate insurance offerings within MySuper products between different groups of members. The Stronger Super reforms leave this flexibility intact, with two exceptions. First, funds will be required to provide all members with life and TPD cover on an opt-out basis. Second, where a MySuper product offers income protection insurance, it must be offered to all members of the product. Aside from these changes, the ability of funds to differentiate insurance offerings in MySuper products between different groups of members is not diminished under the Stronger Super reforms.

The Cooper Review also recommended that trustees should exercise the same level of care in making decisions about insurance as they should in making investment decisions. As a result, the Stronger Super reforms impose a duty on trustees of MySuper products to manage insurance in the best interests of members and to devise and implement an insurance strategy. The strategy is required to address:

- the kinds of insurance offered to members
- the levels of cover offered to members
- the basis for the decision to offer those kinds and levels of insurance, having regard to the demographic composition of the fund
- the method by which insurers are determined.

Further, prudential standards will require funds to have in place an insurance management framework. This framework includes:

- the insurance strategy

- policies relating to:
  - member insurance premiums
  - underwriting
  - claims assessment
  - the management of declined applications for insurance, applications resulting in reduced cover or restrictions, terminations of cover and requests for reinstatement
- clearly defined roles and responsibilities for the oversight of the framework
- a process to review the appropriateness and effectiveness of the framework.

The Cooper Review considered that the current level of information disclosure for insurance in superannuation products is poor and, as a result, members face considerable difficulty in comparing and contrasting options. To address this issue, the Review recommended that trustees of large funds regulated by the Australian Prudential Regulation Authority (APRA) should be required to publish on their websites the terms and conditions applicable to each type of insurance offered, with a plain English explanation of the terms and conditions, and detailed premium tables. This recommendation is expected to be implemented in an upcoming tranche of legislation.

The Review also recommended that success rates for TPD claims be made publicly available. However, this is not expected to be implemented, as the Government's consultation process identified concerns that this might lead to adverse selection issues (Australian Government 2011b).

In examining the issue of funds providing 'in-house' insurance, the Review found that the savings associated with this practice were not large enough to justify the additional risk which would ultimately be borne by members. The Stronger Super reforms address this issue by mandating that self-insurance of any fund benefits should not be permitted in APRA-regulated funds except in the case of defined benefit funds that are currently allowed to self-insure.

Another issue investigated by the Cooper Review was the inconsistency between benefits paid under insurance policies in superannuation, and the conditions for release of benefits to members under the SIS Act. These inconsistencies have resulted in some members being unable to access a benefit paid from an insurance policy (particularly TPD) until another condition of release (such as reaching the retirement age) was reached. This has been addressed through Stronger Super by aligning the insurance definitions with the conditions of release.

Under the Stronger Super reforms, premiums and other costs of providing insurance to members of MySuper products can be charged to members through an insurance fee. Insurance fees are limited to cost recovery.

Scope for additional criteria

Participants' views

The main concerns regarding insurance raised by inquiry participants relate to the appropriateness of insurance offerings for the demographic profile of employees associated with a particular modern award.

Most inquiry participants agreed that a fund's insurance offering should be appropriate for members' needs. Many also considered that insurance offerings should be tailored to the employees who derive their default superannuation product in accordance with a modern award — rather than just the members of a fund — in order for a fund to be listed as a default fund in that award (ACTU, sub. 29; AIST, sub. 20; AiGroup, sub. 25; Australian Hotels Association, sub. 10; Corporate Super Association, sub. 14; CPA Australia, sub. 39; CSSA, sub. 35; legalsuper, sub. 19; NGS Super, sub. 18). For example, the Industry Super Network argued that:

> MySuper will require trustees to develop and maintain an insurance strategy. Consistent with the wider duty upon the trustees to act in the financial interests of the fund beneficiaries, this strategy should be appropriate for the fund demographic. However, it may not be appropriate for the demographic of the relevant award. This duty should be extended and tested to ensure the product's associated default insurance offering is appropriate. (sub. 27, p. 5)

However, the Financial Services Council noted that the Stronger Super reforms allow funds the flexibility to meet the insurance needs of diverse groups of members, submitting that:

> Under the MySuper framework, a default fund provider will be allowed to tailor the insurance arrangements of any workplace. [In this way, the Stronger Super reforms] recognise the need for default funds to tailor the insurance arrangements according to the demographics of members of that fund, including occupation, age etc. Therefore, the [Financial Services Council] submits that if a default fund meets the legal requirements to hold a MySuper license then no additional requirements should be necessary to be able to qualify for inclusion as a default fund in an award. (sub. 30, pp. 20–2)

The Commission's view

The Commission recognises that insurance is currently a major feature of superannuation, and considers that funds which are seeking to have a product listed in modern awards should be assessed on their ability to offer appropriate insurance.

Employees in different occupations face different risks, and thus require different types of insurance. The more that insurance can be tailored to a member's circumstances, the better will be the outcome for that member. Given that employees within some industries might have unique insurance needs that relate to the level of risk inherent in their occupation, there is likely to be merit in considering insurance on an award-by-award basis.

Superannuation funds are able to vary their insurance offerings in order to meet the potentially diverse needs of industries, workplaces and employees who derive their default superannuation product in accordance with modern awards. The range of insurance offerings within a default product, and the extent to which that range is able to meet the needs of members allocated to that product, should form part of the evaluation when selecting products to be listed in modern awards.

The Commission recognises that the Stronger Super reforms already impose a duty on trustees to manage insurance solely for the benefit of members which, in conjunction with insurance strategies that funds are required to implement, implies that each product will optimise insurance offerings for the product's demographic. The Commission considers that the selection and ongoing assessment of superannuation products for listing in modern awards should go one step further, and ensure that the insurance offerings are appropriate for employees who derive their default superannuation product in accordance with the modern award. The Commission recognises that there will be challenges in gathering adequate data to understand the characteristics of these employees (chapter 9), but, notwithstanding this, an assessment of the appropriateness of a MySuper product's insurance offerings should be given consideration among a range of factors.

Although the Commission believes that the assessment of products to be listed in modern awards should consider the appropriateness of insurance, the Commission sees no case for additional prescriptive criteria to be applied to insurance in default superannuation products for two reasons.

First, as mentioned above, the Stronger Super reforms will effectively require that each fund optimise insurance offerings for its membership base. As a result, it is expected that insurance offerings in default products will be appropriate for members, without the need for additional regulation. Inquiry participants identified no further systemic issues that are likely to remain after the implementation of the Stronger Super reforms that require further intervention.

Second, insurance is a very complex product. If additional regulation is introduced regarding insurance, it could adversely affect other components in unforseen ways. For example, setting an upper limit on premiums might cause funds to reduce some of the costlier components from their offerings, such as automatic acceptance levels. This might increase underwriting expenses and ultimately increase costs to members.

RECOMMENDATION 6.1

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the appropriateness of the MySuper product's insurance offerings for employees who derive their default superannuation product in accordance with a given modern award.

Much of the information that funds would require to demonstrate the appropriateness of their insurance offerings would likely be contained in their insurance management framework (including the insurance strategy) and any contracts between the fund and their insurers.

6.2 Financial advice and member education

Financial advice is commonly made available to superannuation fund members. The advice is typically provided by an employee of the fund or by a wholly owned subsidiary of the fund and can include:

- intra-fund advice
- advice relating to a member's financial situation more broadly.

Intra-fund advice relates to a member's existing interest in the fund and products offered by the fund. It is typically delivered over the phone, but it is sometimes provided through other channels such as seminars presented at member workplaces. The provision of such advice must comply with the sole purpose test of section 62 of the SIS Act.

Advice to members is regulated by the Australian Securities and Investments Commission (ASIC). In 2011, ASIC conducted a study of retirement income advice. It found that of 64 advice examples, only 2 were rated as good, with the remainder considered either adequate (37) or poor (24). Examples graded as poor (accounting for more than one third of the total) represented a breach of the

Corporations Act 2001 (Cwlth). A significant determinant of this result was the conflicted remuneration structure of advisers (ASIC 2012b).

The Independent Financial Advisers Association of Australia found that, of more than 18 000 financial advisers in Australia, only 9 met the definition of independence contained in the Corporations Act (SuperGuide 2012). The incentives faced by advisers in the form of commissions and other conflicted remuneration structures, combined with a lack of independence in the industry, can affect the current quality of financial advice. These issues formed the focus of the FOFA reforms (discussed below).

Stronger Super and Future of Financial Advice reforms

The Cooper Review considered that intra-fund advice is an important tool to assist members in making decisions about their superannuation, and should be proactively provided as part of superannuation products. However, it raised concerns about broader financial advice being bundled with superannuation products.

> By bundling the cost of advice into the price of the product, and by having that cost incurred on an ongoing basis, members do not appreciate the true cost of the advice and may pay much more for the advice than it is worth. Also, members' choices in this regard are limited; they generally cannot opt-out. (Australian Government 2010b, p. 18)

To address these concerns, the Stronger Super legislation requires that:

- trustees do not charge across the membership of the fund for providing personal financial advice (other than intra-fund advice), or for any financial advice on an ongoing basis
- the cost of advice or services provided to employers may not be recovered through a fee charged to any member of the fund.[2]

However, the Cooper Review considered that the provision of financial advice to members through superannuation products helps to ensure that advice remains accessible to those who cannot afford to pay for it from other sources. As a result, the ability to opt into financial advice broader than intra-fund advice on a user-pays basis was supported, and an accompanying recommendation was made that such arrangements should lapse unless expressly renewed by the member.

[2] In the Government's consultation process, however, it was noted that this restriction should not extend to services that assist employers to interact efficiently with the superannuation fund (such as clearing house services) or to services that are designed to educate or benefit members or potential members. These exemptions are yet to be reflected in legislation.

The Stronger Super reforms allow funds to charge members for the costs of providing intra-fund advice through an administration fee. Funds may also charge an advice fee to members that receive broader financial advice.

Additional concerns were raised about commissions for financial advice, and the Review recommended that MySuper products be banned from:

- paying or funding any product-based up-front or trailing commission or other similar payment
- making or funding any payment that relates to volume
- paying premiums for insured member benefits that include or fund an up-front or trailing commission or like payment.

These recommendations are expected to be addressed through the FOFA reforms (chapter 5) which are focused on improving the quality of advice and enhancing retail investor protection. Key measures of the reforms include:

- a prospective ban on conflicted remuneration structures such as commissions and volume-based payments
- a duty requiring advisers to act in the best interests of clients when giving personal financial advice.

Scope for additional criteria

Participants' views

Inquiry participants acknowledged the importance of financial advice to superannuation fund members. For example, REST Industry Super noted that financial advice can help members 'get on the right path at an early stage in life' (sub. 47, p. 18).

While some participants singled out the importance of the availability and quality of intra-fund advice (ISN, sub. DR62), others considered both intra-fund advice and broader financial advice to be important components of a superannuation product (Association of Financial Advisers, trans., p. 136; Rural and Regional Promotions Pty Ltd, sub. DR86). For example, the Australian Institute of Superannuation Trustees submitted that:

> Advice and education services beyond intra-fund advice should also be considered. For example, the existing range and distribution of member financial education services (e.g. seminars and member information), and the ability to access appropriate fee-for-service financial advice should also be taken into account in assessing the quality of advice. (sub. DR69, p. 13)

Strong support for member education programs was presented by Suncorp (sub. DR64), contending that such programs:

- can be delivered at minimal cost
- increase brand loyalty and retention rates, providing funds with commercial benefits
- generate higher levels of member engagement.

The Corporate Superannuation Specialist Alliance added that:

> … the proactive delivery of education to employees is critical to achieving the Government's desired outcome of improving financial literacy and ultimately people's financial independence. Often education and advice provided in the workplace is the only exposure individuals have to proactive financial education. (sub. DR56, p. 4)

On the other hand, the South Australian Wine Industry Association identified that the objectives of increased financial literacy and independence could be achieved through a Government-funded education program delivered to employees (sub. DR71).

The Commission's view

In considering whether the imposition of additional criteria relating to financial advice would be appropriate, the Commission assessed intra-fund advice and broader advice as two separate components.

Intra-fund advice

Equipping individuals to make well-informed decisions about their superannuation, and subsequently increasing member engagement, might improve outcomes for members and for the superannuation system as a whole (chapter 3). The provision of sound intra-fund advice can improve the ability of members to make such decisions.

The Cooper Review identified several shortcomings relating to financial advice in the current superannuation system. The Stronger Super and FOFA reforms aim to address these shortcomings and many other long-running issues relating to financial advice, and should encourage greater independence of such advice in future. In turn, this is expected to improve the value of intra-fund advice to superannuation members.

Therefore, it is the Commission's view that the quality of intra-fund advice should be a factor for consideration when choosing default funds. Such advice can help members to make decisions that improve their financial wellbeing. Also, as the information required to deliver such advice is held by the fund, the fund is best placed to deliver the advice. Although the per-member costs of intra-fund advice are expected to rise under the Stronger Super reforms (Rice Warner 2012), the benefits of such advice remain important. Hence, the quality of intra-fund advice should be considered when selecting products for listing as default products in modern awards.

RECOMMENDATION 6.2

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the quality of intra-fund advice.

The Commission could not identify, nor was it made aware of, any systemic issues relating to intra-fund advice that are likely to remain after the implementation of the Stronger Super and FOFA reforms. Therefore, the Commission sees no case for further prescriptive criteria to be applied in this area.

Broader advice services

The Commission cautions against mandating the bundling of additional components with superannuation products unnecessarily. The bundling of multiple components (such as investment management services, insurance and financial advice) into a single product (such as a superannuation product) can reduce competition within an industry (Kobayashi 2005). This in turn can lead to outcomes that are not in the best interests of members (chapter 3). Although superannuation is currently a major distribution channel for life insurance, and intra-fund advice is a vital component of superannuation products, the link between superannuation and broader advice services is less clear.

Advice relating to a member's broader financial circumstances will usually incorporate a more comprehensive set of information that may include superannuation interests as one of many components. The advantages of having a superannuation fund provide this advice is consequently diminished in comparison with intra-fund advice. Furthermore, there is an established market for such advice, and individuals do not usually face any significant barriers to accessing the advice. Therefore, it is the Commission's view that the availability and quality of advice other than intra-fund advice should not be a mandatory consideration for selecting and assessing products for listing as default products in modern awards.

However, the Commission does not wish to prevent funds from providing access to such advice if they wish to do so. Where funds believe that there is demand for such services among their membership, they could provide access to the advice for members who wish to opt-in on a fee-for-service basis (consistent with the Cooper Review findings).

6.3 Industry connectedness

There are currently some funds that tailor their superannuation products to employees in particular industries (for example, Cbus, HOSTPLUS, legalsuper and REST Industry Super). Some inquiry participants contended that where funds are 'connected' to a particular industry, the fund is better equipped to meet the needs of employees in that industry than are other funds. The Commission therefore considered whether any additional criteria around industry connectedness would be appropriate in the selection and ongoing assessment of products for listing as default products in modern awards.

Scope for additional criteria

Participants' views

Many inquiry participants considered that the default fund selection process should require applicant funds to demonstrate an understanding of, and relevance to, a particular industry. Cbus submitted that:

> … the application of criteria which value industry knowledge and experience … is important because it will assist funds to develop a service approach and product development which will increase the net benefit to members. (sub. 15, p. 10)

legalsuper noted that:

> Members of specific occupational industries have common superannuation needs that are very different to members of other occupational industry groups. This enables specialised funds to provide products and services specifically designed for them, and to provide tailored products and services not available through funds with a more diverse membership profile. (sub. 19, p. 2)

The Accommodation Association of Australia (sub. 28), Ai Group (sub. DR79), HOSTPLUS (sub. 8), Restaurant and Catering (sub. DR43), the State Public Services Federation Group of the CPSU (sub. 16), the Transport Industry Superannuation Fund (sub. DR91) and Unions NSW (sub. 13) made similar comments, while the Master Plumbers and Mechanical Services Association of

Australia emphasised that its members should be able to 'identify [a default fund] as being relevant to their business and industry' (sub. 33, p. 1).

United Voice further argued that only industry funds were able to achieve the benefits related to industry association.

> The industry-based model also allows funds to tailor products and services, such as insurance offerings, to meet the needs of their particular industry, occupational grouping or demographic. Moreover, the industry model also allows for a more effective compliance process, with relevant employer associations and unions working with their industry fund to provide information (consistent with privacy laws) to help chase up arrears. Without that industry connection (and with the threat of employers being able to opt-out of default funds if they were chased for arrears) it would be much more difficult for funds to ensure compliance. (sub. DR88, p. 13)

The Commission's view

Where funds are 'connected' to a particular industry, there might be components of their products that are highly suited to employees in that industry. However, it is the appropriateness of those components, rather than industry connectedness per se, that should form part of the consideration for the selection and ongoing assessment of superannuation products for listing as default products in modern awards. This has been recognised in the listing in modern awards of some funds that draw their membership from a variety of industries. For example, AustralianSuper is listed as a default fund in 69 modern awards that cover a diverse range of industries from alpine resorts to corrections and detention.

Therefore, it is the Commission's view that although a fund may have a close understanding of a particular industry through direct association, explicit consideration of this association is unnecessary in the selection and ongoing assessment of products for listing as default products in modern awards.

6.4 Administrative efficiency

Employers and members face costs in interacting with superannuation funds (chapter 2). Employers administer employee contributions, and failure to do so can lead to fines. Employers incur costs in the form of time and resources spent selecting default funds, administering contributions and otherwise acting on behalf of their employees. A survey conducted for the Australian Taxation Office found that administrative efficiency was a significant factor in determining an employer's choice of, and level of satisfaction or dissatisfaction with, a default fund (Colmar Brunton 2010a). Members and beneficiaries incur time and transaction costs when obtaining advice or account information, selecting product options, making claims on insurance policies or arranging to receive benefits on retirement.

Funds can take actions to reduce these costs for their stakeholders. Administrative efficiency is important to improve outcomes for stakeholders, and to minimise total costs in the superannuation system.

The limited choice of default funds in some awards (chapter 2) can restrict employers' abilities to choose administratively efficient funds that minimise the costs they face. This in turn can reduce the incentives that funds face to provide good service to employers (chapter 3).

Small and medium employers might be more adversely affected by administrative inefficiencies than large employers for two reasons:

- Clearing houses are available to larger employers, but smaller employers are unlikely to want to incur the cost of, and might be too small to be able to secure, the services of a clearing house.
  - Small employers have access to the Small Business Superannuation Clearing House, which may simplify their superannuation guarantee obligations. However, the service excludes medium-size employers with 20 or more employees. Furthermore, according to the Australian National Audit Office, take up has been low and it is less efficient than private sector clearing houses (ANAO 2012). At a recent meeting of the Superannuation Roundtable, a proposal to better promote the service was agreed to (Shorten 2012e).
- Without the resources to choose a default superannuation fund through an enterprise bargaining agreement, smaller employers are more likely to rely on provisions contained in awards (ABS 2011b).

Stronger Super reforms

The Cooper Review outlined many recommendations that together establish the SuperStream administrative reforms. In general, the recommendations promote the use of electronic commerce, standardised forms and member tax file numbers to:

- improve the quality and speed at which transactions are processed
- standardise the interactions between employers and funds
- consolidate lost accounts.

The *Superannuation Legislation Amendment (Stronger Super) Act 2012* sets out the framework to implement the data and payment regulations and standards that form the basis of the SuperStream reforms. A SuperStream working group was established to guide the development of standards and procedures to be included in the reforms (Australian Government nd). The SuperStream Advisory Council will take over the role of providing advice to Government from the working group and will also consult stakeholders on these matters (Shorten 2012g).

Scope for additional criteria

Participants' views

Some participants to this inquiry noted the burden that superannuation can impose on employers (AJ and BJ Smith, sub. DR65; Business SA, sub. DR55; Electrical Contractors Association, sub. 17; FSC, sub. 30; ISN, sub. 27; MLC Ltd−NAB Wealth, sub. 44; REST Industry Super, sub. 47; South Australian Wine Industry Association, sub. DR71; United Voice, sub. DR88). As a result, administrative efficiency is identified as a major consideration of employers when choosing between funds (ACCI, sub. DR83; AIST, sub. DR69; CSSA, sub. DR56; ISN, sub. DR62).

Some participants expressed concern about the administrative efficiency of some funds, particularly in modern awards where there are few funds listed and hence few alternatives for employers to choose from. For example, the Council of Small Business Organisations of Australia noted that:

> Due to the placement of a fund in an industrial award or instrument there is no motivation for a fund to be efficient in dealings with employers … employers cannot change to a different, more employer friendly fund, as the choice of fund (other than those mandated in the award) is not one that we can make. We also have no room for complaint as these organisations are outside the public service and there is no capacity for APRA or ASIC to demand they become more efficient. (sub. 7, p. 5)

The Financial Services Council added that:

> In some cases, the service provider (super fund) can be inefficient or generally provide a poor quality of service to the employer … Employers who are unhappy with their default fund are then only able to contract out of that relationship by instituting an enterprise agreement at significant cost. (sub. DR80, p. 11)

Further, the Australian Chamber of Commerce and Industry pointed out that, due to the difficulties faced by some employers in changing funds 'nomination as a "fund" in awards reduces the need for the fund to address service efficiency' (sub. DR83, p. 3).

Other participants maintained that the SuperStream reforms make any consideration of administrative efficiency redundant (AustralianSuper, sub. DR74). For example, the Industry Super Network considered that it is ‘more appropriate to have such matters dealt with as part of the Stronger Super, SuperStream and small business clearing house initiatives’ (sub. DR62, p. 9). This sentiment was supported by AMP, which noted that ‘the administrative efficiency of a fund will largely be standardised through the implementation of the SuperStream reforms’ (sub. DR85, p. 5).

The Association of Superannuation Funds of Australia went further, submitting that competitive pressures already provide enough incentive for funds to provide a seamless experience for employers, and that the Small Business Superannuation Clearing House also helps to solve issues of administrative efficiency. It also cautioned against the creation of administrative efficiency benchmarks that might require funds to accommodate the inefficient practices of some employers (sub. DR75).

The Commission’s view

The SuperStream reforms are expected to improve the general administrative efficiency of the superannuation industry in the long run. However, the reforms do not improve the incentives for funds to efficiently interact with members and employers, particularly small- and medium-sized employers. Consequently, there might be areas of the fund’s business that fall outside the scope of the SuperStream reforms that affect the ease with which members and employers may interact with funds. For example, the quality and accessibility of call centres may still vary between funds, impacting on the experience of stakeholders.

The administrative efficiency of a fund will directly flow through to the costs incurred by employers, potentially impacting on the level of compliance with their superannuation guarantee obligations, as well as on the profitability of the business. The effect on businesses can, in turn, impact on employees. The administrative efficiency of a fund will also flow through directly to employees, in terms of the ease with which they can access details of their account, switch between products and options, make voluntary contributions and receive benefits.

Given the importance of these factors to members and employers, the Commission considers that there is a case for funds applying to have a default product listed in modern awards to be assessed on the administrative experience of members and employers in dealing with the fund. Relevant procedures, such as whether the fund has an appropriate contributions arrears policy and process, could also be considered as part of the assessment. Fund-level information — such as service standards, member- and employer-satisfaction surveys or other qualitative and quantitative information — could assist in this assessment.

RECOMMENDATION 6.3

The selection and ongoing assessment of default superannuation products for listing in modern awards should include consideration of the administrative efficiency of the fund.

It is the Commission's view that explicit administrative efficiency benchmarks should not be set. There would be significant costs involved with this approach, including tasking an organisation or group of experts to determine the benchmarks, and imposing reporting requirements on funds. Also, since the SuperStream reforms are already expected to improve the administrative practices of funds to some degree, it is not clear that the additional benefits would outweigh these costs. Further, a qualitative understanding of employer and member experience and satisfaction might not be gained through a comparison that is based on quantitative benchmarks.

7 Performance of the default superannuation fund selection system

Key points

- In preceding chapters, the Commission recommends seven factors that should be taken into consideration in the selection and ongoing assessment of default superannuation products and funds for listing in modern awards. A selection system is needed within which this consideration can take place.
- This chapter assesses the performance of the current system for selecting default funds, as evaluated against a set of principles for a well-designed system. As a first principle, the system should give primacy to the best interests of employees who derive their default superannuation product in accordance with modern awards.
  - It should also be contestable, transparent, consistent with other relevant policies, procedurally fair and include an ongoing assessment of listed default products.
  - It should not impose an undue burden on any party, or destabilise the superannuation market.
- While the current default system has delivered stability and partial transparency and has led to the listing of default funds which have delivered relatively strong average returns when compared to the net returns of non-default funds, it falls short of meeting other principles of a well-designed default system.
  - It is based primarily on precedent and the consent of industrial parties. As such, it is not fully contestable and therefore may not include funds which could better serve the interests of employees who derive their default superannuation fund in accordance with modern awards, thus forgoing potential benefits of competition.
  - It does not provide for full procedural fairness, with some funds unable to have their case for listing as a default fund heard by an unbiased decision maker.
  - There is no requirement for an ongoing assessment of the list of funds in awards, and no established process for removing a listed default fund, even where there are serious concerns about governance or underperformance.
- The absence of a more open and transparent selection system has reduced the competitive pressures on incumbent default funds. In some cases this has resulted in inefficiencies (including unnecessary burdens on employers, who sometimes have no choice but to use a listed default fund for some or all of their employees).
- Around 10 per cent of awards do not list a default fund. There is insufficient evidence to indicate whether employees or employers operating in these industries have been affected by the absence of a default fund, or the direction of any effect.

In chapters 4 to 6, the Commission evaluated a number of potential criteria that could be used in the selection and ongoing assessment of superannuation products for listing as default products in modern awards. It did not identify the need for any prescriptive criteria beyond those required to be met for an Australian Prudential Regulation Authority (APRA) authorisation of a fund's MySuper product.

FINDING 7.1

There is no case for the selection and ongoing assessment of default superannuation products for listing in modern awards to involve any prescriptive criteria over and above those used by the Australian Prudential Regulation Authority in authorising MySuper products.

That said, while the Commission does not consider that there is a need for additional prescriptive criteria, there are seven factors that should be considered when a third party is selecting products to be listed in modern awards. This is for two main reasons.

- The Stronger Super and related reforms provide an effective foundation to promote disclosure and comparability of default superannuation products and funds but, given the uncertainty surrounding the likely number, mix and quality of MySuper products, there needs to be a 'quality filter' to distinguish among them.
- There is an administrative burden for employers in being required to choose from the potentially very large number of MySuper products.

For the most part (with the notable exception of the factor relating to a fund's administrative efficiency), the factors apply filters to the underlying MySuper criteria used by APRA. Therefore, to ensure the interests of employees who derive their default superannuation product in accordance with modern awards are the primary objective in selecting default products, and to minimise the administrative burden placed on employers, the Commission considers that the following factors should, as a minimum, be taken into consideration when assessing whether a MySuper product (or a default product offered by an exempt public sector superannuation scheme) should be listed as a default product in a modern award.

- The appropriateness of the MySuper product's long-term investment return target and risk profile for employees who derive their superannuation products in accordance with a given modern award (as a primary factor).
- The fund's expected ability to deliver on the MySuper product's long-term investment return target, given its risk profile (as a primary factor).

- The appropriateness of the fees and costs associated with the MySuper product, given:
  - its stated long-term investment return target and risk profile
  - the quality and timeliness of services provided.
- Whether governance practices are consistent with meeting the best interests of members, with particular focus on the mechanisms put in place by fund trustees to deal with conflicts of interest, and the transparency involved with disclosing those conflicts.
- The appropriateness of the MySuper product's insurance offerings for employees who derive their default superannuation product in accordance with a given modern award.
- The quality of intra-fund advice.
- The administrative efficiency of the fund.

Given that the overriding objective of the default selection system should be the best interests of employees who derive their default superannuation product in accordance with a modern award, the Commission considers that its proposed factors for consideration represent the most relevant factors that apply across all default products, while also taking into account the interests of employers.

In some specific cases, there may be other factors, in addition to the seven factors above, that are relevant to the needs of employees who derive their default superannuation product in accordance with a modern award. Where such factors are present, the decision maker should be permitted to take them into account.

The factors for consideration are of sufficient importance to the best interests of employees who derive their default superannuation product in accordance with a modern award that decision makers should be required by law to consider them. As such, they will need to be enshrined in legislation.

RECOMMENDATION 7.1

The factors for consideration should be enshrined in legislation. The legislation should also allow the decision maker to consider other factors that may be relevant, provided it clearly and publicly states its reasons for considering those factors.

Some of the factors for consideration are specific to each default product (such as fees, investment return objective and risk profile). As noted in previous chapters, funds will be able to offer tailored MySuper products for large employers and may, in some cases, be permitted to offer more than one MySuper product on a public-offer basis. The performance of each of these products against the product-specific factors for consideration could vary, perhaps substantially. Other factors for consideration (including administrative efficiency and governance processes) relate to the fund as a whole, or might, depending on the fund and its products, have to be considered on either a product or a fund basis (such as intra-fund advice).

It will therefore be important that:

- the characteristics of each product and of the fund are considered by the default decision maker
- both fund and product details are listed in awards (chapter 9).

Process for considering the factors

The process by which these factors are taken into consideration will be the ultimate determinant of whether the best interests of employees who derive their default superannuation fund in accordance with modern awards are met if their superannuation contributions are allocated to a default product fund under a modern award. Importantly, the factors are subjective rather than prescriptive. To properly consider them will require a decision maker to analyse a wide range of complex information and exercise considerable judgement (the identity of the decision maker is considered in chapter 8). Judgement will be required on such matters as:

- how to weight the importance of each factor
- whether to limit the assessment to those factors identified by the Commission, or whether there are circumstances that require consideration of other additional factors
- how to best assess and respond to the characteristics and needs of the employees covered by each award. This may be particularly important in awards that cover a large and diverse group of employees (chapter 2).

The importance of exercising judgement in the selection of default products was highlighted by the Actuaries Institute.

> Many of these issues require qualitative judgements and, as a result, we do not believe that the selection process can therefore be reduced to a mechanical sequence of decisions … it would therefore be preferable to simply codify the factors that should be considered.
>
> Of course, a key objective of the selection process should be to ensure that the default fund selected for an Award or agreement is appropriate for the needs of the employees under that Award or agreement. It should also be incumbent on those who determine the default fund to demonstrate that a suitable process has been followed. (sub. 45, p. 2)

The MySuper reforms will assist in this regard, by providing for improved information disclosure and clearer comparisons between the default products offered by different funds. Nevertheless, a decision maker (agent) still needs to make the same kinds of trade-offs and judgements that an informed individual (principal) would — by 'standing in the shoes' of that individual or group of individuals.

Judgements required of a decision maker include consideration of the factors identified by the Commission, their relative importance and the appropriate fit for employees who derive their default superannuation product in accordance with the relevant modern award. Given the need for a decision maker (at least in the medium term — see chapter 8), the Commission has also considered the extent to which the current system, and its decision makers, conform with relevant principles of good process.

Given the primary objective of the process is to meet the best interests of employees who derive their default superannuation product in accordance with modern awards, the Commission considers that the following principles should guide the assessment of the current process used to select default products. These same principles are used to assess the merits of reforms to the process (chapter 8).

RECOMMENDATION 7.2

The process used in the selection and ongoing assessment of superannuation products for listing as default products in modern awards should adhere to the following principles.

- ***Best interests — there is an explicit focus on meeting the best interests of employees who derive their default superannuation product in accordance with a modern award.***
- ***Contestability and competition — all default products have an equal opportunity to be assessed for listing in awards, and competition provides the incentive for the ongoing innovation, efficiency, performance and consumer focus of superannuation funds.***
- ***Transparency — relevant information is made publicly available and potential conflicts of interest are declared.***
- ***Procedural fairness — all parties have the right to put forward their case for consideration by an unbiased umpire.***
- ***Minimum regulatory burden — each party involved incurs the minimum cost and inconvenience compatible with achieving the aims of the process.***
- ***Market stability — the superannuation market is not destabilised.***

- ***Consistency with other policies** — alignment with other relevant policy directions, including the Stronger Super and Future of Financial Advice reforms.*
- ***Regular assessment** — all default products must earn their listing in an award on a regular basis.*

There was broad support from inquiry participants for these principles (including from Ai Group, sub. DR79; AMP, sub. DR85; Business SA, sub. DR55; Cbus, sub. DR81; FPA, sub. DR76; Suncorp, sub. DR64).

The Queensland Nurses' Union pointed out that trade-offs between the principles may be required.

> Some of the principles outlined in recommendation 7.1 for the selection and ongoing assessment for listing as default funds in modern awards may be contradictory. For example, promoting contestability could lead to increasing regulatory burden and instability of the broader superannuation system. (sub. DR61, p. 5)

The Commission acknowledges that different options for reform of the default superannuation selection system will meet each of these principles to a greater or lesser degree. To the extent that tradeoffs between the principles are required, these will be considered in assessing options for reform (chapter 8).

Following a description of the current process (section 7.1), these principles will be used to assess its performance (sections 7.2 to 7.9). The Commission's conclusions about the current process are set out in section 7.10.

7.1 The current fund selection process

Selecting default funds in modern awards

Modern awards were developed in 2008 and 2009, and came into effect on 1 January 2010 (see chapter 2 for more detail on award modernisation). Though most of the currently listed default funds obtained their listing during the award modernisation process, additional default funds have subsequently been added to many modern awards.

During award modernisation

The superannuation funds that were selected for listing in the initial drafts of modern awards were largely those that were already listed in award-based transitional instruments relevant to the coverage of the modern award. As discussed in chapter 2, due to the nature of the historical development of award superannuation, most funds that were listed in award-based transitional instruments were industry funds established and chosen by industrial parties.

In deciding which default funds to list in modern awards, the Australian Industrial Relations Commission (AIRC) considered that:

> … the nomination of default funds should be made on some readily ascertainable basis and one which does not lead to any disruption. For that reason it was decided to provide for named default funds as the primary basis. (2009a, p. 22)

Many, but not all, of the funds that were listed in previous instruments were listed as default funds in the corresponding modern award.

The financial outcomes for employees who derive their default superannuation fund in accordance with a modern award were not explicitly assessed by the AIRC.

> We do not think it is appropriate that the [AIRC] conduct an independent appraisal of the investment performance of particular funds. Performance will vary from time to time and even long term historical averages may not be a reliable indicator of future performance. We are prepared to accept a fund or funds agreed by the parties, provided of course that the fund meets the relevant legislative requirements. (2008b, p. 6)

Following the publication of the draft modern awards, superannuation funds and industrial parties made 74 applications to list additional funds as default funds on the basis that:

- the fund was nominated as a default fund in an award-based transitional instrument relevant to the coverage of the modern award, or
- the representatives of the main parties covered by the award consented to the inclusion of the fund.

