1. Executive summary

In this submission, I have made the following recommendations:

- That option 2 is the preferred option for reforms to selecting superannuation funds.
- In the event that options 3 or 4 are recommended by the Commission, a duty of care must be enforced on the body or persons empanelled to make decisions involving which funds to be named in awards.
    - This duty of care must require the body or persons to act in the best interests of members when selecting funds to be named in an award. The definition of 'members' should include current members of employee and ex-employee divisions, as well as potential members of these divisions.
- Insurance in the form of guaranteed minimum cover must form part of the selection criteria for funds in addition to MySuper compliance.
- The duty to act in the best interest of members must be extended to the industrial parties when considering awards.
- A candidate fund for selection in an industrial award must be able to demonstrate that their MySuper asset allocation and its implicit risk profile has been appropriately tailored to the goals, objectives, investment time horizons and risk tolerance of the workers in that industry.
- Any investment return criteria required by candidate funds must be viewed within the context of the candidate fund's asset allocation and rick profile.

2. What is an industrial award?

I raise this point first, as I believe that the Commission appears to have deliberately ignored this very question. Unfortunately, this is an issue that cannot be ignored, as it goes to the heart of this and every other matter allowed for in an industrial award.

Put simply, it appears to have gone unnoticed by the Commission that an industrial award is merely a ratified agreement between employer and employee representatives. And in any agreement, there are generally these two parties, who are there to agree on this, like any other matter. I will agree that Fair Work Australia is a third party of sorts, however, this body is here, merely to rule where the two parties are unable to agree, and then to stamp the finalised agreement as binding.

In the Commission's draft report, there are 4 options to reform the process of selecting superannuation funds. Option 1 assumes no agreement can be reached between the parties with regards to superannuation. Option 2 assumes very little change. Option 3 assumes that superannuation is like minimum wage and option 4 will direct participants to use certain funds in their award, whether they agree to this or not.

Whilst I accept that minimum wage determinations are best left to economic experts who are well versed in the different definitions of 'inflation', 'costs of living, etc, there appears to be very little evidence tendered in the draft report that superannuation is a matter such as this. Employer and employee representative groups already have this expertise from years of representing their constituents as trustees of representative superannuation funds and I'm not sure that the Commission has given this truth much weight.

Some have referred to this as a 'boys club' but please allow me to ask this question: Does anyone know of any other type of agreement between two parties, contractual or otherwise, where third parties are shoehorned in?

It's normally at this point that someone will try to argue that the industrial parties have some sort of a conflict of interest. The poverty of this argument relies on reversing the burden of proof, and accepting a reversal of ordinary business practice where controlling entities are entitled to be represented on the boards of the bodies that they control. Acceptance of this specious line of reasoning suggests that it might also be a conflict of interest for employers to be the entity offering long service leave (or any other permitted entitlement of employment) in the workplace, as they might be deemed to have a conflict of interest. Obviously, this is slightly odd.

Having additional parties set particular matters in awards is a significant precedent and should not be embarked upon lightly. Future intrusions into matters involving the existing parties can be easily envisaged, and it is easy to call upon our long service leave example from the previous paragraph to illustrate this: It's not hard to imagine a future where the financial services industry might try to argue that employers who offer long service leave to their employees are 'conflicted' and that a choice of provider should be allowed. It is comparatively easy for insurers to create a lucrative product where employers (or employees) might pay a premium to that insurer in return for a long service leave-like payout on the event that a set period is worked by an employee with that employer. Like 10 years, for example.

The other issue is this: Is it only a matter of time before the industrial parties are sidelined entirely as matters get 'outsourced' to other entities to decide?

My first recommendation is that option 2 is the option recommended by the Commission in the final paper.

Should the Commission recommend an alternative option, my other recommendation is that a duty of care to act in the best interests of members, be enforced on the body (or persons) empanelled to make this decision. This would be a duty similar to section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cwlth) with the same intentions as this duty.

This is also consistent with the first dotpoint of recommendation 7.1, where the best interests of members are paramount. You simply cannot introduce a third party (or parties) with no accountability to the end users and if this has been done in the past, then it was simply wrong to do so.

3. Insurance and other non-MySuper criteria

One of the disturbing things that came out of the Productivity Commission's review so far is draft finding 7.1. The suggestion is that MySuper, alone, as authorised by APRA, should be the sole criteria. The draft finding is definite in claiming that there is no case for any additional criteria.

However, the finding is at odds with draft recommendation 6.1, which does recognise a need for the fund's insurance offerings to be compatible with the characteristics of employees covered by specific awards.

Obviously, these can't both be right. The draft report tacitly acknowledges this discrepancy by considering recommendation 6.1 as a 'nice to have' rather than a finding, but the damage is out there.

I recently chatted at length to a manager of a fund about the offering that they have for the workers in their industries. One of the interesting things brought up in this discussion was the role that insurance has when examining the needs of this fund's members. Now remember, the default option – which will, in most cases, become a fund's MySuper option – houses most of a super fund's members. In the case of industry funds, corporate funds, public sector funds and retail funds that service specific industries as default funds, it will be the vast majority of members of those funds.

