9 August 2012

Mr. Mike Woods
Deputy Chairman
Productivity Commission
LB2 Collins Street East
Melbourne Vic 8003

Dear Deputy Chairman

RE: Financial Services Council Supplementary Submission

We write to you following the release of the Productivity Commission's interim report in June 2012. This supplementary submission will respond to the draft report.

The Financial Services Council (FSC) supports the MySuper reforms and this inquiry and looks forward to contributing to the enhancement of the system by ensuring an open, transparent and competitive approach to the selection of MySuper default funds.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks, trustee companies and public trustees. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

We look forward to discussing the contents of this submission with you.

Regards

ANDREW BRAGG
SENIOR POLICY MANAGER

FINANCIAL SERVICES COUNCIL SUPPLEMENTARY SUBMISSION

PRODUCTIVITY COMMISSION INQUIRY –

DEFAULT SUPERANNUATION FUNDS IN MODERN AWARDS

INDEX

1. SUMMARY AND RECOMMENDATIONS

Key points

The Financial Services Council welcomes the Productivity Commission's draft report into default superannuation funds in Modern Awards.

We believe it highlights the failings of the present default superannuation system which:

- Fails to place the member at the centre of considerations;
- Lacks transparency;
- Lacks contestability;
- Has embedded conflicts of interest; and
- Does not provide procedural fairness.

The FSC concurs with the Commission that the member must be placed at the centre of considerations in redesigning an arcane default superannuation structure (draft recommendation 4.1)

As identified by the Commission, contestability is a necessary element in maximising member value; but is a missing feature of the current system. The widely proven method of enhancing a consumer product's features and pricing is through a contestable market model and we believe this should remain the Commission's objective in redesigning the system.

Although we strongly welcome the above assessment (the Commission's findings) of the present arrangements, we are concerned that the Commission's preferred models for reform would not address the concerns such as contestability identified in the draft report and therefore may not serve the best interests of members.

Australia has benefitted from almost 30 years of pro-market competition reform where industries have been deregulated and the benefits have flowed to consumers. For instance, the 2011 superannuation fees report shows that superannuation fees have fallen most heavily where workplaces tend not be award covered (where compulsory default funds exist in Modern Awards).[1]

[1] Rice Warner Actuaries – Superannuation Fee Report 2011 – available at www.FSC.org.au

We make the following points about the draft report and MySuper reforms:

1. The FSC welcomes the Commission's draft report findings on the present system and the endorsement of a contestable market model for default superannuation;
2. We further welcome the assessment that there should not be any further criteria other than the prescriptive MySuper product detailed in legislation which requires a licence variation from the Australian Prudential Regulation Authority (APRA) for default fund status under any circumstance;
3. The FSC believes the outcome of this inquiry must be deregulation – not the imposition of further regulation on employers or the superannuation industry;
4. The new MySuper framework has not yet commenced – it should begin on 1 July 2013 without regulation which undermines its open, transparent and consistent application across Australian workplaces;
5. The new regulatory structure for MySuper must be enduring in that it should not need regular structural review or reform following commencement;
6. The regime to facilitate employer choice of MySuper must minimise employer compliance search costs, ambiguity and industrial disputation. It must expressly eliminate legal liability where an employer selects a MySuper product.
7. The only test an employer must meet is whether a complying MySuper product is the default fund, to apply a further test suggests a deficiency exists in the Parliament's design for MySuper and the prudential regulator's licensing regime;
8. Consolidation is rapidly reducing the number of superannuation funds – there is likely to be approximately 100 superannuation entities in 2020; and
9. Timing – as an integral element of the MySuper reforms, the new regime for workplace default fund selection must commence with the MySuper regime on 1 July 2013.

In relation to delivering the reform the Commission has identified is necessary, we make the following points about options 1 and 3-4:

1. The Commission's option 1 – where default funds would not be listed in awards remains our preferred position as it eliminates the need for any Fair Work Australia (FWA) or other process for listing or delisting funds as every MySuper product would be an eligible default

fund at the workplace level. This approach recognises the significant regulatory change delivered by MySuper where the default fund will be designed in legislation and licenced differently by APRA.

2. Option 1 creates the most competitive market which is in the best interests of consumers / members according to OECD principles. This option also represents an enduring approach which will not require further legislation, future reviews or regulatory change. It would future-proof the MySuper framework as consolidation in the industry occurs.
3. Many employers want to select a default fund from a complete listing of approved MySuper providers. We therefore challenge the rationale of options 3-4 which truncate the list of permissible MySuper products for employers at the award level. We believe this is inconsistent with the evidence presented by employer groups (such as ACCI), research conducted by Westfield / Wright and Cameron Research findings that employers regularly review their default fund;
4. To this end, the new APRA data collection for superannuation will, for the first time, provide detailed information about every default investment option. A government website designed to assist employer compliance should be developed – a similar website can be found in Hong Kong;
5. Permitting the choice of a non-award MySuper product restores flexibility contained in many pre-Modern Awards which also occurs today under 13 Modern Awards not containing default funds. We understand this competitive market structure operates well and does not deliver an undue compliance burden to employers (as the Commission noted in the draft report);
6. While appealing in theory, including a "no worse off" test where an employer selects another MySuper product delivers the following negative consequences:
    a. Subjectivity and a wide range of factors to judge the test upon;
    b. Employer fear of liability and increased cost;
    c. The threat of increased industrial unrest arising from an employer's choice of default fund where conflicted parties are present;
    d. Creation of a new regulatory structure with associated cost and bureaucracy;
    e. Ultimately the restriction of employer choice would fail to address the systemic contestability issues identified by the Commission; and
    f. There is no justification to create a third process for award covered workplaces in addition to the existence of MySuper in legislation with licensing from the prudential regulator. Doing so creates suggests a deficiency exists in the MySuper legislation;