The AIRC approved 67 of these applications and considered that ‘either basis would constitute a good reason for the fund being specified as a default fund in a modern award’ (AIRC 2009a, pp. 22–3).

In accepting a fund or funds recommended by the parties, the AIRC was not required by the *Fair Work Act 2009* (Cwlth) to ensure that the parties had considered the relative merits of competing funds, or that they had necessarily proposed funds that would best meet the interests of employees who derive their default superannuation fund in accordance with the relevant modern award.

Since the commencement of modern awards

Once modern awards commenced on 1 January 2010, the process by which an additional default superannuation fund is listed in a modern award is for a person or organisation (who is generally required to have standing — see below) to make an application to Fair Work Australia (FWA) under the Fair Work Act to vary the award, and for that application to be granted.

When a variation application is made, all subscribers to the electronic mailing list for the relevant award are notified of the application. The application is posted on the FWA website and submissions in response to the application are invited. Anyone may make a submission (as opposed to a variation application), though FWA may decide how much weight to place on each submission. FWA can hold a hearing before deciding whether the application will be granted, but is under no obligation to do so, particularly where the application is not controversial.

Between January 2010 and August 2012, 30 applications were made to vary the superannuation provisions of a modern award. A hearing was held for 22 of these applications. Over 70 per cent of the applications made during this period were successful.

Standing

An applicant is generally required to have standing to make an award variation application, though FWA has the power to consider an application and vary the award on its own initiative in some circumstances. An applicant will have standing if they are:

- an employee, employer or ‘organisation’ covered by the award, or
- an ‘organisation’ entitled to represent the industrial interests of an employer or employee covered by the award. An ‘organisation’ is an employer or employee representative body registered under the *Fair Work (Registered Organisations) Act 2009* (Cwlth).

Parties without standing (such as superannuation funds) must find a party with standing who is willing to bring the application, or rely on FWA exercising its discretion to vary the award on its own initiative. To date, there has only been one case brought under the Fair Work Act in which standing was explicitly considered (box 7.1). This case did not definitively establish the principles by which standing will be granted or by which FWA will exercise its own initiative power.

Box 7.1 **AMP application for inclusion as a default fund**

In March 2010, AMP applied to Fair Work Australia (FWA) to vary the Professional Employees Award 2010. AMP's application was supported by the Australian Information Industry Association (which is not a registered organisation and did not take part in industrial negotiations). However, the application was opposed by the Australian Industry Group and the Association of Professional Engineers, Scientists and Managers Australia (both registered organisations that were parties to the relevant pre-modern awards, and were involved in the negotiations that led to the development of the Professional Employees Award 2010). AMP was not listed as a default fund in any relevant pre-modern award or award-based transitional instrument that preceded the Professional Employees Award. (It is separately listed in other modern awards through historical precedent.)

FWA dismissed the application on the grounds that AMP did not have standing. FWA chose not to exercise its power to vary the award on its own initiative, "as it is clear that to include AMP Life Ltd would not be consistent with the approach taken in establishing default funds in modern awards." (2010a, p. 2)

Source: FWA (2010a).

Grounds

In decisions issued to date there have been three grounds on which variation applications have been granted. The first is whether the fund was listed in a pre-modern instrument, such as a pre-modern federal award or a notional agreement preserving a state award, relevant to the modern award's coverage. A pre-modern instrument will be relevant if it covered employees who are now covered by the modern award (FWA 2010f). The pre-modern instrument will not be relevant if the employees for whom the contributions were being made are now covered by a different modern award (FWA 2010c).

The second ground is whether the representatives of the main parties covered by the award consent to the fund's inclusion. Since the focus is on the main parties to the award, consent does not need to be unanimous (FWA 2010d).

The third ground is whether employers were making contributions to the fund before 12 September 2008 for the benefit of employees who are now covered by the modern award (FWA 2010c, 2010e).

When making a decision, FWA is not limited by the laws of precedent or by the grounds in the application — it is free to make a decision based on other grounds.

In addition to the three grounds, if funds that are listed in the award merge or change names, they can apply to have this change reflected in the award (table 7.1).

Table 7.1 **Grounds used in applications made under the Fair Work Act to vary the superannuation provisions of a modern award[a]**
January 2010–August 2012

Ground	*Number*
Fund was included in a relevant pre-modern instrument	14
Consent of industrial parties	4
Contributions are already being made to the fund on behalf of employees covered by the award (as at 12 September 2008)	11
Fund merger or name change	9
Other grounds	16

a Includes variation applications and applications brought in the 2012 Modern Award Review. Some applications have not yet been determined. Applications may be brought on more than one ground. FWA may base its decision on other grounds.

Source: Productivity Commission estimates.

Review

FWA is currently conducting an interim review of modern awards, and is required to review modern awards every four years. It could potentially include superannuation provisions in those reviews. Outside the four-yearly award reviews, funds remain listed in awards unless industrial parties bring the matter of their ongoing inclusion to the attention of FWA. This means that there is:

- no regular process for assessing whether the default funds listed in modern awards are acting in the best interests of employees who derive their default superannuation fund in accordance with the modern award
- no established procedure for the removal of a default fund from an award. This is the case even when:
  - a listed default fund is delivering verifiably inferior outcomes for its members
  - serious concerns about the governance of a listed default fund are raised
  - a listed default fund has merged, been taken over or otherwise ceases to exist (16 of the 103 funds currently listed in modern awards are no longer active)
  - a listed default fund fails to meet legislative and regulatory requirements.

Though rarely used in relation to superannuation, FWA has the power to vary modern awards on its own initiative, meaning that a listed fund could be removed at any time if it became demonstrably unsuitable for listing.

Exceptions to the general award default arrangements

Awards without a default fund

While the processes for selecting default superannuation funds described above apply in most awards, there are exceptions. In particular, 13 of the 122 modern awards do not list any default superannuation funds. These awards cover a wide range of industries, from fire fighting to labour market services to various types of mining and maritime services.

Just as the inclusion of default funds in modern awards is largely a matter of history and precedent, the absence of a default fund in 13 modern awards is also due to historical factors. The AIRC and/or industrial parties chose not to include default funds in these awards because there were no default funds listed in the relevant pre-modern instruments (see, for example, AIRC 2009b).

Where awards do not list a default superannuation fund, employers are free to choose any complying fund as a default fund. There is little evidence about how these employers approach the task of selecting a default fund, though hypotheses can be made for several industries. For instance, because the Rail Industry Award 2010 and the Fire Fighting Industry Award 2010 cover industries that are (or have been) largely in the public sector, it is likely that most employers in these industries use the relevant public sector superannuation fund or its successor as their default fund.

Economy-wide studies indicate that employers rarely undertake their own assessment of default funds, but instead tend to rely on precedent, industry norms or advice from those who may be more knowledgeable about superannuation (see below). This could be attributed to the costs of conducting a tender or engaging consultants to select a default fund, which are likely to be prohibitive for most employers given their small size. Indeed, the Association of Superannuation Funds of Australia suggested that ‘the use of competitive tenders and/or tender consultants … is more common when there is no default fund listed in an award, particularly in the case of larger employers’ (sub. 31, p. 7).

There is insufficient evidence on whether employees covered by awards that do not list a default superannuation fund have been affected by this absence, or if any effect is positive or negative. Some employers are likely to have incurred additional costs in selecting a default fund but may also have gained some benefit for their employees or for themselves (such as being able to choose a fund that is administratively efficient and responsive to their needs).

Awards that allow contributions to be made to 'grandfathered' funds

The modern awards that list default funds allow employers to continue making default contributions to funds to which they were contributing before 12 September 2008. The AIRC intended that this 'grandfathering' provision would minimise inconvenience to employers (2008a).

Very little information is available on the use of the grandfathering provision. The Association of Superannuation Funds of Australia suggested that 'the funds benefitting from the grandfathering provisions in the main are relatively small funds and/or regionally based although there are exceptions' (sub. 31, p. 7). Asset Super considered that 'grandfathering clauses are a safety net for small employers who do not have access to professional advice and who do not belong to industrial associations' (sub. 32, p. 2). Ai Group said that grandfathering arrangements:

> … have been common in awards since the late 1980s. For example, an employer who was using a particular complying superannuation fund prior to the making of the *Metal Industry (Superannuation) Award* in 1989 was entitled to continue to use that fund after the award was made. The employer is still entitled to use that fund as a default fund because the pre-modern award exemptions have been preserved through the grandfathering provision in modern awards. (sub. DR79, p. 11)

Grandfathering may also be used for many payments to corporate superannuation funds, as only a small number of corporate funds are listed as default funds in modern awards (for instance, the BHP Billiton Super Fund is listed as a default fund in the Coal Export Terminals Award 2010 while the Rio Tinto Staff Superannuation Fund is not).

Several inquiry participants commented on the absence of information on the use of the grandfathering provision. For instance, the Industry Super Network (ISN) noted:

> It is not known how many grandfathered funds are currently being used by employers as a result of the grandfathering arrangements inserted in superannuation clauses as a result of the 2008 decision. Nor is there any data on the number of employees, size of contributions or the type of fund being utilised. There is some anecdotal evidence that some employers are utilising the grandfathering arrangements to extend the use of a preferred default fund named in one award to other award dependent employees. However, it is suggested that the grandfathering arrangements are primarily used to allow continued contributions to retail or master trust funds. (sub. 27, p. 39)

There is also considerable doubt about the permissibility and application of the grandfathering provision in many circumstances, including in relation to corporate mergers, takeovers and restructures (Mercer, sub. 34).

Employers make the final selection

If an award lists more than one default superannuation fund, or does not list a default fund, employers must choose a fund (or funds) to receive superannuation contributions for employees who do not choose a fund for themselves (chapter 2). In doing so, there is no legal obligation on employers to compare funds in any structured way.

Though employers ‘have different resources, capabilities and interests with respect to how they select their default fund’ (ANZ Wealth, sub. DR82, p. 3), the ‘vast majority’ of employers have not actively selected their current default superannuation fund — they simply use the fund they have ‘inherited’ (Colmar Brunton 2010b, p. 27).

> The initial selection decision is critical because what your employers do is select and forget. (Financial Services Council, trans., p. 65)

Those employers who have chosen a default fund tended not to conduct their own research into available funds, instead relying on advice from a range of sources (box 7.2).

Many inquiry participants submitted that employers would prefer to choose from a small number of funds rather than from the hundreds of funds in the market. For example, Eldercare submitted that:

> … from an employer perspective, we would prefer not to be given the responsibility of choosing a default fund from an extensive list, and would favour choosing from a small number of proven funds in awards. (sub. DR57, p. 1)

Many also highlighted that the burden of choosing between a large number of funds can be costly for employers.

> … some employers are troubled by the responsibility of selecting the default superannuation fund for their employees as they see this as an onerous obligation and one they are not necessarily capable of discharging satisfactorily. (Industry Funds Forum, sub. 51, p. 2)
>
> It is important that the number of funds listed in awards remains limited to prevent overwhelming employers with excessive options for default funds. It is unrealistic to expect employers to spend the time examining the relative merits of potentially dozens of different superannuation funds. (Australian Hotels Association, sub. 10, p. 9)
>
> We … do not wish to see further complex decisions imposed upon tourism businesses who are not necessarily equipped to make such decisions … (National Tourism Alliance, sub. 4, p. 1)

Box 7.2 How do employers choose a default superannuation fund?

Administrative convenience

[Employers] want to "get on and build" rather than be concerned with intimate and complex issues of superannuation administration. (Master Builders Australia, sub. 41, p. 4)

Generally, the primary concern of employers in this process is the ease of the transaction process with a fund and any employer costs involved. (Australian Hotels Association, sub. 10, p. 7)

Employers naturally evaluate funds based on the ease of contribution and processing … most employers look for ease of processing and online transactions in choosing their default funds. (Colmar Brunton 2010b, p. 27)

Industry norms and experience

[Employers] will most likely choose the fund that most of their employees are members of already. If it is a new business the employer will most likely choose the fund that he/she has some experience with … It is very rare for an employer to research the benefits (i.e. fees, etc) of a fund and base their choice on that data. (Tasplan, sub. 6, p. 1)

Historically, in the previous state based industrial system and currently in the federal modern award system employers have utilised a default fund already listed … this will continue as employers will have already established a system and relationship with the relevant fund and established relevant financial transaction processes to minimise delays and costs … Where more than one fund is nominated, the selection made by an employer is either ad-hoc or based on previous experience with the fund in question, with little to no investigation into the relative features of each fund. (Electrical Contractors Association, sub. 17, pp. 1−2)

Advice from financial advisers

Employers typically receive advice from consultants and/or financial advisers to assist them select an appropriate fund. As part of the selection process a number of criteria are generally considered including pricing (fees), selection of investment options, strength of brand, insurance premiums and coverage, education, member service and access to financial advice etc. (Colonial First State, sub. 42, p. 2)

Ordinarily, the assessment of a fund against factors such as the ones set out in the Draft Report is carried out for an employer or an employee by a qualified licensed financial adviser (who will be subject to statutory and general law duties). (Law Council of Australia, sub. DR67, p. 4)

A combination of these factors

Businesses will often choose a fund based on prior experience with a fund if they have such experience, or alternatively, based on the fund which suits the majority of their employees. In many cases they will seek guidance from their employer organisations, such as the state Real Estate Institutes, Real Estate Employer's Federation, or Real Estate Institute of Australia. (REI Super, sub. 26, p. 1)

When they eventually understand that they have to choose a super fund (for themselves or a new employee) [small businesses] will seek advice from their accountant (when they finally choose one), a financial adviser, TV/magazine advertisements, business group mentors, their family or Google. (COSBOA, sub. 7, p. 2)

To avoid the cost of comparing funds:

> Most employers do not actively seek information about the performance of their default superannuation fund … [They] consider this to be the employee's responsibility to investigate if it is something they are interested in. This attitude is reinforced by the perceived lack of distinction between different superannuation funds and different superannuation fund types. None of the employers had considered changing their default fund, or changing the default options within their chosen fund. (Colmar Brunton 2010b, pp. 28–9)

However, it is also costly for employers to ensure that they are contributing to the fund specified in the award or awards that cover their employees.

> For some [employers] subject to multiple awards, there is an ongoing need to assess which of their employees are covered by particular awards and subsequently which superannuation funds must be used as defaults. (MLC Ltd–NAB Wealth, sub. 44, p. 5)

The Australian Chamber of Commerce and Industry (ACCI) noted that 'increased fund "closure" also means that employers may need to select new defaults more often than in the past' (sub. DR83, p. 5).

7.2 Meeting the (relevant) employees' best interests

Participants' views

Inquiry participants generally supported the principle that the selection of default funds should be conducted with the best interests of employees who derive their default superannuation product in accordance with modern awards in mind.

> Default funds should be selected on the basis of advancement of members' interests, and MySuper products may not all achieve this aim – or at least not to the same extent. (eo Financial Services, sub. 12, p. 2)
>
> … the selection of a default fund … must be demonstrably in the best interests of workers covered by modern awards, as well as their employers. (AIST, sub. 20, p. 6)

However, differing views were expressed about the extent to which the current process takes employees' best interests into account. Many participants focused on the above-average returns received by members of default funds chosen under the current process, and considered that these returns demonstrate that the best interests of employees who derive their default superannuation product in accordance with modern awards have been well served (chapter 4). In contrast, others considered that the default selection system needs to change.

> … the current arrangement of nominating specific default superannuation funds in Modern Awards does not serve the best interests of employees, employers or the community at large (BT Financial Group, sub. 46, p. 1)

> [In its draft report] the Commission proposes changes to the current system to better align the default superannuation arrangements with the important principle that the arrangements must meet superannuation fund members' best interests. Ai Group supports this principle and agrees that changes are needed to the existing system. (sub. DR79, p. 2)

Participants also expressed concern about the conflicts of interest that can arise in the absence of a requirement to make a decision in the best interests of employees. As noted in chapter 3, various agents acting on behalf of employees can have conflicts of interest, including industrial representatives, employers and fund managers. eo Financial Services suggested that employees' interests can sometimes diverge from those of their industrial representatives.

> At present, nominated default funds or funds seeking nomination as a default fund are not required to address or to reveal actual or potential conflicts of interest or duty (or both) and where applicable, nor are applicants to vary an award to nominate a fund as a default fund required to reveal their connection to or interest in the fund. (sub. 12, p. 3)

Similarly, the Financial Services Council said:

> The few parties registered under [the *Fair Work (Registered Organisations) Act 2009*] are the only stakeholders entitled to appear before Fair Work Australia. As typically each of these parties has pre-existing affiliation with an industry superannuation fund, the only stakeholders entitled to access Fair Work Australia are therefore conflicted. Accordingly the process is not transparent. In other words, the decisions about default funds are not made by Fair Work Australia, they are made elsewhere in a non-transparent manner. (sub. 30, p. 16)

Vincent Mahon noted that:

> Last year FWA permitted the MTAA Superannuation Fund access to retail sector employees. The application was made by the Australian Manufacturing Workers Union (AMWU). The two AMWU officials making the application before FWA … were trustees of MTAA Superannuation Fund. The applicants had a conflict of interest … The MTAA balanced fund was ranked 49 out of 49 over the three (3) years to June 2010. Yet FWA approved the MTAA Superannuation Fund application. (sub. 1, p. 2)

In relation to the potential for employer conflicts of interest, ISN considered that:

> Where employers have a number of competing default fund options; either a limited number of named funds within an award or an unlimited choice of funds, there is a potential for conflicts to arise. The business environment raises these potential conflicts with large banking corporations which businesses are reliant upon dominating the retail superannuation options. (sub. 27, pp. 31–2)

The Industry Funds Forum was of the view that:

> Where there are multiple default funds listed in modern awards consideration needs to be given to the potential for conflict of interest should the employer be guided by anything other than the best interest of their employees. (sub. 51, p. 10)

In contrast:

> Suncorp believes employers' and employees' interests with regard to superannuation are closely aligned and strongly rejects the notion of principal–agent conflict. (sub. 38, p. 2)

The Commission's view

The Commission notes the relatively strong returns received by members of default funds chosen under the current process (chapter 4). It also recognises that the size, complexity and tight timeframes of the award modernisation process may have explained the AIRC's decision not to assess financial outcomes for employees who derive their default superannuation product in accordance with modern awards during the award modernisation process (see above). However, the Commission is concerned by the ongoing absence of an explicit requirement to give primacy to the interests of employees who derive their default superannuation product in accordance with modern awards. This is particularly problematic given that principal–agent issues are present.

As outlined in chapters 3 and 5, these problems arise because an agent making decisions on behalf of a principal may not always act in the latter's best interests, and the principal does not always have the information, resources or inclination to monitor the actions of the agent. Generally, employees whose superannuation is paid into a product because it is the default product do not take an active interest in their superannuation and are unlikely to ensure that their agents faithfully represent their interests.

There are several reasons why principal–agent problems are likely to be present when industrial parties are deciding which superannuation funds to recommend for listing as default funds in awards.

- Many industrial parties are likely to have other potentially conflicting interests in the field of superannuation, either as trustees of an industry superannuation fund or as employees of an organisation that nominates trustees to a fund. In either case, these representatives could have an interest in ensuring that the fund they are associated with is listed as a default fund in the award.
- Industrial parties may represent their members rather than all the workers covered by a particular award. This can mean that the majority of workers may

not be represented in the selection of a default fund (only 18 per cent of Australian employees were union members in their main job in August 2011 (ABS 2012b)).

Principal–agent problems are also likely to arise where the employer chooses from a relatively large number of listed funds. In such cases, employers have little incentive to investigate the relative merits of different default funds and to select a fund that best meets their employees' needs. Indeed, they are likely to have an interest in maintaining existing superannuation arrangements because this minimises their administrative costs. They are also likely to face an incentive to use funds that are easy for them to deal with, or funds that offer benefits to employers in exchange for default fund status (though the scope to offer such benefits is limited by the *Superannuation Industry (Supervision) Act 1993*). These incentives may lead some employers to choose a default fund that is less suited to their employees than other available funds.

The Commission also notes that similar concerns could apply in relation to employer selection of funds in the instances where the relevant award does not list any fund.

In order to counteract possible conflicts of interest, the Commission considers that where default superannuation products are listed in awards, the process for the selection and ongoing assessment of default products should include explicit requirements for all parties involved in default listing — employee representatives, employers, employer representatives and default decision makers — to make decisions in the best interests of employees who derive their default superannuation product in accordance with modern awards.

7.3 Contestability and competition

In considering the appropriate degree of competition in the default superannuation market, it is important to understand the economic concept of contestability, which can be defined as:

> The degree of ease with which firms can enter or leave a market reflecting the level of potential competition. In a contestable market the threat of new entrants causes the incumbent firms to operate at levels approaching that expected in a competitive market. (Industry Commission 1996, p. xix).

In a competitive market, firms have an incentive to innovate, and this leads to greater efficiency and improved outcomes for consumers and/or firms. Though contestability is a necessary condition for competition, it is not by itself sufficient to gain the advantages of competition. For reasons discussed in chapter 3, measures to strengthen demand-side competition will also be required to achieve a competitive outcome.

Participants' views

Participants had varying views as to whether the process used to select superannuation funds for inclusion as default funds in modern awards is contestable, and whether contestability is desirable.

Are contestability and competition important?

Several union groups suggested that it would not be desirable to increase the contestability of the default fund market.

> A fund that has been purposely developed to service the needs and requirements of a particular workforce or industry must be given the right to be a default fund (SDA, sub. 24, p. 7)
>
> United Voice does not support any recommendations by the Productivity Commission that would result in the opening-up of default arrangements to greater contestability or wider choice of fund. (sub. DR88, p. 7)

Similar views were expressed by some other industry and public sector funds.

> Contestability can be deceiving and not necessarily in the interests of fund members although competition from industry funds against retail funds has been healthy to date. (Unions NSW, sub. 13, p. 7)
>
> Cbus takes issue with the findings in the Draft Report that underpin the conclusion that that current system displays … insufficient contestability. It is worth remembering that the primary place for contestability is the market, not the setting of the safety net. (sub. DR81, p. 4)
>
> The existing superannuation fund environment already has adequate competition built into it through the choice provisions under the Superannuation Guarantee legislation and the portability provisions in Superannuation Industry (Supervision) legislation (LGsuper, sub. DR59, p. 2)

In contrast, some participants emphasised the potential benefits of increasing contestability and competition.

> ACCI supports the view that funds should be exposed to appropriately channelled competition, or at least the threat of it, and that this is necessary to help offset the significant market advantage of award nomination. (sub. DR83, p. 6)
>
> The possibility of new markets and new customers is a key driver of price competition and of new investments and innovation. This is true for all superannuation funds (be

they retail funds or industry funds) which expend resources to market, compete and distribute their products, as well as to maintain their existing customer base. (ANZ Wealth, sub. 48, p. 2)

… BT recently competed for the default business of Employer C and was able to outbid the incumbent industry fund. The impact on the average employee with a balance of $50 000 was a reduction in total annual fees of 7%. (BT Financial Group, sub. 46, p. 2)

Transparency and contestability are critical elements in any marketplace, including default superannuation. Contestability is more important than transparency because if there is restricted choice transparency does not assist in getting the best outcomes. (CSSA, sub. 35, appendix C, p. 1)

Is the current process contestable and competitive?

Many inquiry participants considered that, under current arrangements, the default superannuation market is not contestable, and that the absence of competitive pressure has negative effects on the quality and value of superannuation products.

CPA Australia's primary concern with the current process for nominating default superannuation funds in modern awards is … the "closed shop" nature of the arrangements (sub. 39, p. 1)

Specifying individual default funds in awards and thereby creating effective oligopolies /monopolies for certain funds has reduced the overall level of competition in the sector. This has led to an upward impact on fees for these funds and resulted in reduced quality of products and services for members … these arrangements are restrictive, anti-competitive and compromise the best interests of employees and members. (Colonial First State, sub. 42, p. 2)

There is currently not contestability or competition with default superannuation funds listed in Modern Awards. Increased competition invariably leads to a lowering of costs and an increase in quality. (CSSA, sub. 35, appendix C, p. 2)

The lack of necessary competition in this area is an important issue that needs to be solved quickly … (Association of Financial Advisers, sub. DR73, p. 2)

… contestability is a necessary element in maximising member value; but is a missing feature of the current system (FSC, sub. DR80, p. 3)

In contrast, United Voice did not see the need for greater contestability, saying that 'the current model of regulated award distribution of default super funds is established on transparent and objective merit-based criteria' (sub. DR88, p. 13). Tasplan (sub. 6) considered that there is a level playing field between industry and retail funds, and ISN considered that '… the current process is more open and transparent than has been suggested by some'(sub. 27, p. 48).

Several participants suggested that it is easy for a superannuation fund to find an industrial party to bring a case before FWA to include that fund in an award (Cbus, sub. DR81; Unions NSW, sub. 13). The Australian Council of Trade Unions (ACTU) therefore considered that:

> The fact that very few retail funds seek award inclusion via this route speaks volumes about their inability to convince a relatively informed group of potential sponsors of the value of their products. (sub. DR77, p. 9)

The Transport Industry Superannuation Fund — one of the few funds not previously listed in awards that has sought to obtain listing — spoke of the substantial barriers it encountered in doing so (box 7.3).

Box 7.3 The experience of the Transport Industry Superannuation Fund in applying for listing as a default fund in awards

During public hearings, the Transport Industry Superannuation Fund described its experience in attempting to obtain listing in the Road Transport and Distribution Award 2010 and the Road Transport (Long Distance Operations) Award 2010. The fund had not previously been listed in awards and so:

> Since September 2008 it has been operating via a system of choice by members or through grandfathered arrangements with an excess of 3800 employers. (trans., p. 147)

In applying to be listed, it claimed that it faced considerable barriers.

> It is a very tight closed little shop … 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 …
>
> The quality of the fund counts for nought, because you have all these incumbents in there who have many different vested interests …[When considering our fund for listing they] are not looking at it going, “Well, gee, you’ve got a better definition of total and permanent disability and arson, that will be good for a whole bunch of drivers,” … “Wow, how did you do that?” That’s not the discussion. [Instead], it’s, “No, well, that will encroach on what we're doing and we’re trying to stitch up some sort of [enterprise agreement] over here with some other larger group” …
>
> So when you ask about [our] experience, it’s all these things going on in 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 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. (Transport Industry Superannuation Fund, trans., pp. 155–6)

United Voice expressed concern about potential negative consequences of contestability, and suggested that:

> Wider choice of default fund would simply lead to the addition of a distribution cost, which would outweigh any of the expected benefits of lower administrative costs … As a result of the proposed reforms, Rice Warner estimate that distribution costs will increase by $75 per member per annum. (sub. DR88, pp. 15–16)

Similarly, the ACTU suggested that:

> … competition tends to generate additional distribution costs as funds invest more in marketing their products to sustain their revenue base. Research by Rice Warner estimates that such costs for the average industry fund member could increase by up to $45 per annum. (sub. DR77, p. 13)

In addition, as discussed in chapter 6, a range of participants also commented on industry connectedness.

The Commission's view

As is evident from the process described in section 7.1, not all superannuation funds can present their case for being listed in an award on an equal basis. Funds that have not previously been included as a default fund are not able to present their case unless they can find an industrial party that has standing before FWA and is willing to make the application. Given that a significant proportion of industrial parties have an interest in (and nominate trustees to) one or more superannuation funds, they could be expected to extend preference to those funds, to the potential detriment of competitors. Even some funds that had been included in pre-modern awards but have only 'slight' coverage of the national industry now covered by the modern award have had their application for inclusion denied (see, for example, FWA 2010g).

A limitation on contestability in terms of employers' selection processes is that employers must generally choose one of the relatively small number of default funds listed in the award (though the grandfathering provisions allow some employers to continue to make payments to the fund to which they were contributing on 12 September 2008). This means that most employers of employees who derive their default superannuation product in accordance with modern awards have only a limited ability to switch to a fund that better meets their employees' interests, or to a fund that has better administrative systems (but still meets employees' interests).

The current processes of fund selection (both for listing in awards and by employers from those listed) therefore have the effect of reducing the contestability of the default fund market. This reduces competition, and reduces the likelihood that the fund ultimately chosen meets the best interests of employees who derive their default superannuation product in accordance with modern awards.

It also reduces dynamic efficiency, reducing the likelihood that, over time, consumers are offered new and better products, and existing products at lower cost.

This may lead to less innovation and poorer financial and administrative performance in the default superannuation market.

Allowing all funds to present the case for listing their default products in awards on an equal basis is likely to lead to improved outcomes for employees. Similarly, allowing employers to choose from a wider range of products listed in the relevant award would further enhance contestability and spur the benefits of competition. Importantly, it is not necessary that all, or even most, employers make active comparisons and decisions about default superannuation products in order to drive improved product and services offerings. The threat of competition is sufficient.

This does not imply, however, that the benefits of competition can be achieved without some costs. In particular, increasing competition may lead to increases in marketing and distribution costs. However, minimising these costs would only be possible if there was a single national default fund, and if that fund was efficient, low cost and innovative.

> The objectives of reducing superannuation administrative costs and minimising complexity for workers can best be achieved by implementing a government-backed [universal default fund]. (Ingles and Fear 2009, p. 15)

For a range of historical reasons, Australia did not go down this path, instead adopting a model of competition between funds from different sectors (St Anne 2012). Given this framework, enhancing contestability and providing incentives for funds to deliver improved products are essential in ensuring that the interests of employees who derive their default superannuation product in accordance with modern awards are best served.

7.4 Transparency

Participants' views

Participants generally agreed that the default selection process should be transparent.

> … it is essential that the listing of any superannuation funds be subject to a robust and transparent process. (Mercer, sub. 34, p. 6)

> Transparency is important. (Unions NSW, sub. 13, p. 7)

> Suncorp opposes any selection process for default superannuation funds. If, however, a selection process were to remain, this process must be transparent. Transparency can be achieved by requiring Fair Work Australia to provide written decision statements that are publicly reported. (sub. 38, p. 2)

However, there were differing views on the transparency of the current process. Asset Super said:

> The current process for listing default superannuation funds in awards is transparent. (sub. 32, p. 4)

A number of participants held the opposite view.

> The present system is failing consumers and employers — it lacks transparency and is no longer appropriate following the introduction of MySuper. (FSC, sub. 30, p. 1)

> The current model for the selection of default superannuation funds is not based on merit, is not transparent and … leads to an inequitable outcome that is very much biased in the favour of industry funds. (Association of Financial Advisers, sub. DR73, p. 2).

> The existing FWA process surrounding the variation of Modern Awards to include a new nominated default fund is opaque. Without this transparency, the cost (through the need to employ expert resources) and effort of interacting with the system can often override any benefits. This leads to inertia in the system where employees are disadvantaged by a lack of competitive tension amongst superannuation providers. (AMP, sub. 52, p. 5)

ISN also indicated that there is scope to improve the transparency of the current process, in suggesting that 'all relationships, including payments and commercial arrangements other than superannuation, between the fund and its related entities, on the one hand, and employers, employer organisations, and employee organisations relevant to the subject modern award, on the other hand' (sub. 27, p. 5) should be disclosed as part of the fund selection process. Similarly, 'AIST accepts that existing arrangements, while resulting in good, well-performing outcomes for millions of Australians, could be seen as having insufficient transparency [and] can *appear* opaque' (sub. DR69, p. 5).

The Commission's view

Open and transparent processes are essential for good public policy outcomes. While there is concern about the grounds used by FWA to assess whether additional superannuation funds should be included as default funds in modern awards, the processes used by FWA to list funds in awards meet appropriate standards of transparency. FWA habitually publishes variation applications, allows interested parties to comment on those applications, and generally publishes its decisions. It may hold hearings and publish transcripts of those hearings. Its written decisions include an explanation of the basis on which the decision was made (see, for example, FWA 2010f).

However, while the decisions made by FWA may be transparent, there are shortcomings in the transparency of the bases on which the decisions are made:

- During the award modernisation process, the AIRC accepted the default fund or funds agreed by the industrial parties (AIRC 2008b).
- Industrial parties did not always, and are still not required to, disclose to their members or to the public the basis upon which they select and nominate superannuation funds for inclusion as default funds in modern awards.

Taken together, these shortcomings mean that the selection of the overwhelming majority of the current default funds listed in modern awards was not made on a fully transparent basis. A transparent assessment process is required that puts employees' interests first and is based on known and appropriate factors.

7.5 Procedural fairness

Related to contestability and transparency is the concept of procedural fairness. In order for a decision to meet the requirements of procedural fairness, the decision maker:

- must allow parties the opportunity to put their case and to be heard
- must not be biased or be seen to be biased.

Participants' views

A number of participants made comments relating to the procedural fairness of the current process. The Financial Services Council submitted that:

> As retail funds do not have formal links with unions or employer associations (i.e. retail funds do not share directors who work for a union or employer association) they are effectively locked out of the current system. (sub. 30, p. 4)

eo Financial Services considered that:

> The lack of accountability means that funds cannot be sure why they were excluded when other funds were included — especially when funds that are included might not have better investment performance or lower costs than those that were excluded … there seems to be no basis other than 'who you know' for being successful in the selection process. (sub. 12, pp. 2–3)

The Transport Industry Superannuation Fund said:

> The current system does not provide transparency, fairness or a competitive landscape that ensures the best outcome for members' accumulation of superannuation for retirement. (sub. 40, p. 8)

Other participants (including MLC Ltd–NAB Wealth, sub. DR87 and Suncorp, sub. 38) had similar views.

The Law Council of Australia considered that:

> … if FWA were charged with applying additional criteria, consideration would need to be given to how such criteria could be applied consistently with the concepts of natural justice, rights of appeal and other administrative law principles. This is especially the case as the viability of a fund may very well depend on whether it is named as a default fund in a Modern Award. (sub. 23, p. 5)

A number of participants, including DEEWR/Treasury (sub. DR89) and United Voice (sub. DR88) disagreed with the Commission's assessment that the current selection process lacks procedural fairness. ISN considered that:

> This view fails to properly appreciate the role of the industrial tribunal and the rights and obligations imposed by the Fair Work Act on FWA and those industrial organisations and others who have significant components of their activities controlled by the Fair Work Act. (sub. DR62, p. 4)

Australian Super focused on the ability of FWA to fairly consider the views of industrial parties, and stated:

> We reaffirm the central relevance of FWA in determining all workplace conditions, including superannuation, in a manner which accords due process and properly includes the views of workplace participants. (sub. DR74, p. 4)

The Commission's view

As discussed in section 7.3 with reference to contestability, the current process does not provide all superannuation funds with an equal opportunity to put their case for listing as a default fund in an award to FWA. This inequality arises regardless of a fund's ownership. Many retail funds, non-incumbent industry funds and potential market entrants (including foreign firms) are not on an equal footing with the (mainly industry) incumbent funds in the default market.

