# Submission in response to the Productivity Commission's draft report on default superannuation funds in modern awards

**8 August 2012**

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D No. 44/2012

## Executive Summary

- The ACTU welcomes the Productivity Commission's recognition that the existing system of award default selection has operated well and in the best interests of most default members.

- We support the Commission's view that factors in addition to mere *MySuper* compliance should be taken into account when deciding which funds are named in awards. However, we believe that fund performance, measured in terms of net returns to members over an extended period, should determine whether a fund is eligible for potential award inclusion.

- We welcome the Commission's recognition that the practice of 'flipping' is an important issue for disengaged members. However, we believe that funds which engage in flipping should not be eligible for consideration for inclusion in awards.

- In relation to the four reform options discussed by the Commission the ACTU agrees that Option 1 should be rejected as being inconsistent with the interests of default members. While the current selection method (Option 2) could continue to serve the interests of default members well, we believe the process should be made more rigorous than hitherto.

- We believe Option 4, which would involve the creation of a stand-alone selection body, is inconsistent with the status of superannuation as an industrial matter and would generate a degree of cost and regulatory burden disproportionate to its responsibilities.

- We welcome the Commission's consideration of Option 3, which is broadly consistent with the ACTU's proposal in our original submission. As canvassed in our oral submission, an alternative approach would be for the *Fair Work Act* to be amended to require Fair Work Australia to refer these matters to a member or members of an appointed panel of subject matter experts who would prepare a report on the application of the selection criteria to a set of relevant funds. Fair Work Australia would then consider this report when deciding which funds should be named in individual awards. This is our preferred approach and is broadly consistent with the substance of Option 3 in the Commission's draft report.

- In keeping with the industrial status of superannuation, and the policy intent of the *Fair Work Act*, the ACTU believes the views of employer and employee representatives must be given precedence when Fair Work Australia is deciding which funds are named in awards. It would be highly inappropriate for those agitating mere commercial interests, as opposed to the interests of employers and employees, to participate as of right in proceedings before Fair Work Australia.

- The ACTU strongly opposes the Commission's recommendation that employers be allowed to opt-out of awards on the matter of default superannuation. There is no evidence that such a reform is wanted by employers or is needed to enhance the interests of default members. Such an opt-out will subject employers to increased compliance and selection risk and be subject to potential abuse.

## Introduction

The ACTU welcomes the opportunity to comment on the Commission's draft report of its inquiry into default funds in modern awards. This new submission follows our initial submission made in April and our oral evidence given to the Commission in July.

We are pleased that the Commission has confirmed what unions and not-for-profit funds have been arguing for many years, namely that the existing system of default fund selection has generally operated well. It has proven to be a stable and efficient source of above-average returns for many workers who are obliged to make contributions but do not wish or feel able to make a choice about which fund those contributions should be paid into.

We are also pleased that the Commission has rejected the argument made by many in the retail sector that employers should be able to choose any product to act as a default provided it complies with the new *MySuper* regulations. We agree that such an approach would not be consistent with protecting and advancing the best interests of many default fund members.

However, while parts of the draft report make a valuable contribution to the debate on how present arrangements should be reformed, we have a number of concerns. We flagged many of these concerns during our oral evidence to the Commission's recent public hearing in Melbourne. Here we discuss those issues in more detail. We are happy to elaborate further upon request.

## The Factors for Consideration

Our view is that while the *MySuper* reforms will make an important contribution to protecting the long-term financial interests of default members, the scope that will exist for funds to offer a large number of variously priced and branded products which allow 'flipping' means that factors in addition to *MySuper* compliance must be taken into account when selecting defaults in awards. We therefore support the Commission's view that *MySuper* compliance is a necessary but insufficient condition for a fund that wishes to be named in a modern award as a default.

The Commission's list of factors for consideration in addition to *MySuper* compliance provides a useful basis for informing selection decisions. However, our view remains that a record of delivering relatively low net returns to members and of 'flipping' members into higher cost products should act to exclude funds from being considered for award inclusion.

