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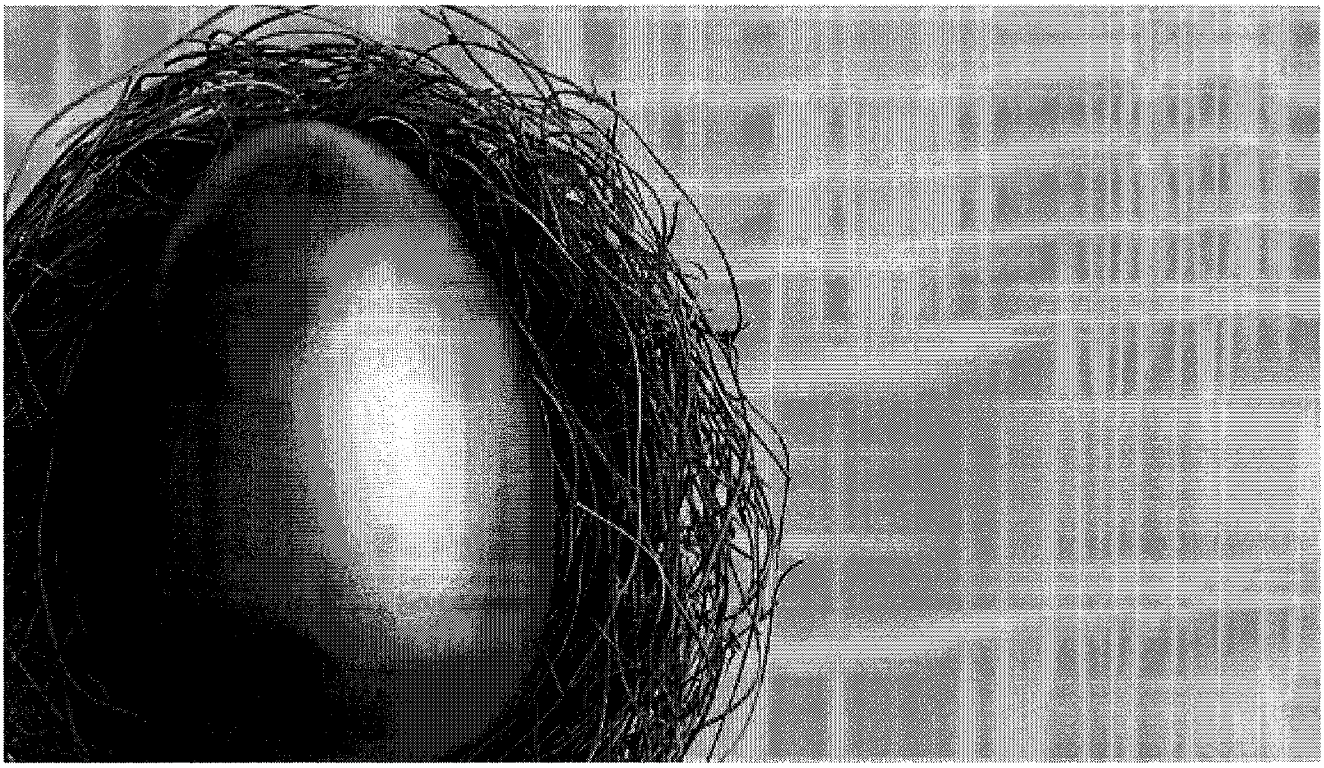

SUBMISSION TO THE PRODUCTIVITY COMMISSION: RESPONSE TO THE DRAFT REPORT INTO THE NAMING OF DEFAULT SUPERANNUATION FUNDS IN MODERN AWARDS

NAB WEALTH (MLC)

AUGUST 2012

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About Nab Wealth (MLC)

MLC is the wealth management division of the National Australia Bank. MLC provides investment, superannuation, insurance and private wealth solutions to individual, corporate and institutional customers.

MLC is one of the largest providers of financial services, including superannuation, in the market and manages $123.5 billion on behalf of individual investors and corporate customers in Australia (as at March 2012).

Clients of the superannuation funds which we administer (employers and employees) will be affected by the changes emanating from MySuper including decisions about selecting and naming funds (or MySuper products) as 'defaults' in modern awards.