In addition, as is apparent from the discussion of transparency in section 7.4, there is no requirement for industrial parties to disclose the basis upon which they select and nominate superannuation funds for listing as default funds in modern awards.

This leaves open the possibility that this aspect of the selection process may involve bias.

Taken together, these shortcomings mean that the current process for selecting default superannuation funds does not provide procedural fairness. Funds that offer products that may serve employees' best interests are unable to have the merits of those products considered and assessed in a fair and balanced way. Changes to the selection process are needed so that, before decisions are made, affected parties have a right to be heard by an impartial decision maker. In addition, as discussed in chapter 8, some mechanism for appeal or judicial review is an important component of fair process.

7.6 Regular assessment

Participants' views

A wide range of inquiry participants highlighted the importance of there being a process for regularly assessing the list of selected default funds. Mercer submitted that:

> … there needs to be a regular review process so that the listed funds are not guaranteed long term recognition within an award. Such a result can lead to less innovation and poorer results for the employees covered by that award. (sub. 34, p. 6)

Master Builders Australia said:

> As funds consolidate, the list of named funds will not meet the requirements of being straightforward and helpful to employers unless regularly updated … This further underlines the need for a regular statutorily vindicated review of modern award provisions that ensures they are meeting employer and employee needs. (sub. 41, p. 6)

The Financial Services Council considered that:

> … there is neither a process nor review mechanism for the selection of default superannuation funds in Modern Awards … Neither APRA nor ASIC has regulatory capacity to remove a default fund selected by Fair Work Australia; accordingly the present system represents a failing of consumer protection. (sub. 30, p. 10)

The ACTU acknowledged that 'there is a case for a more rigorous and consistent approach' to reviewing default funds included in awards, and noted that:

> … there is a risk that a named fund begins to underperform for a period of years. It is open to the relevant industrial parties to identify underperformance and take appropriate action. However, the extent to which fund performance is reviewed and acted upon is uneven, reflecting the fact that in the context of their broader bargaining

> activities particular employer and employee representatives attribute varying levels of priority to award default fund issues. (sub. 29, p. 11)

REST Industry Super said that it:

> … supports a periodic review and assessment of superannuation funds which best meet the design criteria for nomination as default funds in modern awards in any particular industry. (sub. 47, p. 4)

The Commission's view

The Commission considers that in the absence of an ongoing assessment process and a realistic likelihood that funds with unsuitable default products will no longer be listed in awards, listed funds are likely to face reduced incentives to act in the best interests of default fund members. Further, the presence of unsuitable funds and products in awards is not in the best interests of employees who derive their default superannuation product in accordance with modern awards. The creation of a process for the regular assessment of default funds or products listed in awards is therefore essential (at least in the medium term — chapter 8).

7.7 Minimising regulatory burden

The process used to select default superannuation funds should impose the minimum possible cost and inconvenience on the parties involved, subject to achieving the aim of ensuring that the best interests of employees who derive their default superannuation product in accordance with modern awards are met.

Two aspects of regulatory burden merit specific consideration:

- The overall administrative burden of the selection process.
- The compliance burden imposed on employers.

Participants' views

Overall burden of the selection process

Few participants made specific comments about the regulatory burden imposed by the current selection process. However, some implicitly suggested that the current process imposes appropriate burdens, by emphasising the benefits of the current system of selecting suitable funds for different groups of employees. For instance, legalsuper said:

> By assigning specific funds to each award, employers are guided as to their most appropriate choice of superannuation fund, thereby helping to ensure retirement outcomes are more suitable for employees working under those awards. (sub. 19, p. 1)

In contrast, a number of participants considered that once MySuper is in place, a further selection process would be burdensome.

> Given the strict and appropriate criteria designed by the Government for MySuper and the legislation requiring that only MySuper compliant funds and trustees operate in the default space, it may be considered onerous and burdensome to have a further subset of requirements for selection in Modern Awards. (Colonial First State, sub. 42, p. 4)
>
> We do not believe the prudential framework, particularly the enhanced MySuper framework, is so lacking in efficacy as to warrant another regime and another regulatory party to be embedded in the framework to identify limited funds to which default contributions can be made. (MLC Ltd–NAB Wealth, sub. 44, p. 5)

ISN suggested that a more burdensome process would be justified.

> Although the proposed framework will place additional requirements upon funds that seek to be named in modern awards, this is appropriate. Australia's superannuation system must continue its transition into a mature, well-regulated system. Funds that seek to be named in modern awards should meet heightened public expectations. Being subject to reasonable due process that provides public accountability, and that will result in improved public policy, is to be expected. (sub. 27, p. 3)

Burden placed on employers

Participants suggested that selecting and interacting with a default fund can place a particular burden on employers. For example, ACCI considered that:

> Many employers find dealing with the system unduly onerous, and for many there is excessive complexity and a lack of standardisation. (sub. 37, p. 3)

Others suggested that default funds can be difficult for employers to deal with (Adam Johnston, sub. 54). The Council of Small Business Organisations of Australia said that:

> Due to the placement of a fund in an industrial award or instrument there is not motivation for a fund to be efficient in dealings with employers. (sub. 7, p. 5)

Similarly, the Financial Services Council was of the view that:

> The captive market enjoyed by many large superannuation funds has failed to provide an incentive for the adoption of efficient and user-friendly administration services. Employers, as major users of superannuation administration services have no choice but to utilise the fund regardless of its administrative capacity/functionality. (sub. 30, p. 9)

In contrast, ASFA considered that default funds do in fact have a strong incentive to be responsive to employers' needs, and noted that:

> Most awards have more than one default fund listed. As well most funds rely for most if not a substantial proportion of their contributions from employers not subject to an award. There is strong competition in regard to signing up employers for default arrangements. (sub. DR75, p. 5)

Many participants also commented on the way in which employers go about selecting a default fund (box 7.2), and on the potentially onerous nature of this choice.

Other participants suggested that the role of the selection process is to produce a small shortlist of funds, in order to make it easier for employers to choose a default fund.

> The value of nominating eligible default funds is to assist employers in their selection process. (Australian Hotels Association, sub. 10, p. 2)
>
> … the purpose of the award nomination is to give confidence to the employer that the nominated fund is a quality offering. (Tasplan, sub. 6, p. 9)
>
> … providing employers with a large range of funds from which to choose undermines the purpose of the award default system, which is to ensure an employee voice in the choice of fund, and to control the risk of a poor choice. (Cbus, sub. 15, p. 8)

The Commission's view

Overall burden of the selection process

The process currently used to select default superannuation funds does not place an undue regulatory burden on any party. However, this is not the direct result of good design but rather a consequence of the current process falling short when measured against sound principles:

- Because there is no requirement to give primacy to the best interests of employees who derive their default superannuation product in accordance with modern awards when selecting default funds, industrial parties do not have to spend time establishing and articulating what those interests may be and how the nominated funds best meet those interests.
- Because the process is not contestable, funds incur few costs in attempting to obtain or retain listing as a default fund.
- Because transparency is lacking, little effort is devoted to preparing and publishing relevant information.

- Because there is no requirement for regular assessment, the costs of preparing for and conducting regular and ongoing assessments are minimised.

Correcting these shortcomings is likely to involve an increase in the overall regulatory burden imposed by the selection process. However, improving the selection process — in ways that increase the regulatory burden as efficiently as possible — will be worthwhile if, overall, it leads to substantially better outcomes for employees that outweigh the additional regulatory costs.

Burden placed on employers

The Commission considers that to simplify employer choice, there would be benefit in providing employers with a concise list of default products from which to choose. At the same time, the Commission shares the concern expressed by inquiry participants that superannuation funds listed as default funds in modern awards, in the absence of contestability or regular assessment, do not have strong incentives to be responsive to the needs of employers of workers who derive their default superannuation product in accordance with a modern award. This is particularly the case when only a small number of funds are listed in an award. These privileged funds remain listed and have almost guaranteed market share regardless of the costs or burdens they impose on the employers who must make payments to them.

Therefore, in order to promote greater efficiency in the default superannuation market, the Commission considers that there would be benefit in listing more funds in awards that currently list only one or two. (In chapter 8, the Commission recommends that modern awards that list default superannuation funds should, where possible, identify a small subset of products for each award that it judges best meets the interests of employees who derive their default superannuation product in accordance with a given modern award). In addition, in another measure to reduce inefficiency, the Commission is recommending that a fund's administrative efficiency should be considered as a relevant factor in the default selection process (chapter 6).

7.8 Market stability

There are a number of ways in which the default fund selection process could affect the stability of the superannuation market. The more the selection process promotes change in the list of funds in a given award, the more likely it is that employers will be required to change default funds, and the greater the potential for significant changes in the flow of contributions between funds. Such changes could have consequences for the level of liquidity needed by, and thus the investment opportunities available to, superannuation funds. In addition, funds that lose default members would potentially experience a loss of scale that could have detrimental consequences for all members of the fund. The combined impact of these factors could potentially lessen confidence in the superannuation market more broadly.

Participants' views

Few participants commented on the effect of the default fund selection process on the stability of the superannuation market. Those participants who did mention stability did so with reference to the potential for default fund selection to affect the investment opportunities available to funds, and the returns on those investments.

> If industry funds are less certain about the stability of their members and assets and their future growth, this may reduce the willingness of funds to provide additional capital to finance infrastructure assets. (REST Industry Super, sub. 47, p. 41)
>
> High participation rates and strong cash flows also help funds to provide stability and confidence in the superannuation system (Industry Funds Forum, sub. 51, p. 10)

Similarly, Infrastructure Partnerships Australia said:

> The Productivity Commission must also be mindful of any changes to the regulatory structure that results in greater 'churn' and could work against the stability required to make illiquid and longer dated assets attractive. (sub. 9, p. 1)

Suncorp considered that the principle articulated in the draft report (which was expressed as 'avoiding system instability'):

> … appears to be targeted at avoiding the circumstances experienced in Chile, where significant competition in the Superannuation sector led to high churn rates that adversely affected the stability of member investments. It is important to avoid introduction of a similar instability to the Australian system, however, it is also important to improve competition.
>
> Some level of "instability" is required to allow default contributions to move between funds and drive commercial competition. Suncorp proposes that this principle would be more effective if the emphasis was placed on *sustainability* as opposed to *instability*. (sub. DR64, p. 6)

The Commission's view

The process currently used to select default superannuation funds promotes stability. Because some funds do not have an equal chance to present their case to be listed as a default fund, and current default funds are unlikely to lose default status, there is little risk that the current process for the selection of default funds will provoke large movements of members from one fund to another. Were this to occur under future changes, it could have significant consequences (chapter 8).

However, as discussed above with reference to contestability, the small likelihood that funds may be challenged for their default fund status also leads to inefficiencies, which in turn can lead to the best interests of employees who derive their default superannuation product in accordance with modern awards not being met. There is therefore a need to find a balance between promoting contestability and ensuring the stability of the default superannuation market.

In addition, as explained in chapter 8, some employees could end up worse off due to the creation of multiple accounts in different funds, unless the new fund is significantly better than the employee's existing fund. Therefore, to the extent that a stable system prevents the creation of multiple accounts, a selection system that promotes stability can have benefits for members.

7.9 Consistency with other policies

As discussed in preceding chapters, this inquiry is occurring at the same time as other significant reforms to the superannuation and financial services industries are being implemented. In particular, the Stronger Super and the Future of Financial Advice (FOFA) reforms will change the way in which default superannuation products and financial advice are provided. Broadly, these reforms are intended to deliver better outcomes to superannuation fund members through simpler products, greater transparency and enhanced competition, and to ensure that financial advice is provided by professional advisers acting in the best interests of their clients.

Participants' views

Many inquiry participants commented on the way in which the introduction of MySuper will affect the default superannuation market. Some suggested that the additional requirement for funds to gain authorisation to offer a MySuper product should in turn allow any fund that offers a MySuper product to be listed in awards. Similarly, some participants considered that MySuper will make it unnecessary to continue to list funds in awards. Others noted that MySuper is primarily a disclosure rather than a quality regime, and that the most suitable funds for employees covered by different awards still need to be chosen and listed in the award. These differing views are discussed in more detail in chapter 8.

The Commission's view

The Commission considers that the process used to select superannuation products and funds to be listed as defaults in modern awards should be consistent with the direction of the Stronger Super reforms.

In one respect, this would require the selection process to be based on clear and simple information that was made available in a transparent fashion. And, as discussed above, there is scope to improve the transparency and other features of the current process.

Similarly, the FOFA reforms are designed to tackle conflicts of interest that have compromised the quality of financial advice. To be consistent with this policy, changes to the default fund selection process would need to be made, including:

- requiring decision makers to act in the best interests of employees who derive their default superannuation product in accordance with modern awards
- improving the disclosure and management of conflicts of interest.

In addition, there are existing requirements for financial advisers to be qualified and licenced — that is, to have expertise. Consistency with these requirements would require that default fund decision makers also have a certain level of expertise.

7.10 Overall assessment of the current process

After considering the current process against the principles outlined in recommendation 7.1, it is apparent that it has both strengths and shortcomings.

FINDING 7.2

The process currently used in the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards has the following strengths. It:

- *has generally led to the listing of funds that have delivered relatively strong average net returns when compared to the net returns of non-default funds*
- *has a measure of transparency*
- *imposes few regulatory burdens and fosters stability in the superannuation market.*

The process has the following shortcomings. It:

- *does not explicitly require decision makers to act in the best interests of employees who derive their default superannuation fund in accordance with modern awards, or to consider the regulatory and administrative burden that may result from their decisions*
- *does not give equal access to all superannuation funds, and therefore does not gain the advantages of contestability and competition*
- *is insufficiently transparent*
- *lacks important elements of procedural fairness*
- *has inadequate mechanisms for the ongoing assessment of funds.*

In view of the nature of the shortcomings of the current selection process, the Commission considers that reform to the process is essential. In its view, this is the only way of ensuring that the factors that should be considered in selecting default superannuation products and funds, as summarised at the beginning of this chapter, will be systematically taken into account. The Commission has considered several options for building on the strengths of the current process, while addressing its shortcomings. The assessment of these options, and recommendation of a preferred option, is the subject of chapter 8.

8 Reforming the selection process

Key points

- A Default Superannuation Panel should be set up within Fair Work Australia comprising the President and an equal number of other full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services. The panel should decide on which products to list in modern awards.
- All funds that offer an authorised MySuper product (and exempt public sector superannuation schemes) should be able to apply to, and be directly heard by, the panel. All interested parties should be given an opportunity to respond to the applications before the panel makes its decisions.
- The panel's decisions on whether or not to list a product should be guided by the best interests of employees, and based on the Commission's factors for consideration (and any other factors the panel considers relevant).
  - The panel should list all products that it judges are suitable. The list should be long enough to ensure that the best interests of employees are not undermined by issues of market instability and the negative impacts of being switched between products for no net gain.
  - The panel should, wherever possible, also identify a small subset of the listed products for each modern award that it judges as best meeting the interests of employees. Identifying a small subset of listed products will assist employers when choosing a product, and spur competition amongst funds.
- Default contributions should only be made to products that have been assessed as suitable by the panel (although contributions could continue to be paid into defined benefit funds without assessment).
  - Grandfathering provisions relating to default superannuation should be removed from all modern awards. Tailored and corporate MySuper products should be required to apply to the panel to receive default contributions, and be assessed on the same factors, but should not be specifically listed in modern awards.
- There should be an ongoing assessment to remove products in exceptional circumstances or when funds merge or change name. A wholesale reassessment of the list of products in awards should be conducted every four to eight years.
- The need to apply factors to determine products to be listed in awards reflects the nascent stage in the development of the MySuper product market. However, in the longer term, as the MySuper product market develops, it will be appropriate to have a review to consider whether to allow employers to choose any MySuper product as their default product.

This chapter focuses on reform to the process for the selection and ongoing assessment of default superannuation products for listing in modern awards. In chapters 4 to 6, the Commission concluded that there is a range of factors that should be considered when determining which products are listed in awards. As a consequence, there needs to be a process for selecting the most appropriate products from the pool of all authorised MySuper products. Chapter 7 concluded that the current process by which funds are selected has significant failings. Therefore, the Commission considers that reform is required.

In its draft report, the Commission presented four options for reforming the process:

- Option 1 involved each employer choosing a product from all available MySuper (or other approved default) products.
- Option 2 represented 'minimal change' relative to current arrangements, with industrial parties assessing all potential products and subsequently nominating a subset to Fair Work Australia (FWA) for listing in awards.
- Option 3 represented a more significant change to the current process, with all funds that wished to have their default product listed in modern awards presenting their case to an expert panel within FWA, which would then decide which products to list.
- Option 4 was similar to Option 3, but decisions would be made by a new expert body independent of FWA, with FWA administering the decision.

Options 2 to 4 shared several common features, including:

- giving employers discretion to select a non-listed fund, provided they could demonstrate, if called upon, that the factors for consideration were taken into account and that their employees would be at least no worse off than if a listed fund had been chosen
- allowing all funds that offer a MySuper product to apply to be listed in a modern award, and the application being assessed against the factors for consideration
- listing between five and ten products in any one modern award
- removing grandfathering provisions relating to superannuation
- maintaining an ongoing assessment process to enable the removal of products in extreme circumstances
- repeating the initial selection process by way of wholesale reassessment every eight years, while also conducting a light-handed assessment mid-way between each wholesale reassessment
- limiting appeals to avoid vexatious claims.

The Commission found that Options 3 and 4 are most aligned with the best interests of employees who derive their default superannuation product in accordance with a modern award, while also addressing the needs of employers when choosing a default product. In the draft report the Commission sought feedback from participants on the relative merits of these two options.

Section 8.1 summarises the views contained in submissions regarding Option 1. Participants' views on Options 2, 3 and 4 are discussed in section 8.2. Sections 8.3 and 8.4 summarise the Commission's views on Options 1 and 2 respectively, guided by the principles outlined in chapter 7. Options 3 and 4 are discussed in section 8.5 along with the Commission's recommended process. To conclude, section 8.6 summarises the assessment of this recommended process against the principles.

8.1 Participants' views — Option 1

Many participants expressed a preference for Option 1, where employers would be allowed to choose any eligible MySuper product (ANZ, sub. DR82; Association of Financial Advisors, sub. DR73; Business SA, sub. DR55; Colonial First State, sub. 42; CSSA, sub. DR56; FPA, sub. DR76; FSC, sub. DR80; Law Council of Australia, sub. DR67; Mercer, sub. DR68; MLC Ltd−NAB Wealth, sub. DR87; Suncorp, sub. DR64).

Proponents of Option 1 argued that the MySuper authorisation process is sufficiently rigorous such that no additional criteria are required to ensure that the best interests of members are protected (AMP, sub. DR85; ANZ, sub. DR82; FSC, sub. DR80; Mercer, sub. DR68; MLC Ltd−NAB Wealth, sub. DR87). For example, Mercer said:

> … under the MySuper regime all products will be required to satisfy numerous legislative requirements, be subject to ongoing monitoring under the *Superannuation Industry (Supervision) Act 1993* and be subject to APRA scrutiny. This will be the first time in APRA's history that APRA will be required to approve a particular superannuation product. In other words, APRA could be considered as the guardian of members' interests. (sub. DR68, p. 5)

Some participants also suggested that the factors for consideration outlined by the Commission overlap with the legislative requirements of MySuper products, and imposing them would:

- duplicate the role of the Australian Prudential Regulation Authority (APRA) in authorising default products (ANZ, sub. DR82; Law Council of Australia, sub. DR67)

- create unnecessary additional cost and complexity (Business SA, sub. DR55; Colonial First State, sub. 42; CSSA, sub. DR56; FPA, sub. DR76; FSC, sub. DR80; Mercer, sub. DR68; MLC Ltd−NAB Wealth, sub. DR87)
- increase regulation with no benefit to members (ANZ, sub. DR82; MLC Ltd−NAB Wealth, sub. DR87).

The Financial Services Council (FSC) said that it 'believes the outcome of this inquiry must be deregulation — not the imposition of further regulation on employers or the superannuation industry' (sub. DR80, p. 4). The FSC further stated:

> Our fundamental concern with an advisory panel is that it creates yet another layer of bureaucracy and cost which will presumably need to be funded by industry. Additionally, the existence of such a panel would suggest that the legislated MySuper safeguards are inadequate or deficient. If that is the case, then it raises the question of why additional criteria are not embedded in MySuper. There is no rational argument for introducing safeguards that will only apply to a subset of MySuper members. (sub. DR80, p. 27)

Supporters of Option 1 also pointed out that many employers have sufficient ability and interest to choose a product appropriate for their employees, and want the flexibility to do so. They pointed to:

- evidence from Cameron Research Group, which shows that around 50 per cent of surveyed medium sized employers regularly review their default fund arrangements, and that 26 per cent have a formal superannuation policy committee (FSC, sub. DR80; Suncorp, sub. DR64)
- evidence presented by employer groups such as the Australian Chamber of Commerce and Industry (ACCI) (sub. 37) which says that modern awards should not prescribe superannuation obligations
- research from Westfield Wright showing that employers do not want another group or entity picking default funds for their business (FSC, sub. DR80)
- the fact that employers can seek expert advice from financial advisers (and under the Future Of Financial Advice (FOFA) reforms, financial advisers have a best interest duty to their clients) (ANZ, sub. DR82), and that employers select many other financial service providers without requiring any additional government intervention (FSC, sub. DR80)
- the fact that the *Superannuation Industry (Supervision) Act 1993* (Cwlth) (SIS Act) prohibits inducements being offered to employers on the condition that employees join a particular fund, thereby ensuring that employers do not pursue their own self-interest (FSC sub. DR80; MLC Ltd–NAB Wealth, sub. DR87).

This was, however, in contrast to other evidence presented to the Commission that highlighted the difficulty that employers would face in choosing one product among all MySuper products (box 8.1). It was also in contrast with evidence from other participants that the SIS Act prohibitions on inducements were not sufficient to protect the best interests of employees (ACTU, sub. DR77; Cbus, sub. DR81; IFF, sub. 51; Queensland Nurses' Union, sub. DR61).

Box 8.1 **Difficulties faced by employers in choosing products**

Some submissions highlighted the difficulty that employers would face in choosing one product among all MySuper products (Michael Burke, sub. 3; Clubs Victoria, sub. 5; Peter Doyle, sub. 2; HOSTPLUS, sub. 8; Electrical Contractors Association, sub. 17; National Tourism Alliance, sub. 4; SDA, sub. 24). For example, CPA Australia said:

> One or more MySuper products should be nominated as the default arrangement in a modern award but there should be a limit on the number of funds that can be nominated to allow meaningful comparisons. To allow all MySuper products to be listed as default funds for a modern award would result in overwhelming choice making it difficult for [employers] to differentiate and make an informed choice in much the same way as if no funds were listed. (sub. 39, p. 2)

Similarly, the South Australian Wine Industry Association said:

> SAWIA employer members state they do not have the knowledge to be able to compare superannuation funds and measure the 'bells and whistles' against other funds when they lack the expertise to do so. This is the role of a financial planner, further each individual employee has different needs depending on their age, personal circumstances and stage of life. (sub. DR71, p. 3)

Several participants expressed a preference for choosing from a limited list of products:

> The limiting of the number of default funds listed in an award to between five and ten as proposed in the [Productivity Commission's draft report] will to some extent lessen the burden of choice being placed on small business by these reforms. (Electrical Contractors Association, sub. DR84, p. 2)

> From an employer perspective, we would prefer not to be given the responsibility of choosing a default fund from an extensive list, and would favour choosing from a small number of proven funds in awards. (Eldercare, sub. DR57, p. 1)

> … employers simply want to choose from a small number of proven funds in awards … (AJ & BJ Smith, sub. DR65, p. 1)

In terms of assisting employers to choose a default product, AMP (sub. 52) and MLC Ltd–NAB Wealth (sub. 44) noted that after the introduction of MySuper, employers will be better able to compare products and base their decision on current information supplied by APRA.

Others pointed to ongoing industry consolidation which will reduce the number of products, making it easier for employers to choose among all MySuper products

(FSC, sub. DR80; Law Council of Australia, sub. DR67). According to the FSC (sub. DR80), there are currently 183 public-offer funds which they expect to be a good proxy for the number of MySuper public-offer products that will be in the market. They expect this number to reduce to 100 by 2020. ACCI (sub. DR83) also noted that the number of funds is expected to contract, and that this would weaken the link between award coverage and fund suitability:

> Contraction of the number of funds offering MySuper products has implications for successive reviews. Fund amalgamations mean that funds offering MySuper products will have increasingly diverse membership in their product … There is also something of a tension between too great a focus on award coverage to determine the appropriateness of a particular fund for nomination as a default and the Stronger Super objective of encouraging fund scale. "Fit" between fund and award coverage may decline over time. (sub. DR83, pp. 5–6)

Many participants favouring Option 1 noted that a key advantage of giving employers the choice of any MySuper product is that it would drive competition in the default superannuation market, with competition representing the best way to ensure that the interests of employees are looked after (Colonial First State, sub. 42; FPA, sub. DR76; FSC, sub. DR80; Law Council of Australia, sub. DR67; Suncorp, sub. 38). BT Financial Group submitted that:

> We believe allowing employers to select a default superannuation fund most aligned to their employees' needs, will bring an important level of competition into the superannuation market place. Active employer decisions will force default superannuation funds to carefully consider how they price and service members. Competition allows for poor performers to be punished by the market, as employers move towards funds that have established themselves as consistent performers … Where companies are permitted to select a default fund for their employees, market participants can compete to offer the most efficient pricing and services possible to win the business. (sub. 46, p. 2)

In a similar manner, some participants argued that choosing a subset of products to be listed in awards would create barriers to entry and likely lead to a less innovative sector (FSC, sub. DR80; MLC Ltd−NAB Wealth, sub. DR87). They considered that it could also prevent employers from finding a default product that suits the demographic needs of their employees, particularly in light of the extent to which demographics vary significantly within cohorts of employees covered by each award (FSC, sub. DR80; MLC Ltd−NAB Wealth, sub. DR87), and across different awards:

> Different workplaces require different superannuation arrangements to reflect their demographic profile. We believe that this is very important. MySuper is proposed to provide some flexibility to tailor a plan to a workplace's requirements. The main requirement for tailoring is insurance design and investment selection. Awards can cover millions of employees, so it is not in any way logical to try to tailor investments

> at an award level, it is better to do so at a workplace level. (CSSA, sub. 35, appendix C, p. 4)

Participants in support of Option 1 were of the opinion that neither FWA nor any other expert panel would ever be able to accurately assess funds against the Commission's proposed factors for consideration, given the high level nature of those factors, the number of funds likely to seek to have their products listed in each award, and the volume and nature of information required to assess applications and understand the characteristics of the relevant industry (ANZ, sub. DR82; Law Council of Australia, sub. DR67; MLC Ltd−NAB Wealth, sub. DR87).

While preferring a 'pure' version of Option 1, some participants suggested ways that Option 1 could be altered, or combined with features from Options 3 and 4, to account for difficulties that employers might face when choosing one product among many (box 8.2).

Box 8.2 **Assisting employer choice**

In response to concerns that employers would face large search costs in choosing among all MySuper products, and that most employers lack the expertise to make an informed choice, several participants proposed ways in which these issues might be mitigated or overcome if Option 1 were adopted.

Some participants submitted that a webpage could be set up within the APRA website (Law Council of Australia, sub. DR67) or elsewhere (FSC, sub. DR80; Suncorp, sub. DR64) with material to assist employers in making their decision.

ANZ suggested creating 'a mechanism such that employers may easily and confidently access competent advice at a cost that is appropriate to their needs' (sub. DR82, p. 3).

Others advocated a non-mandated list of products or funds that could guide employers seeking assistance. The list could be maintained within modern awards (ANZ, sub. DR82; Law Council of Australia, sub. DR67) or outside modern awards (Mercer, sub. DR68; Suncorp, sub. DR64).

A number of other participants argued strongly against Option 1. Their views are summarised in the following section, which explores the feedback received on Options 2, 3 and 4.

8.2 Participants' views — Options 2, 3 and 4

Some participants saw no need (Asset Super, sub. 32) or little need (LGSuper, sub. DR59; REI Super, sub. 26; Unions NSW, sub. DR70) for change in the way in which default superannuation products are listed in modern awards. Others expressed a range of views on Options 2 to 4 as presented in the draft report.

Common features

Employer discretion — in favour

Many participants whose first preference was Option 1 regarded employer discretion to choose a fund not listed in awards as a reasonable alternative (when combined with Option 4 — see below) (AMP, sub. DR85; Association of Financial Advisers, sub. DR73; CSSA, sub. DR56; FPA, sub. DR76; FSC, sub. DR80; Suncorp, sub. DR64). They viewed employer discretion as being crucial to improving contestability, and considered that employers are best placed to select a fund that best suits the particular needs of their employees. According to the FSC:

> 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 any MySuper product would not materially improve competition. Accordingly, permitting unrestricted employer choice is the most critical element in improving the system for each of the key stakeholders in the super system. (sub. DR80, p. 17)

In addition, Suncorp said:

> Employers are in direct contact with employees each and every day and Suncorp therefore believes they offer a better level of decision making as compared to an industry-level decision making panel. (sub. DR64, p. 8)

While acknowledging that employers do have the flexibility to select an alternative default fund by implementing enterprise agreements, the FSC argued that this is unlikely to be an option for many small or medium businesses due to the costs involved in this approach:

> With 1.2 million small businesses in Australia; but fewer than 24 000 enterprise agreements registered with Fair Work Australia (which cover multiple enterprises throughout the economy), it is clear that employers do not view this as a simple solution to selecting an alternative default superannuation fund for their employees. (sub. DR93, p. 9)

However, even those in favour of allowing employer discretion (as well as some who were opposed — see below) expressed concerns about a 'no worse off' test being applied. In general, these concerns centred around the idea that such a test would be burdensome and complex for employers to comply with, and therefore mean that the discretion was unlikely to be exercised (ACCI, sub. DR83; AMP, sub. DR85; ANZ, sub. DR82; DEEWR/Treasury, sub. DR89; FPA, sub. DR76; ISN, sub. DR62; MLC Ltd–NAB Wealth, sub. DR87). For example, ACCI said:

> … for the proposal to provide a credible threat of competition, it needs to be viable. Employers would need to be confident that they can comply with the requirement and that compliance is easily demonstrable in the event they were to elect to provide an external default. To make viable the capacity to select a default fund outside the award list, fund assessment for compliance with the "no worse off" test should not impose cost of any significance on the employer, should be based on publicly available information and must not require the employer to obtain legal or financial advice. (ACCI, sub. DR83, pp. 6–7)

More specifically, the concerns with the 'no worse off' test included that:

- some employees may be worse off, but the majority better off, and a no worse off test would not necessarily capture this (Corporate Super Association, sub. DR63; Mercer, sub. DR68)
- it would require detailed comparison with up to 10 funds, and access to regularly updated information on those products and funds (ACCI, sub. DR83; Corporate Super Association, sub. DR63; Mercer, sub. DR68)
- at the time employers choose a non-listed fund, they have no way of knowing if their employees will be no worse off (Association of Financial Advisers, sub. DR73, Corporate Super Association, sub. DR63; CSSA, sub. DR56)
- the test creates a new regulatory structure that is costly and unnecessary given the existence of MySuper legislation (FSC, sub. DR80)
- there would be a risk of legal liability for employers if they choose a fund which in hindsight turns out to be inappropriate, and this risk would prevent employers from using discretion at all (Ai Group, sub. DR79; AMP, sub. DR85; Association of Financial Advisers, sub. DR73; CSSA, sub. DR56; Electrical Contractors Association, sub. DR84; FSC, sub. DR80; Law Council of Australia, sub. DR67; Mercer, sub. DR68; MLC Ltd–NAB Wealth, sub. DR87)
  - in response to this, it was suggested that no penalty or legal liability should be imposed on an employer if employees turned out to be worse off, as penalties would be a significant deterrent to choosing a non-listed fund in the first place. Instead, it was suggested that employers should simply have to choose another fund (FSC, sub. DR80; Law Council of Australia, sub. DR67; Mercer, sub. DR68; Suncorp, sub. DR64).

While supporters of Option 1 generally preferred that employers not be required to meet a test before choosing a non-listed fund, they offered several possible alternatives to a 'no worse off' test if such a test were to apply (box 8.3).

Box 8.3 **Alternatives to a 'no worse off' test**

Some participants suggested alternative tests that could be applied to protect the interests of employees when employers select an unlisted fund. These included:

- requiring the employer to demonstrate that it had a *reasonable basis for believing* that its employees would not be worse off than if a listed default fund was selected (Law Council of Australia, sub. DR67), or *reasonably expected their decision to leave their employees no worse off* (Suncorp, sub. DR64). The benefits of these tests are that they consider the quality of the decision at the time the decision was made, rather than the outcomes of the decision which are outside the employer's control
- an 'equivalent rights' test, similar to that which applies in successor fund transfers (FSC, sub. DR80)
- requiring employers to select a fund that provides a *similarly competitive offering* to any listed in the award based on the factors for consideration and applied on an aggregate employee basis (Corporate Super Association, sub. DR63).
- requiring the *trustee* of the recipient MySuper product to determine that, compared to any one MySuper product named in any award, employees would be at *no overall disadvantage* in having their contributions made to the recipient product (MLC Ltd−NAB Wealth, sub. DR87).

In terms of how to demonstrate that the relevant test had been met, the Law Council of Australia (sub. DR67) suggested that a standard document be used, such as a certificate from a qualified licensed financial adviser. The Association of Financial Advisers (sub. DR73) suggested that reports from superannuation fund assessment providers could be used as the basis for a 'safe harbour' standard for employers and financial advisers to use. Suncorp saw merit in using an online form:

> Employers should be encouraged, but not required, to justify their choice at the time of the decision making. The employer choice website could provide a simple online form that prompts employers to outline the core reasons behind their decision and allows for brief commentary by the employer. This decision statement would minimise later regulatory burden ... (sub. DR64, p. 9)

Employer discretion — opposed

Other participants were opposed to the idea of allowing employers to choose a fund not listed in the relevant award (ACTU, sub. DR77; Ai Group, sub. DR79; AIST, sub. DR69; AJ & BJ Smith, sub. DR65; AustralianSuper, sub. DR74; Cbus, sub. DR81; DEEWR/Treasury, sub. DR89; Eldercare, sub. DR57; ISN, sub. DR62; Queensland Nurses' Union, sub. DR61; United Voice, sub. DR88).