7. Maintenance of default funds in awards is not appropriate as demographics vary significantly within cohorts of employees covered by awards (they are not homogenous). For example, it is common for a single award to cover highly skilled, highly paid employees and also those with vastly fewer skills and resources. Accordingly the narrowing of available MySuper products for each respective award would prohibit workplace or sub workplace demographics to be addressed in default fund selection;
8. As we do not believe it is appropriate to list default funds in each Modern Award, we do not express a view on the expert panel or Fair Work Australia selection as envisaged under Options 3-4;
9. This supplementary submission focuses on:
    a. An assessment of models 1 and 3-4; and
    b. Facilitation of employer choice in the circumstance that the Commission maintains its preference for options 3-4. We believe it is important that the FSC engages with the Commission in considering the viability of our non-preferred options.

<u>Recommendations</u>

1. MySuper products should not be listed in Modern Awards as default funds (Option 1);
2. Employers should be permitted to select any MySuper product as a default fund;
3. A dedicated MySuper employer website containing materials to assist in meeting superannuation obligations should be created. A complete listing of MySuper providers should be included;
4. Employers must be permitted to select any complying MySuper product without the need to meet any additional test or hurdles;
5. Regardless of whether a test applies, employers selecting a MySuper product cannot be subject to legal liability for their choice of a MySuper compliant fund;
6. Should a test apply, the sole action that can be taken against an employer who contravenes the test is limited to the selection of a different MySuper product. It would be grossly unfair for an employer to face the threat of personal liability having selected an alternative highly regulated and government sanctioned MySuper product;
7. Should a test apply, it should be based on “equivalent rights” rather than a “no worse off” basis;
8. There is no existing body that is currently capable of performing a function which assesses or tests employer MySuper selections;

9. The closest existing body with comparable capacity (though not identical) is the SCT which may be the most appropriate “relevant body”. This would require significant changes to the SCT’s mandate / remit – given any such test would need to be asserted at a “whole of fund” level rather than at an individual / employee level;
10. A complaint should only be heard in the circumstance that 10% of fund members are complainants. This ensures that the process will not be abused and actions will only be brought where a significant proportion of members feel aggrieved;
11. Conflicted parties may not bring complaints;
12. If employer choice of any MySuper product is permitted without an additional test, there is no need for grandfathering. If not, grandfathering provisions which permit an employer to continue using a pre Modern Award default fund will be required; and
13. Extend choice of fund to all defined contribution members, except where this results in an employer paying contributions twice.

DRAFT REPORT OPTIONS

Option 1

Key points:

1. Robust competition at the employer level will provide the best outcome for consumers;
2. Many employers want the flexibility to select a default fund at the enterprise level;
3. Cost and bureaucracy would be removed from the system under this option;
4. Robust consumer protection safeguards exist for members and to govern employer behaviour; and
5. Consolidation is rapidly reducing the number of superannuation funds.

Consumers / members

The Commission identified two problems with option 1 that (1) it is believed that it would not protect the best interests of members and (2) that employers would have to choose a MySuper product from a list of many authorised funds.

We do not believe that option 1 would fail to protect the best interests of members as the only eligible default products would be MySuper funds (subject to numerous consumer protection legislative requirements) in the most competitive market possible. On the contrary, truncating the list of eligible MySuper products may be to the detriment of members as workplaces may be unable to find a default fund which reflects their demographic needs or prevents benefits of competition and scale to accrue.

As noted in our original submission, the advent of the MySuper regulatory framework will deliver a default superannuation product with design features and trustee obligation set in legislation. It will create a segmented default product which does not exist today. This represents a significant change in the regulatory landscape and we believe that any MySuper product should be an eligible default fund for an Australian workplace. Option 1 embodies this recommendation.

Option 1 will permit the strongest possible amount of competition in the market by permitting each MySuper product to become a default superannuation fund at any Australian workplace. Ultimately, increasing competitive tensions in the system will drive the best outcome for members. As stated in our initial submission - according to the OECD, open, competitive markets deliver an optimal outcome in all markets:

> All OECD countries rely fundamentally on competition in product markets to organise production. Competition stimulates innovation and efficiency in the use of resources, thereby leading to greater product diversification and lower prices. Therefore, competitive product markets are in the interest of all consumers.[2]

We do not see a case for truncating the list of funds and therefore undermining the interests of consumers. We have benefitted from almost 30 years of pro-market competition reform where industries have been deregulated and the benefits have flowed to consumers. For instance, the 2011 superannuation fees report shows superannuation fees have fallen most heavily where workplaces tend not to be covered by an award and therefore constrained in the choice of a default fund.[3]

The report highlights the impact of restricting superannuation competition in Modern Awards. Fees in large employer (default) superannuation funds are amongst the lowest at 0.83%. Such employers are typically not restricted by Modern Awards and are free to select any superannuation fund, often via a competitive tender process. Members are clearly benefiting from the highly competitive dynamics in this segment.