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Preliminary comments

MLC appreciates the opportunity to provide comments to the Productivity Commission in response to the issue of the Commission's draft report on Default Superannuation Funds in Modern Awards.

MLC welcomes the Commission's view that the system needs to be 'open, contestable and transparent' and we strongly support robust standards for fund governance and, procedural fairness for all affected parties – features which are lacking currently.

We understand the Commission's stance regarding draft reform proposals for fund selection as follows:

- Option 1: allowing employers to choose any MySuper product is rejected as not protecting the best interests of members.
- Option 2: broadly retaining the current process fails to meet the key aim of opening up the award system to competition and contestability.
- Options 3 and 4: requiring an expert panel in the FWA, or an independent body, to select 5-10 funds using additional criteria (factors) in addition to the MySuper statutory criteria is preferred as being in the best interests of members and on the basis that it helps employers choose a default.

We acknowledge the Commission's role is limited to dealing with the selection of funds in modern awards. The selection of funds, or MySuper default products, should have regard to the new laws related to Stronger Super as well as the Future of Financial Advice. Both of these significant reforms subject the superannuation sector to a prescriptive legislative structure backed by an expansive prudential framework with ongoing regulatory oversight. Consequently, our feedback is provided in the context of these reforms.

We have limited our submission to addressing key issues emanating from the draft report. However, we would be pleased to discuss other aspects of the report if desired.

Options 3 and 4 – assessment and selection by panel

The Commission has asked for comment on Options 3 and 4. MLC is unable to provide support for these options for a range of reasons including, but not limited to, the additional cost and complexity, the unnecessary burden it places on all parties including the employer, the limitation on funds which will continue to hamper competition including diminished capacity for new entrants, potential regulatory arbitrage and the risk of regulatory / procedural disparity due to diverging paths/views between the relevant expert panel and established regulators (in particular APRA).

MLC Recommendation

Our primary position, as outlined in our earlier submission, remains:

- the MySuper regime is a framework that provides significant protection in the prudential management of retirement benefits for Australian workers;
- employers should be able to select any MySuper option and be afforded protection from claims given the extensive regulatory requirements imposed upon trustees (fiduciaries), ongoing reporting to, and regulatory oversight by, APRA;
- this position minimises costs for employees (and employers), promotes competition and transparency by fully utilising the MySuper framework (and avoids the cost of a parallel framework);

Our position accords with the currently discounted Option 1 in the Commission's draft report. It is concerning to us that, before it has even commenced, there are proposals to add yet further requirements via another mechanism to a statutory regime (MySuper) which has at its core, the protection of the best interests of individuals who do not choose their own superannuation product.

MLC prefers Option 1 as a more effective, efficient and competitively neutral option which, unless proven to be otherwise after a reasonable adjustment period, is sufficiently robust to meet the core intent of protecting those who are disengaged or prefer to rely on trustee-designed options.

In this regard it is our contention that the superannuation clause for all modern awards should be revised to cater for 'contributions to any APRA-listed MySuper product which an RSE licensee authorised to offer'. This should ensure that where a product becomes non-complying the provisions of the law take effect to require the employer to contribute to another complying MySuper product (while trustees of the now non-complying MySuper must work with APRA to transfer member entitlements).

Should modern awards list a limited number of funds/MySuper products, MLC further recommends that the current grandfathering be retained in modern awards, subject to the overriding provision of grandfathered funds being a MySuper product.

Options 3 and 4 issues

We believe the Commission's currently preferred options of 3 and 4 do add additional criteria beyond the MySuper provisions increasing complexity and costs to the sector. This would be without factoring in how resources to make the assessments and nominations to awards would be funded.

Given the additional levy imposed on the industry to support the regulators in implementing and managing Stronger Super[1], we question the affordability of developing and maintaining another structure.

It is unclear to us how a panel (at the FWA or other body) would have the capacity and expertise to undertake what appears to us to be significant analysis of each and every fund which applied to be named, provide cogent and public reasoning for exclusions (or inclusions), manage objections and do so in a timely manner.