These participants regarded employer discretion as inconsistent with the award process as it would not require agreement with employees or their representatives (ACTU, sub. DR77; Ai Group, sub. DR79; AIST, sub. DR69; AustralianSuper, sub. DR74; Cbus, sub. DR81; DEEWR/Treasury, sub. DR89; ISN, sub. DR62). Participants stated that there are already effective arrangements for alternative fund choice through enterprise agreements, and these arrangements do not create an excessive burden for employers, particularly for employers sufficiently engaged and motivated to select a fund or product not named in the award (ACTU, sub. DR77, AIST, sub. DR69; AustralianSuper, sub. DR74; Cbus, sub. DR81; DEEWR/Treasury, sub. DR89; ISN, sub. DR62). For example, the Industry Super Network (ISN) said:

> It is open to any employer who is sufficiently engaged to seek to reach an Enterprise Agreement with their staff that deals with superannuation, including the nomination of a fund or choice of default fund … It is entirely appropriate that an employer who seeks to change a fundamental condition of employment should be required to seek the approval of staff and have imposed a requirement that the employees are 'overall better off'. (sub. DR62, p. 21)

Similarly, DEEWR/Treasury stated:

> As a matter of principle and at law, an employer cannot unilaterally determine to 'opt out' of the safety net, including 'opting out' of provisions of a modern award. (sub. DR89, p. 9)

The Australian Institute of Superannuation Trustees (sub. DR69) recommended that further flexibility be built into enterprise agreements to allow the creation of single-issue enterprise agreements for superannuation. It suggested that these could sit alongside other enterprise agreements or the other provisions in the modern award, without superseding any existing enterprise agreements or displacing the coverage of the modern award.

Opponents of employer discretion also pointed out that there are principal–agent issues and conflicts of interest that create the risk that employers make choices outside the award that are not in the best interests of employees (ACTU, sub. DR77; Ai Group, sub. DR79; AIST, sub. DR69; Cbus, sub. DR81; ISN, sub. DR62; Unions NSW, sub. DR70; United Voice, sub. DR88).

Cbus (sub. DR81) and ISN (sub. DR62) warned that employers do not have the expertise to make a selection in the best interests of their employees, and that the employer discretion proposal would lack transparency and provide no clear mechanism for an employee wishing to challenge the employers' choice. In addition, the Australian Council of Trade Unions (ACTU) (sub. DR77) and Cbus (sub. DR81) submitted that there is little if any evidence that such a reform is desired by employers.

Allowing all funds to apply to be listed in an award

There were differences in opinion among participants about who should be able to apply and be heard by the decision maker to have default products listed in awards.

Proponents of Option 1, while preferring that employers be allowed to select any MySuper product, were supportive of the recommendation to allow all funds offering an authorised MySuper product to apply to have their products listed, and regarded it as a significant improvement on the current system (CSSA, sub. DR56; FSC, sub. DR93; Suncorp, sub. DR64).

Many other participants also suggested that any fund offering an authorised MySuper product should be able to apply to have it listed in awards (AJ & BJ Smith, sub. DR65; Australian Hotels Association, sub. 10; IFF, sub. 51; ISN, sub. 27; Transport Industry Superannuation Fund, sub. DR91).

Others believed that it would not be appropriate to allow those funds that wish to be listed in a modern award to apply directly to the decision maker (AustralianSuper sub. 36; Cbus, sub. DR81; Queensland Nurses' Union, sub. DR61; United Voice, sub. DR88). They claimed there is currently adequate scope for funds to be heard by gaining the support of an employer or employee covered by the relevant awards, and that this is a low hurdle (chapter 7).

Instead of allowing all funds to directly apply to have their default products listed in an award, DEEWR/Treasury (sub. DR89) suggested that funds seeking to be listed could participate by presenting information to an expert panel through expressions of interest as part of the eight-yearly reassessments. The panel would assess the expressions of interest and provide a report to a Full Bench of FWA for decision (see below).

Number of listed products

In the same way that some participants objected to Option 1, some submissions emphasised the need to restrict the number of products listed in awards to ease the burden on employers from having to choose among too many products (AJ & BJ Smith, sub. DR65; Cbus, sub. 15; COSBOA, sub. 7; Eldercare, sub. DR57; Electrical Contractors Association, sub. DR84; legalsuper, sub. 19; SDA, sub. 24).

Some participants supported a range of five to ten products (AIST, sub. DR69; Cbus, sub. DR81; CSSA, sub. DR56; ISN, sub. DR62), although ISN saw a case for providing FWA with discretion to increase or decrease the range.

Other participants noted that by limiting the list of products to between five and ten, contestability could be impeded (Business SA, sub. DR55, FPA, sub. DR76; FSC, sub. DR80).

Grandfathering and removal of listed products

ISN called for the removal of the current grandfathering provisions from awards, on the basis that default contributions for new employees should only be made to products that have been subject to the selection process:

> As a matter of principle the grandfathering arrangements should be designed to minimise disruption and benefit the employee. Grandfathering arrangements should apply to the individual not the workplace. An employer should not be entitled to continue to make contributions to a fund that has failed the selection process for future employees. (sub. DR62, p. 25)

Many other participants were in support of removing grandfathering if employers were given the discretion to choose any MySuper product not listed in the award (Corporate Super Association, sub. DR63; CSSA, sub. DR56; FPA, sub. DR76; MLC Ltd−NAB Wealth, sub. DR87).

There was, on the other hand, concern expressed over the removal of grandfathering, especially in the absence of flexibility to choose outside the listed products. Some participants (FSC, sub. DR80; Mercer, sub. DR68) argued that the removal of grandfathering would create a barrier to fund mergers and industry rationalisation unless the relevant modern awards were amended whenever appropriate after a fund merger. Concern over the removal of grandfathering also extended to defined benefit funds and corporate funds being prevented from receiving default contributions for employees who derive their default superannuation product from modern awards (Corporate Super Association, sub. DR63; Mercer, sub. DR68).

Many participants highlighted concerns with the transitional issues involved in removing grandfathering and/or removing products from the list in awards during the ongoing assessment and/or periodic reassessment. Some participants emphasised the potential negative impacts for employees who were forced to change products:

- Mercer (sub. DR68) noted that this would create multiple accounts for employees (and multiple sets of fees and insurance premiums), and require them to consider whether they wish to consolidate accounts or stay in their existing product through choice of fund provisions.

- MLC Ltd−NAB Wealth (sub. DR87) highlighted the risk that moving members from their current option on a single prescribed day or in a short time frame would expose members to transactions being undertaken without regard to their investment merit.
- MLC Ltd−NAB Wealth (sub. DR87) and the Law Council of Australia (sub. DR67) were concerned about changes to, or loss of, insurance benefits that may be excluded under new policies. The Law Council of Australia said:

  > Removal of grand-parenting provisions is likely to cause significant disruptions and potential for employees to suffer loss if their superannuation is unilaterally moved to new default funds from current default funds in which they have been members for many years. This may have a significant effect on employees' insurance cover, and may give rise to additional fees and charges payable by employees who acquire multiple accounts. (sub. DR67, p. 5)

Other participants (AiGroup, sub, DR79; Mercer, sub. DR68; South Australian Wine Industry Association, sub. DR71) emphasised the potential negative impacts on employers. For example, AMP said:

> The administrative burden placed on employers, especially medium to large employers, in changing default superannuation funds is also considerable. In order to change a default superannuation fund, an employer is bound by the Superannuation Guarantee Act to issue all employees with a choice of fund form (and act on and retain returned forms). (sub. DR85, p. 7)

Effects on funds and system-wide stability were also mentioned, such as:

- the potentially large call on the assets and impact on liquidity and future investment returns of delisted funds (or funds that can no longer receive default contributions due to the removal of grandfathering) as members transfer account balances to new funds and contribution inflows drop (Mercer, sub. DR68)
- the effect on longer term investment decisions, because in making these decisions, funds must have some level of certainty as regards expected contribution in-flows and out-flows (Law Council of Australia, sub. DR67)
- the impacts on remaining members of delisted funds (or funds that can no longer receive default contributions due to the removal of grandfathering) as scale reduces, and fees potentially increase (Mercer, sub. DR68).

MLC Ltd−NAB Wealth (sub. DR87) also noted that if all transactions occur within a restricted period, it is likely that the volume of transactions will impact members' retirement savings through higher fees and costs as well as adding to systemic risk.

Participants raised several different suggestions about how to overcome the problems with delisting funds from awards (box 8.4).

Box 8.4 **Dealing with delisting funds from awards**

Several participants proposed grandfathering arrangements that might help to deal with potential instability issues arising when funds are delisted from awards. The Financial Services Council (sub. DR80) maintained that, if employers are not permitted to choose from any MySuper product without facing an additional test, then existing grandfathering arrangements should continue. The Law Council of Australia went further, stating that:

> … not only should the current grand-parenting regime continue, but it should be extended in the event that Option 3 or 4 is chosen to ensure that the removal of a fund from the approved 'default MySuper' product list does not result in loss to employees or an impact on long term investments by superannuation funds. (sub. DR67, p. 6)

The Industry Super Network suggested more limited grandfathering arrangements might be appropriate (in order to minimise disruption and benefit the employee) where the 'successor of a current fund named in a modern award or a fund selected in the future, on further examination, fails a selection process' (sub. DR62, p. 25).

Mercer (sub. DR68) suggested that there could be a different test for funds being taken off a list than the test for being put on the list. As alternatives, they suggested that high-performing funds could be allowed to remain on the list even if this resulted in a larger number of funds on the list than the limit allowed, or that grandfathering arrangements could be put in place to allow employers to continue paying contributions to the fund, where they were already doing so.

The Electrical Contractors Association (sub. DR84) proposed a 12 month transitional compliance period before delisting could be instituted, to allow funds to demonstrate compliance or create products that do comply.

Ai Group suggested that whether a fund is currently listed as a default fund should form an additional criteria for continuing selection:

> It is quite likely that in a reassessment of default funds to be listed in awards there would be only marginal differences between some funds that might be included and some that might not be included. These differences could well relate to the vagaries of the ranking methodology employed. In these circumstances, even putting aside the costs involved in changing funds, it is likely there would be a reasonable doubt whether a move was advantageous. Once the costs of moving were taken into account, even further doubt would arise. (sub. DR79, p. 4)

Timing and process for reassessment

Participants highlighted the importance of the panel working with APRA in the reassessment process. For example, Mercer said:

> Where very serious issues exist, we note these should have been picked up by APRA and [that fund's] MySuper authorisation would be threatened. The relevant panel should work with APRA to ensure any adverse impacts on members and employers are minimised. (sub. DR68, p. 9)

In addition, DEEWR/Treasury said:

> It will be important that there is effective communication and exchange of information between the two bodies ... APRA will have an ongoing role in monitoring the performance of all MySuper products, including [that] of funds listed as defaults in modern awards, and this information will assist FWA in assessing such funds at regular, defined intervals. Information on changes to the status of listed funds (for example, funds have merged, undergone name changes, had their MySuper authorisation cancelled, etc.) must also be provided by APRA to FWA. (sub. DR89, pp. 3–4)

Some participants noted that the timetable for four- and eight-yearly reassessments might be inadequate and might not align with the performance of funds or the requirements of businesses and employees (Business SA, sub. DR55). The Corporate Super Specialist Alliance (sub. DR56) suggested that a three-yearly reassessment would be more appropriate.

Many participants opposed restricting new applications to the eight-yearly reassessment, believing that it would prevent employees accessing new and improved products (Association of Financial Advisers, sub. DR73; CSSA, sub. DR56), or that it would prevent adding to the list in the event that the number of products in an award dropped too low (ACCI, sub. DR83). For example, the Corporate Super Specialist Alliance said:

> It would appear logical that if a superannuation fund is recognised as being superior to its peers, or if a new fund is developed that offers superior features and benefits, that employees should be able to get access to this fund rather than waiting an arbitrary period, such as 8 years, for a reassessment of default funds within an award to occur. Imposing this limitation on the ability to add funds will not encourage creativity and innovation of fund design. It could also lead to funds that are nominated becoming complacent and not regularly improving and updating their offering. (sub. DR56, pp. 4−5)

It was suggested that funds be allowed to apply at any time (Transport Industry Superannuation Fund, sub. DR91) or during the light handed four-yearly reassessments (FPA, sub. DR76).

Suncorp (sub. DR64) and DEEWR/Treasury supported the timing of reassessment outlined in the draft report. According to DEEWR/Treasury, it:

> … strikes an appropriate balance between the creation of a simple and stable award safety net for the benefit of employers and employees, with appropriate assessments of default funds in modern awards by FWA on a periodic basis. Lastly, it complements the existing frameworks and processes in the FW Act. (sub. DR89, p. 4)

Option 2

AustralianSuper (sub. DR74) supported Option 2 on the basis that it best incorporates positive improvements to the selection process, including the introduction of selection criteria, a requirement that parties declare conflicts of interest, consideration of a wider array of funds and implementation of an ongoing review process.

Cbus (sub. DR81) and United Voice (sub. DR88) maintained that the current process did not need to be changed significantly, and expressed a preference for Option 2 on the basis that it resembled the current process more closely than any other option. Cbus was not concerned about the lack of expertise of FWA:

> There is no evidence that FWA members would struggle to evaluate comparative data regarding the structure and performance of a MySuper fund. Indeed FWA members regularly assess complex evidence in making decisions - economic evidence, company finances, demographic data, engineering and scientific information, and so forth. (sub. DR81, p. 8)

United Voice cautioned that promoting competition among funds could 'lead to the addition of significant distribution costs, thereby eroding returns to members by as much as 8.2%' (sub. DR88, p. 8). This concern was also expressed by the ACTU (sub. DR77).

Options 3 and 4

Options 3 and 4 were the Commission's preferred options in the draft report. The key difference between these options was that in Option 3 the decisions about which products are listed in awards would be made by an expert panel within FWA, whereas in Option 4 these decisions would be made by a new expert body independent of FWA, with FWA administering the decision.

Some participants (ACCI, sub. DR83; Suncorp, sub. DR64) were less concerned about whether the panel sat within or external to FWA, and more concerned about the process for appointing the panel and the way that it operated. For example, Suncorp said that:

> Ultimately, it is the membership of the panel and the quality of the decision making that will have the greatest influence over the perception of independence, not the body or name under which the panel operates. (sub. DR64, p. 9)

Many participants favoured Option 3 (ACTU, sub. DR77; Ai Group, sub. DR79; AIST, sub. DR69; CPSU, sub. DR78; DEEWR/Treasury, sub. DR89; Eldercare, sub. DR57; ISN, sub. DR62; NUW, sub. DR72; Queensland Nurses' Union, sub. DR61; Unions NSW, sub. DR70). They viewed superannuation contributions as deferred wages and inherently an industrial matter and, on that basis, considered FWA to be the most appropriate body for the task of listing products in modern awards. According to DEEWR/Treasury:

> Superannuation is part of an employee's total remuneration and as modern awards form part of the safety net, and superannuation is an award matter, we consider it would be highly undesirable to split responsibility for modern award matters between FWA and another body. FWA is experienced in considering competing submissions on industrial matters and working constructively with stakeholders in undertaking the many functions for which it is responsible under the Fair Work Act 2009 … This extensive expertise, combined with the administrative simplicity provided by retaining responsibility for modern awards within the one body, means FWA is the most appropriate body to undertake the selection and ongoing assessment of default superannuation funds in modern awards. (sub. DR89, p. 3)

Supporters of Option 3 also said that creating a new independent body would involve unnecessary duplication of existing FWA processes (ACTU, sub. DR77; AiGroup, sub. DR79; AIST, sub. DR69; AustralianSuper, sub. DR74; ISN, sub. DR62; Unions NSW, sub. DR70), and that such a body would not have adequate experience and knowledge of industrial matters (ISN, sub. DR62; NUW, sub. DR72). They also thought that an independent body would not give sufficient weight to employer or employee interests (AIST, sub. DR69) and would be subject to conflicts of interest (AIST, sub. DR69; ISN, sub. DR62).

There was support among proponents of Option 3 for a panel based on the Minimum Wage Panel. For example, the National Union of Workers said:

> The [Minimum Wage] Panel has so far operated in an efficient and effective manner and the NUW believes it would be an appropriate and effective template for the introduction of a similar panel to determine default superannuation funds in modern awards. (sub. DR72, p. 5)

Similarly, the Australian Institute of Superannuation Trustees said:

> The Minimum Wage Panel works well; it is integrated into the tribunal's operation; it is subject to the Fair Work Act, including the requirement to balance interests and have regard to broader economic factors; it uses the resources and infrastructure of Fair Work Australia, and so there are minimal extra costs; and its point of difference is the ability to co-opt members with specialist expertise. In other words, it is a model ideally suited for extension into superannuation. (sub. DR69, p. 8)

Others argued that APRA should play a role in determining issues such as performance, scale, governance, conflicts of interest and administrative efficiency, before the final decision is made by FWA (AustralianSuper, sub. DR74; Master Builders Australia, sub. 41; NGS Super, sub. 18; Queensland Nurses' Union, sub. DR61). While DEEWR/Treasury saw a case for information exchange between

APRA and FWA, they said that it was important that the roles of APRA and FWA are kept separate and clearly defined:

> APRA must retain responsibility for regulatory oversight of the superannuation industry and for authorising funds to offer MySuper products (a prerequisite for any fund seeking listing as a default fund). FWA's role would be to assess funds against relevant factors, and then make 'on-balance' judgements about which superannuation funds should be listed as default funds in modern awards. (sub. DR89, p. 3)

The ACTU (sub. DR77) and DEEWR/Treasury (sub. DR89) proposed that the expert panel sit external to FWA and provide a report to FWA to assist FWA in deciding which products should be named in individual awards. DEEWR/Treasury detailed their preferred approach:

> The expert panel would conclude its assessment by providing a report to a FWA Full Bench listing those funds it had assessed as suitable for inclusion in modern awards as default funds, as well as setting out reasons why it may have assessed some funds as unsuitable for inclusion. Given its broader role in managing the overall review assessment and selection process, and its responsibility for conducting reviews of modern awards generally, the Full Bench would consider the panel's report, hear the views of the industrial parties and determine whether or not to vary the relevant awards, as appropriate. The expert panel's report would form the basis of the FWA Full Bench's considerations of the factors which will guide the assessment of the suitability of funds for inclusion in modern awards. (sub. DR89, p. 5)

DEEWR/Treasury saw the benefits of this approach being that it would streamline the process, and ensure that the industrial parties have continual involvement in order to:

> … ensure that the interests of employees continue to be a key consideration for the FWA Full Bench in determining which funds to list as default funds in modern awards but that the interests of employers are also considered. (sub. DR89, p. 5)

As with DEEWR/Treasury (sub. DR89), other participants thought that the views of employers, employees and their representatives should be explicitly taken into account and, in some cases, given precedence in the process of selecting funds for modern awards because they are closest to those most affected by the process (ACTU, sub. DR77; AIST, sub. DR69; HOSTPLUS, sub. 8; IFF, sub. 51; ISN, sub. DR62; NGS Super, sub. 18; NUW, sub. DR72; Queensland Nurses' Union, sub. DR61). For example, the ACTU said:

> Our strong view remains that when Fair Work Australia comes to consider the effectiveness and potential amendment of award default arrangements it must continue to recognise the exclusive industrial status of superannuation and therefore give precedence to the role of those who represent employers and employees. (sub. DR77, p. 9)

In contrast to support for Option 3, many participants whose first preference was for Option 1 identified Option 4 as their next most preferred option (Association of Financial Advisers, sub. DR73; Business SA, sub. DR55; CSSA, sub. DR56; FPA, sub. DR76; FSC, sub. DR80).

These participants believed that FWA does not have the specific knowledge and necessary superannuation experience to make decisions about which products are listed in modern awards (Association of Financial Advisers, sub. DR73; CSSA, sub. DR56). They thought that using an independent body would increase transparency, due process and fairness (FSC, sub. DR80), and would increase the perception of independence from industrial interests and confidence in the process (ACCI, sub. DR83; Association of Financial Advisers, sub. DR73; FPA, sub. DR76).

The Transport Industry Superannuation Fund (sub. DR91) favoured a process whereby APRA would select funds based on the Commission's factors for consideration, and the list would be maintained outside awards. It considered that APRA would be best placed to select funds due to its expertise in superannuation.

8.3 Commission's view — Option 1

As noted above, many participants supported Option 1 (or a variation thereof) where employers could choose any MySuper product, despite the Commission not favouring this option in the draft report. This section assesses this option against the principles outlined in chapter 7.

Best interests of employees

This option does not have an explicit focus on the best interests of employees. It assumes that their best interests will be reflected in the decisions made by employers, and be safeguarded by the Stronger Super reforms and the MySuper authorisation process.

As discussed throughout this report, the Commission has assessed that this safeguard will not necessarily be provided. This is primarily because the MySuper legislation, though placing a general obligation on fund trustees to promote the financial interests of members, serves largely to standardise features and promote disclosure to improve comparability between default products. Given the timing of this inquiry, with the MySuper legislation not yet in force, the Commission is not in a position to observe the quality of products being offered by the market. Accordingly, the Commission is not currently able to be satisfied that the legislation will operate as a sufficient filter to ensure that the best interests of employees who derive their default superannuation product in accordance with modern awards would be adequately protected simply by those employees being placed in any MySuper product.

While the Commission has not identified any additional prescriptive criteria, it has concluded that a range of factors should be considered when selecting default products for listing in modern awards, to ensure that the best interests of employees guide this selection. Not all MySuper products would be judged equally highly against those factors, making some products more likely to advance the interests of employees than others.

In addition, this option does not address the principal–agent problems inherent in a default superannuation system (chapter 3). It shifts the burden of the decision from industrial parties to employers, who do not necessarily have the incentive, interest or expertise to make a decision that is aligned with the best interests of employees and who can be faced with conflicts of interest.

While the Commission accepts that there are some employers who have the interest and expertise to choose a product that best meets the interests of their employees, it does not believe that this is the case for most employers, and particularly not for most small and medium sized employers. It is the Commission's view that other mechanisms (such as enterprise agreements) provide adequate opportunity for those employers with sufficient interest and expertise to choose the best MySuper product for individual workplaces, while also minimising the risk of poorer outcomes on average for employees.

The Commission notes that many supporters of Option 1 have pointed out that the SIS Act prohibits inducements being offered to employers on the condition that employees join a particular fund. The Commission accepts this, but recognises that there is no requirement for inducements to be overtly offered for conflict of interest concerns to emerge. For example, even without prompting from financial institutions, employers might wish to consolidate all their business (including employee superannuation) with one particular institution. This might be administratively simpler for employers, but not necessarily be in the best interests of employees.

Contestability and competition

An advantage of this option is the extent to which it achieves contestability, as there are no restrictions on entry into the market other than the requirement to offer a product authorised to receive default contributions.

It also ensures that competitive forces are at play, as it is fundamentally a market-based approach where participants — in this case employers (as agents of their employees) — are required to make a choice among all funds that offer a MySuper or other approved default product.

Therefore, when compared to other options, Option 1 would provide the benefit of enabling maximum supply-side competition, with known and non-onerous barriers to entry for funds offering MySuper products.

Some participants expressed concerns that increasing competition would encourage funds to spend more on marketing and advertising to entice employers to select them. (This occurred in Chile in the 1980s and 1990s, and as a consequence, regulations were put in place to limit switching between funds — see appendix B.) However, the Commission does not expect that such activity would be widespread given the inertia that is likely to prevail on the demand side, and the likelihood that MySuper products will represent the lower margin end of the superannuation market, making it less worthwhile for funds to spend heavily on marketing these products.

In any event, Option 1 would not solve the issue of a lack of demand-side pressure (chapter 3). In this option, employers are the demand-side participants and, because of the inherent principal–agent issues, they would not necessarily have the incentive to actively participate in the market by choosing and switching between funds based on the best interests of their employees. In other words, employers could ultimately prove to be as disengaged and inactive as the employees for whom they are making decisions.

Because of the lack of demand-side engagement and the presence of principal–agent relationships, the Commission does not currently see it as appropriate to allow unfettered competition on the supply side, as this is unlikely to protect the best interests of employees. The Commission favours an approach that restricts supply sufficiently to protect the best interests of employees while also providing adequate incentives for funds to compete and continually improve their product offerings.

In the long term, however, as the market for MySuper products matures and the MySuper criteria take effect, the number and mix of those products might become more certain, and the average quality of MySuper products might increase. In particular, the MySuper requirements that trustees act in a manner that optimises the best financial interests of members in the long run, and that trustees assess scale to ensure it is consistent with the best interests of members, may mean that MySuper authorisation proves to be sufficient to protect the best interests of employees and that Option 1 therefore becomes potentially more appropriate.

Transparency

Under Option 1, there would be little improvement in transparency about the way a default product is chosen for an employee. In the current process, FWA generally provides an explanation for its decisions. However, decisions are currently made on the basis of precedent or the support of industrial parties, and there is a lack of transparency about the basis upon which industrial parties nominate funds for inclusion as default funds in modern awards (chapter 7).

Under this option, that opaqueness would shift to the way that an employer selects a MySuper product for its workplace. There would be no disclosure as to why an employer chose that particular fund, and no assessment of the appropriateness of that choice other than the assurance that a MySuper product was chosen and the performance of that product would be disclosed on a product dashboard.

In the longer term, if the MySuper requirements (together with the other Stronger Super reforms) came to act as an effective quality filter in response to market changes that they induce, then transparency would be less of an issue. Disclosure through the MySuper authorisation process would be likely to provide sufficient transparency.

Procedural fairness

It is somewhat difficult to assess the procedural fairness principle under this option, as the 'decision maker' is the employer, not a government organisation or judicial entity. It would require that the procedures followed by employers be monitored and deemed as being fair or unfair.

Minimum regulatory burden

This option would reduce the regulatory burden for those involved in the default product selection process in many ways, given that there would be no prescribed procedure for selecting a default product. There is no specific role for industrial parties or FWA or any other decision making body. Funds would not be required to put forward their case against the factors for consideration.

Even if the Commission considered that MySuper authorisation presented a sufficient hurdle for a product to be listed in awards, without the need to consider a range of factors, the Commission does not regard it as practical or desirable for all employers to be required to choose from the expected wide set of MySuper products given the search costs involved. According to APRA, there will be 'no more than 300 generic MySuper products at present indications' (pers. comm, 21 September

2012). The FSC (sub. DR80) estimates that there will be 183 generic MySuper products offered by public-offer funds (which does not include an estimate of generic products offered by non-public offer funds).

The Commission agrees that industry consolidation over time will mean that the number of MySuper products will decrease, and considers that this would potentially make Option 1 a more appropriate solution over time.

In the meantime, however, requiring all employers to choose amongst all MySuper products would involve large search costs, especially in light of evidence that many employers lack the expertise required to make an informed choice and do not have the resources available, or incentive, to gain that expertise (box 8.1).

As noted above, some proponents of Option 1 suggested that the burden on employers could be ameliorated in a number of ways, including through websites to guide employers in their decision, or by including a non-mandated list of products in awards. Until there is more certainty about the number, mix and quality of MySuper products, the Commission does not believe these measures would be sufficient to ensure that the best interests of members are met.

Market stability

The more a process drives change in the composition of products listed in a given award, leading to employers switching default products, the greater the potential for significant changes in the flow of contributions between funds with MySuper products. Some funds that have had a long-standing guaranteed inflow of contributions from their default status in awards would lose that position and potentially experience a loss of scale that could have detrimental consequences for members of the fund and contribute to instability in the market.

This option has the greatest potential to cause instability in the default superannuation market, especially in the short term. Fully opening up the market for default funds in awards could lead to a high degree of switching of default funds by employers, propelled by aggressive marketing campaigns from funds. However, as explained above, the Commission considers that such activity is unlikely to be widespread.

In the Commission’s view, the more likely outcome of Option 1 would be a high level of stability given the significant inertia that would likely prevail on the part of employers, who have little incentive to switch funds on behalf of their employees due to the administrative costs involved in doing so.

Consistency with other policies

At a minimum, this option is consistent with the disclosure regime that underlies MySuper and promotes choice by employers, much as the 2005 choice of fund reforms promoted choice by employees. However, it runs counter to the recent FOFA reforms that seek to reduce the potential for conflicts of interest where financial decisions are made by third parties (chapters 5 and 6). Leaving decisions about superannuation — often the first or second most important savings vehicle an individual will have — to a person unqualified in financial matters (most employers) would be at odds with the thrust of the FOFA reforms.

In the longer term, however, if the MySuper requirements, together with the Stronger Super reforms, came to act as an effective quality filter in response to market changes that they induce, then employers' expertise in financial matters (or lack thereof) would become much less important.

Regular assessments

There is no assessment mechanism built into this option. Employers would not be obliged to assess the appropriateness of the default product at any time. Instead, any assessment would be at the employer's discretion. Given the inherent principal−agent issues, many employers would probably face little incentive to reassess their initial choice of fund to ensure it continued to reflect the best interests of employees.

The Commission notes the evidence provided to it showing that around 50 per cent of medium-sized employers regularly review their superannuation arrangements. However, it is not clear to the Commission that this review was conducted with the best interests of employees in mind — employers might switch for other reasons such as administrative convenience. The evidence also indicates that the remaining half do not regularly review their superannuation arrangements, which would be of some concern were Option 1 to be adopted. In addition, the share of small employers regularly reviewing their superannuation arrangements would likely be even lower than that for medium-sized businesses.

Conclusion

The Commission considers that, while the MySuper legislation seeks to provide information that will better enable superannuation products to be compared, employers are not best placed to make this comparison from the expected full suite of products that will be available in the medium term. This is due to the inherent principal–agent issues that exist between employers and employees, and the stated lack of interest and expertise on the part of many employers when it comes to choosing a default product, particularly from a large number of available products.

Therefore, the Commission currently does not support Option 1. The Commission considers that adoption of Option 1 would not be in the best interests of employees in the medium term relative to other options involving an assessment of the factors for consideration outlined by the Commission, particularly given the uncertainty regarding the number, mix and quality of MySuper products to be offered from 1 July 2013.

In the longer term, however, the Commission considers that Option 1 has the potential to become a more appropriate option. This is because:

- expected industry consolidation will lead to a fall in the number MySuper products on offer, reducing search costs for employers
- the MySuper authorisation criteria and broader Stronger Super reforms are likely to increase the average quality of MySuper products over time and narrow the quality differential between them.

The Commission therefore proposes that there be a future review of the recommended process, including an assessment of the appropriateness of employers being able to use any MySuper product as a default superannuation product (chapter 9).

8.4 Commission's view — Option 2

Under Option 2, the industrial parties would assess all potential products and nominate a subset to FWA for listing in awards. Under this option, the industrial parties would be obliged to:

- consider all funds in good faith
- assess the performance of the applicant funds against the factors for consideration
- demonstrate to FWA that they are making their decision according to the best interests of the employees who derive their default superannuation product in accordance with modern awards, while having regard to the administrative and compliance impact on employers.

Best interests of employees

This option improves on the current process. Industrial parties would be required to consider all applicant funds against the factors for consideration, disclose any conflicts of interest and present their case with the best interests of members explicitly identified. In this sense it goes some way to addressing the principal–agent issues identified in chapter 7.

However, it is not clear that industrial parties would always have the expertise to be best placed to make decisions in the best interests of employees who derive their default superannuation product in accordance with modern awards. Moreover, where a balance of judgement is required, industrial parties would likely retain the incentive to preserve the status quo or choose industry funds with which they may have an association. Applicant funds might also press their ability to provide ancillary services to a membership base which overlaps with that of the industrial parties as a way of promoting a favourable assessment of their fund by the industrial parties making the submission to FWA. There would need to be a strong mechanism to counter these potential factors.

In addition, and in the absence of additional expertise, FWA might lack the expertise and/or information to assess:

- whether the industrial parties had adequately discharged their obligation to make decisions in the best interests of employees
- the reasonableness of any objections from interested parties that claim that the industrial parties have not acted in the best interests of employees
- whether the industrial parties had followed a transparent and fair nomination process given the historical association between industrial parties and industry funds.

Depending on how many and which products are listed, there is also the possibility that, in the absence of grandfathering (under Option 2, grandfathering was to be removed), many employees will be moved into a new fund. As noted below, some employees could end up worse off due to the creation of multiple accounts, unless the new fund was significantly better than the employee's existing fund.

Contestability and competition

Contestability would be improved under this option compared with the current process because all funds would be able to apply to be listed as a default fund in an award and industrial parties would be obliged to consider all funds. However, some would argue that full contestability is not possible where the process is still weighted toward the views of the industrial parties.

Greater contestability, together with a regular review process, would spur competition. However, in this option the industrial parties are the main demand-side participants, and incentives for funds to compete on price and performance could be muted to the extent that industrial parties are perceived as making decisions for conflicted reasons rather than based on merit.

Transparency

In theory, transparency would increase because industrial parties would be required to disclose the basis on which they nominate funds for inclusion in awards against the factors for consideration. Currently there is no such requirement on those parties (chapter 7).

The disclosure of information at the application, response, consideration and decision stages would also be more detailed and rigorous as, in each case, the factors need to be explicitly considered.

In practice, FWA would need to convince itself that the industrial parties have followed a transparent process in genuinely considering all applicant funds and that their nomination of particular funds is not driven primarily by historical precedent and association with those funds.

Procedural fairness

Procedural fairness is improved in one sense because all parties would be given the opportunity to put forward their case and be heard. However, it is not clear that each of the applications would be given equal weighting by industrial parties, given their familiarity with industry funds. At the very least, this process leaves open the perception that it might not be procedurally fair.

Minimum regulatory burden

From a process perspective, those involved in the process would be affected in different ways under this option.

- Industrial parties would need to put more time and effort into their submission to FWA.

- FWA would need to consider the responses of all interested parties and decide whether, in its view, the industrial parties have met their obligations. This is likely to be more time consuming than the current precedent-based decision making process. This burden would be exacerbated if many objections were raised by interested parties, especially if these objections resulted in FWA requiring the industrial parties to revisit their submissions. In addition, FWA would be likely to require additional resources as, in its current form, it might lack the expertise for considering whether due process has been followed by the industrial parties.
- The process for funds would be more burdensome in some respects, as each would need to make its case against the factors for consideration. However, for funds that currently do not have standing, this process could be less burdensome (and considerably more attractive) than the process of finding a party with standing that is willing to apply on their behalf (chapter 7).
- The experience of employers would differ depending on the relevant award and whether the employer is a new or existing employer. Where the number of listed products is less than it is currently, new employers would benefit as it would be easier to choose a product. However, some existing employers would likely be disadvantaged due to the potential for their existing funds to no longer be listed or able to be used under the grandfathering arrangements.

Market stability

If, under this option, there was little movement from the status quo, stability would be retained. However, if it led to many employers having to switch from their current default fund — because it was no longer listed — to one that was listed, then some change would occur, increasing the risk of fund and market instability.

As discussed in chapter 7, the desirability of stability needs to be weighed against the potential benefits from contestability.

Consistency with other policies

This option is consistent with other policies to the extent that it promotes the best interests of members and greater transparency. However, it is not totally aligned with the direction of the FOFA reforms, which aim to reduce conflicts of interest and ensure that financial decisions are made in the best interests of those concerned. These characteristics might not apply to decisions made by all industrial parties (chapters 5 and 6).