[2] The Organisation for Economic Co-operation and Development (OECD) "Competition: Economic Issues" - http://www.oecd.org/about/0,3347,en_2649_34833_1_1_1_1_37463,00.html
[3] Rice Warner Actuaries – Superannuation Fee Report 2011 – available at www.FSC.org.au

Table 1 – Rice Warner Actuaries Fees Report 2011

Table 1. Fees 2011

Fees by superannuation segment – Year to 30 June 2011						
Sector	Segment	Operating	Investment management	Operating & investment management[1]	Advice	Total Fees[1]
		(%)				
Wholesale	Corporate	0.30	0.47	0.77	0.02	0.79
	Corporate Super Master Trust (large)	0.24	0.58	0.82	0.02	0.83
	Industry	0.43	0.66	1.09	0.04	1.13
	Public Sector	0.22	0.56	0.78	0.04	0.82
Retail	Corporate Super Master Trust (medium)	0.87	0.71	1.58	0.25	1.83
	Corporate Super Master Trust (small)	1.04	0.77	1.81	0.39	2.21
	Personal Superannuation	0.84	0.60	1.44	0.43	1.87
	Retail Retirement Income	0.62	0.67	1.30	0.45	1.75
	Retirement Savings Accounts	0.60	1.70	2.30	-	2.30
	Eligible Rollover Funds	1.95	0.45	2.40	-	2.40
Small Funds	Self-Managed Super Funds	0.33	0.52	0.85	0.15	1.00
Total		**0.45**	**0.58**	**1.03**	**0.17**	**1.20**

[1] Components may not add up to totals due to rounding.

4

To limit the number of MySuper providers to 10 funds per award (as envisaged under options 3-4) would create a significant barrier to entry. For instance, it would not permit international entrants from competing in a growing market despite prescriptive licensing arrangements which must be met prior to establishment. It would also introduce a systemic concentration risk that does not exist today.

Additionally, it would arguably expose the Commonwealth Government to legal liability. Having first authorised providers against strict criteria and subsequently restricted employer choice, it is arguable that the Commonwealth would be liable for damages were a listed fund to deliver poor performance or worse, suffer some form or operational loss.

[4] Ibid

Employers

Further, option 1 would remove the need for a FWA selection process as any default superannuation product (MySuper) would be eligible for selection under a Modern Award. This approach would remove bureaucracy and cost from the industrial and superannuation systems. It would also formally remove the need for industrial parties, to be part of the superannuation system, such as employer groups and unions.

In research undertaken for this inquiry, a Westfield / Wright assessment of small and medium sized employer preferences showed that such employers do not want industrial parties picking default funds for them. The principle is that employers do not want another group or entity picking default funds for their businesses. This point was highlighted by small and medium sized business owners which participated in the Westfield / Wright research indicated significant concern with this approach as funds become compulsory service providers to small or medium businesses. In some cases, the service provider (super fund) can be inefficient or generally provide a poor quality of service to the employer. As recognised by the Commission:

> The administrative efficiency of a fund will directly flow through to the costs incurred by employers, potentially impacting on the level of compliance with their superannuation guarantee obligations, as well as on the profitability of the business. The effect on businesses can, in turn, impact on employees. The administrative efficiency of a fund will also flow through directly to employees, in terms of the ease with which they can access details of their account, switch between products and options, make voluntary contributions and receive benefits.
>
> Given the importance of these factors to the interests of members and employers, the Commission considers that there is a case for funds applying to be listed in modern awards to be assessed on their administrative efficiency in meeting the needs of members and employers, against a set of relevant benchmarks.[5]

Employers who are unhappy with their default fund are then only able to contract out of that relationship by instituting an enterprise agreement at significant cost. There is also broader point about the ongoing role of superannuation funds in the industrial system. Employer groups have supported this notion such as ACCI – who in their initial submission state:

> Whilst superannuation has its genesis in the industrial relations system, and its regulation retains aspects of that legacy, it is now a sophisticated financial/retirement income product (offering varying degrees of investment options, insurance levels and benefits), governed by complex regulations and prudential standards. There are

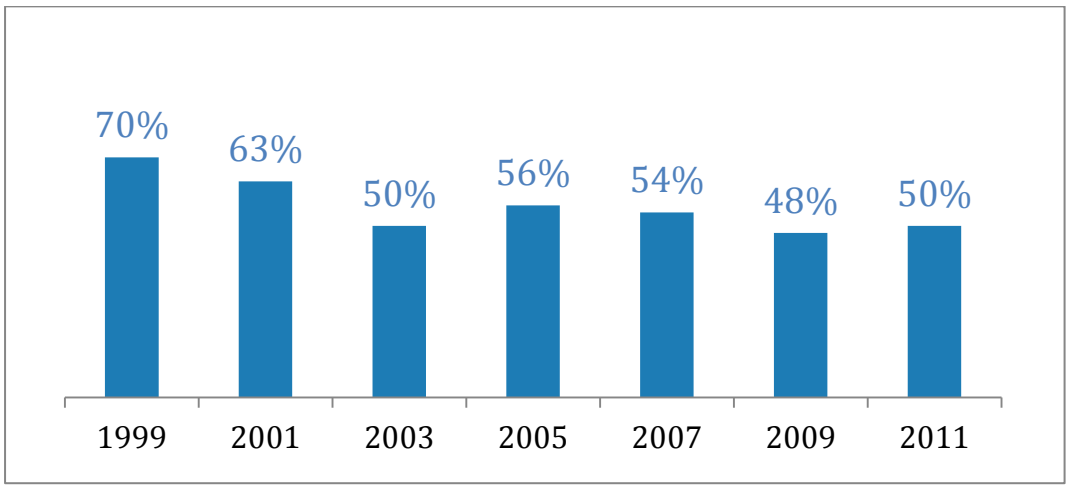
[5] Draft Report p110

> many complex interfaces between the fund, its members, employers and various regulators. Certainty and clarity is not assisted by the multiplicity of regulation sources. Employers support superannuation guarantee legislation governing the superannuation system in Australia, with primary oversight continuing to be by the ATO and APRA.
>
> Consistent with ACCI's longstanding public policy position of removing dual and overlapping legal obligations from the compulsory superannuation system for private sector employers, modern awards should not supplement the guarantee legislation with award prescription of general superannuation obligations.[6]

In short, a large number of employers do not want superannuation fund arrangements to be dictated to them by third parties.