We also question the capacity of a panel to undertake such a role in a dynamic and effective manner for a range of options in a way that truly delivers more optimal outcomes particularly as modern awards can cover very disparate workplaces and worker demographics. To the extent that the awards do reflect homogeneity of worker, it is unlikely a single award reflects the actual demographic structure of a [larger] workplace. In this case, employers are likely to bear the burden of potentially having to contribute to more than one MySuper product in different funds as named in relevant awards (see also comments in the section below 'Limitation on funds named in awards and tenure').

Presumably there would also be a consequent requirement for a panel / body to have an audit/review capacity and a concomitant obligation to institute processes to remove or replace a fund which failed to meet the criteria (or factors) upon which their appointment was granted.

Apart from adding further cost we are concerned that over time there would be divergence in practices and standards between the panel and prudential regulators leading to confusion and/or unnecessary overlap in regulatory compliance/oversight.

Our contention remains that the extensive changes being made by the Government through the Future of Financial Advice reforms and the imposition of a statutory product, MySuper, for employees who do not choose their own fund obviates the need for named funds in modern awards.

Limitation on funds named in awards and tenure

Embedment of only 5-10 funds in each modern award reduces competition and is likely to lead to a less robust and innovative sector.

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[1] $467.1 million over 7 years to be paid by APRA regulated funds, the cost of which will be borne ultimately by superannuation members.

It prevents, or is likely to prevent, new entrants to the sector leading to stagnation in provider aptitude and attitudes. Furthermore, it continues to create complexity for employers subject to multiple awards where there is no consistency across the awards. If this is to be addressed, it suggests that one or more of the same MySuper products must be listed across all of the awards. This will also limit competition.

Pursuing Options 3 and 4, which both limit the funds named in awards, and the period for which they are valid (broadly 8 years) is likely to lead to costly transfers of member data and monies around the system. This is in addition to the significant costs of regulatory reform already being borne by funds (and hence their members) which may or may not be named in the awards.

Most of the existing industry is in the process of developing compliant MySuper products. A separate process to assess and name MySuper products in modern awards and one that further requires employers to justify using an unnamed but complying MySuper arrangement implies the MySuper regime is deficient.

This, along with the potential to abandon any grandfathering provisions (see further below), is deeply concerning given the significant costs involved in its development and implementation and the flow on effects to members.[2] These costs will be paid for from member accounts.

No worse off test and possible alternative

As part of the current draft proposals and pursuant to the currently preferred options of 3 and 4, the Commission has recommended that any employer selecting a complying MySuper product which is not named in an award be capable of demonstrating that their employees are 'at least no worse off'.

This test is an extremely arduous requirement to impose upon employers (and trustees of complying MySuper products). From a legal perspective it places an employer in the predicament of having to predict and, arguably, guarantee that the MySuper product will always provide outcomes, and perform as well as, any (one or more) of the named funds. That is an impossible hurdle and one which will naturally drive employers to selecting only from limited funds named in awards.

We do not support the need for employers to undertake any form of comparison in order to select a fund outside an award (as MySuper is intended to be a safe option generally). However, should awards name specific funds and a comparison obligation eventuate there is a

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[2] Based on a range of sources, it is estimated that many providers have planned that MySuper will cost will over $25 million over a 5 year period and have already commenced significant development. In addition, the SuperStream measures (to enhance back office efficiencies through, for example, standard data and transfer protocols) is likely to cost the industry in the hundreds of millions.

possible alternative which provides some relief for employers, references the work and recommendations of the Super System Review panel (Cooper panel) and mitigates some legal risk which we believe is too high under a 'no worse off' approach.

The Cooper panel, when considering the issues and problems associated with 'successor fund transfers' and resulting impediments to mergers and management of legacy, proposed that the current 'equivalence test'[3] be changed to a test of 'no overall disadvantage'.

In the case that MySuper alone is not seen as a reasonable safety net for selection by an employer where employees do not choose their own option, a trustee could be required to determine that their MySuper product, not named in a particular award, provides benefits to a workplace where there is 'no overall disadvantage' to the employees in being enrolled in that MySuper product rather than in a MySuper specified in any given award. It should not be necessary to undertake comparison across multiple in an award or between awards. A single comparison based on the 'no overall disadvantage' is a reasonable approach rather than having to continuously assess against a fund in different awards depending upon which employers wish to utilise a non-specified MySuper product.