Regular assessments

Given the current lack of any regular assessment mechanism, this option strengthens the assessment process by ensuring that there is a periodic wholesale reassessment of the overall list of products, and an ongoing mechanism to remove demonstrably unsuitable, unauthorised or non-existent products as required.

Conclusion

It is the Commission's view that, under Option 2, there remains a risk that the process will not be, or will not be seen to be, sufficiently open and contestable, and that the outcomes may not be in the best interests of employees. In particular, the Commission is concerned that Option 2 does not adequately deal with the principal−agent issues relating to the industrial parties nominating products on behalf of employees when the industrial parties have potential conflicts of interests in making those decisions (even though those interests would need to be declared). It also requires FWA to consider matters (such as whether the industrial parties have adequately discharged their obligations, and the merits of any objections raised by interested parties) for which it does not currently have expertise. Therefore, Option 2 is not supported by the Commission.

8.5 The Commission's recommended approach

In its draft report, the Commission expressed a preference for Options 3 and 4 and sought feedback on those options. The Commission received substantial feedback, relating both to the common elements (outlined above) and the key difference between them — whether the decisions on which products are listed in awards are made by an expert panel within FWA or an independent body.

Based on the feedback from submissions and its own further analysis, the Commission has developed the recommended approach outlined in this section. This approach most closely resembles Option 3 from the draft report, but differs significantly in some aspects.

Who makes the decision

In the eyes of some, a panel independent of FWA could be viewed as being able to exercise a greater degree of independence and objectivity than a panel within FWA and, therefore, make decisions that are more independent and objective. However, establishing a new independent body would come at the cost of a greater commitment of resources than a panel within FWA, and would require new administrative processes.

In addition, establishing a new independent body would be a significant departure from the way in which industrial matters in modern awards are currently dealt with. While superannuation will remain within the ambit of industrial matters for as long as default superannuation products are listed in modern awards, FWA would be simply administering the decision of another body.

Further, there is a risk of three ‘regulators’ potentially overlapping: APRA, FWA (while ever default superannuation arrangements remain in modern awards) and the proposed new body. The potential for overlap, conflict and confusion between three entities is a concern.

The core of the Commission’s proposal is to ensure that there is a competent body that is transparent, procedurally fair and has appropriate expertise to make well-informed, merit-based decisions. The Commission considers that this can be achieved with a sufficient degree of independence and at a lower overall cost by establishing a panel within FWA that includes appropriate independent experts.

This approach will achieve the objective of opening up the process in a way that best meets the interests of employees while minimising the degree of change and additional regulatory burden. This is particularly relevant given that, over time, the maturing of the market for MySuper products may mean that it is no longer necessary to list default products in modern awards (as outlined above).

Therefore, the Commission recommends that a specific purpose Default Superannuation Panel be set up within FWA to make decisions about which products are listed in awards. The panel should comprise the FWA President (or delegate), and an equal number of full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services.

The part-time members should not be representatives of particular organisations or parties to modern awards, but should be appointed as independent members, whose sole function is to work on the listing of default products in modern awards. They should be appointed for a fixed term. Decisions of the panel should be made by majority, and where panel members have a conflict of interest, this should be disclosed.

As described, the Default Superannuation Panel is similar in its structure and operation to the Minimum Wage Panel (box 8.5).

Box 8.5 **The Minimum Wage Panel**

The *Fair Work Act 2009* (Cwlth) provides for an annual wage review conducted by the Minimum Wage Panel of Fair Work Australia. The panel comprises the President of FWA, three other full-time members and three part-time members.

The part-time members' sole function is to work on the annual wage review. Such members must have knowledge of, or experience in, one or more of the following fields:

- workplace relations
- economics
- social policy
- business, industry or commerce.

Decisions of the panel are made by majority. Where panel members have a conflict of interest, they must disclose it and not deal with the matter in question.

The part-time members are appointed by the Governor-General for a fixed term of no greater than five years. The full-time members of the panel are chosen by the President from the full-time members of the tribunal.

Source: *Fair Work Act 2009* (Cwlth)

The secretariat for the Default Superannuation Panel would be comprised of FWA staff. The panel would commission research from (or through) its secretariat as required. As with the minimum wage review process, all research undertaken for the selection and assessment of products would be published so that submissions can be made on the issues covered in that research.

This approach, where there are experts internal to FWA, is in contrast to the proposal of some participants that there be an expert panel that hears from applicant funds and reports to FWA on its assessment of the applications received. The Commission judges that it is essential for transparency, credibility and accountability that the experts are internal to FWA and are party to the decision-making process. It is also crucial that funds have the opportunity to present their case directly to the decision maker (inclusive of the experts) rather than to an external panel of experts (see below).

This approach is also in contrast to calls for APRA to play a role in the selection of default products for awards. The Commission does not consider that it is appropriate for APRA to have a role in selecting default products or in filtering the products (based on factors such as investment returns) from which FWA then makes its selection. Such an approach would conflict with APRA's role as prudential regulator and its responsibility for authorising MySuper products. The

Commission does, however, expect FWA and APRA to have an ongoing close liaison (see below).

RECOMMENDATION 8.1

A Default Superannuation Panel should be established within Fair Work Australia to make decisions about which products are listed in awards. The Default Superannuation Panel should be made up of the Fair Work Australia President (or delegate), and an equal number of full-time members of the tribunal and part-time independent members appointed for their expertise in finance, investment management or superannuation advisory services. The part-time members should not be representatives of particular organisations or parties to awards, but should be appointed as independent members based on their expertise.

Who can participate in the process and how

Chapter 7 highlights the problems with the current default selection process in terms of contestability and procedural fairness, where only those with standing are likely to have their application to list a default fund in an award considered.

In light of these problems, the Commission considers that, under the reformed process, it is essential for all funds that offer a generic MySuper authorised product (and exempt public sector superannuation schemes (EPSSSs), which are also eligible to receive default contributions and to be listed in modern awards) be given standing solely for the purpose of listing default superannuation products in modern awards. This will allow them to apply to have their products listed in awards, and be directly heard by the Default Superannuation Panel within FWA. (Funds offering tailored MySuper products and MySuper authorised corporate schemes will also be able to participate, but in a different way to generic products — see below).

All funds that wish to have their default product listed in modern awards (including funds that are currently listed) would need to submit an application that builds a case against the factors for consideration identified by the Commission, and any other factors at the discretion of the Default Superannuation Panel (chapter 7). Their application would be considered by the panel on that basis.

Following applications by eligible funds, the Commission proposes that there be a period during which any party with sufficient interest, including industrial parties, would be able to make a submission to the Default Superannuation Panel, responding to the applications.

While some participants suggested that precedence should be given to the views of industrial parties, the Commission does not consider this to be appropriate. The Commission acknowledges that industrial parties play the key role in other aspects of modern award decision making, but does not consider such a role is appropriate in the case of superannuation due to the need for decisions to be made through an independent expert process and to avoid potential conflicts of interest. Furthermore, the weight attached to the individual submissions received from interested parties, including industrial parties, should depend solely on the merits of the case they put forward to the Default Superannuation Panel.

In the interests of transparency, the Commission considers it crucial that all parties making submissions to the Default Superannuation Panel be required to publicly disclose any conflicts of interest, and that all submissions be publicly available.

RECOMMENDATION 8.2

Funds that are authorised to offer a MySuper product (and exempt public sector superannuation schemes) should be given standing solely for the purpose of listing default superannuation products in modern awards. This will allow those funds to make applications to have their products listed in modern awards, and be directly heard by the Default Superannuation Panel.

Applications should outline a case against the factors for consideration identified by the Commission (and any other factors at the Default Superannuation Panel's discretion), and be made publicly available.

Any party with sufficient interest, including industrial parties, should be given the opportunity to submit their views on the applications received by the Default Superannuation Panel. When doing so, they should be required to publicly disclose any conflicts of interest. All submissions should be publicly available, and the panel should determine the weight placed on the submissions it receives according to the merits of the arguments put forward.

How decisions are made and how many products are listed

In its draft report the Commission recommended that the number of products listed in modern awards be restricted to between five and ten products, in order to promote competition while avoiding excessive search costs for employers.

The Commission continues to see merit in there being a short list of products in awards for several reasons:

- It makes it easier for new employers to choose a default product.

- Many awards currently list only a small number of products (chapter 2) and this number appears to have been manageable for employers.
- It drives competition between products to get on the short list and can lift standards throughout the industry which, as outlined above, is important in the absence of demand-side pressure.

However, feedback on the draft report has made it clear that a short list derived from an assessment of the Commission's factors for consideration would lead to some unintended consequences that are likely to act against the best interests of some employees. These include consequences for some existing employees and consequences for stability of the superannuation market.

Consequences for existing employees

Issues arise from employees being required to move from one product to another as a result of MySuper products moving on and off the list in awards (or from no longer being able to receive default contributions due to the removal of grandfathering).

When an existing default fund can no longer receive contributions for employees who derive their default superannuation product in accordance with modern awards, employers will be required to choose a new default fund. New accounts will be created with the new fund for each of their employees. In practice, this will lead to the affected employees having an additional superannuation account — one in the 'old' fund and one in the 'new' fund — unless they exercise choice to remain in the 'old' fund, or consolidate their existing balance into the 'new' fund.

Having multiple accounts in different funds will mean that members pay multiple sets of fees. If fees are charged as a percentage of fund assets or income, paying fees to multiple funds will not significantly affect members' interests. However, if fees are charged per account (as is common with many administration fees), having multiple accounts will disadvantage the member.

Having multiple accounts could also mean that members will have multiple insurance policies and premiums, though this varies between funds (box 8.6). If the member obtains equivalent or better insurance coverage through their new fund, the additional cost of insurance policies that are offered by the old fund are likely to be an unnecessary drain on members' retirement savings. If the new fund offers a lesser insurance coverage, on the other hand, the member could be better served by retaining multiple funds (and paying multiple premiums), provided that coverage is not cancelled in the old fund.

Box 8.6 Insurance coverage when contributions are no longer being made to a fund

Superannuation funds vary in their approach to unilaterally cancelling the insurance coverage of individual members when regular employer contributions are no longer being made to the fund. There is currently no legislation that regulates what funds should do with different types of insurance when contributions cease.

Most funds automatically cancel income protection cover after not receiving employer contributions for a period of time — typically from one month to one year.

Some funds continue to provide life and/or total and permanent disability cover as long as the account balance is sufficient to cover the premiums. Other funds discontinue coverage when a member's balance falls below a certain amount, or when no employer contributions have been received for a certain period of time. Both the amounts and the periods of time vary considerably between funds.

When considering the effects of a fund no longer being able to receive superannuation contributions for employees who derive their default superannuation product in accordance with modern awards, there are two issues that arise in relation to the insurance coverage of members who do not make active choices — the level of cover and the breadth of cover.

When a fund is no longer receiving contributions for an employee, the employee's total level of coverage might increase, decrease or remain the same.

- If a member's assets in the old fund are fully transferred to a new fund, the change in level of cover will depend on the default insurance offering of the new fund.
- If a member's future contributions are made to a new fund, but some assets remain in the old fund, the change in level of cover will depend on the practices of the old fund, as well as the default insurance offering of the new fund.

The breadth of cover may also vary, since terms and conditions of insurance policies vary between funds. So when an individual obtains coverage in a new fund at the expense of coverage in their old fund, they may effectively experience reduced cover — even if the insured amount is the same — if the new fund excludes certain events or occupational hazards that were covered by the old fund. In addition, an individual might be refused cover by the new fund for a pre-existing condition that was covered by the old fund. For these reasons, it may sometimes be advisable for members to retain the account with (and thus the insurance policies offered by) the old fund.

The risk of adversely affecting insurance coverage when changing funds will be mitigated by the factors for consideration in selecting default funds (including the appropriateness of a fund's insurance offering) and when members are actively engaged with their superannuation and make informed choices. There are, however, a number of reasons why this does not always occur (chapter 3).

For some employees, the detriment caused by paying multiple fees and insurance premiums will be outweighed by the benefits offered by the new fund, such as significantly better investment returns. However, if the performance of the new fund is not substantially better than that of the old fund, the net outcome could be that the employee is worse off.

Therefore, with a short list of products in awards, and movement of products in and out of awards, there are more likely to be more employees who are forced to move to a fund with a MySuper product that performs only marginally better, and then end up being worse off as a result of the move. This problem is exacerbated when the maximum number of products listed is prescribed, as it means that some products might miss out on being listed simply because the numbers are limited, and not because they are materially worse than the listed products. The negative effects on employees could also be compounded by the potential for losses on balances remaining in the old fund that arise due to the loss of scale and/or cash flow issues that the delisted fund experiences from losing its award default listing (see below).

If the new and existing accounts are consolidated, there is more chance that most employees end up better off — notwithstanding the potential adverse effects for some employees of changes to insurance coverage — because employees will not incur two sets of fees and insurance premiums and will not have their existing balances potentially impacted by the fund's delisting. However, it is not possible to assume that most employees would voluntarily consolidate as the award default selection process is, by definition, designed for disengaged employees. Chapter 9 explains why it is not practical or appropriate to automatically consolidate multiple accounts that are created due to these changes.

Consequences for market stability

There will also be market stability issues associated with products moving on and off the list (or from no longer being able to receive default contributions due to the removal of grandfathering).

When a fund can no longer receive contributions for employees who derive their default superannuation product in accordance with modern awards, it will experience a reduction in membership and lose a source of cash flow. This could be considerable depending on the fund's reliance on award-based default superannuation. This could affect the investment decisions and performance of the fund, its scale, viability and, ultimately, the returns to members who remain with that fund.

It might be appropriate for an individual fund to incur these consequences when its default product performs poorly and is not judged as suitable for employees who derive their default superannuation product in accordance with modern awards. However, if the panel is forced to keep the list of funds in an award to a prescribed maximum and therefore exclude funds simply because the quota has been filled, there is a risk of unduly penalising a well performing fund and its members.

In recognition of the above issues, the Commission's proposed reforms do not include a firm quota of preferred funds for listing in awards (see below).

Grandfathering

Retaining grandfathering would avoid the unintended consequences (outlined above) of potentially making employees worse off through the creation of multiple accounts, and of market instability arising from funds no longer receiving a relatively stable stream of default contributions. It would do this by allowing employers to continue paying contributions into their existing funds. (An alternative to current grandfathering would be to allow contributions to continue for existing but not new employees.)

However, it is the Commission's view that only products that have been assessed by the Default Superannuation Panel as meeting the factors for consideration should be able to receive default contributions. To ensure that the best interests of employees are upheld, it is not appropriate to exclude any product from this assessment process (other than defined benefit funds — see below). Therefore, the Commission recommends that, after a transition period (chapter 9), all grandfathering related to default superannuation be removed, and the potential consequences on existing members and system stability be dealt with another way (as outlined below).

RECOMMENDATION 8.3

After a transition period, grandfathering provisions relating to default superannuation should be removed from all modern awards.

Employer discretion

In the draft report, it was proposed that employers should be permitted to choose a non-listed fund provided they could demonstrate, if called upon, that the factors for consideration were taken into account, and that their employees would be no worse off than if a listed fund were chosen. This employer discretion clause could be one way of reducing the potential for existing employees to be worse off as a result of changing funds and acquiring multiple accounts. In doing so, employer discretion could also reduce the risk of market instability.

However, inquiry participants identified several problems with allowing employer discretion, particularly with regard to an appropriate test for safeguarding the best interests of members, and compliance with that test.

Having conducted further analysis and reviewed the feedback on the draft proposal, the Commission agrees that it is difficult to design an appropriate test that safeguards the best interests of members while not placing so high a burden on employers that it is rarely used. The Commission therefore judges that employer discretion is not a feasible way of dealing with the risks of adversely affecting existing members and the risks to market stability.

Nevertheless, the Commission acknowledges the evidence that some employers want flexibility to choose from outside the award list and have the expertise to do so in a way that meets the best interests of their employees. Accordingly, the Commission considers that some degree of flexibility for employers remains important. This forms a key consideration in the design of some aspects of the Commission's recommended approach, detailed in the following section.

The listing of products in modern awards

The Commission proposes dealing with:

- the risks of adversely affecting existing members
- the risks to stability of the superannuation market, and
- the need to give employers flexibility

by listing in a given award *all* MySuper products deemed by the Default Superannuation Panel to be suitable as assessed against the factors for consideration.

The Default Superannuation Panel would assess applications and select *all* products that it considered suitable against an assessment of the Commission's factors for consideration, and any other factors the panel considered relevant. The number of products listed would be at the discretion of the panel, and the panel would need to be guided primarily by the best interests of employees who derive their default superannuation product in accordance with modern awards, without having to adhere to a prescribed maximum number of products. The Commission does not support mandating a specific quota of products to be listed in each award because this would limit competition between funds, unnecessarily creating rents for those funds whose products are listed, and because it unnecessarily limits choice for employers.

Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing it, even if this creates a longer list. This is because, in order to meet the best interests of employees, the list would need to be long enough to minimise any unintended consequences.

This approach has several advantages:

- It reduces the risk that an employee ends up worse off by being moved into a product that is only marginally better than their current product.
- There will be fewer movements of members between funds and therefore the risk of market instability is reduced.
- It makes it administratively easier for existing employers, as their current fund is more likely to be listed, preventing them from having to pay into a new fund for their employees.
- It increases the opportunity for employers to choose a fund that they consider best meets the unique needs and characteristics of their employees.

In giving the panel the discretion to list as many products in a given modern award as it deems suitable, and advising it to err on the side of listing a product where the decision is marginal, the Commission recognises that the decisions will be complex and require judgement.

That said, to retain the benefits outlined above of having a short list — to assist new employers when choosing a product and to spur competition — the Commission considers it highly desirable that, wherever possible, the panel identify in each modern award a small subset of the listed products that it judges as clearly best meeting the factors for consideration and best promoting the interests of employees. The Commission suggests that identifying a subset of five to ten products strikes an appropriate balance between promoting competition while avoiding excessive search costs for new employers — though ultimately the number chosen will be a decision for the panel.

In making its decision on which products are suitable for listing and which products are identified in the small subset, the panel should equally consider the merits of products that cater to:

- the specific needs of employees in particular industries or occupations
- the needs of heterogeneous groups of individuals that are employed in a wide range of industries.

The panel might wish to conduct the process of selecting default products in groups of awards which cover employees with similar characteristics, or indeed to consider all awards at once. As the number of industry-specific funds declines, the case for approaching the task in the latter manner increases.

If the panel expects there to be little variation across awards, or groups of awards, it could also consider a generic list of products, rather than maintaining separate lists for each award. This could be particularly relevant given that the panel might encounter difficulty identifying an award-specific list of suitable products that is long enough to deal with the risk of adversely affecting existing members and market stability. In this case, the small subset of funds identified as best meeting the interests of employees might still be award specific.

Transparency of panel decisions

The Commission considers that it is crucial that the reasons for the panel's decisions about which products are found suitable for listing, and which are identified in the subset of products that best meet the factors for consideration, are clearly articulated and made easily accessible to the public. The panel should also clearly state any other factors for consideration that they have taken into account when making their decisions, and why (chapter 7).

The provision of such information will increase transparency of the process and strengthen the accountability of the panel. It will also ensure that employers have access to information about why particular funds were listed, should they wish to refer to it when making a decision about which product to choose from among the list. This information may also be useful for employees considering consolidating accounts or making an active choice if their existing product is delisted.

The Default Superannuation Panel may choose to release a draft decision, and then allow a period for further submissions from any party with sufficient interest. At this point, the panel could hold a public hearing to gather more evidence if required.

RECOMMENDATION 8.4

The number of default products listed in a given modern award should be at the discretion of the Default Superannuation Panel. The decision about whether or not to list a product should be based on an assessment of a fund's application against the factors for consideration identified by the Commission, and any other factors at the panel's discretion.

Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing it even if this creates a longer list. Given the absence of grandfathering, a longer list will reduce the need for employers to change default funds. This will help ensure that the best interests of employees

are not undermined by issues of market instability and the potential negative impact of having multiple accounts (unless employees exercise choice to consolidate their existing balances).

In addition, it is highly desirable that, where possible, the panel identify in each modern award a small subset of those products found suitable for listing that it judges best meet the interests of employees who derive their default superannuation product in accordance with that modern award. Identifying a small subset of products will assist employer choice and encourage competition.

The reasons for the panel's decisions about which products are found suitable for listing, and which are identified in the subset of products that best meet the factors for consideration, should be clearly articulated and made easily and publicly accessible.

Where an award does not currently list default funds (currently 13 of the 122 modern awards), the Commission sees no need for this situation to change. However, should there be applications to list default products in one of those awards, the Default Superannuation Panel would need to consider on what grounds it would open up the award.

Regular assessment process

Chapter 7 outlined the inadequacy of the current assessment mechanism. In considering an appropriate mechanism, the Commission has attempted to strike a balance between ensuring that the list of funds contained in awards remains in the best interests of employees on an ongoing basis, and ensuring that the mechanism for doing so is not overly burdensome.

The Commission considers that there are two important components of any assessment mechanism.

Ongoing 'watching brief'

There needs to be an ongoing 'watching brief' that would enable the removal of products from the list of products in a modern award in exceptional circumstances. These circumstances might include a fund's MySuper authorisation being revoked, a fund merging with another fund and the listed MySuper product no longer existing, or a fund becoming demonstrably unsuitable.

The Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 spells out the mechanism that applies to a fund's authorisation being revoked. The explanatory memorandum to the Bill states that:

> If APRA cancels the authorisation of a fund to offer a MySuper product and the fund is not authorised to offer any other MySuper product, APRA will be required to notify FWA in writing. In addition, if APRA becomes aware that a fund ceases to be an exempt public sector superannuation scheme and is not authorised to offer a MySuper product APRA must notify FWA in writing of that fact.
>
> If FWA receives a notice in writing from APRA that a fund is no longer authorised to offer any MySuper product or has ceased to be an exempt public sector superannuation scheme and is not authorised to offer a MySuper product, then FWA must ensure that the text of the modern award is updated to remove any invalid references to the fund as soon as reasonably practicable after receiving the notice. It is intended that invalid references to non-compliant funds be removed quickly in order to avoid confusion for employers and employees. (Shorten 2012a, p. 62)

The Commission supports this approach. In the Commission view, it is also important that the ongoing watching brief take account of changes that are driven by fund mergers, and situations where a fund becomes demonstrably unsuitable for listing. In both of these cases, it is important that there is ongoing liaison between APRA and FWA (chapter 9).

In terms of adding products after the initial process of listing products in awards, the Commission acknowledges, and agrees with, the views of many participants that there should be no restriction in relation to the timing of applications to have a product assessed. To constrain the timing of applications could impede innovation and stifle competition.

To limit the potential burden that allowing applications at any time could place on the panel, it might wish to restrict how often an applicant with a product found to be unsuitable can reapply. When new applications are made, interested parties would need sufficient time to respond to the application.

The decisions of the Default Superannuation Panel should be determinative (subject only to review on grounds of jurisdictional error — see below). Therefore, industrial parties should not be granted approval for subsequent variation applications that seek to override the decisions of the panel merely because the parties disagree with the choice of default superannuation products made by the panel.

RECOMMENDATION 8.5

The Default Superannuation Panel should undertake ongoing assessment of the list of superannuation products in modern awards to ensure that any unauthorised, non-existent or demonstrably unsuitable products are removed as required.

Once the initial process of listing funds in modern awards is complete, applications to the panel to add a MySuper product (or a product offered by an exempt public sector superannuation scheme) should be permitted at any time, subject to any limits the panel places on how often an applicant with a product that has been found to be unsuitable can reapply.

Periodic reassessment

There also needs to be a wholesale reassessment of the list of products on a periodic basis. This will ensure that:

- the products listed are those that best meet the interests of employees who derive their default superannuation product in accordance with modern awards over time, and the subset of best products also remains up to date
- funds with products in the subset of best products face a credible threat of losing that status (or even being removed altogether), thus providing an incentive to remain competitive, and for other funds to strive to have their product named as one of the best if it previously missed out.

The Commission notes the concerns of participants that having a periodic reassessment at a set point in time runs the risk of causing instability in the market due to the large transfer of funds that is likely to take place in a short period of time should a fund get delisted.

However, as explained above, a key advantage of having a longer list of products in modern awards is that it reduces the likelihood that a fund will be removed altogether. Funds whose products are identified in the subset as best meeting the interests of employees could lose that status, but contributions would still be able to be paid into that product while ever it remains listed. Contributions would only have to cease if the product was no longer listed (subject to a transition period to be determined by the panel — chapter 9).

The Commission also notes the concerns of some that an eight-year time period would be too infrequent. A four-yearly process would have the advantage that it could potentially be conducted as part of FWA's review of modern awards and so reduce costs and complexity for all involved. On the other hand, a wholesale reassessment every four years could be administratively costly. The benefits might also be difficult to capture if there is insufficient change in the industry and in the suitability of products over such a short period — especially as there would be an ongoing assessment to remove products in exceptional circumstances throughout that period.

The Commission judges that it is best left to the discretion of the Default Superannuation Panel to decide how often to reassess the list of products in awards. The panel will be able to strike the best balance between the costs of conducting such an exercise and the benefits from doing so in terms of ensuring that the best interests of employees are protected over time. As guidance, the Commission considers that a four- to eight-year period would be appropriate. There would be no requirement to reassess all awards at once — the panel could conduct the reassessment on an award-by-award basis, or in groups of awards.

The Default Superannuation Panel would need to provide adequate notice as to when the wholesale reassessment of the products listed in a given award will occur. As part of the reassessment process, any fund with a MySuper product (or EPSSS) could apply, and all funds with listed products would need to reapply if they wish to retain that listing. The initial application process would be repeated, with a list of suitable products determined, and from that a small subset of the best products identified.

RECOMMENDATION 8.6

The Default Superannuation Panel should conduct a reassessment of the list of products in modern awards periodically, at which time the full selection process would be repeated and all funds that wish to have their default products listed in awards would need to apply or reapply.

The frequency of this reassessment should be at the discretion of the Default Superannuation Panel, but the reassessment should be conducted no more often than every four years and no less often than every eight years.

Should a product lose the status of being in the subset of products judged as best meeting the interests of employees who derive their default superannuation product in accordance with a modern award, contributions could continue to be made into that product, as long as it remains listed for that award. Default contributions to a product would only need to cease if the product was no longer listed.

Treatment of tailored MySuper products and corporate funds

The analysis above focuses on the generic MySuper products that will be offered by funds. However, under MySuper, funds will be able to offer tailored MySuper products for large employers (chapter 2). To do so, these products will need to gain separate authorisation from APRA.

A tailored MySuper product could be fundamentally different to a fund's generic MySuper product, including with respect to its investment strategy, services and fees (Shorten 2012b). Therefore, it is the Commission's view that these products should be required to be assessed and deemed suitable by the Default Superannuation Panel before default contributions for employees who derive their default superannuation product in accordance with modern awards can be paid into them. Like generic products, the panel should assess the product against the Commission's factors for consideration, and any other factors at the panel's discretion, but the decision should ultimately be based on whether the product meets the best interests of employees of the particular employer, or of a particular workplace of the employer, in question.

The Commission is sensitive to the commercial realities of tailored MySuper products and the potential benefits of those products for employees. It wishes to minimise the burden placed on funds in seeking approval from the panel, and on employers seeking to obtain a tailored product that is in the best interests of their employees.

Therefore, the Commission suggests that where a tailored MySuper product is based on a fund's generic MySuper product or on a previously assessed tailored product, the panel should only need to assess the tailored MySuper product for any differences from a MySuper product that has already been assessed as being suitable. Where there are few differences in a tailored MySuper product, the assessment can be brief and the process will require less effort by the fund and the panel.

The Commission also suggests that funds be permitted to apply to the panel at the same time as they apply to APRA for authorisation of their tailored product (and have the panel's decision conditional on APRA authorisation). This approach aims to ensure there are no unnecessary constraints and delays on employers who may wish to consider having a tailored product created for their employees.

Given that tailored MySuper products will be employer-specific products, it is not appropriate for them to be listed in awards. Awards will therefore require a clause stating that employers may, instead of choosing a listed product, pay into their employer-specific MySuper product as long as it has been approved by the Default

Superannuation Panel. This process could also be used for corporate funds that have received MySuper authorisation and wish to receive default contributions for employees who derive their default superannuation product in accordance with modern awards.

Tailored MySuper products and MySuper authorised corporate funds that have been approved by the Default Superannuation Panel would need to reapply on a periodic basis (at the discretion of the panel) to ensure that they continue to meet the best interests of the relevant employees.

The Commission notes that in the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012, defined benefit funds will be eligible to receive default contributions, even though they will not be MySuper authorised. The Bill also makes provision for employers to continue to pay into a defined benefit fund for employees who derive their default superannuation product in accordance with modern awards. According to the Explanatory Memorandum to the Bill:

> Each modern award must include a new term that permits an employer to make contributions to a superannuation fund or scheme for employees that do not have a chosen fund if the employee is a 'defined benefit member' of the fund or scheme. (Shorten 2012a, p. 63)

Given the advantages that defined benefit funds generally bestow on members, the Commission supports the approach outlined in the Bill and considers it appropriate that defined benefit funds be exempt from assessment by the Default Superannuation Panel.

RECOMMENDATION 8.7

In order to receive default contributions into a tailored MySuper product or a MySuper authorised corporate fund for employees who derive their default superannuation product in accordance with a modern award, funds should be required to apply to the Default Superannuation Panel for approval. As with generic products, applications should be permitted at any time, and should be made and assessed against the factors for consideration outlined by the Commission (and any other factors at the panel's discretion).

These employer-specific products should not be listed in modern awards. Rather, modern awards that list superannuation products should specify that employers may pay into their employer-specific MySuper product provided that it has been assessed by the Default Superannuation Panel as being suitable.

FINDING 8.1

The Commission notes that the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 makes provision for employers to continue to pay into a defined benefit fund for employees who derive their default superannuation product in accordance with modern awards. The Commission supports this approach and considers it appropriate that defined benefit funds be exempt from assessment by the Default Superannuation Panel.

Appeals and judicial review

Currently, modern awards can be varied by a single member of FWA and decisions by a single member can be appealed to a Full Bench of FWA by a person aggrieved by the decision (who must have an interest in the decision beyond that of an ordinary member of the public). However, once a Full Bench of FWA has made a decision about a modern award, it cannot be appealed any further. Similarly, decisions of the Minimum Wage Panel are final and cannot be appealed.

However, under the Constitution, the judiciary always retains the right to review decisions of tribunals for jurisdictional error. This right of review was previously exercised by the High Court in relation to the Australian Industrial Relations Commission but under the Fair Work Act it is exercised by the Federal Court, with the possibility of an appeal to the High Court. Under these arrangements, the Federal Court can review the Minimum Wage Panel's decisions about minimum wages and FWA's decisions about modern awards and any other matter.

Applications for review may only be made on the basis that FWA has not exercised its jurisdiction properly, where the applicant believes that FWA or the Minimum Wage Panel have exercised their decision making power in such an erroneous way that they have either failed to exercise their jurisdiction or have exceeded it.

The Commission considers that by allowing all funds that offer a MySuper product (and exempt public sector superannuation schemes) to apply to, and be directly heard by, the panel, and allowing all parties with sufficient interest the right to make a submission to the panel in response to an application, there will be sufficient opportunity for participants in the process to put their views to the Default Superannuation Panel.

Therefore, the Commission judges that, as with decisions of the Minimum Wage Panel, decisions of the Default Superannuation Panel should be final and reviewable only on the grounds of jurisdictional error.

RECOMMENDATION 8.8

Decisions of the Default Superannuation Panel should be final and reviewable only on the grounds of jurisdictional error.

8.6 Assessment of the recommended process

This section summarises the assessment of the Commission's recommended approach against the principles outlined in chapter 7.

Best interests of employees

The recommended process explicitly focuses on the best interests of employees. It addresses the principal–agent problems by ensuring that MySuper products are assessed by a Default Superannuation Panel of FWA, with the panel making merit-based decisions on which products to list in modern awards. This contrasts with default products being primarily chosen by employers or industrial parties, or being recommended to FWA by an external panel of experts, with FWA then making its decision.

In addition, the process is designed in a way that maximises the likelihood that all employees are made better off, and greatly reduces the likelihood that some employees are made worse off. Giving the Default Superannuation Panel the discretion to list as many products as it judges are suitable, against an assessment of the factors for consideration (and any other factors at the panel's discretion), minimises the risk that employees are made worse off due to having multiple accounts.

- Employees who are currently members of products that do not get listed in the new process are likely to be better off. This is because where a decision is marginal, the panel should err on the side of listing a fund, and products that do not get listed will be clearly inferior, in the panel's view, to the products that do get listed.
- Employees of new employers will be better off than under the current system as the new employers are likely to choose one of the products identified in the subset of products that have been judged by the panel as best meeting the interests of employees.
- Employees currently in a fund that is listed in the new process will experience no change in their circumstances (all other things equal), provided that their employer retains that fund.

– If employers change their default product from a listed product to one that has been identified in the subset of products that best meet the interests of employees, their employees may end up worse off if the costs of having multiple accounts are not outweighed by the benefits of being in one of the products in the subset. Therefore, it is important that employers are aware of the consequences of moving employees between listed funds (chapter 9).

Contestability and competition

The Commission's recommended approach reduces unnecessary barriers to entry for funds and strengthens contestability by allowing funds to apply directly to a panel within FWA, rather than requiring them to present their case to industrial parties or find an employer or employee to present a case on their behalf.

Greater contestability, together with a regular reassessment process based on the best interests of employees, would spur competitive forces to ensure that funds continue to innovate and improve their product offerings over time.

Transparency

Transparency is increased compared to the current process because funds seeking to have their products listed in awards would be required to provide comprehensive public applications to the Default Superannuation Panel, addressing the factors for consideration. The applications, together with submissions from other interested parties, would be scrutinised by the Default Superannuation Panel. Given that the submissions would be public, each participant would be able to view the arguments of the other parties and respond accordingly.

Ensuring that the reasons for the decisions made by the Default Superannuation Panel are clearly articulated and made public also increases the transparency and accountability of the panel's deliberations and decisions.

Releasing a draft decision and inviting comment on the draft before a final decision is made is another potential way to increase transparency and accountability, and increase the opportunity for funds and interested parties to participate in the process.

Procedural fairness

The recommended process achieves the objective of procedural fairness, as all funds and other interested parties have the right to be heard directly by an independent expert decision maker.

Minimum regulatory burden

The regulatory burden involved with this process is greater overall than the current process, essentially as a consequence of there being more robustness in the applications by, and assessment of, funds. However, as discussed in chapter 7, improving the selection process in ways that increase the regulatory burden can be worthwhile if it leads to substantially better outcomes overall.