Additionally, many employers see superannuation as an element of their retention strategy in an increasingly tight labour market. This point is illustrated in the following Cameron research – the number of employers reviewing the default superannuation fund:

Table 2 – Cameron Research Group assessment on medium sized business (20-500 full time staff) review of default fund arrangements[7]

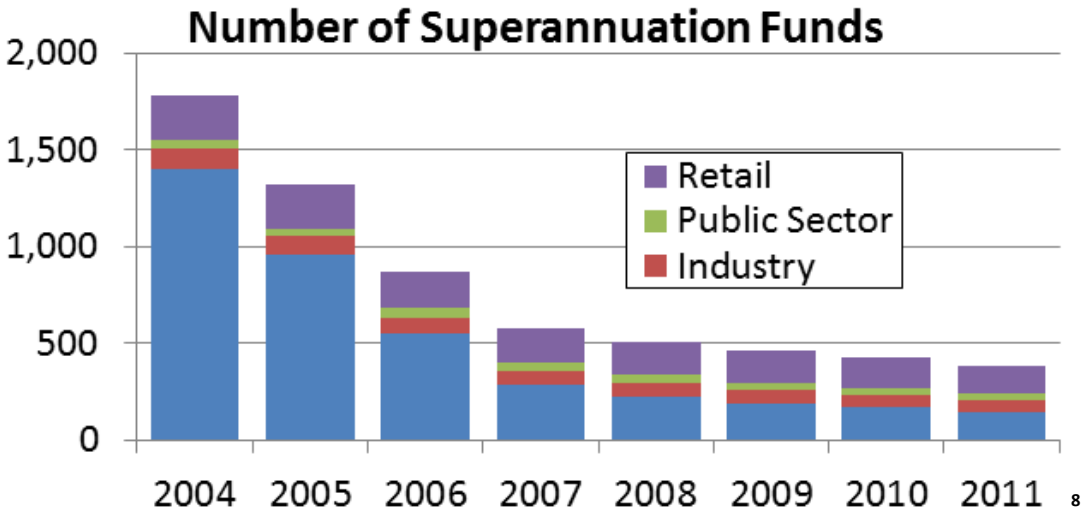


A further issue has been raised that employers may benefit from incentives under an open market where any MySuper product could become a default fund. However the existing provisions under Section 68A of the SIS Act prevent trustees and their associates from providing benefits to employers on the condition that the employer's employees join the fund.

[6] ACCI Submission to this inquiry - P19
[7] Cameron Research Group - The Australian Medium Sized Business Market for Superannuation : 2011

Consolidation of superannuation funds will also make the employer selection of a default fund easier over time. The following table illustrates the significant reduction of superannuation funds over the past decade:

Table 3 – Number of superannuation funds based on APRA figures



[8]

To provide some idea of the extent of superannuation industry consolidation, in 2004, there were 1,785 APRA regulated superannuation entities; today this number is 368. Not only are there vastly fewer corporate superannuation funds, industry and retail fund sectors have almost halved, as have those funds with a "public offer" designation.[9]

From 1 July 2013, a licensed superannuation provider (RSE licensee) will only be entitled to offer one single public offer (generic) MySuper product per RSE. An RSE licensee must separately apply to APRA in order to offer a MySuper product.

Today, providers with an RSE licence may offer an infinite number of default superannuation products and solutions to the market. This will not be the case under MySuper.

There are presently 183 public offer RSEs – we expect this to be a good proxy for the number of MySuper public offer solutions which will be in the market. New research indicates this number will decrease to around 100 superannuation funds by 2020.[10]

[8] APRA Annual Superannuation Statistical Bulletin – issued 29 February 2012
[9] APRA Annual Superannuation Statistical Bulletin – issued 29 February 2012
[10] Coredata "Survival of the fittest" - http://www.coredataconsulting.com/wp-content/uploads/2012/08/Survival-of-the-Fittest-White-Paper_FINAL.pdf

The expectation of widespread consolidation is not controversial within the industry, with both for-profit and not-for-profit advocates agreeing:

> A significant number of not-for-profit funds have indicated they are considering mergers, so a 40% industry-wide reduction in 2020 is not unrealistic and may even be conservative," says Fiona Reynolds, chief executive officer of the Australian Institute of Superannuation Trustees (AIST).[11]

This will vastly reduce any search costs employers may face in selecting a MySuper product.

The largest impact of the rationalisation of the default superannuation industry will be felt in the case of small employers. The Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 allows an RSE licensee to offer a different MySuper product to a large employee (with more than 500 employees). However the RSE licensee is not entitled to offer a different product to an employer with less than 500 staff.

That is, a standardised MySuper product can only be provided to small and medium sized businesses with up to 500 employees under this new law.

For workplaces with more than 500 employees, the Government has sought to allow them to determine the most appropriate MySuper to reflect respective demographics, yet the current FWA process prevents this from occurring.

Table 4 – Employer superannuation changes under MySuper

FACTOR	TODAY	MYSUPER FROM 1/7/13
Number of default solutions offered by a super fund	Infinite default solutions / unregulated	One public offer MySuper default fund per RSE
Ability for a provider to vary a default offering to a small or medium sized business (sub 500 employees)	Infinite flexibility	Not permissible – the same MySuper option can not have its underlying characteristics altered.
Dedicated default super regulation and licensing	No – public offer (not default) licence category	Yes
Default fees and pricing	Unregulated	No ability to charge a higher fee than stated
Dedicated default super website	No	To be developed by APRA and ATO (expected)

[11] Ibid p5

RECOMMENDATION

MySuper products should not be listed in Modern Awards as default funds (Option 1).

Employers should be permitted to select any MySuper product as a default fund.

