Default Superannuation Funds in Modern Awards

Productivity Commission Draft Report

Cbus Submission

3 August 2012

1. Introduction

Cbus welcomes the opportunity to comment on the Productivity Commission's Draft Report in its inquiry into 'Default Superannuation Funds in Modern Awards'. Cbus has previously provided information to the Inquiry in our submission dated 4 April 2012.

This submission addresses:

- The factors to be considered by Fair Work Australia ('FWA') in nominating the default funds in a Modern Award;
- The appropriate composition of FWA, and sources of advice to FWA, in making its decision; and
- Issues associated with the proposal that employers be empowered to unilaterally select an alternative default.

Before turning to those issues, Cbus lends its support to a number of the Productivity Commission's (the Commission) draft findings.

Cbus supports the draft finding that FWA should apply additional qualitative factors in choosing the appropriate default funds for a Modern Award, rather than allow any MySuper fund to be listed. Cbus also welcomes the Commission's view that FWA should nominate between five and ten funds from which an employer whose employees are covered by the award may choose. As the Commission acknowledges, this provides sufficient competition, without imposing additional burdens on employers.

2. The factors to be considered

The Draft Report identifies non-exhaustive and non-prescriptive following factors which FWA should consider when selecting the default funds for inclusion in Modern Awards. In summary these are:

- The appropriateness of the MySuper product's investment return objective and risk profile;
- The fund's expected ability to deliver on the MySuper product's investment objectives;
- The appropriateness of the fees charged by the MySuper product, given its stated investment return objective and risk profile;
- Whether governance structures are, as far as legislative requirements allow, consistent with meeting the best interests of members;
- The mechanisms put in place by fund trustees to deal with conflicts of interest, and the transparency in disclosing those conflicts;
- The likelihood of members being switched to higher cost divisions of the fund, or facing significantly higher fees for features of their policies (such as insurance), upon exiting their current employment;
- The compatibility of the fund's insurance offerings with the characteristics of employees to whom the superannuation provisions in that Modern Award apply;
- The quality of member- and fund-specific intra-fund advice; and
- The administrative efficiency of the fund.

Subject to the comments below, Cbus supports the factors identified in the Draft Report.

By and large the factors identified in the Draft Report are the factors that should be considered by a tribunal in selecting the group of superannuation funds into which an employer may direct the superannuation savings of those employees who do not themselves choose a fund

These factors allow FWA to consider matters related to the governance of a Trustee, they are more appropriately focused on the quality, suitability and costs of the default investment, insurance and ancillary services provided by Trustee.

(a) Flipping

Cbus is particularly pleased that the Commission has addressed the issue of flipping.

In our earlier submission Cbus was particularly critical of the practice of flipping by some superannuation funds.

We welcome the draft finding that FWA should address the likelihood of flipping, and that this would count against a fund being chosen as a default fund.

Cbus accepts that there may be instances where the withdrawal of a fee-discount that is based upon an employee's ongoing membership of a particular employment class is valid.

However Cbus strongly believes that FWA needs to be empowered to vigilantly guard against the possibility of price gouging, and we welcome the Commission's draft findings in this regard.

(b) Investment performance

Cbus is disappointed that the Draft Report rejects past investment performance a factor when selecting default funds.

We note that the Draft Report suggests that past performance may be validly considered when evaluating a fund's expected ability of meeting its investment objective.

In our view this does not give sufficient weight to past investment performance, and we continue to urge that it be listed as a stand-alone as a factor.

In drawing its conclusions on this issue, the Commission relies upon the research showing that past performance is not a good indicator of future performance. The Commission appears to have accepted that the weight of evidence favours this conclusion.

However, the Commission does acknowledge the existence of contrary evidence.

This evidence has been bolstered by a recent review by Deloitte Access Economics for ISN, 'Persistence in Superannuation Fund Returns'[1].

Deloitte finds a significant relationship between the past investment performance of a fund and expected future returns.

This work suggests that the Commission should review its reliance on previous research, and provides a basis for the further consideration of past performance as a stand-alone factor in the form of ten year rolling average or the like.

(c) Governance

The Draft Report identifies the structure of board representation as a factor which should be considered when selecting default funds for inclusion in Modern Awards.

The test proposed is *'whether governance structures are, as far as legislative requirements allow, in the best interests of the members'*.

On its face it is hard to disapprove of this criteria.

1 http://www.industrysupernetwork.com/wp-content/uploads/2012/07/DAE-Persistence-in-super-fund-returns.pdf

However, Cbus is concerned that the rationale supporting the inclusion of this factor is focussed exclusively on the role and prevalence of "independent" directors, and that the supporting commentary suffers from a lack of definitional clarity.

"Independent directors" are supported by interest groups who variously consider "independent" as independent of management, independent of sponsoring organisations, and subject matter experts. This creates an appearance of many voices in support of a concept, whereas in fact there is little consensus, and the draft paper does not unpack the context within which various calls for greater "independence" have been made.

Cbus submits that in applying this factor, FWA should not focus on the composition of the Trustee Board. Nor should it artificially rate a fund as superior simply because it has a certain proportion of its Board independent of its sponsoring organisations.