The burden placed on each party involved in the process is likely to vary.

- Resources would be required to set up the Default Superannuation Panel and staff the panel's secretariat (chapter 9). The fact that there is an established similar process within FWA (the Minimum Wage Panel) could help to minimise these additional costs.
  - Conducting the process in groups of awards and/or creating a generic list of products across awards are both ways of reducing the regulatory burden of the process without compromising the best interests of employees where the characteristics of employees across awards are similar.
- The process for funds would be more burdensome in some respects as each fund would need to gather information to put their case against the factors for consideration. However, as funds currently do not have standing, this process could be less burdensome than the process of finding a party with standing that is willing to apply on their behalf.
- Erring on the side of a long list of funds in awards, both in the initial process and on an ongoing basis, will reduce the burden on employers that currently have a default product, as it minimises the likelihood that they will be required to change products.
  - For a new employer with no default fund, having a small subset of best products identified for a given award will assist them in choosing a product. Whether this is easier than the current process or not will depend on the number identified in the subset by the panel for a given modern award relative to the number currently listed.
- If industrial parties choose to submit their views to the panel in response to applications from funds, they would need to put resources into preparing those submissions against the factors for consideration.

Market stability

The process has been designed in such a way as to minimise the extent to which members need to change funds for no net gain, and therefore it minimises the risk of unnecessary market instability.

To the extent that identifying a small subset of funds encourages employers to switch employees from a listed product to one in the subset, those funds that are not identified in the subset could experience a reduction in membership and reduced cash flow and scale.

Funds that are no longer listed will experience a reduction in membership and lose a source of cash flow. The effects on these funds could be considerable, depending on their reliance on award-based default superannuation. It is, however, appropriate for a fund to incur these consequences if the panel has judged it as unsuitable for employees who derive their default superannuation product in accordance with modern awards.

Consistency with other policies

This option is consistent with the approach taken to national minimum wage cases where interested parties can make representations to the Minimum Wage Panel. The panel, acting as the independent umpire, makes decisions on the basis of public evidence provided by these parties, as well as commissioned research.

Given that this option represents greater contestability and transparency, and has decisions being made by a panel in the best interests of those concerned, it is also consistent with the objectives of other policies such as Stronger Super and FOFA.

Regular assessment

Given the current lack of any regular assessment mechanism, this option greatly strengthens the reassessment process by ensuring that there is a periodic wholesale reassessment of the list of products, and a mechanism to remove unauthorised, non-existent or demonstrably unsuitable products on an ongoing basis.

9 Maximising the benefits of the proposed reforms

Key points

- The Commission proposes that its reforms should ideally be legislated in full by 2014, so that the new process, together with the consideration of factors relevant to the selection of default products, can be applied in 2014. This could potentially occur in conjunction with the review of modern awards that will take place that year.
- The reforms will affect stakeholders in different ways.
  - Employees who derive their default superannuation product in accordance with modern awards will benefit because their best interests will be the primary objective in the selection and ongoing assessment process, and there will be increased competition in the default market. However, some employees will find themselves in different funds, and will need to consolidate to avoid having multiple accounts. They will need accessible information from government agencies to help them make good decisions in response to the changes.
  - Employers generally will benefit from the improved administrative capabilities of the funds they deal with. However, some employers will incur the cost of changing default funds, and will need to be promptly informed of changes to award listings.
  - The reforms will not affect all superannuation funds in the same way. All funds that wish to have their default products listed in awards (including funds that are currently listed) will need to submit an application for listing in 2014, and at least every eight years thereafter.
  - The Default Superannuation Panel established within Fair Work Australia will have a range of responsibilities, and will need to be resourced appropriately.
- From a community-wide perspective, the reforms should have the considerable net benefit of improving superannuation outcomes for employees who derive their default product in accordance with modern awards, and for fund members more broadly, by spurring improvement in the quality of superannuation products.
- When superannuation products are listed in awards, their names and identification numbers need to be used in a clear and consistent manner, and a reasonable transition period will be needed, to allow employers and funds time to adjust.
- An independent public review of the reforms should be conducted after the first periodic reassessment of all awards has been completed, ideally in 2023. It should examine whether the process and factors for consideration for default product selection remain useful and relevant, and include the possibility of employers being able to use any MySuper product as a default superannuation product.

This chapter examines the implementation and transition issues associated with the Commission's recommended reforms to the system for listing default superannuation products in modern awards, with a view to maximising the net benefits of the reforms.

As discussed in chapter 8, the Commission expects that overall benefits will flow from the reforms it proposes. As is appropriate, the benefits will primarily be realised by employees who derive their default superannuation product in accordance with modern awards, and by members of default superannuation funds more broadly (by explicitly making the best interests of these employees the primary objective and by spurring improvement in the quality of default products). A range of benefits will also accrue to the wider community, as well as to some employers and superannuation funds.

The Commission's proposed reforms will affect all stakeholders in the superannuation industry — employees, employers, funds and regulators, and will impose some costs. Costs of reform will be borne in particular by those funds (both listed and 'grandfathered') that are assessed as not meeting the best interests of employees who derive their default superannuation product in accordance with modern awards. They would no longer be able to receive default superannuation contributions made on behalf of those employees. Costs will also arise for the members and employers who were using those funds.

In order to fully realise the potential benefits of the reforms, the costs of implementation will need to be minimised to the greatest extent possible while still achieving the stated aims. The reforms should be implemented as soon as practicable (section 9.1) and employers promptly notified of the changes (section 9.2). Employees will need assistance to understand the changes and be encouraged to make informed decisions when required (section 9.3), and employers and funds will need a transition period (section 9.4). It is also essential that the Default Superannuation Panel be given appropriate resources and legal status (section 9.5) and that information about default products and their selection be made publicly available (section 9.6). Finally, the new process for selecting default products should be independently reviewed (section 9.7).

9.1 Implement the reforms as soon as practicable

Participants' views

Inquiry participants suggested a number of timeframes for implementing changes to the process used in the selection and ongoing assessment of default superannuation products for listing in modern awards. BT Financial Group (sub. 46), the Financial Planning Association of Australia (sub. DR76) and the Financial Services Council (sub. DR80) suggested that the introduction of the Commission's proposed reforms could coincide with the introduction of MySuper products in 2013.

Similarly, the Australian Chamber of Commerce and Industry (ACCI) considered that:

> … the requirement that default contributions from 1 October 2013 [now 1 January 2014] will need to be made into a fund authorized to offer a MySuper product, and that modern awards will only prescribe funds authorized to offer MySuper products has implications for the superannuation system … it is important that modern awards are varied sufficiently before 1 October 2013 to accurately prescribe post 1 October 2013 obligations. (sub. DR83, pp. 4–5)

In contrast, the Industry Super Network (ISN) suggested that:

> … the process would be more effective if it was undertaken as a single exercise during the 2014 Fair Work Australia review of modern awards. The best means of achieving this, which may involve a staggered approach, should remain in the hands of the decision maker. (sub. DR62, p. 28)

Timing the proposed new default product selection process to coincide with Fair Work Australia's (FWA) four yearly reviews of modern awards was also supported by DEEWR/Treasury (sub. DR89), and amounts to suggesting that the new process should not be implemented before 2014.

Others agreed with the view put forward by the Commission in the draft report, suggesting that assessment of the default funds listed in awards should occur as soon as practicable, and ideally during 2014 (for example, Business SA, sub. DR55; CSSA, sub. DR56). However, the Association of Financial Advisers considered that:

> 2014 is still a long way off … the current model is significantly deficient, and change is required as soon as possible. We believe that the Government should be capable of moving sooner than 2014 … (sub. DR73, p. 4).

Several others participants (including John McAuley, sub. 53; REI Super, sub. 26 and Tasplan, sub. 6) suggested that the implementation of the reforms should be delayed further — potentially by several more years. Unions NSW said:

> There should be no change to the current default arrangements in awards until MySuper is fully bedded down and experienced. This in our view is 5 years. (sub. 13, p. 7)

ACCI took a different approach.

> In ACCI's view the assessment of funds for inclusion in an award should be driven by different considerations [to the award review process], the most important of which are

the timing of Stronger Super and access to reliable data. The reality of both the Commission's preferred options is that the normal processes applying to modern awards, including review and variation, will need to be modified for at least this aspect of their superannuation clauses to give effect to the policy object of the Commission's preferred recommendations. (sub. DR83, p. 9)

The Commission's view

The Commission considered several potential timeframes for implementing the proposed new assessment and selection process set out in chapter 8. For instance, the introduction of the reforms could occur in 2013 to coincide with either:

- the initial introduction of MySuper products in July 2013
- the removal of funds that do not offer a MySuper product (or other approved default product) from awards, which must be undertaken by FWA by 31 December 2013.

However, in practice, the time required for the drafting and passage of relevant legislation (section 9.5) would preclude such rapid implementation. In addition, the Default Superannuation Panel needs to be selected and appointed, and a competent secretariat established.

A more realistic timeframe would be to implement the necessary legislative and policy changes during 2013 and 2014. Ideally, this would mean that the new process for listing default superannuation products in awards can commence during 2014. This approach has considerable merit.

- It would allow sufficient time to implement the necessary legislative and procedural reforms.
- It would minimise unnecessary delay.
- It would provide stakeholders with time to prepare for the changes. This will be particularly important for superannuation funds, given that the Commission recommends all funds seeking to have their products listed in modern awards will need to apply, including those funds currently listed in modern awards.
- It could potentially allow consideration of the superannuation provisions in awards to be undertaken in conjunction with FWA's review of modern awards, thereby minimising the overall cost of undertaking the award variations that will be required. (The review of modern awards is prescribed by section 156 of the *Fair Work Act 2009* (Cwlth) and is scheduled to take place early in 2014.)

While delaying the reforms for several more years would have the benefit of allowing the industry to fully adapt to the MySuper reforms before starting additional reforms, it unnecessarily postpones realisation of the benefits of the reforms.

In recommending that the new selection process for default products should, if possible, be applied in 2014, the Commission does not intend to limit the Default Superannuation Panel's scope to stagger consideration of the products listed in default awards, or to consider groups of awards at the same time (chapter 8).

RECOMMENDATION 9.1

The legislative and policy changes necessary to give effect to the Commission's recommended reforms should ideally be put in place in 2013 and 2014. This would allow the new process, together with the consideration of factors relevant to the selection and ongoing assessment of default superannuation products for listing in modern awards, to be applied during 2014, and potentially coincide with the review of modern awards that will take place that year.

9.2 Promptly inform affected employers

Participants' views

Several participants emphasised the importance of notifying employers when a fund can longer accept default superannuation contributions for employees who derive their default superannuation product in accordance with modern awards.

> Employers would need to firstly be made aware that the fund is non-compliant, consult with employees over a new fund, invest time, money and resources into adjusting superannuation payments to funds that do meet the stated criteria and adjust relevant electronic financial transactions. We suggest that if existing funds are found to fail the new criteria, the government must provide for:
>
> - … A notification to both employers and employees concerning the status of their current fund in relation to compliance.
> - A 12 month transitional period whereby employers have time to identify a new default fund. (Electrical Contractors Association, sub. 17, p. 2)

Business SA considered that:

> As the new default superannuation fund process is implemented, it will be necessary to inform and educate businesses [about] the system and what their options are. This should be conducted by [the Australian Prudential Regulation Authority (APRA)] in association with business membership organisations. (sub. DR55, p. 3)

The Commission's view

When a fund is no longer permitted to receive superannuation contributions made on behalf of employees who derive their default superannuation product in accordance with modern awards, notifying employers who are contributing to these funds on behalf of these employees is the first and most crucial step in ensuring that contributions begin to flow into the products and funds listed in the award. Indeed, employers are the only participants in the superannuation system who are aware of precisely which employees derive their default superannuation product in accordance with modern awards.

- Employees will not necessarily know whether they are award reliant, or which award applies to them, or of the role the award plays in determining the destination of their superannuation.
- Neither superannuation funds nor government agencies have sufficient information about the employment arrangements of individual employees that could be used to identify and notify all employees who derive their default superannuation product in accordance with modern awards.
- Employers are required to provide employees with the entitlements specified in the award or agreement, and to keep records when employees exercise choice of superannuation fund. This means they should know which employees derive their default superannuation product in accordance with modern awards and which are in the default superannuation fund.

Few data that would enable employers to be identified and contacted are available. The Australian Taxation Office (ATO) enforces superannuation guarantee requirements, and in so doing collects information, for its own use, about employers and the superannuation contributions they make. The Australian Securities and Investments Commission has a register of business names, but access to many of the details in the register is limited and, importantly, many businesses do not employ staff.

This means that no data are publicly available that would enable the employers of workers who derive their default superannuation product in accordance with modern awards to be identified (which is a necessary first step in contacting them to advise them of the changes). Therefore, in attempting to ensure that all affected employers are notified of changes to award default superannuation arrangements, it will be necessary to use a number of channels. Employers could be contacted and provided with relevant information through:

- the ATO

- industry-specific, state and national employer organisations (though some employers may not belong to any of these types of organisation)
- FWA's award-specific electronic mailing list (though many employers may not subscribe to these lists)
- notices and articles in mainstream and industry-specific media.

This may result in some employers being informed of the changes to award default fund listing more than once, and in others not receiving any direct notification. This situation also arises when other aspects of awards — notably wage rates — are changed. Employers may (or may not) be notified of changes to award wages through one of the channels listed above, but are nevertheless expected to pay current wage rates. To the extent that employers are able to keep abreast of award wage requirements, similar systems should prove sufficient for notifying employers of changes to award default superannuation arrangements.

9.3 Assist affected employees to understand the changes and make informed decisions

Participants' views

A number of inquiry participants commented on mechanisms for, and the importance of, notifying employees of changes to award default superannuation arrangements. ISN considered that:

> … it would be reasonable to have processes in place that inform any employees who are members of the fund that the fund, although remaining MySuper authorised, is no longer listed in the relevant award and informing the employee that choice is available to them and that they should in the circumstances seek independent financial advice. (sub. DR62, p. 25)

ACCI described how employees might respond when they are notified that the default fund has changed.

> Some employees might decide to choose the former fund, perhaps because the employee has selected an investment option with that fund. Some employees might decide to exercise choice, and nominate a totally different fund, perhaps because they do not like the proposed new default. There is no particular time by which an employee must return a choice form. Under the current regime employees not choosing the former default fund would end up with an additional account, although the implications of this may be reduced under SuperStream. (sub. 37, pp. 5–6)

AiGroup commented on the burden that changing funds would place on employees.

> Asking employees to become accustomed to a new fund, to provide a new fund with

information already provided to their existing fund, to reassess insurance offerings and other features of the new fund and to re-nominate their beneficiaries in the event of the employee's death, would impose a burden upon employees. (sub. DR79, p. 5)

Mercer sounded a note of caution about:

> … significant disruptions and cost for … employees who are members of the delisted fund and who may end up with two accounts (and two sets of fees and insurance premiums) and/or incur a withdrawal fee when their existing account is transferred to their new fund. (sub. DR68, p. 3)

The Law Council of Australia warned of the:

> … potential for employees to suffer loss if their superannuation is unilaterally moved to new default funds from current default funds in which they have been members for many years. This may have a significant effect on employees' insurance cover, and may give rise to additional fees and charges payable by employees who acquire multiple accounts. (sub. DR67, p. 5)

Rural and Regional Promotions highlighted that:

> … many members in default funds are unaware that they have the ability to switch from one fund to another, this also adds to their disconnect from taking an active interest in their fund. There is a natural disinclination for funds, unions and employers to actively advise members that they are free to switch to other funds. (sub. DR86, p. 3)

The Commission's view

As discussed in previous chapters, the proposed reforms are designed primarily to benefit employees who derive their default superannuation product in accordance with modern awards. The proposals aim to ensure that employees who are placed into a default fund listed in an award will have their best interests served by that placement. The reforms are likely to also benefit employees who choose one of the products listed in an award.

The proposed reforms will be clearly beneficial for employees who are entering the labour market for the first time and who do not exercise their right to choose a fund, as there will be a greater chance that these employees become members of a fund that meets their best interests.

In addition to benefiting new employees, the proposed reforms will also benefit existing employees who are moved to a fund that in net terms better meets their interests. It is, however, difficult to estimate how many employees will change funds as a result of the reforms (box 9.1). As discussed in chapter 8, the overall effect on these employees is likely to depend on whether they consolidate their superannuation balances into the new product and fund, the savings they make in terms of reducing the number and value of administration fees and insurance premiums they are charged, and the effect that the consolidation may have on their insurance coverage.

Box 9.1 Estimating the number of employees who will change funds as a result of the proposed reforms

The number of employees who have their contributions paid to different funds as a result of the reform to the selection process for default superannuation products in modern awards will depend on a range of factors. These include:

- the number of funds that are currently receiving default contributions but do not have products listed in awards once the new selection process has taken place. These funds include:
  - those that are currently listed in a modern award but do not obtain listing for their default product(s) following the new selection process
  - those that were receiving contributions under the 12 September 2008 grandfathering clause, and do not obtain listing for their product(s) following the new selection process.
- the rate of uptake of enterprise agreements (which can provide for default contributions to be made to funds that are not listed in the award)
- whether employees exercise choice of fund in the face of a proposed fund change, in favour of their current fund or another fund.

The number of employees who exercise choice of fund will in turn depend on employees' awareness of their current superannuation arrangements, their satisfaction with those arrangements, and their willingness to incur the costs of changing funds in order to derive the benefits of moving into a fund that better suits their needs. These costs could include exit fees; the time and effort involved in assessing options, making decisions and completing paperwork; and the risk that the chosen fund proves to be a relatively poor choice for that employee (chapter 3).

There are also several other potential ways in which employees (and fund members more generally) may be affected.

- To the extent that funds that no longer have products listed in awards experience a decline in investment returns (see below), this decline is likely to flow through to the returns to remaining fund members
- Superannuation funds will incur some additional costs in applying to list their default products in modern awards, and may pass those costs on to members.

Given the potential for employees to be made worse off by paying multiple fees and insurance premiums — even when their future superannuation contributions are made to a product that has been assessed as being a better choice — it is important to ensure that affected employees have enough information to make informed decisions about their superannuation, and particularly about account consolidation and the insurance implications of changing funds.

Current and planned mechanisms for informing and assisting affected employees

Ensuring that affected employees have sufficient information to make informed decisions about their superannuation will, at a minimum, involve:

- informing employees that their superannuation contributions will be paid to a different fund if they don't make an active choice, and which product will receive their future contributions by default
- reminding them that they are free to choose any product offered by any fund that will accept them as a member, including those not listed in the award
- providing information which explains how to consolidate multiple accounts, and the potential benefits and costs of doing so.

As discussed in section 9.2, employers will take a primary role in informing employees who derive their default superannuation product in accordance with modern awards that default superannuation arrangements have changed. Employers are currently required to use the ATO's standard choice form to notify employees that the employer is changing default funds. The standard choice form includes the name and contact details of the new fund. The instructions for completing the form strongly encourage employees to read ASIC's consumer guide to superannuation (box 9.2).

Box 9.2 ***Super Decisions***

Super Decisions is a free consumer information booklet prepared by the Australian Securities and Investments Commission. It explains the basics of superannuation and provides guidance on super choice and how to compare funds.

It provides 'key tips about super' that are expressed in simple, everyday language:

> Look before you leap when choosing a fund. Compare retirement and insurance benefits and other features. Keep fees and charges down.
>
> Super's a long term investment, so take investment ups and downs in your stride.
>
> Consolidate your super accounts where possible, to avoid paying fees for more than one account and to stop you losing track of your super. Keep your fund(s) up to date with your address and how you'd like your death benefits paid.
>
> If you're changing or consolidating super funds, make sure you don't lose valuable insurance benefits. (p. 4)

Source: ASIC (2011b).

The new superannuation fund will also provide information to affected employees, in the form of a product disclosure statement. This must be distributed within three months of the new member joining the fund. From 1 July 2013, funds will also be required to report contributions to their members on a quarterly or six-monthly basis. This is designed to ensure that employees can track whether their superannuation entitlements are paid in a timely manner, and may further assist in raising members' awareness of, and engagement with, their superannuation.

In addition, the potential for multiple small account holdings to persist will be partially mitigated by the introduction of account auto-consolidation (box 9.3).

Box 9.3 **Auto-consolidation of accounts with low balances**

The Government has announced a program of auto-consolidation for superannuation accounts with low balances.

> From January 2014, the ATO will facilitate the auto consolidation of accounts with low balances by providing details of these accounts to members' active funds. The information will be provided annually and will include details of lost accounts, accounts that have not received a contribution or rollover for two years with balances under $1,000 and accounts in eligible rollover funds. These are the accounts that the government has identified as candidates for auto consolidation. Funds will be responsible for arranging consolidation unless the member opts out. (ATO 2012d)

The aim of auto-consolidation is to 'reduce the amount of fees paid on multiple accounts and maximise retirement benefits' (Shorten 2011a). As such:

> The $1,000 auto consolidation threshold may increase to a higher amount subject to a review by the Treasury, ATO and [the Australian Prudential Regulation Authority] in late 2014. (ATO 2012d)

The importance of auto-consolidation is recognised by the industry.

> The value of these initiatives to counter the problem of many people holding multiple accounts, often with small balances, and seeing their savings eroded through the payment of multiple administration fees and insurance premiums, is widely endorsed. The need to ensure that members clearly understand the impact of a move to consolidate their accounts, including on their insured position, was often emphasised during discussions as was ensuring that there is a genuine ability for a member to opt-out of this process if they determined that it was in their interests to operate multiple accounts. (Australian Government 2011b, p. vii)

Changes to legislation and regulations to give effect to auto-consolidation are yet to be drafted, and so some details (such as the timeframes in which funds must consolidate accounts and the treatment of accounts with active insurance policies) are not yet known.

Are further measures to assist employees required?

The combination of notification via the standard choice form, general advice in the *Super Decisions* publication, product disclosure from the new superannuation fund and auto-consolidation of accounts with low balances will ensure that all affected employees are informed of the changes to their superannuation arrangements and will have access to information to help them decide whether to consolidate multiple superannuation accounts (or for funds to undertake that task for them in certain cases).

Despite these measures, it is possible that having future superannuation contributions paid into a different fund will be disadvantageous for some employees who derive their default superannuation product in accordance with modern awards. Adverse effects are most likely to arise where the change of fund leads to multiple account holdings and members do not consolidate their accounts (which they are able to do at any time). Even when consumer-friendly information is available, 'many consumers remain ignorant of why account consolidation is important or how to go about it' (Choice 2006, p. 15). It can also be difficult for consumers to understand the ways in which account consolidation could affect their insurance coverage.

The program of auto-consolidation for superannuation accounts with low balances (box 9.3) provides a partial response to this inertia. A similar system of auto-consolidation could potentially be established for accounts with higher balances, where the multiple accounts have arisen due to changes to default superannuation arrangements in awards. However, in considering such an approach a number of significant issues arise.

- First, there is no way of reliably distinguishing between employees who have never made decisions about their superannuation (and so are truly in the default fund by default), and those who have actively chosen to be in a fund that is their employer's default fund (but who have not filled in a choice form to that effect, or did so more than five years ago). An auto-consolidation program is therefore likely to include many employees who have chosen to be in their current product or fund. While those employees could opt out of the auto-consolidation, the existence of a significant number of employees who wished to opt out would negate many of the benefits of automating consolidation in the first place.
- Second, it is likely that auto-consolidation would result in some employees losing valuable insurance coverage. As discussed in box 8.6 (chapter 8), it is possible that the new fund may exclude coverage for certain events, occupational hazards or pre-existing medical conditions that were covered by the old fund. In such situations, employees are likely to benefit from retaining insurance policies

offered by the old fund, and would be adversely affected if their account was automatically consolidated into the new fund. Though some employees will be aware of these insurance issues and opt out of auto-consolidation on that basis, it is possible that many of the default members who would have been better off retaining their current insurance coverage would not take the steps needed to do so.

- Third, the number of employees who will be affected by the changes to award default arrangements is not yet known (box 9.1). Were a large number of employees to be affected and their balances automatically consolidated to their new funds, there is potential to significantly adversely affect the stability of, and thus the returns received by members (including choice members) in, the old funds. Depending on the size of the funds that were no longer able to receive contributions for employees who derive their default superannuation product in accordance with modern awards, the movement of these employees from these funds could in turn have implications for the stability of the superannuation market, and the confidence people have in it.

In light of these issues, the Commission does not consider that auto-consolidation of multiple accounts that have arisen due to changes to award default arrangements would be appropriate at this time. Measures outlined in chapter 8 to minimise the transitional effects on members mean that fewer employees are likely to have multiple accounts, and thus the potential benefits of auto-consolidation are commensurately smaller.

9.4 Allow a reasonable transition period for employers and funds

Many employers and superannuation funds will be affected by the changes to award default superannuation arrangements. To a large extent, these effects will be transitional in nature. As such, the provision of an adequate timeframe for transition will be important in minimising any potential adverse consequences of the reforms.

Participants' views

Consequences for employers

A number of inquiry participants (including the South Australian Wine Industry Association, sub. DR71) commented on the potential consequences of reforms to the default system for employers, particularly if the reforms require them to change default funds.

REST Industry Super said that:

> … there is no question that changes to the nominated default superannuation fund would cause some inconvenience, be it the need for system configuration, the use of disclosure material to employees and associated material to all recruitment locations, as well as the need to liaise with additional parties for contribution reconciliations and insurance claims. (sub. 47, p. 10)

ACCI commented:

> When an employer changes the fund into which default fund contributions are being made the employer must give the affected employees (employees who have not chosen a fund whose contributions are being paid into the former default fund) a new standard choice form which identifies the new default fund. The employer may have to enter into a standard employer sponsorship with the new default [fund] unless there is already such an arrangement in place. The employer will have to enrol all affected employees except those who return a properly completed standard [choice] form before that happens. (sub. 37, p. 5)

AMP suggested that:

> The administrative burden placed on employers, especially medium to large employers, in changing default superannuation funds is also considerable. In order to change a default superannuation fund, an employer is bound by the Superannuation Guarantee Act to issue all employees with a choice of fund form (and act on and retain returned forms). (sub. DR85, p. 7)

Mercer warned of ‘significant disruption and costs for many thousands of employers’ (sub. DR68, p. 3).

Similarly, AiGroup said:

> Changing default funds would impose a substantial compliance burden on employers. In addition to changes in payment arrangements and the like, it would also require an employer to identify which employees had chosen to contribute to funds previously listed in an award and which employees were members of these funds as a result of their being listed as default funds. (sub. DR79, p. 5)

The Association of Superannuation Funds of Australia (ASFA) suggested that if employers are not required to change from their existing default fund, they may be unlikely to do so.

> Incumbency is also very important for determining which fund or funds are being used as a default. Changes to default funds listed in an award (in terms of any additional fund or funds being listed) are unlikely to lead to many employers reconsidering the default fund they use. (sub. 31, p. 6)

Consequences for superannuation funds

Several inquiry participants put forward views on the potential consequences for superannuation funds of any reforms that led to different funds receiving contributions made on behalf of employees who derive their default superannuation product in accordance with modern awards.

REST Industry Super said that:

> … if a fund loses membership through the opening up of default fund status in modern awards, this could impact on its ability to continue to offer the benefits of scale to its members … Loss of [funds under management] results in higher cash outflows and increases the need for liquidity in the fund's default investment option. This could limit the ability of a fund to invest in less liquid assets such as infrastructure projects which typically are expected to provide higher returns than other assets classes but are illiquid and require significant capital investment … The removal of infrastructure based on the assumptions outlined above results in reduced gross returns. (sub. 47, pp. 11–13)

Mercer similarly warned of:

> … a potentially disastrous impact on the delisted fund (with a potential large call on its assets as members transfer account balances to the new default funds of the thousands of employers who can no longer contribute to the fund) and a significant drop in contribution inflows. The fund's liquidity and future investment returns may also be adversely impacted. (sub. DR68, p. 3)

Mercer also considered that removing a fund from award listing could result in 'a potentially serious adverse impact on the remaining members of the delisted fund with its reduced scale, potential fee increases and potential lower liquidity' (sub. DR68, p. 3).

Likewise, ACCI suggested that:

> In the world of MySuper defaults there will be a clear competitive advantage for a fund to be nominated in one or more modern awards and it seems likely that funds offering MySuper products which fail to be nominated in any relevant modern award will seek to amalgamate or perhaps to exit the default field. (sub. DR83, p. 5)

MLC Ltd–NAB Wealth suggested that 'forced transition of superannuation arrangements (to specifically named funds in awards)' will involve 'significant adverse consequences (for members)' (sub. DR87, p. 6).

> … moving members from their current option on a single prescribed day or in a short time frame will expose members to transactions undertaken without regard to their investment merit (i.e. potentially selling low, buying high) …
>
> Funds and products within funds have commonly had illiquid assets (with an appropriate calibration to expected entrants and exits). These can be classified either as assets that are illiquid due to the characteristics of the underlying investments (property

or private equity for example) or assets that are illiquid due to legal impediment. In both cases the valuation of the asset can be problematic and if it is to be moved into a new fund structure it needs to be quarantined to ensure that it does not affect the investments of other clients or members. Some funds may not have the capacity to manage and/or quarantine these assets …

Of particular concern would be the consequences of large sums moving around the industry over short periods of time. The potential for arbitrage in the market place at an industry wide level could be huge, to the detriment of the uninformed member. (sub. DR87, p. 6)

Transition period

AIST (sub. DR69), the Electrical Contractors Association (sub. DR84) and the South Australian Wine Industry Association (sub. DR71) suggested that a transitional period of at least 12 months should be provided, 'so that employers can get advice regarding their default fund and communicate the change to employees' (sub. DR71, p. 4).

Mercer recommended that:

… employers be provided with a three year period to justify their default is appropriate … Any shorter period may hinder the ability of employers to make an appropriate choice of default fund (sub. DR68, pp. 3 & 10)

The Commission's view

Consequences for employers

For those employers who are affected by the reforms, there will be ongoing benefits for some, and additional costs for others, albeit generally of a transitional nature. Employers will be particularly affected by the Commission's proposed reforms if they were making contributions to a fund that is no longer able to receive contributions made on behalf of employees who derive their default superannuation product in accordance with modern awards. Those employers will be required to change to one of the funds that offers a default product that is listed in the award.

As noted above, these employers will be required to use the ATO's standard choice form to notify employees that the employer is changing default funds. If the standard choice form is provided to all employees who are currently members of the default fund, employers will satisfy their requirements, obviating the need for them to search their records to ascertain how employees came to be in that fund.

The number of employers who change funds as a result of the reforms will depend on a range of factors that mirror those affecting employees outlined in box 9.1. As participants highlighted, changing default superannuation funds would involve a range of (largely transitional) administrative costs. Given that there will be between four and eight years between wholesale reassessments, these transitional costs would occur infrequently for the vast majority of employers (and many employers will not incur them at all, because they will continue to be able to use their current default fund).

Indeed, in some cases, a change of default fund could bring ongoing benefits to employers, if it means that they are able to select a fund that has better administrative systems or is more efficient in responding to their needs. In this regard, one of the factors for consideration in the selection and ongoing assessment of funds is its administrative efficiency (chapter 6). The Commission anticipates that the greater competition between funds will improve this aspect of their operation (amongst others), to the benefit of all employers. In addition, there will be direct benefits to employers who are newly able to engage with a longer list of funds that have better administrative capabilities.

Consequences for superannuation funds

Funds that can no longer receive award default contributions

As noted above, some of the costs of reform will be borne by funds that are no longer able to receive contributions made on behalf of employees who derive their default superannuation product in accordance with modern awards. Until the Commission's proposed new selection process is completed, it is not possible to know exactly which funds these will be (or how many such funds there will be). However, it is clear that this group will include:

- funds that are currently listed in a modern award and that are not successful in having their default product(s) listed following the Commission's proposed new selection process
- funds that were receiving contributions under the 12 September 2008 grandfathering clause, and that do not obtain listing for their default product(s) following the new selection process.

Similar considerations will also apply for funds with products that are listed following the new selection process, but are later found not to sufficiently meet the factors for consideration and are removed from award listing.

The affected funds may experience a reduction in membership and funds under management. They may also lose any reputational benefits that being listed in an award may bring. With less certainty about future income, they would need to adjust their investment portfolios. They may simultaneously be adjusting their portfolios in response to heightened incentives to improve investment performance (chapter 7).

However, the only funds that will experience these reduced returns are those that offer a default product that does not meet the requirements of the new process — that is, funds whose default product has been judged as delivering outcomes that are unsuited to employees who derive their default superannuation product in accordance with modern awards. As such, the Commission considers that these funds were advantaged by having previously been listed as default funds in awards, rather than disadvantaged by no longer being listed. Moreover, given the dynamic nature of the superannuation industry, the funds that are no longer able to receive award default contributions can work to have their products relisted by better addressing the factors for consideration. Funds also have the option of directly approaching employers and employees to obtain default status at the enterprise level through an enterprise agreement, or to become the fund of choice for individual employees.

Other consequences for funds

Most funds will also be affected because they will face greater competition in the default market. This will particularly affect the funds that are included in those modern awards that currently list only a handful of funds (chapter 7).

In addition, any fund that wishes to have its default product listed in a modern award will bear the costs of participating in the application and selection process in 2014 and every four to eight years thereafter. At a minimum, this will require every fund that wishes to have its default product listed (including funds that are already listed) to articulate their claims for selection against the factors for consideration recommended by the Commission. Funds that are not successful in obtaining inclusion will bear this cost for no return.

Transition period

The Commission is mindful that employers will need to be given a reasonable period of time to make necessary changes once new default products are listed in any award. Likewise, superannuation funds will need time to adjust their investment portfolios in response to changes in the projected flow of funds. This suggests that providing an adequate timeframe for transition will be important for both employers and funds.

The Minimum Wage Panel within FWA — on which aspects of the Default Superannuation Panel are modelled — provides a short transition period for annual changes to award wages. In recent years, the panel has announced its decision in June, with the new wage rates taking effect on 1 July. A similar mechanism, but with a significantly longer adjustment period, could be used by the Default Superannuation Panel.

FWA has used a range of other transition periods during award modernisation and for other variations to award provisions. Some award variations apply from the date of the decision, some are backdated, some apply on a fixed date in the near future, and others are gradually phased in over a number of years. These different responses depend on the time needed by stakeholders (notably employers) to adapt to the changes, and the risk of adverse consequences that could arise if changes were made too quickly.

The Default Superannuation Panel will be best placed to assess these risks, and to determine whether, and the extent to which, they vary between awards. The Commission therefore considers that when listing default products in awards the Default Superannuation Panel should also decide on appropriate transition periods. In doing so, it should take into account the best interests of employees who derive their default superannuation product in accordance with modern awards, as well as the needs of employers and superannuation funds. Providing a reasonable transition period will also assist in mitigating any wider risks to the superannuation market that may arise during transition.

