# 8 Reforming the selection process

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| 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. |
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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.

## 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).

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| 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) |
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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).

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| 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). |
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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.

## 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).

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| 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). |
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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).

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| 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) |
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#### 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.

## 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).

## 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.

## 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).

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| 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) |
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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

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.

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| 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). |
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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

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

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

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

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 Billalso 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

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

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

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

## 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.