We note the Commission's concerns about using a past performance criterion to list default funds in awards (Draft, pp. 67-69).

There is, of course, no necessary relationship between past and future fund performance. However, as recent research by Deloitte Access Economics using APRA data has shown, in practice there is a statistically significant level of persistence in fund returns. Deloitte concludes that a likely source of the fact that industry funds tend to outperform retail funds over time is the profit orientation of the latter[1].

In addition, for the purpose of deciding which funds are eligible for consideration for inclusion in awards, and in a context where securing the highest possible net returns to members should the overriding aim of policy, it seems perverse to design a system in which funds with a proven record of delivering relatively low net returns could potentially be named.

In terms of ensuring the best interests of default members are promoted, and encouraging public confidence in the new selection and review arrangements, we believe there remains a strong case for limiting those funds for consideration for inclusion in awards to those that APRA report as being among the top 100 best performing in terms of net returns over an extended period such as 8 years. This would generate a category of well performing funds in the context of which further factors for consideration would then be applied for the purposes of selecting the funds to be named in each award.

In the context of the Commission's recommended review process, those funds whose average performance over each 8 year cycle after 2013 placed them outside the top 100 could be removed from the relevant awards.

[1] Deloitte Access Economics (2012) *Persistence in Superannuation Fund Returns, research report for Industry Super Network*, Kingston ACT.

We welcome the Commission's recognition of the problem of 'flipping' (Draft, pp. 91-92). However, we do not agree that the likelihood of flipping should merely be a factor for consideration.

Where government has legislated to compel employees to make contributions to privately operated funds there is a special responsibility on policymakers to protect such employees from business practices that exploit their disengagement. Flipping is such a practice. It is not always possible for policymakers to eliminate the principle-agent problems that are present across the superannuation industry. However, in the context of selecting default funds in awards it would be a relatively straightforward process to allow only those *MySuper* products which expressly require the consent of members before they are transferred to another part of the product to be eligible for consideration for default status.

We note the Commission's view that because the government intends *MySuper* products to be low cost and simple 'this requirement makes it much less likely members will be moved to a significantly higher cost product (but does not entirely eliminate the possibility)' (Draft, p. 91).

As we observed in our initial submission to the Commission, the government has unfortunately decided to allow funds to discount *MySuper* administration fees to larger employers. This is likely to encourage a proliferation of variously priced and branded *MySuper* products which will inhibit the transparency and comparability that are meant to deliver greater simplicity and lower cost. In this context the well-established business model of agreeing to provide low cost plans on the basis that future turnover will enable funds to charge much higher fees is very likely to endure.

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

## The Selection Process

In its draft report the Commission discusses four options for reforming the selection process (Draft, pp. 141-176).

We agree with the Commission that Option 1, where each employer chooses any MySuper product, is not an appropriate model for selection and should be rejected. Option 2 broadly reflects current practice. The current model has generally served award default members well. If the model was to remain in place it would very likely continue to operate in the interests of default members. However, we believe now is a good opportunity to adopt a more rigorous and structured process than has hitherto been the case.

Option 4 involves the establishment of a new independent body charged with the sole purpose of determining the selection of funds. Unions, along with many employers and in keeping with government policy, regard superannuation contributions as deferred wages and therefore appropriate to collective bargaining and industrial regulation. Further, the present Fair Work system offers an established, efficient and flexible framework within which a more rigorous approach to default selection can be implemented with relative ease. The creation of a new stand-alone body would generate a degree of cost and regulatory burden disproportionate to the periodic nature of its responsibilities. Given the industrial status of superannuation, and the existence of institutions already familiar with administering modern awards, we do not believe that a new independent body is appropriate or necessary.