We recommend the most appropriate way to assist employers is to create an employer-focused superannuation website which contained information about the available MySuper products.[12] This "choice" of default fund requirement exists today and in other jurisdictions. As identified by the Commission, presently in a number of awards, an employer is obliged to select a default fund from up to 18 default funds.

In other jurisdictions where compulsory pension systems are not embedded in the industrial regulations, such as Hong Kong and New Zealand, employers must choose from a list of approved trustees/funds. In Hong Kong, there are 40 approved schemes. Admittedly in both of these comparable jurisdictions, there would be fewer schemes than we anticipate there will be MySuper generic products.[13] However the point remains that employers are forced to choose under nearly all awards today (sometimes from up to 18 funds) and other jurisdictions require an employer to select a fund rather than have the selection made for them.

Accordingly we maintain our view that allowing employers to select from a list of MySuper products may not be as daunting as the Commission perceives. Small and medium business owners make decisions about their operations on a daily basis. They select many other financial services providers without requiring any additional government intervention.

However as superannuation is not a key function for every business, we recognise that assistance may be required for employers in making a default fund selection.

RECOMMENDATION

A dedicated MySuper employer website containing materials to assist employers in meeting superannuation obligations should be created. A complete listing of MySuper providers should be included.

[12] Recommendation 5 – FSC primary submission

[13] FSC estimated in the primary submission that there would be approximately 183 generic MySuper products by using the number of public offer licences as a proxy. This number will reduce to approximately 100 due to the significant forces of consolidation in the superannuation industry (as per Coredata's findings referred to above)

Options 3-4

Key Points

In respect of options 3-4 the following comments focus on facilitating a structure for employers to select an unlisted MySuper product which:

- Expressly eliminates legal liability;
- Limits industrial disputation;
- Promotes simplicity and ease of compliance; and
- Provides a clear and sole solution in the event of a dispute.

As noted, we believe the maintenance of default superannuation funds in awards is not necessary given the introduction of MySuper. However given the Commission has identified a number of alternative proposals for creating a contestable market, we have sought to provide our views on the workability and effectiveness of those alternatives.

Our comments on these proposals follow under “major themes”.

MAJOR THEMES

Employer choice of MySuper product (draft recommendation 8.2)

The FSC views this draft recommendation as a key element in the draft report. We support the proposal that an employer could select a non-listed MySuper product however we have significant concerns about application of a "worse off" test.

As noted by the Commission:

> The current process of fund selection therefore has the effect of reducing the contestability of the default fund market. This reduces competition, and reduces the likelihood that the funds chosen best meet default fund members' interests.
>
> It also reduces dynamic efficiency, reducing the likelihood that, over time, consumers are offered new and better products, and existing products at lower cost. This may lead to less innovation and poorer financial and administrative performance in the default superannuation market.[14]

We strongly agree with this statement about competition in the market. In making this draft recommendation, the Commission recognised that:

- Under existing awards which do not specify default funds or permit an employer to select another complying default fund, "the Commission is not aware of any problems that arose from these arrangements;"[15]
- Contestability will be improved;
- Employers have an obligation to select a default fund under the SIS Act and Stronger Super will make this less of a compliance burden; and
- Tailoring will deliver default funds which better reflect the demographic profiles of workplaces.

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.

[14] Draft report P128
[15] Draft report P157

There are two major benefits in allowing an employer to select a non-listed MySuper product as their default fund:

- The members and employers can benefit from the flexibility of the complete range of approved products in the market (in terms of price, product features, innovation); and
- Employers benefit from efficiency and service quality.

In light of MySuper legislation presently before the Parliament, there are two further practical reasons why the Commission's draft recommendations on facilitating employer choice are critical and must be retained:

- Many employers with less than 500 employees do not negotiate enterprise agreements with their employees, and as such cannot exercise 'collective choice', but in order to achieve competition amongst MySuper products these employers should not be prevented from being able to select a MySuper product that is not listed in an award; and
- An enterprise agreement may not prescribe a large employer MySuper product as the chosen super product for the employees the agreement covers.

It is very common for large employers to have multiple enterprise agreements covering subsets of their organisations, such as particular sites or operational units. The *Fair Work Act 2009* (FW Act) provides for single enterprise agreements to have a wide range of coverage provisions:

> An enterprise agreement *covers* an employee or employer if the agreement is expressed to cover (however described) the employee or the employer. – S53(1) of the FW Act.

In particular, if there is a dispute as to the appropriate coverage of a proposed agreement, Fair Work Australia must take into account "whether the group of employees who will be covered was fairly chosen, take into account whether the group is geographically, operationally or organisationally distinct." – s238(4A) of the FW Act.

As such, when selecting whether or not to prescribe a superannuation fund in an enterprise agreement, some large employers will have a number of enterprise agreements, each of which could cover less than 500 employees. It is not clear whether a single enterprise agreement that covers less than 500 employees could nominate a large employer MySuper product as the prescribed fund. It is even less clear whether this would be possible where other enterprise agreements are being

negotiated at the same employer and it is not certain how many employees of the employer will be members of that fund.

Furthermore, not all employers with over 500 employees have an enterprise agreement, or at least an enterprise agreement that has a clause that nominates which fund superannuation entitlements are to be paid into. It would be contrary to the desire to promote competition between MySuper products, both generic and large employer products, to prevent a large employer from choosing any MySuper product.

It may be the case that where a 'large employer' negotiates only one enterprise agreement to cover their entire workforce, that enterprise agreement could stipulate which superannuation fund is to receive contributions for those employers covered by the agreement. Doing so is an exercise of 'collective choice' and allows the unions and employers negotiating the agreement to choose between any of the MySuper products on offer, including a large employer MySuper product that may have been negotiated between an employer and a super fund. In this circumstance the employer choice provisions would be superfluous.