Rather than focus Board composition, and the so-called independence of Directors, Cbus submits that the focus should be upon whether the governance structures, (including but not limited to Board composition) reflect an orientation towards a member-only focus.

3. Performance of the current default fund selection system

(a) Contestability and the role of funds in the selection of default funds

The Draft Report recommends that:

> *All funds that are authorised to offer a MySuper product (and exempt public sector superannuation schemes) should be able to apply to be listed in an award and have the application considered on its merits.*

This is suggested in order to ensure contestability between funds for selection as a default fund.

It is also suggested that extending standing all MySuper funds would address perceptions of conflict associated with the fact that some industrial representatives are also providers of default superannuation services.

Cbus supports the Draft Report's call for a process to select default funds that is transparent, contestable and procedurally fair. The system should also be efficient and should not promote instability or uncertainty.

However, Cbus takes issue with the findings in the Draft Report that underpin the conclusion that that current system displays insufficient procedural fairness, and insufficient contestability.

It is worth remembering that the primary place for contestability is the market, not the setting of the safety net. The Australian Industrial relations Commission ('AIRC') noted as much when it said

[69]"…the award provision does not limit an employee's right to nominate a fund. Nor does it limit the ability of superannuation funds which are not default funds to market their products to employees and employers".2

The Draft Report calls for all funds to have 'the equal right to put the case' for inclusion in an Award. The call for all funds to be able to present their views "on an equal footing" requires some examination.

Standing is rarely at large, in any Court. The failure to accord all comers a right to be heard is not properly characterised as a failure to accord natural justice. It is a mechanism to ensure that the industrial focus remains on primary function of the tribunal.

Sections 157-158 of the Fair Work Act 2009, which limit the class of people who may apply to vary an award, do not provide superior rights to some superannuation funds.

No superannuation fund currently has a right to be heard. In order to have their voice heard by FWA, a superannuation fund needs the support of an employer or employee covered by the relevant Modern Award, or a relevant registered organisation.

This is a low threshold. Certainly a much wider group is now able to apply to vary an award than the more limited notion of "parties" that existed prior to the Fair Work Act 2009.

Whether this is appropriate depends upon the purpose of the decision.

If the purpose of the hearing is to allocate segments of the financial services market between competing financial services providers, that is one thing.

But the purpose of default funds in awards is to ensure that, in the absence of individual choice, and in the absence of a collectively agreed fund, an employer directs the employee's retirement savings to an appropriate fund.

The distinction was illustrated in oral evidence to the Commission by the ACTU[3] when considering whether an entertainment company should be granted standing to vary an award to increase the number of public holidays. Other examples are not difficult to conceive. Suppliers of safety equipment would not be able to make application to prescribe the use of equipment in an Award be allowed, and so forth.

The Commission needs to also guard against adverse consequences of opening standing to MySuper funds.

To confer standing on every MySuper fund is to invite endless applications for Award variations, with each new product, new insurance offer, each report by a ratings agency,

2 [2009] AIRCFB 800 Award Modernisation Decision, September 2009

3 Melbourne 30 July 2012, ACTU Assistant Secretary Tim Lyons

each publication of annual or quarterly or monthly returns. It would invite funds to use the tribunal rather than the market place to compete for business. FWA would be loath to refrain from hearing fresh applications (particularly where new information was available).

(b) Procedural Fairness

The Draft Report is critical of the current system for nominating a default fund in a Modern Award. The Commission notes that, in making of Modern Awards the AIRC did not explicitly consider financial outcomes for members. Funds were effectively rolled over from previous awards.

While the Commission acknowledges that the standards applied by the AIRC were consistent with the Fair Work Act 2009, it clearly disapproves of the failure of the AIRC to consider the merits of the funds or identify criteria that overtly placed the members best interest at the heart of decision making is noted.

In Cbus' submission, too much has been made of the procedural approach adopted by the AIRC in modernising awards, and not sufficient attention has been had to the procedural fairness afforded to applicants to FWA in routine award variation matters, or to the approach likely to be adopted in the scheduled four yearly reviews of Modern Awards.

The principle task of the AIRC in making Modern Awards was to rationalise the number of awards, and ensure that the provisions in each award conformed to the new legislation. It was a massive undertaking to reduce 1500 awards into 122 Modern Awards. Most commentators doubted that the task could be completed within the 18 months allowed by government.

In March 2008 AIRC Vice – President Lawler addressed an industrial conference in Sydney, his speech was reported in the following terms -

> "'Award simplification took five years, and this is a more complex process,' he said. We are not going to be able to be conducted in the normal fashion. There will have to be some ruthlessness by the AIRC.'
>
> Lawler said the timeframe will be 'exceptionally difficult' to meet. The traditional process of a report back to employer organisations and unions for further input will 'go by the way', he said.
>
> Lawler said he had looked at the industry areas he covers and 'it does one's head in'.
>
> 'It is complicated, difficult and boring,' he said. 'The timetable means we will have to be ruthless.'
>
> 'It will be a web page consultation process at first. Every submission will go up on the web page in such a way as people will be easily able to look up what they want.'