9.5 Ensure that the Default Superannuation Panel has appropriate skills, resources and legal status

Participants expressed a range of views about whether the Default Superannuation Panel within FWA would be an appropriate decision maker, and about whether it would possess, or could acquire, the necessary skills and experience to make decisions in the best interests of employees who derive their default superannuation product in accordance with modern awards. These views are addressed in chapter 8.

Resources for the Default Superannuation Panel

The Default Superannuation Panel (supported by a secretariat) will need to perform a range of new functions. These include:

- calling for applications from superannuation funds that wish have their default products listed in modern awards, and for information on the needs and best interests of employees who derive their default superannuation product in accordance with modern awards
- considering the information provided by superannuation funds, industrial parties and other interested stakeholders
- exercising judgement about how the applicant products and funds compare against each of the factors for consideration recommended by the Commission (and potentially other factors) for each award or group of awards
- selecting suitable products for listing in each award or group of awards, and a small subset of funds to be identified as best meeting the interests of employees who derive their default superannuation product in accordance with modern awards
- publishing applications, decisions (and potentially draft decisions) and other relevant information
- maintaining an awareness of the suitability of listed products for employees who derive their default superannuation product in accordance with modern awards, through an ongoing assessment process, including ongoing liaison with APRA
- conducting a wholesale reassessment of the list of funds every four to eight years
- undertaking associated administrative tasks.

FWA will require additional resourcing to allow the Default Superannuation Panel to successfully fulfil these functions. The level of resourcing will need to be sufficient for it to obtain the necessary expertise to conduct these new tasks. The exact level of resourcing needed to accomplish this will depend on the detail of the processes adopted by FWA, and on the existing resourcing and expertise that it can bring to this task.

By way of indicative guidance, the budget papers prepared for the former Australian Fair Pay Commission (the predecessor of the Minimum Wage Panel) show that its budget was close to $7.5 million in 2008-09 (O'Neill 2009). FWA does not disclose the full resources currently employed by the Minimum Wage Panel.

It will be important that the panel's budget is clearly separated from the budget allocations used for FWA's other functions. Such quarantining will ensure that the process is transparent and provides a basis for assuring all stakeholders that the selection of default products for listing in modern awards is conducted in an appropriately rigorous fashion.

Resourcing will also need to be sufficient to enable the Default Superannuation Panel to obtain relevant data in a timely manner. This may be particularly important given the limited availability of data on employees who derive their default superannuation product in accordance with modern awards (box 9.4).

Box 9.4 **Data on employees who derive their default superannuation product in accordance with modern awards**

The Default Superannuation Panel's decisions will affect employees who derive their default superannuation product in accordance with modern awards. As discussed in chapter 2, this includes:

- award-reliant employees
- employees who receive above-award wages but are reliant on the award for their superannuation, and
- employees covered by enterprise agreements that incorporate the superannuation provisions in the award by reference.

However, there are currently no award-level data on any of these groups, and thus there is no precise measure of the number of employees who derive their default superannuation product in accordance with modern awards. This absence of data makes it difficult to estimate the number of employees who will have their contributions paid to different funds as a result of the reform to the selection process for default superannuation products in modern awards (box 9.1).

Fair Work Australia is currently mapping the coverage of each modern award to the industry classifications used by the Australian Bureau of Statistics. Drafts of this work were published in August 2012 (FWA 2012c). Once completed, these maps should assist in obtaining data on award-reliant employees.

There may then be scope for further work to refine the identification of award-reliant employees and improve the data collected on superannuation provisions in individual and collective agreements. However, the feasibility of obtaining reliable data, and the costs and benefits of their collection, would need to be carefully assessed.

Legal basis and protections

Participants' views

The Law Council of Australia commented on a number of legal issues of relevance to the operation of the Default Superannuation Panel.

Consideration also needs to be given to the possibility of:

(i) a fund seeking judicial review of the decision; and

(ii) exposure to legal actions (in the form of individual or class actions) for compensation to:

(A) a fund that is excluded from an approved 'default MySuper' list as a result of an error made in the assessment process;

(B) a fund that has suffered a loss as a result of something published by FWA or the expert panel that is incorrect; or

(C) employers or employees for loss suffered as a result of contributing to MySuper products selected by FWA or the expert panel on its approved 'default MySuper' product list.

… Consideration needs to be given to the legislation that would need to be put in place to ensure that FWA or the expert panel applies the criteria for its approved 'default MySuper' product list consistently with other Commonwealth legislation (ie. the Corporations Act 2001 (Cth) and the Future of Financial Advice (FOFA) legislation). (sub. DR67, pp. 4–5)

The Commission's view

The Default Superannuation Panel will need a legislative basis for its operations. The Commission envisages that this could be partly modelled on current legislative arrangements for the Minimum Wage Panel that are contained within the *Fair Work Act 2009* (Cwlth). In developing the legislative framework, it will be important that:

- the factors for consideration are prescribed in the legislation (recommendation 7.1)
- principles of good process (recommendation 7.2) are followed
- all aspects of the default product selection process (as recommended in chapter 8) are provided for in (or permitted by) legislation, including that all eligible superannuation funds have standing solely for the purpose of listing default superannuation products in modern awards
- a legislative basis is provided to enable APRA to share data with the Default Superannuation Panel, and vice versa.

Inquiry participants raised a number of concerns about legal consequences that could arise from the Default Superannuation Panel's decisions in certain situations, such as very poor performance of a listed superannuation product, breach of statutory duty or negligence. As a consequence of participants' concerns, the Commission obtained legal advice from the Australian Government Solicitor (AGS) about whether a Default Superannuation Panel could be liable in such situations.

The AGS advised that if the panel was established under the Fair Work Act, section 580 of the Act would protect members of the panel from liability. This would not, however, prevent the decisions of the Default Superannuation Panel from being reviewed by the judiciary for jurisdictional error (decisions made by FWA and the Minimum Wage Panel are similarly reviewable). The Commission seeks to limit opportunities for appeal in order to avoid vexatious claims but supports the provision of review where the panel has not properly exercised its jurisdiction (chapter 8).

9.6 Provide clear information about default products and their selection

Public reporting

A recurring theme of this report is that, for the best interests of employees who derive their default superannuation product in accordance with modern awards to be fully realised, an open and transparent process is needed to assess which products should be listed as defaults in modern awards. This openness and transparency must extend to all aspects of the decision-making process.

Participants' views

Of all the inquiry participants, Suncorp made the most detailed suggestions about openness and transparency.

> Suncorp suggests that FWA should be required to publish an annual report into the default superannuation in modern awards system. Key statistics that should be included in the report are the:
>
> - number of applications received
> - number of applications approved or denied
> - reasons for denial
> - average time taken to assess applications
> - longest time taken to assess an application
> - estimated number of employees working under awards that had applications denied
> - estimated annual dollar value of superannuation contributions made under awards that had applications denied
> - number of awards reviewed and not reviewed for default superannuation fund purposes.

> In all cases these statistics should be provided both in total and broken down by fund type. (sub. 38, p. 6)

The Commission's view

The Commission considers that Suncorp's suggestions have merit, though the capacity for reporting to occur on an annual basis will depend on the choices made by the Default Superannuation Panel about the conduct of the selection process. Unless some form of staggered or rolling assessment is adopted, periodic reporting timed to coincide with the four to eight yearly reassessment process may be more appropriate.

In terms of publishing information about the process used to select default products, the most useful information to report and the most appropriate reporting formats will depend on a range of factors that are best assessed by those with day-to-day involvement in the process. Accordingly, the Commission does not intend to specify in detail exactly how the Default Superannuation Panel should report on the process it uses to select superannuation products for listing in awards. It is already FWA's practice to publish a statement of its decisions, and the Default Superannuation Panel would be required to adopt a similar practice.

Clearly identifying products in awards

There is currently considerable variation in the way in which default superannuation funds are listed in modern awards. For example, Asset Super is listed in different awards as either Asset Super, Asset Limited or the Australian Superannuation Savings Employment Trust. In addition, some funds named in awards no longer appear to be operating.

> Although the 122 awards name 103 funds the number of active funds has been reduced to approximately 86, with 6 funds wound up; 7 funds merged and the status of 4 funds is unknown but not active. A number of funds do not exist as named in awards. (ISN, sub. 27, p. 36)

The variation in fund names and the presence of non-operational funds in awards can make it difficult for employers to be confident that they have correctly identified the funds to which they are required to contribute.

The Commission's reforms provide an opportunity to rationalise the way in which default products are listed in awards. In the draft report, the Commission recommended that the superannuation fund names and identifying numbers used by APRA should be used by FWA to list superannuation funds in modern awards. Since the draft, for reasons discussed in chapter 7, the Commission has formed the view that default superannuation products should be assessed by the Default Superannuation Panel. As a consequence, default superannuation products, rather than funds, should be listed in awards.

However, while each MySuper product will have a generic name, funds will also be able to give the product different names when offered to members from a particular subset of the total membership of that product — a practice known as 'white labelling'. Though the white labelled products will have the same investment strategy and the same fee structure, they will be permitted to have different names, logos and member communication material, including different product disclosure statements (APRA 2012c). In order to prevent confusion about white labelled products on the part of both employers and employees, it will be important to ensure that, in addition to the generic product name, the fund name and product identifiers are listed in awards.

RECOMMENDATION 9.2

The product names and identifiers and fund names used by the Australian Prudential Regulation Authority should be used by Fair Work Australia to list default superannuation products in modern awards.

As mentioned in chapter 8, draft legislation currently before Parliament provides that if APRA cancels the authorisation of a fund to offer a MySuper product, it must notify FWA in writing of that fact (Shorten 2012a). The Commission supports this approach, and considers it to be an essential feature of a well-functioning award default system.

Other issues that may require special consideration

Exempt public sector superannuation schemes

Exempt public sector superannuation schemes (EPSSSs) will not be able to offer MySuper products, but will nevertheless be eligible for selection as a default fund in a modern award. Some of the recommended factors for consideration could have a different degree of importance in relation to EPSSSs. Comparing default products offered by EPSSSs with MySuper products on an equal basis may also pose challenges, as EPSSSs are not bound by the same regulatory framework. They may structure their default products in different ways, and may collect and report different information to other funds. Therefore, the Default Superannuation Panel will need to be aware of the impact that its processes may have on EPSSSs, and ensure that it does not place an undue burden on them. The panel should nevertheless strive to assess EPSSSs on the same basis as they do other funds.

Modern enterprise awards

The *Fair Work (Transitional Provisions and Consequential Amendments) Act 2009* (Cwlth) provides that a range of existing awards that apply to a single enterprise may be modernised. Existing enterprise awards will cease to operate on 31 December 2013 unless an application to be modernised is made and granted before that date. To date, five applications for modernisation of such awards have been made. Of these, four have been rejected and one (dealing with enterprise awards applying to Telstra Corporation) has been granted. The details of the modern enterprise award for the Telstra Corporation are still in the process of being determined.

The Commission considers that its proposed factors for consideration would provide a sound basis for selecting default superannuation products for listing in all awards, including enterprise awards. However, the treatment of default superannuation products in modern enterprise awards is a matter best left to the discretion of the Default Superannuation Panel, taking into account the views of the relevant parties and FWA more broadly.

9.7 Review the new process for selecting default products, including the factors for consideration

The Commission's proposed reforms offer the prospect of gains to default fund members and to the community more generally. Nonetheless, as discussed in preceding chapters, changes ensuing from other reform initiatives (particularly the introduction of MySuper) will have implications for default funds and their members. These implications cannot be fully known in advance. And there is inevitably some degree of uncertainty about precisely how the Commission's proposed reforms will play out in practice, particularly given the uncertainty regarding the number, mix and quality of MySuper products to be offered from 2013.

Against this backdrop, and in keeping with a best-practice policy-making process, the Commission considers that provision should be made for an independent public review of the impact of the proposed new arrangements for selecting default superannuation products for listing in modern awards. A number of participants supported the Commission's proposed approach to such a review (box 9.5).

Box 9.5 **Participants' comments on the proposed review**

Participants generally supported the Commission's proposed approach to review.

> The CSSA agrees … that there is merit in conducting an independent public review after the first wholesale reassessment of funds, to ensure that the criteria for default fund selection remain useful and relevant and that the selection process is working as intended. (sub. DR56, p. 5)
>
> Ai Group supports this [review] proposal but this should not prevent any problems which become apparent being addressed at an earlier time. (sub. DR79, p. 8)

Others supported the concept of a review, but suggested that it should be conducted much earlier than 2023.

> The T.I.S. Fund disagrees with the recommendation that the new system should be reviewed in 2023. Any new system should be reviewed within 5 years of the date it is implemented to prevent the consolidation of a bad system. (Transport Industry Superannuation Fund, sub. DR91, p. 2)

Others questioned whether it was possible to meaningfully consider the timing and content of a review planned that will not occur for over a decade.

> ISN questions the utility of proposing a specific date and broad terms of reference for a review in eleven years time. It is likely that there will be considerable change within the industry and its regulatory environment in the intervening period. ISN has no fundamental objection to recommendation 9.3, however, we propose a less prescriptive approach which simply recognises that there should be a future review of the arrangements for the selection of default funds. This could be a stand-alone review, or be part of a future wider superannuation review. (ISN, sub. DR62, p. 28)

ACCI suggested that the need to review the factors for consideration may increase over time, because mergers will lead to increasing diversity in the membership of each fund (sub. DR83).

Timetable for the review

In chapter 8, the Commission recommends that the list of default superannuation products in awards be the subject of a wholesale reassessment every four to eight years, following an initial selection process which would ideally commence in 2014.

Reviewing the process and factors for consideration before the first periodic reassessment of all awards has been completed would appear to be premature. Instead, the Commission considers that reviewing the process and factors for consideration after they have been applied at least twice for each award would be appropriate. Ideally, the review would be conducted in 2023.

The Commission recognises, however, the importance of flexibility, particularly where there may be a need to respond to any unforseen effects of the new selection system or to significant consolidation in the superannuation system. As such, any legislated review timetable should provide for the ability to schedule the review before 2023, should the need arise. Conversely, should the initial selection process occur later than 2014, there would need to be flexibility to delay the review beyond 2023.

Who should undertake the review?

Rather than specify who should conduct a review that is recommended to occur in a decade's time, it is more appropriate to specify the characteristics of the reviewer. The Commission considers the review should be undertaken by a body that:

- is independent of industrial parties and superannuation funds
- has relevant skills and expertise
- has the capacity to provide a transparent public review.

This could be a stand-alone, independent review, or be conducted as part of any future review of the broader superannuation system.

RECOMMENDATION 9.3

An independent public review of the arrangements for the selection and ongoing assessment of default superannuation products for listing in modern awards should be conducted after the first periodic reassessment of products listed in awards has been completed, ideally in 2023. Amongst other things, the review should examine:

- ***whether the factors considered in selecting products for listing in modern awards remain useful and relevant***
- ***whether the selection process is working to deliver outcomes that are in the best interests of employees who derive their default superannuation product in accordance with a modern award***
- ***the appropriateness of employers being able to use any MySuper product as a default superannuation product.***

A Public consultation

In keeping with its standard practice, the Commission has actively encouraged public participation in this inquiry.

- Following receipt of the terms of reference on 6 February 2012, it advertised the inquiry in major metropolitan newspapers and sent a circular to likely interested parties.
- In late February 2012, it released an issues paper to assist those wishing to make written submissions. Some 54 written submissions were subsequently received (table A.1). After releasing the draft report in June 2012, the Commission received a further 40 submissions (denoted in table A.1 with the prefix 'DR'). All submissions are available online at: www.pc.gov.au/projects/inquiry/default-super.
- As detailed in table A.2, it met informally with a wide range of stakeholders.
- Following release of the draft report, public hearings were held in Melbourne and Sydney. The participants at these hearings are listed in table A.3.

The Commission is grateful to all inquiry participants for their input.

Table A.1 **Submissions received**

Participant	*Submission number*
Accommodation Association of Australia	28
Actuaries Institute	45, DR60
AJ and BJ Smith Pty Ltd	DR65
AMP	52, DR85
ANZ Wealth	48, DR82
Asset Super	32
Association of Financial Advisors	50, DR73
Association of Superannuation Funds of Australia (ASFA)	31, DR75
Australian Chamber of Commerce and Industry (ACCI)	37, DR83
Australian Council of Trade Unions (ACTU)	29, DR77
Australian Hotels Association	10
Australian Industry Group (Ai Group)	25, DR79
Australian Institute of Superannuation Trustees (AIST)	20, DR69
Australian Manufacturing Workers' Union (AMWU)	49
AustralianSuper	36, DR74
BT Financial Group	46
Burke, Michael	3
Business SA	DR55
Cbus	15, DR81
Centre for the Study of Choice, University of Technology Sydney (UTS)	22
Clubs Victoria	5
Colonial First State	42
Community and Public Sector Union (CPSU)	DR78
Cooper, Jeremy	DR94
Corporate Super Association	14, DR63
Corporate Super Specialist Alliance (CSSA)	35, DR56, DR90
Council of Small Business Organisations of Australia (COSBOA)	7
CPA Australia	39
Department of Education, Employment and Workplace Relations (DEEWR)/Treasury	DR89
DFA Australia	21
Doyle, Peter	2
Eldercare	DR57
Electrical Contractors Association	17, DR84
Employment Law Committee of the Law Society of NSW	11
eo Financial Services	12
Financial Planning Association of Australia (FPA)	DR76
Financial Services Council (FSC)	30, DR80, DR93
HOSTPLUS	8
Industry Funds Forum (IFF)	51
Industry Super Network (ISN)	27, DR62
Infrastructure Partnerships Australia	9
Johnston, Adam	54
Law Council of Australia	23, DR67
LGsuper	DR59
legalsuper	19

(Continued next page)

Table A.1 (continued)

Participant	*Submission number*
Mahon, Vincent	1
Master Builders Australia	41
Master Plumbers and Mechanical Services Association of Australia (Master Plumbers)	33
McAuley, John	53
Mercer	34, DR68
MLC Ltd–NAB Wealth	44, DR87
Name withheld	DR66
National Tourism Alliance	4
National Union of Workers (NUW)	DR72
NGS Super	18
Queensland Nurses’ Union	DR61
REI Super	26
Restaurant and Catering	43
REST Industry Super	47
Rural and Regional Promotions Pty Ltd	DR86
Shop Distributive and Allied Employees Association (SDA)	24
South Australian Wine Industry Association	DR71
State Public Services Federation Group of the CPSU	16
Suncorp	38, DR64
Sy, Wilson	DR58
Tasplan	6
Transport Industry Superannuation Fund	40, DR91, DR92
Unions NSW	13, DR70
United Voice	DR88

Table A.2 **Meetings**

Participant
Australian Capital Territory
Australian Industry Group (Ai Group)
Council of Small Business Organisations of Australia (COSBOA)
Department of Education, Employment and Workplace Relations (DEEWR)
The Australia Institute
The Treasury
Victoria
Australian Chamber of Commerce and Industry (ACCI)
Australian Council of Trade Unions (ACTU)
Australian Institute of Superannuation Trustees (AIST)
Corporate Super Association
Deloitte Access Economics
Fair Work Australia
Professor Geoffrey Giudice, University of Melbourne
Industry Super Network (ISN)
Mercer
Rice Warner Actuaries
New South Wales
AMP
Association of Superannuation Funds of Australia (ASFA)
Australian Prudential Regulation Authority (APRA)
Australian Securities and Investments Commission (ASIC)
Jeremy Cooper
Financial Services Council (FSC)
Industry Funds Forum (IFF)
SuperChoice
Susan Thorp and Steve Satchell, University of Technology Sydney (UTS)

Table A.3 **Public Hearings**

Individual or organisation	*Transcript page numbers*
Melbourne – 30 July 2012	
Australian Institute of Superannuation Trustees (AIST)	3–18
Australian Council of Trade Unions (ACTU)	19–40
Australian Industry Group (Ai Group)	41–58
Sydney – 31 July 2012	
Financial Services Council (FSC)	61–81
Unions NSW	82–89
United Voice	90–104
Law Council of Australia	105–115
Industry Super Network (ISN)	116–134
Association of Financial Advisers/Corporate Super Specialist Alliance (CSSA)	135–146
Transport Industry Superannuation Fund	147–156

B International experience — default funds in pension systems

In 1994, the World Bank undertook a review of pension systems in various countries. It recommended that pension systems should consist of three pillars.

1. A mandatory, publicly-managed and tax-financed pillar (like Australia's old-age pension).
2. A mandatory, privately-managed and fully-funded pillar (like Australia's superannuation system).
3. A voluntary pillar (individual savings) (World Bank 1994).

Many countries have since adopted a three-pillar model for their pension system. However, there is still considerable scope for differences between countries within the World Bank's framework, such as the default arrangements in mandatory pillars or the degree to which competition between funds is permitted. This appendix focuses on these features, examining:

- New Zealand — for its process for selecting default KiwiSaver providers
- Sweden — for the national default fund which all members are allocated to when they do not exercise a choice of fund
- Chile — for the high administration costs imposed on individuals as a result of extensive marketing expenditure by funds, and the recent reforms that have led to a single default fund
- the Netherlands — for its industrial relations system which determines pension funds for workplaces and industries
- Hong Kong — for the roles that stakeholders play in choosing funds and the presence of industry-specific funds.

New Zealand

In 2007, New Zealand introduced KiwiSaver, an automatic-enrolment, voluntary savings system administered by Inland Revenue. Employees are automatically enrolled in the system and can contribute a minimum of two per cent, and a maximum of eight per cent, of their gross wages to the system. Individuals can opt out of KiwiSaver if they wish, and can opt back in at any time. There are several incentives to join and contribute to KiwiSaver schemes, including government contributions, fee subsidies, employer contributions and tax incentives. In general, contributions to KiwiSaver products (schemes) are preserved until members reach superannuation age (65). However, members may make a one-off withdrawal when buying their first home (Commission for Financial Literacy and Retirement Income nd).

As in the Australian system, all individuals in New Zealand are free to choose their own KiwiSaver scheme. Where an employee has not made a choice, they are automatically enrolled in their employer's chosen scheme (if the employer has made such a choice) or in one of six default schemes. According to section 50 of the *KiwiSaver Act 2006* (NZ), default members are allocated on a 'sequential' basis between the appointed default schemes. The default providers were determined by the New Zealand Government prior to the commencement of KiwiSaver, and a retendering process is expected to take place in 2014.

Default provider selection process

The Ministry of Economic Development conducted an 'open, competitive tender process' (Inland Revenue 2011a) in 2006 to appoint default providers. In making their decisions, Ministers received advice from independent external experts who carried out detailed evaluations of the applicants.

Criteria used to select default providers included:

- security and organisational credibility
- organisational capability
- proposed design of the provider's Default KiwiSaver Scheme
- administration capability
- competitive fee levels
- investment capacity/capability (Cullen 2006, 2007).

Littlewood (2012) made several criticisms of the 2006 process for selecting default providers, arguing for changes to be made to the process when the default providers are reviewed in 2014. Criticisms included that the 2006 process:

- was not transparent, with:
  - poor disclosure of the Government's reasons for decisions
  - decisions seemingly made on a 'least risk to Government' basis, rather than in the best interests of members
- provided a competitive advantage to default providers without any compensation, through:
  - the automatic enrolment of default members
  - the reputational effect of being endorsed by Government, which attracts additional members
- appointed too many default providers, given the small size of the New Zealand market.

Default KiwiSaver providers

The New Zealand Government appointed six default providers:

- ASB Group Investments Limited.
- AMP Services (NZ) Limited.
- ING (NZ) Limited.
- Mercer Human Resource Consulting Limited.
- National Mutual Corporate Superannuation Services Limited (trading as AXA New Zealand).
- TOWER Employee Benefits Limited (Cullen 2007).

Each of the default providers have aspects of their products set by Default Provider Notices. The Notices took effect from the time the providers were appointed, and are valid until 30 June 2014.

The Notices specify:

- that between 15 and 25 per cent of member assets are invested in growth assets
- that default providers must ensure that non-default investment products are available to members of the default KiwiSaver scheme
- fee types and amounts that may be charged to members

- reporting requirements for default providers.

The set of default KiwiSaver schemes applies consistently to all individuals in New Zealand. This contrasts with Australia, where default superannuation products are determined by award through the industrial relations process, or by workplace through the enterprise bargaining process. No suggestions have been made in commentaries of the KiwiSaver system that different default schemes should apply to different individuals.

However, one notable difference between the two systems is the absence of bundling of other components with KiwiSaver schemes — that may optimally vary by industry — such as insurance.[1]

Some features of default KiwiSaver products have set benchmarks for the rest of the industry to follow. For example, the requirement for default products to have low fees is thought to have encouraged price competition amongst all providers (Ministry of Economic Development 2010). This indicates that mandated features of default products can play a role in shaping competition in the industry more broadly.

The decision to impose a conservative investment strategy on default schemes has been a point of debate in New Zealand. Although conservative strategies have meant members of default KiwiSaver schemes fared relatively well during the recent economic downturn, they may not be in the long-term best interests of members. Over a long time horizon, growth strategies will outperform conservative strategies (Basu and Drew 2009). However, the investment time horizon of some KiwiSaver members may be quite short as they can, on a one-off basis, withdraw the balance of their account to purchase their first home.

Role of stakeholders

The New Zealand Government, Inland Revenue, KiwiSaver providers and employers all play a role in administering the KiwiSaver system for employees and other members.

Apart from the Government providing concessions and appointing default providers, Inland Revenue handles much of the administration supporting KiwiSaver. All employee and employer contributions are received by Inland Revenue, and then forwarded on to the relevant KiwiSaver provider. Organisations

[1] Life insurance in New Zealand is voluntary. There are no requirements for insurance to be bundled with other products or for individuals to hold any insurance cover.

seeking to register a KiwiSaver product must seek certification from Inland Revenue. To become certified, organisations must meet specific criteria (Inland Revenue 2011a).

KiwiSaver providers must complete a scheme provider agreement, which defines the relationship between the provider and Inland Revenue. The agreement details both operational and technical requirements. Providers must produce an annual report including audited accounts and membership details, and lodge an annual statistical return with the Financial Markets Authority (Inland Revenue 2011b). Providers must also send and receive information in a secure and timely manner, using automated processes and a single standard for business-to-business communications with all scheme providers. Providers must ensure that they are integrated with the central KiwiSaver business-to-business gateway (Inland Revenue 2007).

Employers are generally required to act as an intermediary between employees and Inland Revenue. They must:

- provide a KiwiSaver information pack to employees who are to be automatically enrolled, and those who choose to opt in
- where the employer has chosen a KiwiSaver scheme, provide employees with information about that scheme
- make compulsory employer contributions of two per cent of the employee's earnings to Inland Revenue, in addition to the contributions deducted from the employee's earnings
- provide information to Inland Revenue about employees enrolled in a scheme (Inland Revenue 2009).

Employees can choose a scheme other than their employer's chosen provider or the default provider they have been allocated to. They may also choose between the contribution rates of two, four or eight per cent of their pre-tax earnings. If they do not wish to be enrolled in a scheme, employees can opt out between two and eight weeks of starting their job (Inland Revenue nd).

Sweden

Sweden has a three-pillar pension system, with a second pillar known as premium pension, which is similar to Australia's compulsory system. The premium pension system is centrally administered by the Swedish Pensions Agency (SPA), which also has responsibilities for other types of pensions. The SPA is funded by an annual fee imposed on each individual pension account of 0.3 per cent of assets.

On behalf of each employee, employers contribute 2.5 per cent of wages to the employee's premium pension account. The contributions are paid to the National Tax Authority, together with the employer's monthly tax obligations. The National Tax Authority then forwards the premium pension contributions to the SPA.

The SPA acts as a clearing house, forwarding contributions to pension funds chosen by each individual. The pension funds then invest the contributions. The SPA also keeps account records for members of all funds, functioning as a single access point for all individuals seeking information about their accounts. Benefit payments are also administered by the SPA.

To facilitate choice of pension funds for individuals, the SPA maintains a catalogue of premium pension funds. The catalogue lists each fund, along with a description of its total capital, fees, returns over the last five years, and a measure of risk. The catalogue is freely available to the public and funds are not charged a fee to appear in the catalogue. When it was first introduced in 2000, the catalogue listed 456 funds. It now includes more than 800 funds. Working-age adults are asked to choose a fund from the catalogue. If no choice is made, the individual's contributions are allocated to a single national default fund (Stewart 2005; Weaver 2005).

The national default fund

Initially, two thirds of individuals chose a fund other than the national default fund, although the default fund attracted more members than any other fund. Women and younger people were more likely to make an active choice. Since the inception of the system, the proportion of individuals choosing a fund other than the default has fallen significantly. As a result, membership of the default fund as a proportion of total members in the system has risen from 33 per cent in 2000, to 42 per cent in 2010 (Cronqvist and Thaler 2004; Johannisson 2010).

The fund has followed a strategy of minimising costs in order to reduce fees for members. It has achieved this through comparatively small marketing and investment expenditures — the majority of the fund's assets are invested passively. The fund has also targeted a high level of growth. Until 2010, between 70 and 90 per cent of assets were invested in equities, with the majority in foreign equities (Weaver 2005). In 2010, the fund shifted to a lifecycle investment strategy. Now, 100 per cent of member assets are invested in equities until members reach 55, then a gradually increasing proportion is shifted to fixed income investments as members age (Johannisson 2010; Palmer nd).

Low costs

The Swedish system demonstrates the benefits that can be achieved by a single national default fund with small marketing and investment expenditures. Rather than having default members allocated across various funds, concentrating them in a single fund achieves scale benefits, spreading fixed costs more thinly across the membership of the fund. The default fund engages in limited marketing activities as its purpose is simply to receive and invest the contributions of individuals who make no choice of fund. Also, the passive investment strategy employed by the fund results in minimal trading costs and fees to investment analysts.

Total fees charged to members of the Swedish default fund amounted to 0.6 per cent of assets in 2005, and this is projected to decline to less than 0.3 per cent by 2025 (Impavido, Lasagabaster and García-Huitrón 2010). This is considerably lower than fees observed in most other pension systems around the world, including the Australian system (Tapia and Yermo 2008).

The use of a passive investment strategy has not diminished returns for members. The investment performance of the default fund has exceeded that of the median pension fund in Sweden (Stewart 2005).

In addition to the Swedish premium pension system achieving low costs for members, costs experienced by employers and funds are also reduced through centralised administration. The single payment that employers make once a month covers all their employees, and is combined with their tax payment to reduce administrative costs. As payments for all employers are made to a single organisation, it standardises and simplifies employer obligations.

State management

One common concern around state-run funds is the degree to which investment decisions are politically motivated. This does not appear to have occurred with the Swedish default fund (Turner 2006), but the default fund has — to a greater extent than private funds — made investment choices based on social and environmental issues. It has disinvested in companies found guilty of violating international conventions to which Sweden adheres, including conventions on human rights, labour, the environment and bribery and corruption. In 2004, 38 companies were on the default fund's investment exclusion list, including some large multinational companies. This raises the question of whether the investment returns of participants in a national fund should be diminished in order to pursue social goals (Turner 2006; Weaver 2005).

Marketing issues

When the system was implemented, the Swedish Government commenced an extensive advertising campaign encouraging individuals to choose their fund. The only way individuals could gain membership in the default fund was by not making an active choice, and they were prevented from rejoining the fund if they subsequently made an alternative choice. In addition, free advertising was provided for alternative funds in the form of the catalogue produced by the SPA.

Initial advertising by alternative funds focused on their past performance and level of local investment. As a result, the fund to attract the largest share of members (other than the default) was Robur Aktiefond Contura, which had increased in value by 534 per cent over the preceding five years. However, the fund lost 70 per cent of its value over the next three years, and was significantly outperformed by the default fund over this period (Cronqvist and Thaler 2004).

Chile

Chile was one of the first countries to implement a three-pillar pension system on which the World Bank's recommendations were based. Pension reform in 1981 introduced mandatory individual accounts. Since its introduction, the system has undergone various changes.

Chilean workers contribute 10 per cent of their earnings, plus a fee for administration and insurance of approximately 2.3 per cent of their earnings, to an authorised pension fund (*Administradoras de Fondos de Pensiones* — AFP) (Iglesias-Palau 2009). The contribution is administered by employers on behalf of their employees. Before 2010, it was the responsibility of employees to choose both an AFP and the investment option within that AFP, but this has since changed (see below).

There are currently six AFPs. The entrance of new AFPs is restricted, and subject to government approval (Business News Americas 2007).

The types of investment options each AFP may offer are defined by legislation. Each fund must offer four options — B through E — and has the option of offering a fifth option — A. Funds are not permitted to offer any other investment options. Each investment option is restricted in the amount of each asset class it may invest in. Option A is a high growth option, with funds permitted to allocate as much as 80 per cent of member assets to equities. The level of risk and growth assets declines through the investment options to option E, which may only invest in cash and fixed interest. Individuals who do not choose an investment option will be placed by default into option B, C or D depending on their age (Ferreiro Yazigi 2003).

Administrative fees for members were high in the 1980s and 1990s as a result of large marketing expenditures by AFPs. It was common practice for AFPs to recruit large sales forces that were paid commissions for attracting new members to the fund. Incentives such as small appliances were frequently offered to potential members (Turner 2006). Between 1982 and 1998, average marketing costs for AFPs ranged between 21 and 52 per cent of total expenses (James et al. 2000).

The marketing costs in the system have subsided over time as a result of three factors. First, the Government imposed restrictions on the frequency with which individuals could switch between funds, and regulated the use of sales agents. Second, consolidation within the industry has reduced the competitive forces that drove marketing expenditure (Holzman and Hinz 2005). Third, the introduction of an auction process focusing on fees to determine the default provider has helped to create price-based competition (Social Security Administration 2012).

In 2010, the requirement for employees to make a choice of AFP was removed. Instead, all employees commencing work with an employer are automatically allocated to a single default AFP. Employees may still make an alternative choice if they wish. The default AFP is determined every two years by an auction process where the AFP that offers the lowest administrative fee is authorised as the default fund for the next two years. The fund maintains its position as the default provider during those two years unless:

- another fund offers a lower fee for at least two consecutive months
- another AFP provides a higher rate of return sufficient to make up for a higher administrative fee, or
- it violates AFP regulations (Social Security Administration 2012).

Netherlands

It is not mandatory in the Netherlands for all employees to maintain individual pension accounts. However, industrial relations processes have led to a requirement for most employers to contribute to individual pension accounts for their employees. Where employer and employee representatives in a particular industry agree on pension arrangements for employees in that industry, the Government will usually make such arrangements mandatory for all workplaces in the industry. Where such industrywide arrangements are not present, many employers voluntarily contribute to individual pension accounts on behalf of employees. As a result, 90 per cent of employees in the Netherlands are covered by such arrangements (VB and OPF 2012).