Without an open market as envisaged under the draft recommendations, the benefits of contestability will not be enjoyed by members and employers.

As noted in our initial submission, Australia has benefitted from almost 30 years of pro-market competition reform where industries have been deregulated and the above benefits have flowed to consumers. Despite the superannuation industry being characterised by a market distortion (compulsion to pay superannuation), we see no evidence suggesting this market is different from others. In other words, increased levels of disengagement do not remove the need for a market structure with competitive tensions as a large number of users are sensitive to cost and service quality.

For example, it has been shown that a large number of members are engaged with their superannuation – up to 30% of Australians select a non-default fund.[16] Factors giving rise to exercising choice of fund at the employee level are likely to include product features and cost. From an employer's perspective, a default superannuation fund is a service provider. If the service quality is poor, the employer ought to be permitted to consider another provider. Examples of employer

[16] Payment Adviser – choice of fund statistics – February 2011

experiences of poor administration quality of default superannuation funds were noted in COSBOA's initial submission.

Selection of non-award listed MySuper products

According to the draft report, "the Commission is seeking feedback on which body, under each of the options presented below, would monitor compliance with the requirement that employers choosing a fund not listed in the relevant award justify their choice if called upon, and how they would do so."[17]

The FSC believes that while appealing in theory, including a "no worse off" clause for employees where an employer selects another MySuper product delivers the following negative consequences:

- Subjectivity and a wide range of factors to judge the test upon;
- Employer fear of liability and increased cost;
- The threat of increased industrial unrest arising from an employer's choice of default fund where conflicted parties are present;
- Undermining of the Parliament's intent for default superannuation funds and second-guessing of APRA's licence conditions for MySuper;
- Creation of a new regulatory structure with associated cost and bureaucracy; and
- Ultimately the restriction of employer choice would fail to address the systemic incontestability issues identified by the Commission.

Instead the FSC recommends the only test an employer must meet is whether the chosen product is a compliant MySuper fund. In other words, were option 1 to remain unattractive to the Commission, options 3-4 would be significantly enhanced with a simple employer choice facility (an employer could select any complying MySuper product without applying a test).

Further, this would restore the flexibility that existed in many pre-Modern Awards where an employer was free to select any complying superannuation fund as a default fund (such as the NSW Clerks Award). By restoring this level of flexibility, it must be noted that the advent of the MySuper regime delivers a far tighter consumer protection regime than existed under the "complying superannuation fund" pre-Modern Award approach.

[17] Draft report P20

Restricting employer choice to circumstances where a legal test is satisfied creates a third element which is additional to Parliament's intention for designing a default superannuation product and APRA's endorsement of a providers' capacity to offer a MySuper product. In light of this new default fund structure, the FSC does not support this proposal.

RECOMMENDATION
Employers must be permitted to select any complying MySuper product without the need to meet any additional test or hurdles

The following comments relate to the facilitation of employer choice in the circumstance that the Commission maintains its preference for options 3-4 with an employer test.

No "worse off" test

According to the Commission:

> While there was substantial evidence that many employers value having default funds listed in awards to reduce the burden on them of needing to choose a fund, it is the Commission's view that having a number of funds listed in awards should not impede the flexibility of employers to choose any fund not listed as long as:
> - That fund is approved, under the Stronger Super legislation, to receive default contributions (that is, is a fund offering a MySuper product, or an EPSSS or a defined benefit fund)
> - In doing so, their employees are no worse off than if a listed fund had been chosen.[18]

We strongly support the Commission's assertion that employers should not be impeded in selecting an alternative default fund. However we do not believe the proposed test is practical.

However, in proposing rudimentary design features of this mechanism, the Commission has suggested that:

> …employers should have to justify their choice to the relevant body, if called upon, against the factors for consideration identified by the Commission and demonstrate that their employees are at least no worse off than if a listed fund had been chosen. Like tax, this would be a self-assessment regime, but no 'return' or notice would be required in the first instance. However, evidence of reasons for the choice would have to be produced on request.[19]

[18] Draft report P154
[19] Draft report P158

The framework envisaged by the Commission is silent with respect to:

1. Which "relevant body" would be involved in this process: and
2. How this process would operate.

The framework must facilitate employers making a choice of default fund in the interests of their employees where they are not overburdened by fears of process or liability. Accordingly, given the pre-existing concerns employers have about liability and superannuation;[20] it must be made clear that an employer who selects a MySuper product which is not listed in the award cannot be liable for that selection. Given that a superannuation entity must obtain a MySuper designation from APRA, the employer must have legal certainty that their choice of an approved trustee would not attract liability. This is because the employer has acted consistently with its legal obligations.

This legal protection must be afforded to employers regardless of any process which ensues. The process we are proposing is a variation on the Commission's draft findings that employers would have to show cause to a pre-existing body.

This is a critical design feature of this option. A failure to address this issue will mean that the matters raised by the Commission such as contestability and transparency will not be reformed as employers will not feel comfortable in selecting a MySuper fund. In other words, it is critical that employers who select an APRA approved MySuper are given a safe harbour.

RECOMMENDATIONS

Regardless of whether a test applies, employers selecting a MySuper product cannot be subject to legal liability for their choice of a MySuper compliant fund

Should a test apply, the sole action that can be taken against an employer who contravenes the test is limited to the selection of a different MySuper product. It would be grossly unfair for an employer to face the threat of personal liability having selected an alternative highly regulated and government sanctioned MySuper product

[20] Westfield/ Wright research 2012 - tabled in our initial submission

Framework for making a selection

The following is our preference of how this proposal would operate where an employer selects a non-listed MySuper product:

1. Employer determines the relevant award-listed fund is unsuitable and conducts a search for a MySuper product (which may include a competitive tender process);
2. Employer selects another MySuper product; and
3. Employer begins paying default superannuation contributions to the non-award listed MySuper product.