He said the process does not lend itself to conventional hearings by the AIRC. There will be some hearings, but he was not sure how that will work".

That said, any person wishing to make a submission was able to do so, all submitters were given an opportunity to submit a submission in reply, draft awards were published for further submission and comment. Submitters were free to provide the AIRC with research to support their submissions. Many superannuation funds took advantage of this, and Draft awards were varied in response to those submissions.

To the extent that there were any shortcomings in the AIRC processes in establishing Modern Awards, they were aberrant, and not indicative of FWA's current or future processes.

Indeed, as the Draft Report notes, there have been a number of successful applications to vary Modern Awards dealt with using FWA's normal "adversarial" processes, which include open hearings, the ability to call and cross examine witnesses and so forth.

These applications have succeeded on a range of grounds. While is its true that the grounds have been reasonably narrow, Cbus submits that as time elapses, fewer applications to vary Awards will be "tidying up" from the Modernisation process, and there will be more scope for applications based on new circumstances.

(c) What is the desirable mix of industrial and finance knowledge in the selection of default fund?

The Draft Report canvasses four potential options to improve the selection of default funds in Modern Awards. These are (1) employers be empowered to choose from amongst all MySuper products, (2) that industrial parties nominate funds from amongst the full range of MySuper products, (3) that an expert panel within FWA select from amongst all MySuper products, and (4) that an expert panel outside of FWA select from amongst MySuper products.

Cbus notes that, (despite its recommendation to extend standing to all MySuper funds), the Draft Report does not present an option whereby FWA continue to select default funds, with all funds able to apply for inclusion in an award.

That said, Option 2 is the best option of those identified in the Draft Report.

This is because it is preferable that FWA be informed by experts rather than comprised of experts.

Expert evidence should be put before the Tribunal by applicants and interveners. Interveners can include consumer advocacy agencies, government bodies, regulators and so forth.

Most Court processes require experts to provide evidence which is tested through cross examination in an open Court. It is open for other parties to call expert evidence in rebuttal. This approach has broad community understanding and meets principles of transparency and contestability.

It is recognised that this approach has been the subject of criticism over many years but reform has focussed on how to get the best evidence before the tribunal. This is consistent with the approach and focus of the Australian Law Reform Commission 4

Appointing panels of experts to a FWA tribunal or to a newly constituted tribunal will not remove allegations of bias but merely relocate the focus of the bias allegation to other elements of the process. It is also possible that expert deliberations would be less transparent, and afford lower standards of procedural fairness than FWAs current open processes.

FWA members are appointed with tenure to ensure their independence.

They are appointed and supported to be good decision-makers, and have a statutory obligation to make decisions in equity, good conscience, and the substantial merits of the case.

There is no evidence that FWA members would struggle to evaluate comparative data regarding the structure and performance of a MySuper fund. Indeed FWA members regularly assess complex evidence in making decisions - economic evidence, company finances, demographic data, engineering and scientific information, and so forth.

3. Employer discretion to Opt Out

Cbus objects to the draft finding that

> *Employers selecting default funds for employees to whom the superannuation provisions in modern awards apply should be able to choose a fund not listed in the relevant award. However, in this circumstance, employers should be required to justify their choice, if called upon, by demonstrating that:*
>
> *• the factors for consideration identified by the Commission were taken into account when making the decision*
>
> *• their employees are at least no worse*

4 Australian Law Reform Commission, 'Experts: Adversarial Background Paper 6' (1999), Chapter 13 at http://www.alrc.gov.au/sites/default/files/pdfs/publications/DP62.pdf

Cbus supports efforts to improve the selection of default funds in modern awards however mechanisms to delegate decision making to individual employers is opposed.

The concerns identified by the Commission about FWA as decision maker are likely to exist and be even more pronounced by the delegation of decision making to self-selecting employers. Most obviously, the delegation would lack transparency and risk the perception of conflict.

The Commission has noted that the judgement involved in applying and balancing the identified, criteria, non-exhaustive primary factors and factors is complex. The Commission found that at best, the current capacity of FWA needs to be supplemented (option 3) so that it can properly meet this obligation.

In order for an employer to choose a fund that is not listed in a modern award it is proposed that an employer would undertake this process with the same rigour as FWA and then apply a no disadvantage test.

Whilst there maybe employers who believe that they can 'have a go,' Cbus is sceptical that many would be able to achieve the required standard.

In the earlier submission to the Commission, Cbus noted that 4% of businesses were aware of the existence of inducements or benefits offered by default fund to reward or incentivise the choice of default fund.[5] Cbus submit that reducing the level of qualification, scrutiny and accountability of decision makers will not enhance community confidence in the selection process.

Employer organisations associated with Cbus have advised that there is little if any membership demand to select funds beyond what is offered in an Award. The mechanism for employers or employees to create 'tailor made' arrangements can be found in the bargaining stream. Consistent with the objects of Fair Work Act 2009, bargaining should be encouraged as the appropriate mechanism by which an employer and a group of employees covered by an award can elect to opt out of the award provisions.

5 The ATO commissioned Report 'Investigation Superannuation: Quantitative Investigation with Employers Colmar Brunton, 20 January 2010 See Figure 47 on page 56