Most pension funds in the Netherlands serve only one industry or workplace and it is typical that only one fund will cover the workforce of any particular industry. There are 95 industrywide funds and 543 single-employer funds. Most employees are members of industrywide funds (Kakes 2006).

Almost all funds in the Netherlands are defined benefit funds, with pension benefits determined by the average wage of the employee over their working life. Most have some unique features not commonly found in defined benefit systems in other parts of the world. For example, where funds are in financial difficulty, employers, employees and members in retirement may be required to contribute to the fund's recovery (VB and OPF 2012).

The governance and operation of Dutch pension funds are highly regulated. Funds must:

- be run on a not-for-profit basis
- have a board of trustees made up of equal numbers of employer and employee representatives
- serve the interests of all stakeholders, including members and employers
- not vary the contribution rate between members
- not require medical examinations for members joining the fund (VB and OPF 2012).

Hong Kong

The Hong Kong pension system's second pillar is known as the Mandatory Provident Fund (MPF) system. The system was introduced in 2000 and replaces the voluntary Occupational Retirement Schemes Ordinance system.

Employers and employees are each required to contribute an amount equal to five per cent of the employee's income to the employee's individual MPF account, up to a cap of HK$1250 per month. Employees earning less than HK$6500 per month are not required to make contributions. However, employers in Hong Kong must contribute to an MPF fund for employees, regardless of how much the employee earns (this contrasts with Australia — see chapter 2).

There are 40 authorised MPF funds offering an aggregate of 445 products. All are run by for-profit companies in the financial services sector. In order for a fund to become an authorised MPF fund, it must:

- comply with Hong Kong law and regulations
- be controlled by trustees that maintain professional indemnity insurance and meet criteria on capital adequacy, financial soundness and fitness and propriety
- comply with prescribed standards relating to internal controls and investment of assets
- be subject to ongoing monitoring by the MPF Schemes Authority (MPFA 2012).

The funds and their products are listed on the regulator's website.

Employer and employee choice

Under the MPF system, employers are required to choose one or more MPF funds and enrol each employee in a fund. Employees may choose any product within the fund chosen by their employer. If an employee does not make a product choice, they default into the fund's conservative product. Each fund is required to offer a conservative product, which may only invest in bank deposits and money market instruments.

Employees may set up personal accounts with MPF funds of their choice and make voluntary contributions to those funds. They may also transfer benefits between any of their accounts, including the account into which their employer contributes. However, employees do not currently have the right to choose the fund that their employer contributes to.

Legislation will come into effect on 1 November 2012 that will allow employees to choose their own fund. The change is intended to increase price competition among funds, which was found to be lacking in a 2007 report by the Hong Kong Consumer Council, when compared with other countries such as Australia. The introduction of employee choice has been delayed several times due to concerns over aggressive marketing strategies that might be employed by funds and their salespeople after the legislation is introduced. Legislation will require salespeople (who may be bankers, fund managers or insurance agents) to be registered with the MPF Schemes Authority. Salespeople will also continue to be regulated by the three different regulators in their respective industries. Penalties will apply to salespeople who mislead customers (MPFA 2012; Yiu 2011).

Industry funds

There are two non-public offer ‘industry funds’ in Hong Kong, both of which may be chosen by employers in the catering and construction industries. The funds are run by for-profit trustees that also administer some public-offer products. These industry funds were set up to deal with the high labour mobility and the practice of paying wages on a daily basis within those industries. Employers in the catering and construction industries are not required to enrol employees in these funds. However, there are benefits that can accrue to employees and employers using the industry funds. Costs associated with frequently changing funds are minimised for employees to the extent that their new employer uses the same fund as their previous employer. Employers can also benefit, as they are exempted from having to provide casual employees with monthly pay records if they pay contributions for those employees into an industry fund (MPFA 2012).

References

ABS (Australian Bureau of Statistics) 2007, *Employment Arrangements, Retirement and Superannuation, Australia*, Cat. no. 6361.0, Canberra.

—— 2009, *Employment Arrangements, Retirement and Superannuation, Australia*, Cat. no. 6361.0, Canberra.

—— 2011a, *Australian Industry 2009-10*, Cat no. 8155.0, Canberra.

—— 2011b, *Employee Earnings and Hours,* Cat. no 6306.0, Canberra.

—— 2012a, *Counts of Australian Businesses, including Entries and Exits*, Cat. no. 8165.0, Canberra.

—— 2012b, *Employee Earnings, Benefits and Trade Union Membership — August 2011*, Cat. no. 6310.0, Canberra.

—— 2012c, *Australian Labour Market Statistics*, Cat. no. 6105.0, Canberra.

—— 2012d, *Key Economic Indicators,* Cat. no. 1345.0, Canberra.

ACCC (Australian Competition and Consumer Commission) 2008, *Merger Guidelines 2008,* www.accc.gov.au/content/index.phtml/itemId/809866 (accessed 12 June 2012).

—— 2012, *Anti-competitive conduct,* www.accc.gov.au/content/index.phtml/itemId/816373 (accessed 12 June 2012).

AIRC (Australian Industrial Relations Commission) 1994, *The Australian Insurance Employees' Union & Others v Adjustor and Assessors (Ass Risks) Pty Ltd & Others Superannuation Test Case* (1994) 55 IR 447 (Superannuation test case), http://ww3.e-airc.gov.au/archives/1994superannuation (accessed 10 September 2012).

—— 1999, *Building and Plumbing Industry Award Simplification Decision*, print R770, http://www.airc.gov.au/asdecisions/R7700.htm (accessed 10 September 2012).

—— 2008a, *Decision — Award Modernisation*, [2008] AIRCFB 1000, par. 90.

—— 2008b, *Statement — Award Modernisation*, [2008] AIRCFB 717, par. 29.

—— 2009a, *Decision — Award Modernisation*, [2009] AIRCFB 800, par. 66–69.

—— 2009b, *Statement — Award Modernisation*, [2009] AIRCFB 450, par. 124.

—— 2009c, *Timeline*, www.airc.gov.au/awardmod/fullbench/timetable.cfm#2008 (accessed 8 February 2012).

AIST (Australian Institute for Superannuation Trustees) and IFF (Industry Funds Forum) 2008, *Member Insurance Research*, www.aist. asn.au/media/2245/aist _2008.06.03_research_IFF&AIST_member_insurance_research.pdf (accessed 24 April 2012).

—— 2012, *A Fund Governance Framework for Not-for-Profit Superannuation Funds*, Second edition, September.

Ambachtsheer, K., Capelle, R. and Lum, H. 2006, *Pension Fund Governance Today: Strengths, Weaknesses and Opportunities for Improvement*, Rotman International Centre for Pension Management Working Paper, October, Toronto.

ANAO (Australian National Audit Office) 2012, *Audit Report No. 47 2011–12: Small Business Superannuation Clearing House*, Canberra.

APRA (Australian Prudential Regulation Authority) 2004*, Superannuation: Licensing and Registering a Superannuation Entity — Explanatory Guide on Licensing and Registration*, July, Sydney.

—— 2005, *Statistics: Classification of Superannuation Entities*, Sydney, May, www.apra.gov.au/Super/Publications/Documents/Classification-of-superannuation-entities.pdf (accessed 16 April 2012).

—— 2007, 'Celebrating 10 years of superannuation data collection 1996–2006', *APRA Insight*, no. 2, Sydney.

—— 2011, *Prudential Standards for Superannuation*, Discussion Paper, September, Sydney.

—— 2012a, *Annual Superannuation Statistics: June 2011*, February, Sydney.

—— 2012b, *Draft Prudential Standard SPS 114 — Operational Risk Financial Requirements*, www.apra.gov.au/Super/PrudentialFramework/Documents/Draft-Prudential-Standard-SPS-114-Operational-Risk-Financial-Requirement-(April-2012).pdf (accessed 3 June 2012).

—— 2012c, *Instruction Guide, Application form – Authority to Offer a MySuper Product*, Sydney, 3 May.

—— 2012d, *MySuper Application Process*, Presented by Ross Jones (Deputy Chairman) at The Association of Superannuation Funds of Australia NSW Luncheon, Sydney, 20 August, www.apra.gov.au/Speeches/Documents/Ross%20Jones_ASFA_20%20August%202012_FINAL.pdf (accessed 21 August 2012).

—— 2012e, *Quarterly Life Insurance Performance: December 2011*, table 1(f), Sydney.

—— 2012f, *Quarterly Superannuation Performance Statistics*, August, Sydney.

—— 2012g, *Reporting Standards for Superannuation*, Discussion Paper, September, Sydney.

—— 2012h, *Response to Submissions: Prudential Standards for Superannuation*, April, Sydney.

—— 2012i, *Statistics: Annual Superannuation Bulletin: June 2011*, February, Sydney.

—— 2012j, *Statistics: Superannuation Fund-level Profiles and Financial Performance*, June 2011 (issued 29 February 2012), February, Sydney.

ASFA (Association of Superannuation Funds of Australia) 2008, *Annual Superannuation Survey*, prepared for ASFA by McNair Ingenuity Research, www.superannuation.asn.au/policy/reports-2007-09.

ASIC (Australian Securities and Investments Commission) 2002, *A Review of the Research on the Past Performance of Managed Funds*, Report 22, www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/FMRC_Report.pdf/$file/FMRC_Report.pdf (accessed 26 September 2012).

—— 2003, *Regulatory Guide 53: The Use of Past Performance in Promotional Material*, www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/past_perf_guide.pdf/$file/past_perf_guide.pdf (accessed 19 April 2012).

—— 2011a, *National Financial Literacy Strategy*, Report 229, Sydney.

—— 2011b, *Super Decisions*, https://www.moneysmart.gov.au/media/275360/super-decisions.pdf (accessed 4 September 2012).

—— 2012a, *Our Role*, www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role (accessed 20 March 2012).

—— 2012b, *Shadow Shopping Study of Retirement Advice*, Sydney.

ATO (Australian Taxation Office) 2011a, *Guide to Superannuation for Employers,* 13 July, www.ato.gov.au/businesses/content.aspx?menuid=0&doc=/content/00249857.htm&page=21#P535_33034 (accessed 21 May 2012).

—— 2011b, *Running a Self-managed Super Fund*, 3 November, www.ato.gov.au/superfunds/content.aspx?doc=/content/46427.htm (accessed 11 May 2012).

—— 2011c, *Self-managed Super: Making Sure it Works for You and the Community,* www.ato.gov.au/corporate/content.aspx?doc=/content/00270847.htm (accessed 4 June 2012).

—— 2012a, *Changes to the Super Guarantee,* www.ato.gov.au/taxprofessionals/content.aspx?doc=/content/00245692.htm&pc=001/005/054/006/001&mnu=0&mfp=&st=&cy= (accessed 4 June 2012).

—— 2012b, *Guide to Superannuation for Employers*, http://www.ato.gov.au/businesses/content.aspx?menuid=0&doc=/content/00249857.htm&page=6&H6 (accessed 16 July 2012).

—— 2012c, *Key Superannuation Rates and Thresholds: Superannuation Guarantee,* www.ato.gov.au/superfunds/content.aspx?doc=/content/60489.htm&page=19&H19 (accessed 20 April 2012).

—— 2012d, *Questions and Answers for Super Funds — Consolidation and Use of Tax File Numbers*, www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00305619.htm&page=2 (accessed 3 September 2012).

—— 2012e, *Self-managed Superannuation Funds: A Statistical Overview, 2009−10,* www.ato.gov.au/superfunds/content.aspx?menuid=0&doc=/content/00316375.htm&page=3&H3.

Australian Fair Pay Commission 2006, *Appendix I: Award Relevance Study: Use and Relevance of State and Federal Awards Final Report,* Award Review Taskforce Report Wage and Classification Structure, 1 August.

Australian Government 2006, *Rethinking Regulation,* Report of the Taskforce on Reducing Regulatory Burdens on Business, Canberra, January.

—— 2009, *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System — A Statistical Summary of Self-managed Superannuation Funds,* Canberra.

—— 2010a, *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, — Final Report: Part One, Overview and Recommendations* (Cooper Review), Canberra.

—— 2010b, *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System — Final Report: Part Two, Recommendation Packages* (Cooper Review), Canberra.

—— 2010c, *Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System — Superstream — A Proposal to Bring the Back Office of Super into the 21st Century*, Canberra.

—— 2010d, *Stronger Super: Government Response to the Super System Review*, Canberra.

—— 2011a, *Stronger Super Information Pack*, September, Canberra.

—— 2011b, *Stronger Super: Outcomes of Consultation Process*, Canberra.

—— nd, SuperStream Working Group Terms of Reference, http://strongersuper.treasury.gov.au/content/consultations/working_groups/superstream/administration/downloads/SuperStream_Terms_of_Reference.pdf (accessed 3 September 2012).

Bashears, J., Choi, J., Laibson, D. and Madrian, B. 2006, *The Importance of Default Options for Retirement Savings Outcomes: Evidence from the United States*, NBER Working Paper No. 12009, Cambridge Massachusetts.

Basu, A.K. and Drew, M.E. 2009, 'Portfolio size effect in retirement accounts: what does it imply for lifecycle asset allocation funds?', *Journal of Portfolio Management*, vol. 35, no. 3, pp. 61–72.

Benartzi, S. and Thaler, R.H. 2007, 'Heuristics and Biases in Retirement Savings Behavior', *Journal of Economic Perspectives*, vol. 21, no. 3, pp. 81–104.

Bilson, C., Frino, A. and Heaney, R. 2005, 'Australian retail fund performance persistence', *Accounting and Finance*, vol. 45, pp. 25–42.

Brown, J., Farrell, A. and Weisbenner S. 2011, *The Downside of Defaults*, NBER Working Paper No. NB11-01, Cambridge Massachusetts.

Buchanan, J. and Considine, G. 2008, 'The significance of minimum wages for the broader wage setting environment: understanding the role and reach of Australian awards' in Australian Fair Pay Commission, 2008 *Minimum Wages Research Forum Proceedings*, vol. 1, Research Report No 4a/08, October, pp. 47–62.

Business News Americas 2007, *Commission to Issue Verdict on BancoEstado AFP Entry by Jun 25*, www.bnamericas.com/news/insurance/Commission_to_issue_verdict_on_BancoEstado_AFP_entry_by_Jun_25 (accessed 4 June 2012).

Business Victoria 2011, *About Victorian Industrial Relations,* 8 August, www.business.vic.gov.au/BUSVIC/STANDARD/PC_50492.html (accessed 21 May 2012).

Canstar Cannex 2011, *Report No. 2 — Superannuation Star Ratings,* September.

Carroll, G., Choi, J., Laibson, D., Madrian, B. and Metrick, A. 2009, 'Optimal Defaults and Active Decisions', *The Quarterly Journal of Economics*, vol. 124, no. 4, pp. 1639–74.

Chant West 2012, *Another Strong Month on the Markets Pushes Funds Higher*, Media Release, www.chantwest.com.au/PDFFiles/Chant%20West%20Media%20Release%20-%20February%202012%20Performance.pdf (accessed 2 April 2012).Choice 2006, *The Super Secret: How Multiple Accounts Cost Consumers Billions*, Research Report 2006:1, Marrickville, November.

Clare, R. 2006, *The Introduction of Choice of Superannuation Fund — Results to Date*, Association of Superannuation Funds Australia, February.

—— 2008, *Retirement Savings Update,* ASFA Research and Resource Centre, February.

—— 2010, *Employer Contributions to Superannuation in Excess of 9% of Wages: Results of Survey and Other Research*, Association of Superannuation Funds Australia, March.

Colmar Brunton 2010a, *Investigating Superannuation: Quantitative Investigation with Employers,* Final Quantitative Report, Prepared for the Australian Tax Office, 20 January.

—— 2010b, *Understanding Superannuation Preliminary Report: Qualitative Investigation with Employers, Consumers & Industry prepared for Australian Taxation Office*, Canberra, 25 March.

Commission for Financial Literacy and Retirement Income nd, New Zealand Superannuation, www.sorted.org.nz/home/sorted-sections/retirement/new-zealand-superannuation (accessed 6 March 2012).

Commonwealth of Australia 2012, *Parliamentary Joint Committee on Corporations and Financial Services — Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012*, March.

Cronqvist, H. and Thaler, R. 2004, 'Design Choices in Privatized Social-Security Systems: Learning from the Swedish Experience', *American Economic Review*, vol. 94, no. 2, pp. 424–8, May.

Cullen, M. (New Zealand Minister for Finance) 2006, *KiwiSaver On Track with Default Providers Selected,* 7 December.

—— 2007, *Easier Saving One Step Closer*, 2 April.

Cummings, J.R. 2012, *APRA Working paper — Effect of Fund Size on the Performance of Australian Superannuation Funds*, www.apra.gov.au/AboutAPRA/Documents/SA_WP_EFSP_032012_ex.pdf (accessed 24 May 2012).

DEEWR (Department of Education, Employment and Workplace Relations) 2012a, *Australian Enterprise Agreements Data*, www.deewr.gov.au/workplacerelations/Pages/AustralianEnterpriseAgreementsData.aspx (accessed 16 April 2012).

—— 2012b, *Superannuation — Increasing the Superannuation Guarantee to 12 per cent,* www.deewr.gov.au/Department/Documents/Files/6_Fact_Sheet_SG%20_rate_increase.pdf (accessed 27 March 2012).

Delaney, J., Watson, J. and Wickramanayake, J. 2011, *Australian Superannuation Fund Ratings: What Investors Need to Know*, Department of Accounting and Finance, Monash University, Working Paper Series, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1913997 (accessed 26 September 2012), August 22.

Deloitte 2010, *Super System Review — Default Fund Costs Under the MySuper Proposal*, Super System Review Appendix D, 19 April.

Deloitte Access Economics 2012, *Persistence in Superannuation Fund Returns*, Report commissioned by Industry Super Network, 24 June.

Department of Commerce (WA) 2012, *Western Australian Industrial Relations System Coverage,* 15 May, www.commerce.wa.gov.au/labourrelations/content/Employers/About_IR_in_WA/Western_Australian_industrial_.html (accessed 21 May 2012).

Department of Human Services 2011, *Small Business Superannuation Clearing House Contributions Reach Over $100 million,* Media Release, Australian Government, Canberra, 7 November, www.humanservices.gov.au/corporate/media/media-releases/2011/2011-11-21-small-business-superannuation-clearing-house-contributions-reach-over-$100-million (accessed 2 May 2012).

Drew, M. and Stanford, J. 2003, 'Principal and Agent Problems in Superannuation Funds', *Australian Economic Review*, vol. 36, no. 1, pp. 98–107.

—— , —— and Veeraraghavan, M. 2002, *Selecting Australian Equity Superannuation Funds: A Retail Investor's Perspective*, EFMA 2002 London Meetings, Working Paper Series, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=314886 (accessed 26 September 2012), June 20.

Ellis, K., Tobin, A. and Tracey, B. 2008, *APRA Working Paper — Investment Performance, Asset Allocation, and Expenses of Large Superannuation Funds*, October.

Farmarkis-Gamboni, S., Rozenbes, D. and Yuen, K. 2012, *Award-reliant small businesses*, Research Report 1/2012, Fair Work Australia, Melbourne.

Fear, J. and Pace, G. 2008, *Choosing Not to Choose – Making Superannuation Work by Default*, The Australia Institute, Discussion Paper No. 103, November.

Ferreiro Yazigi, A. (ed.) 2003, *The Chilean Pension System*, 4th edn, Santiago.

Finch, N. 2005, 'The Trouble with MER: The Disclosure of Fees and Charges in Australian Superannuation and Investment Funds', *Journal of Law and Financial Management*, vol. 4, no. 1, pp. 32–50.

FSC (Financial Services Council) 2012, *Superannuation Governance Policy*, Sydney.

FWA (Fair Work Australia) 2010a, *Decision — AMP Life Limited,* [2010] FWA 2475.

—— 2010b, *Background to Award Modernisation Process*, www.fwa.gov.au /index.cfm?pagename=awardsmodern (accessed 3 February 2012).

—— 2010c, *Decision — AMWU,* [2010] FWA 6098.

—— 2010d, *Decision — Asset Limited and Austsafe Super,* [2010] FWAFB 461.

—— 2010e, *Decision — Austsafe Super,* [2010] FWA 3426.

—— 2010f, *Decision — Sunsuper Pty Ltd,* [2010] FWAFB 321.

—— 2010g, *Decision — Westscheme Pty Ltd*, [2010] FWAFB 12.

—— 2011a, *Annual Wage Review 2010-11* [2011] FWAFB 3400, http://www.fwa.gov.au/decisionssigned/html/2011fwafb3400.htm (accessed 22 August 2012).

—— 2011b, *FWA Transcript,* AM 2011/52.

—— 2012a, *Agreement Making*, www.fwa.gov.au/index.cfm?pagename= agreementsmakeabout (accessed 20 April 2012).

—— 2012b, *Annual Wage Review 2011-12* [2012] FWAFB 5000, http://www.fwa.gov.au/decisionssigned/html/2012fwafb5000.htm#P915_67077 (accessed 22 August 2012).

—— 2012c, *Draft spreadsheets with modern awards and relevant ANZSIC classes listed*, www.fwa.gov.au/index.cfm?pagename=wagereview2013&page=research_map2 (accessed 11 September 2012).

—— 2012d, *Find an agreement,* www.fwa.gov.au/index.cfm?pagename= agreementsfind (accessed 12 June 2012).

—— 2012e, *Modern Awards*, www.fwa.gov.au/index.cfm?pagename= awardsfind#modernawards (accessed 19 September 2012).

—— 2012f, *Modern awards review 2012,* www.fwa.gov.au/index.cfm?pagename= awardReview2012 (accessed 21 May 2012).

—— 2012g, *Modern awards review 2012 — Timetable*, [2012] FWA 5721, 5 July 2012, http://www.fwa.gov.au/decisionssigned/html/2012fwa5721.htm (accessed 27 August 2012).

FWO (Fair Work Ombudsman) 2011a, *Underpaid? Complaints*, www.fairwork. gov.au/complaints/underpaid/pages/default.aspx (accessed 2 April 2012).

—— 2011b, *Workplace laws go national fact sheet*, www.fairwork.gov.au/ resources/fact-sheets/conditions-of-employment/ pages/workplace-laws-go-national-fact-sheet.aspx (accessed 20 April 2012).

Gallery, G., Gallery, N. and Brown, K. 2004, *Superannuation Choice: The Pivotal Role of the Default Option*, Journal of Australian Political Economy, Issue 53, pp. 44-66.

——, —— and McDougall L 2010, *Don't Judge a Superannuation Default Investment Option by Its Name*, 19 April, eprints.qut.edu.au/35780/1/c35780.pdf (accessed 7 June 2012).

Gerrans, P. 2006, 'Morningstar ratings and future performance', *Accounting and Finance*, vol. 46, no. 4, pp. 605–628.

Gruen, D. 2011, *Compulsory Superannuation and National Saving,* Presented at the Economic and Social Outlook Conference, 30 June – 1 July 2011, University of Melbourne, www.treasury.gov.au/PublicationsAndMedia/Speeches/2011/ Compulsory-superannuation-and-national-saving (accessed 14 May 2012).

Hallahan, T.A. 1999, 'The information content of portfolio performance history and persistence in fund performance: An examination of rollover funds', *Accounting and Finance*, vol. 39, no. 3, pp. 255–274.

Higgs, H. and Worthington, A. 2010, *Economies of Scale and Scope in Australian Superannuation Funds*, Griffith Business School Discussion Papers, no. 2010-15, Brisbane.

High Court of Australia 1986, *Re: Manufacturing Grocers' Employees Federation; Ex parte Australian Chamber of Manufacturers* (1986) 160 CLR 341.

Holzmann, R. and Hinz, R. 2005, *Old-Age Income Support in the 21st Century: An International Perspective on Pension Systems and Reform*, World Bank, Washington.

Iglesias-Palau, A. 2009, 'Pension Reform in Chile Revisited: What Has Been Learned?', *OECD Social, Employment and Migration Working Papers*, No. 86, OECD, Paris.

IGT (Inspector-General of Taxation) 2010, *Review into the ATO's Administration of the Superannuation Guarantee Charge,* Report to the Assistant Treasurer, Canberra, March.

Impavido, G., Lasagabaster, E., and García-Huitrón, M. 2010, *New Policies for Mandatory Defined Contribution Pensions: Industrial organisation models and investment products*, The International Bank for Reconstruction and Development, Washington.

Industry Commission 1996, *Competitive Tendering and Contracting by Public Sector Agencies*, Report No. 48, Australian Government Publishing Service, Melbourne.

Ingles, D. and Fear J. 2009, *The Case for a Universal Default Superannuation Fund*, The Australian Institute Policy Brief No. 3, September.

Inland Revenue 2007, *Technical Requirements (Running a KiwiSaver scheme)*, www.ird.govt.nz/kiwisaver/providers/running/technical-requirements/ (accessed 14 March 2012).

—— 2009, *Role of Employers (How it works)*, www.ird.govt.nz/kiwisaver/employers/how/role-of-employers/ (accessed 13 March 2012).

—— 2011a, *Operational Requirements (Running a KiwiSaver scheme)*, www.ird.govt.nz/kiwisaver/providers/running/operational-requirements/ (accessed 14 March 2012).

—— 2011b, *Who's Involved? (About KiwiSaver)*, www.ird.govt.nz/kiwisaver/providers/about/who/ (accessed 14 March 2012).

—— nd, Automatic Enrolment, www.kiwisaver.govt.nz/new/join/how-to/auto-enrol/ (accessed 13 March 2012).

ISN (Industry Super Network) 2010, *Supernomics – Addressing Failures of Competition in the Superannuation Market*, March.

James, E., Ferrier, G., Smalhout, J. and Vittas, D. 2000, *Mutual Funds and Institutional Investments – What is the Most Efficient Way to Set Up Individual Accounts in a Social Security System*, in Shoven, B. 2000, 'Administrative Aspects of Investment-Based Social Security Reform', University of Chicago Press.

Johannisson, I. 2010, *Swedish Pensions Agency*, presentation to the OECD Working Party on Private Pensions, 30 November, www.pensionsmyndigheten.se/download/18.2c8f793e1335aaf986a8000298000/ Presentation.pdf (accessed 8 June 2012).

Jones, S. 2011, *Australian Superannuation Handbook 2011-12*, Thomson Reuters, July.

Kakes, J. 2006, *Financial Behaviour of Dutch Pension Funds: a Disaggregated Approach*, De Nederlandsche Bank, DNB Working Paper No. 108/ July 2006, Amsterdam.

Kingston, G. 2004, 'Superannuation: A Guide to the Field for Australian Economists', *Economic Analysis & Policy*, vol. 33, no. 2, pp. 203–26.

Kobayashi, B., 2005, 'Does economics provide a reliable guide to regulating commodity bundling by firms? A survey of the economic literature', *Journal of Competition Law & Economics*, vol. 1, no. 4, pp. 707–746.

Korporaal, G. 2012, ‘APRA to Urge Mergers on Small Super Funds’, *The Australian*, June 18, p. 21.

Littlewood, M. 2012, *KiwiSaver: Changing the Default Provider Regime*, Retirement Policy and Research Centre, The University of Auckland.

Ministry of Economic Development 2010, *Report on KiwiSaver Supply Side Evaluation: July 2010*, Wellington.

Morningstar 2009, *Submission to Review into the Governance, Efficiency, Structure and Operation of Australia’s Superannuation System*, Sydney, December.

MPFA (Mandatory Provident Fund Schemes Authority) 2012, *Mandatory Provident Fund Schemes Authority*, http://www.mpfa.org.hk/eindex.asp (accessed 18 July 2012).

OECD (Organisation for Economic Co-operation and Development) 2009, *OECD Guidelines for Pension Fund Governance*, Working Party on Private Pensions, June, Paris.

O’Neill, S. 2009, ‘Workplace relations overview’, *Budget Review 2009-10*, Parliamentary Library Research Paper, no. 33 2008-09, pp. 113–14.

Palmer, E. nd, Sweden: Competition in the Pensions Sector – a Low Cost Model, www.oecd.org/dataoecd/0/48/40478237.pdf (accessed 8 June 2012).

Parliament of Australia 2012, *House of Representatives Official Hansard*, *Questions in Writing — Fair Work Australia*, *Modern Awards*, Question no. 736, pp. 708-727.

Patten, S. 2012a, ‘APRA Puts Pressure on Union Funds’, *Australian Financial Review*, June 18, p. 1.

—— 2012b, ‘Cooper Wants More Non-Aligned Directors’, *Australian Financial Review*, April 12, p. 6.

—— 2012c, ‘Funds Face Full Disclosure Rule’, *Australian Financial Review*, May 15, p. 8.

PC (Productivity Commission) 2001, *Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation*, Report no. 18, Canberra.

—— 2009, *Executive Remuneration in Australia*, Report no. 49, Final Inquiry Report, Melbourne.

Preston, M., Pung, A., Leung, E., Casey, C., Dunn, A. and Richter, O. 2012, *Analysing Modern Award Coverage using the Australian and New Zealand Standard Industrial Classification 2006: Phase 1 Report,* Research Report 2/2012, Fair Work Australia, Melbourne.

Rice Warner 2007, *Is Choice of Fund Working?*, Touchstone Newsletter, January, www.ricewarner.com/images/newsroom/1235564272_1Is_Choice_of_Funding_Working_January_2007.pdf (accessed 18 April 2012).

—— 2010, *The Future of Super*, Touchstone Newsletter, July, www.ricewarner.com/images/newsroom/1279676461_Touchstone%20Newsletter%20-%20The%20Future%20of%20Super.pdf (accessed 18 April 2012).

—— 2012, *Superannuation Fees Research*, report prepared for the FSC, Sydney.

Rozenbes, D. 2010, *An Overview of Compositional Change in the Australian Labour Market and Award Reliance*, Research Report 1/2010, Fair Work Australia, Melbourne.

SCT (Superannuation Complaints Tribunal) 2009, *What Does the Tribunal Cover?* www.sct.gov.au/Page.aspx?pid=26 (accessed 22 May 2012).

Shorten, B. (Minister for Employment and Workplace Relations and Minister for Financial Services and Superannuation) 2011a, *A Better Deal for Superfund Members*, Media Release no. 131, 21 September.

—— 2011b, *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 Explanatory Memorandum*, Parliament of the Commonwealth of Australia, Canberra.

—— 2012a, *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 Explanatory Memorandum*, Parliament of the Commonwealth of Australia, Canberra.

—— 2012b, *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 Supplementary Explanatory Memorandum*, Parliament of the Commonwealth of Australia, Canberra.

—— 2012c, *Superannuation Legislation Amendment (Stronger Super and Other Measures) (No. 2) Bill 2012: Superannuation Data and Payment Standards Explanatory Memorandum*, Parliament of the Commonwealth of Australia, Canberra.

—— 2012d, *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 Explanatory Memorandum*, Parliament of the Commonwealth of Australia, Canberra.

—— 2012e, *Superannuation Roundtable Agrees to Promote Small Business Clearing House*, Media Release no. 058, 7 September.

—— 2012f, *Superfund Executive Pay and Investments to be Disclosed*, Media Release no. 021, 27 April.

—— 2012g, *SuperStream Advisory Council — Call for Nominees*, Media Release no. 028, 25 May.

—— 2012h, *Tax Relief for Superannuation Mergers Helps to Lower Fees*, Media Release no. 020, 24 April.

Social Security Administration 2012, *International Update: March 2012*, www.ssa.gov/policy/docs/progdesc/intl_update/2012-03/index.html (accessed 1 May 2012).

Staley, L. 2010, *Keeping Super Safe: A Call for Greater Transparency from Superannuation Funds*, Institute of Public Affairs, April.

St Anne, C. 2012, *A Super History: How Australia's $1 trillion+ Superannuation Industry Was Made*, Major Street Publishing.

Stewart, S. 2005, *Can Behavioural Economics Save us from Ourselves?*, http://magazine.uchicago.edu/0502/features/economics.shtml (accessed 26 April 2012).

SuperGuide 2012, *The Soapbox: Only 9 Truly Independent Financial Advisers in Australia*, www.superguide.com.au/superannuation-basics/truly-independent-financial-advisers-in-australia (accessed 20 April 2012).

Super Ratings 2006, *Submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the Structure and Operation of the Superannuation Industry*, September 2006.

—— nd, Super Methodology, www.superratings.com.au/ratingsnawards/explained-ratings (accessed 22 May 2012).

Sy, W. 2008, *Superannuation Fund Governance: an Interpretation*, Australian Prudential Regulation Authority Working Paper, Sydney, 15 July.

—— and Liu, K. 2009, *APRA Working Paper — Investment Performance Ranking of Superannuation Firms*, June.

—— 2010, 'Improving the cost efficiency of Australian pension management', *Rotman International Journal Of Pension Management*, vol. 3, no. 1, pp. 38–47.

Tapia, W. and Yermo, J. 2008, 'Fees in Individual Account Pension Systems: A Cross-Country Comparison', *OECD Working Papers on Insurance and Private Pensions*, No. 27, OECD, Paris.

Thaler, R. and Sunstein, C. 2009, *Nudge: Improving Decisions about Health, Wealth and Happiness*, Penguin, London.

Towers Watson 2010, *The Superannuation Fund Merger Imperative,* www.towerswatson.com/australia/research/1884 (accessed 12 April 2012).

Treasury (Australian Government Department of Treasury) 2008, *Superannuation Clearing House and the Lost Members Framework,* Discussion Paper, Canberra, November.

—— nda, Stronger Super Key Points: MySuper — Overview, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/key_points.htm (accessed 19 March 2012).

—— ndb, Stronger Super summary: Stronger Super — Government Response to the Super System Review, http://strongersuper.treasury.gov.au/content/Content.aspx?doc=publications/government_response/summary.htm (accessed 19 March 2012).

Turner, J. 2006, *Individual Accounts for Social Security Reform: International Perspectives on the U.S. Debate*, W.E. Upjohn Institute, Michigan.

VB (Dutch Association of Industry-wide Pension Funds) and OPF (Dutch Association of Company Pension Funds) 2012, *The Dutch Pension System: an Overview of the Key Aspects*, The Hague.

Vidley, S. 2004, 'Superannuation: Choice, competition and administration cost', *Journal of Australian Political Economy*, no. 53, June, pp. 27–43.

Weaver, R. 2005, *Social Security Smörgåsbord? Lessons from Sweden's Individual Pension Account*, www.brookings.edu/papers/2005/06saving_weaver.aspx (accessed 26 April 2012).

World Bank 1994, *Averting the Old Age Crisis*, Oxford, New York.

Yiu, E. 2011, *MPF Choice Put Back to July 2012*, http://topics.scmp.com/news/hk-news-watch/article/MPF-choice-put-back-to-July-2012 (accessed 18 July 2012).