That is, an employer could switch contributions to a MySuper product not named in the relevant award if the trustee of the recipient product determines that, compared to any one MySuper product name in any award, the employees (members) would be at no overall disadvantage.

This limits the cost of comparison across and between a range of funds and awards, provides employers with some relief and leverages the skills and capacity of trustees due to experience with 'successor fund transfers'.

Removal of grandfathering (or failure to provide simple opt out from award)

Given the significant expenditure of funds working to implement complying MySuper products in the near term (currently less than a year away from 1 July 2013), the prospect of a very late structural restriction in capacity to participate and the potential ramifications of being forced to transfer existing 'default' members to award-specified funds poses significant risks in destabilisation as well as potential member losses.

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[3] Regulation 1.03(1) of the SIS Regulations defines a successor fund in relation to a transfer of benefits of a member from a fund (called "the original fund") as a fund which satisfies the following conditions:
(a) the fund confers on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits;
(b) before the transfer, the trustee of the fund has agreed with the trustee of the original fund that the fund will confer on the member equivalent rights to the rights that the member had under the original fund in respect of the benefits.

The inclusion of grandfathering in modern awards has provided certainty and clarity for employers and employees with regard to requirements for default funds in awards. MLC strongly submits the current grandfathering in modern awards continue (subject to grandfathered funds being MySuper products) to retain certainty and clarity (and trust) for employers and employees. It also avoids the significant adverse consequences (for members) that forced transition of superannuation arrangements (to specifically named funds in awards) will inflict. This includes but is not limited to the following.

- "Implementation" investment Risk - moving members from their current option on a single prescribed day or in a short time frame will expose members to transactions undertaken without regard to their investment merit (i.e. potentially selling low, buying high).

- Volume of transactions - if all transitions occur within a restricted period, it is likely the volume will impact members' retirement savings through higher fees and costs as well as adding to systemic risk.

- Some arrangements may now have post GFC illiquid/toxic assets and/or some already merged funds may have quarantined assets for particular members that cannot be merged otherwise it contaminates the investments of other members unfairly.

- Funds and products within funds have commonly had illiquid assets (with an appropriate calibration to expected entrants and exits). These can be classified either as assets that are illiquid due to the characteristics of the underlying investments (property or private equity for example) or assets that are illiquid due to legal impediment. In both cases the valuation of the asset can be problematic and if it is to be moved into a new a new fund structure it needs to be quarantined to ensure that it does not affect the investments of other clients or members. Some funds may not have the capacity to manage and/or quarantine these assets.

- Changes to, or loss of, insurance benefits which can be particularly problematic for older workers, those who have changed employment and/or suffer from conditions that may be excluded under new policies.

- Of particular concern would be the consequences of large sums moving around the industry over short periods of time. The potential for arbitrage in the market place at an industry wide level could be huge, to the detriment of the uninformed member.

Counter to purported effect of inducements

MLC understands there have been issues raised about inducements being offered to employers with regard to the selection of default MySuper products.

Apart from the significantly increased trustee duties under MySuper, there is an explicit provision which bans the use of inducements to employers to effectively enrol employees in a fund.

With only limited exceptions, set out in regulation 13.18A of the Superannuation Industry Supervision Regulations 1994 (SIS), section 68A of the SIS Act 1994 prohibits trustees or associates from providing or withholding inducements (a good or service) on the condition that an employee become a member of the fund. The exceptions are primarily to cover common practices which are not detrimental to members.

Employers – safe not to choose

It is our fundamental premise that, just as MySuper is intended to ensure employees are 'safe not to choose' so too employers should be 'safe not to choose'.

An APRA-listed complying MySuper product should be ample validation to enable selection by an employer without the need for further exploration, assessment or analysis and without fear of challenge or litigation which ultimately impedes them in pursuing their primary purpose – conducting a business.

Regardless of process if there is any doubt as to the scope of the employer's role in modern awards, which we contend should allow any complying MySuper, the law needs to provide those employers with adequate protection from litigious or disruptive actions provided they have contributed to any authorised MySuper product.