In our initial submission to the Commission we argued that the existing framework of modern award reviews provides an effective and efficient means of reviewing default funds on a regular basis but that it does not presently guarantee that Fair Work Australia will consider the status of funds as part of each award review. We therefore made the following suggestion for reform:

> To ensure a process occurs we recommend that the *Fair Work Act* be amended to require Fair Work Australia to convene a special purpose full-bench (similar to the minimum wages panel) that would assess the effectiveness of award default arrangements and consider representations for their amendment, based on the criteria identified above. Ideally this would occur in conjunction with, or closely follow, the conduct of the four yearly reviews of modern awards. In line with the mechanism for appointment of part-time members of the

> minimum wage panel[2], provision could be made for the appointment of subject matter experts to assist Fair Work Australia in its deliberations. Additional provision could also be made to specifically allow or require Fair Work Australia to seek or consider the views of relevant regulatory bodies including APRA[3].

In our oral evidence to the Commission's recent public hearing we suggested an alternative approach. This would involve amending the *Fair Work Act* to require Fair Work Australia to refer these matters to a member or members of a panel of subject matter experts who would prepare a report on the application of the selection criteria to a set of relevant funds. Fair Work Australia would then consider this report when deciding which funds should be named in individual awards. This is our preferred approach.

This is broadly consistent with Option 3 in the Commission's draft report. However, when assessing this option the Commission states:

> By ensuring that the overarching objective of the FWA expert panel is the best interests of members, there is no need to give the views of industrial parties more weight than the views of others (Draft, p. 167).

Our system of industrial relations is a tripartite system premised on representing and arbitrating between the interests and views of employers and employees. This is why Section 158 of the *Fair Work Act* 2009 specifies that only an employer, employer or organisation covered by a modern award (or an organisation entitled to represent an employer or employee covered by that modern award) has standing to apply to vary, omit or include terms in a modern award. Further, section 139 of the Act identifies superannuation as an allowable matter in awards, confirming its status as an industrial issue and therefore one that employers and employees (or their representatives) should have priority in determining. Within the overarching framework of the modern awards objective[4], and the exercise of its powers to meet that objective, Fair Work Australia has a broad discretion to inquire into and consider specialist information and broader interests[5].

[2] See sections 627(4), 628(3) and 629(4) of the *Fair Work Act* 2009.
[3] Australian Council of Trade Unions (2012) *Default Superannuation Funds in Modern Awards: ACTU submission to the Productivity Commission*, p. 14.
[4] See section 134 of the *Fair Work Act* 2009.
[5] See section 590 of the *Fair Work Act* 2009.

The argument that in this context 'the views of others' (in practice, the views of multiple superannuation funds jockeying for commercial advantage) should have equal weight to those of the industrial parties is inconsistent with the status of superannuation as an industrial issue and the priority the *Fair Work Act* therefore accords to the views of those most impacted by award content. The views or expertise of external parties may well be relevant to the exercise of modern award powers, but it is the industrial parties and Fair Work Australia who must frame the relevant inquiry. To allow superannuation funds to agitate their commercial interests in this context without an industrial sponsor would effectively be inviting third party interests to dictate the employment safety net. This clearly cannot be reconciled within the policy intent of the *Fair Work Act*.

As we stated in our initial submission, it is currently open to any fund not named in an award to seek inclusion by gaining the support of an employer or employee representative. Having to gain such support does not constitute a significant barrier to entry. The fact that very few retail funds seek award inclusion via this route speaks volumes about their inability to convince a relatively informed group of potential sponsors of the value of their products.

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.

## Employer Discretion

In the context of discussing potential models of default fund selection the Commission suggests that in all cases employers should be able to choose a fund not listed in the relevant award. However, employers who make this choice must be able to demonstrate, if called upon, that their employees are no worse off. The Commission offers the following rationale for making this choice available:

> As the obligation to pay superannuation contributions rests with an employer, it is reasonable that employers who wish to do so be given some scope to choose a default fund outside of those listed in awards. This would add a competitive element to the system which will enhance incentives for all superannuation funds to meet the best interests of members. Moreover, it has the potential, in some circumstances, to allow for closer tailoring of

> superannuation to the needs of particular workplaces than is possible under a system based on awards (Draft, p. 14).

The ACTU has a number of serious concerns about the draft recommendation to facilitate employer discretion and the reasoning it rests on.