These three steps would be the conclusion of the process of changing a workplace default fund. The Commission has sought feedback on the following element: "**employers should have to justify their choice to the relevant body, if called upon**, against the factors for consideration identified by the Commission and demonstrate that their employees are at least no worse off than if a listed fund had been chosen."

Employer is "called upon"

The FSC does not believe this further test is necessary. However, if the Commission believes there needs to be a process where employer choices can be tested "if called upon", we suggest the following process could be employed:

1. A complaint is brought to the Superannuation Complaints Tribunal (SCT)[21];
2. The SCT may seek justification of default fund selection from the employer on the factors identified by the Commission;
3. The employer provides evidence of reasons to the SCT; and
4. SCT determines whether the test is met.

[21] A compliant should only be brought under certain circumstances – see below

"Relevant body"

In assessing the public sector organisations which could become the "relevant body" in an additional process, consideration was given to compliance, efficiency and cost, simplicity, transparency and access.

There is no perfect body in operation today to fulfil this function. This in itself raises issues of regulatory costs and additional bureaucracy. We also considered relevant bodies in the context of our view that there is no longer any place for default funds to be listed in awards. Accordingly we do not believe that Fair Work Australia or a panel advising it would be appropriate.

Despite our view that this approach is undesirable, we believe the SCT is the best placed regulatory organisation as:

- It has expertise in hearing complaints from consumers / members of superannuation funds;
- It is a free service to consumers;
- Pre-existing infrastructure;
- Authority / capacity; and
- Credibility / transparency.

RECOMMENDATION
There is no existing body that is currently capable of performing a function which assesses or tests employer MySuper selections

The closest existing body with comparable capacity (though not identical) is the SCT which may be the most appropriate "relevant body". This would require significant changes to the SCT's mandate / remit – given any such test would need to be asserted at a "whole of fund" level rather than at an individual / employee level

As the Commission has proposed a reverse onus approach, this body would have a role limited to circumstances where a complaint is brought which is why the SCT provides a natural fit.

However the SCT does not presently provide standing to employers. This would need to be rectified so that employers could appear if a complaint is brought. Upon hearing a complaint, and finding that

the test had not been met, the SCT would issue a direction to change the workplace MySuper product to another MySuper. This would be the extent of the SCT's jurisdiction in this area.[22]

There are other concepts in the superannuation system, which serve to protect members' interests. Although not relevant to employers, the successor fund transfer provisions in the SIS regulations are well-understood in the superannuation industry where members' interests in a fund are transferred. In essence, a member can only have their balance transferred where they receive "equivalent rights" as agreed between the trustees of both funds.[23]

RECOMMENDATION
Should a test apply, it should be based on "equivalent rights" rather than a "no worse off" basis

Other bodies

The ATO maintains a relationship with employers including enforcing the superannuation guarantee charge and is a repository for information for employers in meeting their superannuation obligations. However the ATO does not have a function where it hears complaints and therefore does not have expertise in the field.

APRA has prudential overview of financial corporations and does not deal with employers in its function. As a prudential regulatory focused on risk and governance of financial entities, we do not believe it would be appropriate or desirable for APRA to perform this role. However APRA could provide MySuper information to the SCT on request as it authorises the entity offering the product and collects data on the MySuper product.

Who can bring a complaint?

In its draft report, the Commission has recommended that this market should be opened to competition.

[22] It would be necessary for the jurisdictional and statutory issues to be considered further in this context and legislative amendments are likely to be required.
[23] APRA superannuation circular - http://www.apra.gov.au/Super/Documents/I-C-4-Equivalent-Rights-for-Members-in-Successor-Fund-Transfers.pdf

However we have significant concerns with this approach – predominantly as a result of the heavily conflicted nature of the industrial parties involved in the selection of default funds. Presently, almost all superannuation funds listed in awards are industry funds at approximately 70%, the vast bulk of which operate under the equal representation model where unions and employer groups control the boards of these superannuation funds.

Where a union in a workplace is aggrieved by an employer's choice of a non-award listed MySuper product, they may seek to bring a complaint for reasons other than the test or simply seek to use the test as a vehicle to pressure employers into not freely selecting a MySuper product of their choice.

Although the SCT could determine a view based on its experience and the factors identified by the Commission, there is a risk that frivolous complaints may be made by conflicted parties which would benefit from the status quo.

The FSC shares the Commission's concern of systemic bias raised in the draft report:

> This inequality arises regardless of a fund's ownership — though many retail funds are not on an equal footing with the (mainly industry) incumbent funds in the default market. Non-incumbent industry funds and potential market entrants (including foreign firms) are similarly disadvantaged.
>
> In addition, as is apparent from the discussion of transparency in section 7.4, there is no requirement for industrial parties to disclose the basis upon which they select and nominate superannuation funds for listing as default funds in modern awards. This leaves open the possibility that this aspect of the selection process may involve bias.

Accordingly, for the SCT to be permitted to hear a complaint about an employer's choice of MySuper product, a materiality provision of 10% of fund members (in a workplace) should be required. Further, conflicted parties should not be allowed to bring complaints. The FSC is concerned that allowing such access may create industrial disputes on the choice of an employer's superannuation fund.

RECOMMENDATIONS

A complaint should only be heard in the circumstance that 10% of fund members are complainants. This ensures that the process will not be abused and actions will only be brought where a significant proportion of members feel aggrieved

Conflicted parties may not bring complaints

Criteria

We agree with the Commission that it would not be necessary to overlay further regulatory criteria on default eligibility other than a MySuper designation:

> Draft finding 7.1
>
> There is no case for the selection and ongoing assessment of superannuation funds for listing as default funds in modern awards to involve any prescriptive criteria over and above those used by the Australian Prudential Regulation Authority in authorising MySuper products.