Australia has a well-documented underinsurance problem. There are people in various high risk industries who cannot get insurance, due to their occupational rating, however, the invention of group risk means that super funds can arrange insurance for these groups of people and in a cost effective fashion.

My recommendation is that, if nothing else, insurance should form extra criteria on top of ordinary MySuper compliance. And not just any insurance – insurance should be guaranteed minimum cover, not a guaranteed agreement to consider applications for an available minimum level of cover.

4. Transparency as an aim

Whilst I have no general disagreement with the aim of transparency, I query whether an agreement between two parties who should be (theoretically at least) representing their constituents to the best of their ability requires any kind of transparency at all?

Whilst this appears on the surface to be an admirable aim, there is an implied claim here which suggests that transparency at any cost is preferable to none, a claim for which I was unable to find evidence to support in the report.

At the very least, this is none of anyone's business, at the most, it is a vote of non-confidence in the industrial parties' ability to do the jobs that they are there to do. On the other hand, if transparency is going to extend to this, then please extend it to all other allowable matters. There is no reason why default superannuation arrangements should be singled out.

In any event, it would be a better outcome to extend a best interest duty to the industrial parties, instead.

5. Past or projected returns as selection criteria

There have been various attempts by a variety of industry players to have the past performance of superannuation funds included as criteria in this consultation. The Commission has addressed this issue well, correctly pointing out the well-documented unreliability of past returns as a predictor of future returns.

However attractive it may sound to embrace higher returns on behalf of a group of workers, the message at the back of anyone's mind must always be to consider higher potential returns within the context of higher risk. For that is where these higher potential returns will always reside.

The question, then, of how much is enough of a potential return for sections of an industry who have not made an active choice as to how their superannuation is invested is not as simple as these industry players have made out. The question that must be addressed first is how much risk are the industrial parties prepared to subject workers in an industry to?

The means to achieving this level of risk lies with a fund's default asset allocation, that is the asset allocation in the default option which, as mentioned previously in this submission, will inevitably become a fund's MySuper option. Determining the asset allocation for this option in a super fund would, in an ideal world, consist of examining the membership of this fund and considering the goals, objectives, investment time horizons and risk tolerance of this group of members to see what asset allocation is most appropriate to them.

This is not conceptually dissimilar to the job that a financial adviser does when recommending an asset allocation to a single investor – in fact, it's largely identical. The sole difference is that where members of a super fund's default option have generally not chosen to be there, a financial adviser's clients do not have a default available to them in the event that they do not make a decision.

The fact that super members who may not have chosen their asset allocation are, nevertheless, subject to its assumed level of risk due to this act of not choosing their fund, makes it doubly important that these members have their needs considered, when creating or maintaining a portfolio of assets on their behalf.

In addition to this, anecdotal evidence suggests that super funds' default options have progressively become riskier over the years with no evidence that this is due to a corresponding increase in risk tolerance. However, the overwhelming majority of their membership still is in this option.

According to the most recent APRA statistics, the number of members of a super fund that services the building and construction industry has over 98% of their membership in their default option. However if you plotted the members of this fund's risk tolerance on an x-axis and assume that the members' risk tolerance resembles a normal distribution, the suggestion is that 3 standard deviations of the funds membership is clustered around the risk tolerance implied by the default option's asset allocation through no choice of their own. What if the default asset allocation is wrong? What if the bell curve is actually clustered around a different point on the x-axis from the spot where the default asset allocation actually lies?

The fact that members only appear to become aware of other investment options in their default funds at the worst possible times, such as the fund's cash option at the very bottom of a market cycle only appears to confirm that investors, who would ordinarily consider high returns attractive, prize security a little more than what various industry players maintain.

And what of differences between industries? Would a relatively youthful industry such as hospitality have a more risk-tolerant member base than an older industry, such as the legal industry? I have no doubt that they would be different.

Many funds claim to have profiled their default membership. Why not formalise this as a requirement?

I strongly recommend that a fund's default asset allocation and its implicit risk profile be considered as essential criteria on top of ordinary MySuper compliance, with candidate funds being required to demonstrate that their MySuper asset allocation has been constructed to cater to the goals, objectives, investment time horizons and risk tolerance of the workers in that industry. I further recommend that any investment return criteria, whether past or projected, be viewed within this criteria.

6. 'Flipping'

I note that in the draft report at 5.5, on the subject of 'flipping', the Commission has considered that the likelihood of members being flipped to expensive ex-employee divisions is a real risk. I welcome these comments.

However, I also note that the report examines the scenario whereby an employer negotiates discounted MySuper fees for current employees. Whilst I can see why employers may utilise these arrangements, once can see a very real risk to members who are ex-employees or potential ex-employees in allowing such scenarios to proliferate unchecked.

I have already recommended in a number of places that a duty to act in members best interests should be imposed on the industrial parties to awards, as well as any bodies or persons empanelled to make decisions about the default superannuation arrangements for workers under an award.

To ensure that such arrangements are not misused, I recommend that the duty of care to act in members best interests be defined such that 'members' refers to all current or potential members of employee or ex-employee divisions.