Firstly, while employers are obliged to pay superannuation contributions, those contributions belong to the employee. It is therefore important that employees and/or their representatives have a say in relation to which fund those contributions are made. In the absence of individual choice this say is facilitated by the system of modern awards and enterprise bargaining. The Commission's one-sided concern with the obligations and preferences of employers is therefore misplaced.

Secondly, it is not clear from the draft report exactly what the nature and scale of the problem is that would justify allowing any employer to unilaterally opt-out of the awards system on the matter of default superannuation. It is suggested that present arrangements may be acting to hinder the 'closer tailoring of superannuation to the needs of particular workplaces'. Aside from anecdotal assertion, we are not aware of any substantive body of evidence to support this suggestion.

It is clear that many employers are happy to be guided in their selection of default funds by award provisions. So legislating to allow an opt-out, in response to a problem the nature and scale of which is unproven and unclear, seems very likely to prove pointless at worst or disproportionate at best. It would complicate the regulatory framework, adding to uncertainty, and expose employers to selection and compliance risk.

Employers and employees who wish to depart from award terms can do so by reaching an enterprise agreement. It is open to employers and employees to make an agreement that allows every employee to choose any fund they wish. If it is being claimed that for some employers the costs of reaching such an agreement are excessive relative to the benefits of being able to choose a non-award default then this is a claim that requires proper evaluation prior to being used to justify significant regulatory change.

We do not accept that the process of making an enterprise agreement creates an excessive burden for employers. While the experience of making such agreements can vary widely between workplaces, the large majority are completed quickly and efficiently with little cost or disruption to

businesses.

It may be useful to outline the basic agreement making process. Once an employer and employees have decided they wish to reach an agreement the following steps are taken:

- Employees are notified of their representational rights (for example, by email);
- Bargaining representatives are chosen (often a senior manager and a union delegate);
- A written agreement is reached and made available to employees;
- Employees vote (there is no prescribed method, voting can be via email);
- Once agreed, the agreement is lodged with Fair Work Australia for approval.

Our experience is that most employers, of varying sizes, regard this as a straightforward and efficient means of establishing a consensus within workplaces on how work should be performed and rewarded. No doubt there are some employers who view any and all forms of collective bargaining as an unacceptable imposition – particularly those with no experience of the process. However reform based on outliers rarely makes for good policy.

Furthermore, it seems likely that an employer who engages with the detail of award superannuation to the extent that they feel motivated and able to select a different fund is also capable of making an enterprise agreement.

Thirdly, we are concerned that the risks to members of allowing employers to unilaterally opt-out of awards on the matter of default superannuation will out-weigh the supposed benefits. The Commission's proposal appears to rest on the assumption that employers will typically make choices that are in line with the best interests of employees.

However, it is known that the level of superannuation-related literacy and engagement among employers is low. While we believe the use of any opt-out will prove to be minimal, some employers may be encouraged to do so by the marketing efforts of retail funds who view a newly introduced opt-out as an opportunity to expand their contributions base. A marketing-driven climate of 'employer choice' risks encouraging some employers with little understanding of default superannuation to consider changing their default arrangements, selecting new funds that are not in the best interests of employees.

This problem is likely be aggravated by the use of inducements. Section 68A of the SIS Act prohibits a superannuation provider from offering inducements in relation to the choice of a default fund. However, a number of products such as administration services and those that are also made available to employees are exempt from the inducement prohibition. In addition, research for the Australian Tax Office into employer attitudes and behaviour in relation to superannuation found that 13 per cent of employers admitted either to receiving inducements to use their current default fund, or to not being sure if inducements had been offered. 11 per cent of large employers admitted to having been offered inducements to select their current default[6].

It seems likely that the real level of use of prohibited inducements will be higher than that admitted in an anonymised survey. The researchers commented:

> Employers would be more inclined to consider changing their default superannuation if it was clear that membership of one fund would provide financial or resource benefit to the company[7].