This position not only reflects that MySuper contains a high level legislative safeguards but also that award-covered employees deserve the same level of protection.

Advisory panel / FWA

According to the draft report:

> *Option 3 represents a more significant change to the current industrial process, with decisions being made by an expert panel within FWA, and the selection process being opened up to allow all funds to present their case for inclusion in awards to FWA.*
>
> *Option 4 is similar to Option 3, but decisions would be made by an expert body independent of FWA, with FWA playing a minimal role in administering the decision.*
>
> *The Commission is seeking feedback from participants on the relative merits of Options 3 and 4.*

The FSC does not support the ongoing listing of default funds in Modern Awards. We believe that employers should be permitted to select any MySuper product as a workplace default fund.

Accordingly we do not believe that an advisory panel which sits externally or is part of FWA is optimal. An independent advisory panel may, however, increase transparency, due process and fairness as compared with the status quo.

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.

Further, we support the view of other submitters such as the Law Council of Australia that the use of criteria to select a MySuper product is a philosophical shift for the government by introducing an assessment of the commerciality of the MySuper funds available.

As noted above, we believe such an assessment could deliver risks to the Commonwealth Government in circumstances where a fund on a Government endorsed list of MySuper products suffers an operational failure resulting in loss to members.

OTHER MATTERS

Grandfathering

In the event that default funds remain listed in Modern Awards, it would not be appropriate to remove grandfathering provisions. In 2009, Fair Work Australia instituted a flexibility arrangement that employers contributing to existing superannuation funds could continue making contributions despite such funds not being a named fund in a Modern Award. The clause stated that an employer could satisfy their legal obligations by contributing to:

> any superannuation fund to which the employer was making superannuation contributions for the benefit of its employees before 12 September 2008, provided the superannuation fund is an eligible choice fund.

These provisions were designed to provide employers with necessary flexibility as the Award Modernisation process was to impose mandatory default superannuation funds arrangements. Many employers use a default fund because of the grandfathering provisions in Modern Awards.

Any removal of grandfathering would create a further barrier to fund mergers and rationalisation of the industry. For instance, if a fund on an award list were to merge with a fund that was not on the list, the current grandfathering provisions would generally enable employers to continue contributing to the merged fund. However, if grandfathering were removed, this would not be possible unless the relevant modern awards were all amended (presumably following a sitting of the panel charged with choosing the modern award list of funds) to include the merged fund.

Regardless, grandfathering would not be necessary where an employer may choose any complying MySuper product without a test. This is yet another reason to allow employers to select any MySuper as a default fund.

RECOMMENDATION
If employer choice of any MySuper product is permitted without an additional test, there is no need for grandfathering. If not, grandfathering provisions which permit an employer to continue using a pre Modern Award default fund will be required

No choice of fund for certain employees

As stated in the FSC's primary submission, there is a cohort of employees for which no choice of fund (which permits an Australian to select their own superannuation fund) is permitted. This is inconsistent with the policy intention that consumers in a compulsory savings system can access choice of superannuation fund.

The relevant provision is subsection 32C(6) of the *Superannuation Guarantee (Administration) Act 1992* (Cth) which says that an employer complies with the choice of fund rules if it makes contributions in accordance with certain types of industrial instruments.

In post-Fair Work Act parlance, this means an enterprise agreement with an embedded superannuation fund can remove an employee's ability to select their own superannuation fund.

RECOMMENDATION Extend choice of fund to all defined contribution members, except where this results in an employer paying contributions twice.

<u>FSC Superannuation Governance Policy</u>

The draft report canvasses the Commission's concerns that the FSC's Superannuation Governance Policy on remuneration would be ineffective:

> The Commission also questions the effectiveness of these disclosure arrangements, particularly given payments from parent companies are more likely to raise concerns about conflicts of interest. That said, if the Government proceeds with regulations requiring remuneration details to be disclosed, the FSC (and AIST) guidelines are likely to be 'overridden' in any case.[24]

It is certain that any industry self-regulation where inconsistent with the law becomes redundant. However this policy which is presently under development into binding FSC member standards delivers restructuring of retail and corporate superannuation funds to ensure that super boards have:

- An independent chairperson;
- A majority of independent directors; and
- A prohibition on conflicted directorships.

[24] P84

It will also contain ESG and proxy voting records disclosures.

We believe that in keeping with contemporary governance standards and with the significance of the superannuation industry to Australians and the economy, independence is critical.

An independent Chair is required of entities in all other prudentially regulated sectors.[25] It is also considered best practice under the ASX Corporate Governance Council Principles and Recommendations, which apply to listed entities. Further, a majority of independent directors is required of entities in all other prudentially regulated sectors.[26] This is also consistent with Principle 2.1 of the ASX Corporate Governance Principles, which requires that a majority of the board be independent directors.

In terms of board composition, the Commission states:

> The Commission agrees that the equal representation model has generally operated well to date. However, as increasing numbers of industry funds actively broaden their membership beyond their traditional base through becoming 'public offer' funds, the arguments for equal representation become less compelling. Once a fund takes members from outside the industry in which it originated, for these 'outside' members, the board is likely to be 'non-representative'.

We believe that moving to a model which enshrines independence in the board addresses the issue identified by the Commission. The FSC believes this is the most appropriate governance structure for the superannuation industry as the trustees safeguarding Australia's retirement savings.

[25] See for example Prudential Standard CPS 510. This Prudential Standard sets out minimum foundations for good governance of a regulated institution in the deposit-taking, general insurance and life insurance industries. It requires that 'the chairperson of the Board of directors must be an independent director'.
[26] Refer to footnote 1.