These problems of poorly informed and badly motivated choices by some employers are likely to be heightened by what appears to be the Commission's 'light-touch' model of policing and enforcement. Unions regularly deal with instances where employers have failed to pay deducted contributions in whole or in part to the appropriate superannuation funds. Sometimes this failure only comes to light when an employer becomes insolvent. This is one of the reasons why unions argued strongly for regular pay-slip reporting of contributions paid to funds.

Our experience is that the ATO struggles with insufficient resources in the area of SG enforcement, leading to long investigation times and growing pools of unrecovered monies. This leads us to be very doubtful that any public agency will have the added resources necessary to effectively police employers who might decide to opt-out of awards. 'Light touch' enforcement, given added impetus by resource constraints, is very likely to be interpreted by some superannuation funds and employers as a green-light for choices and patterns of behaviour that have little regard for the real interests of employees.

[6] Colmar Brunton (2010*) Investigating Superannuation: Quantitative Investigation with Employers, Final Quantitative Report*, p. 56.
[7] Colmar Brunton (2010) *Understanding Superannuation Preliminary Report: Qualitative Investigation with Employers, Consumers & Industry*, p. 28.

Finally, the Commission states that introducing employer discretion will 'add a competitive element to the system which will enhance incentives for all superannuation funds to meet the best interests of members' (Draft, p. 14). As we indicate above, unilateral discretion in the context of low employer literacy and pro-choice marketing may not generate the competitive processes that the Commission envisages. However, if some form of added discretion did lead to greater competition it is important to recognise that competition tends to generate additional distribution costs as funds invest more in marketing their products to sustain their revenue base. Research by Rice Warner estimates that such costs for the average industry fund member could increase by up to $45 per annum[8].

In the absence of evidence that the interests of members are being damaged by the requirement that employers comply with awards on the matter of default superannuation, and given our concern that allowing employers to unilaterally opt-out is likely to expose employees to a heightened risk of poor and badly motivated choices, the ACTU opposes the Commission's draft recommendations on 'employer discretion'.

## Governance

The ACTU welcomes the Commission's recognition of the importance of good governance to superannuation funds in general and to those funds seeking default status in particular. We further welcome the Commission's view that 'the equal representation model has generally operated well to date' (Draft, p. 87).

We note that the core principles for occupational pension regulation approved by the OECD in 2009 include the following recommendation on accountability:

> The governing body should be accountable to the pension plan members and beneficiaries, its supervisory board (where relevant), and the competent authorities. Accountability to plan members and beneficiaries can be promoted via the appointment of members of the governing body by pension plan members and beneficiaries or their representative organisations[9].

[8] Rice Warner (2012) *Default Superannuation Funds in Modern Awards, research prepared for HOSTPLUS*, Sydney.
[9] OECD (2009) *Recommendation on Core Principles of Occupational Pension Regulation*, OECD, Paris, recommendation 6.3.

In Australia only not-for-profit funds are accountable to members via member representatives on trustee boards.

In our initial submission we noted the lack of evidence-based analysis that has characterised much recent public discussion about equal representation governance and the alleged advantages of imposing a requirement for more independent directors. We therefore welcome the Commission's recommendation that the government consider assembling a panel of corporate governance experts and relevant regulators to assess the appropriateness of board structures of default superannuation funds. If acted upon, the work of this panel should make an important contribution to improving the quality of public debate on this topic.

However, to avoid giving the impression that any such panel should only assess the role and adequacy of the equal representation model, the Commission should make clear in its final report that the panel should examine the main types of board structure found across the whole superannuation industry.

## Defining Returns

It is not always clear in the draft report that there is an important distinction to be drawn between 'net investment returns' and 'net returns'. At times these terms appear to be used interchangeably. What matters to members, and what should be of primary concern to policymakers, is what is credited to individual accounts after all fees, costs and taxes have been deducted. 'Net investment returns' is a pre-deduction measure that can be used to give a misleading impression of how well a fund serves the interests of its members. For the purpose of evaluating the performance of those funds that wish to be named in awards the focus should be on the rates of return after all appropriate deductions have been made.