CORPORATE SUPERANNUATION ASSOCIATION Inc.

ABN 97 799 893 065

PO Box 112
Collins Street West
MELBOURNE VIC 8007
Tel: 0417 114 421 (CEO)
Tel 0414 325 235 (Research Officer)
Email: corpsuper@netspace.net.au
Website: www.corsuper.com.au

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Mr Peter Harris AO and Ms Karen Chester
Superannuation
Productivity Commission
Locked Bag 2
Collins St East
Melbourne VIC 8003

Delivery via web page

Dear Mr Harris and Ms Chester

RESPONSE TO ISSUES PAPER: SUPERANNUATION: ALTERNATIVE DEFAULT MODELS, SEPTEMBER 2016

We refer to the invitation to provide comments on the above Issues Paper.

The Corporate Superannuation Association

Established in 1997, the Association is the representative body for large corporate not-for-profit superannuation funds and their employer-sponsors. The Association now represents a total of 22 funds controlling $72 billion in member funds, held in a total of some 560,000 individual accounts. Of these funds, 12 have outsourced trustee services but maintain significant employer interest through policy committees. In general, these funds are sponsored by corporate employers, with membership restricted to employees from the same holding company group, but we also include in our membership two multi-employer funds with similar employer involvement and focus. A number of our funds have defined benefit divisions.

Size, in terms of funds under management, ranges from $49 billion to $64 million as at 30 June 2015. Some of the smaller funds have their place in the pension fund structures of international groups, hence play an important role in the care and welfare of the worldwide workforces of these groups.

General

We acknowledge the concerns that the selection of default funds has in the past been based on precedent rather than merit. Hence there is a risk that the quality and performance of a default fund may not match potential competitors.

However, we understand that many of the default funds currently used, particularly in the not-for-profit sector, have been performing very well in services and investment, whilst there are MySuper products in the wider market that do not perform so well[1], notwithstanding the quality controls imposed by the MySuper approval and monitoring process.

We acknowledge also that despite many efforts, a large percentage of the public is not engaged for a number of reasons. We recognise that an estimated two thirds of the public rely on default arrangements, as indicated on Page 2 of the Issues Paper.

To open up the market to every MySuper fund provides employees and small employers with difficult choices which they may be ill-equipped to make. Under these circumstances those small employers and employees may seek advice which may be conflicted or sub-standard. The outcomes may end up worse than those in the existing default system.

Current default arrangements of our employer-sponsors

Employee negotiations

Experience and careful negotiation have been devoted to securing satisfactory default superannuation arrangements for the employees of our employer-sponsors. These arrangements include both workplace agreements and award arrangements. Radical alteration to these arrangements, whether by way of prescription of one fund or a panel of funds, or by constraint of award arrangements to exclude the funds currently "grandfathered", would severely disrupt industrial arrangements.

Awards

The retention of corporate funds as default funds in awards, including the retention through grandfathering, has been the result of various forms of bargaining and negotiations. To exclude these funds from awards would result in significant adverse effects for employees, because many provide benefits that exceed SG minimum, provide tailored and favourable insurance arrangements, and are otherwise generously supported by the employer-sponsor in a way that would not apply to an external fund.

Defined benefits

The provision of defined benefits is a valuable arrangement for members which is unlikely to be obtained from an external arrangement. Given the significantly superior benefits, removal of these funds from the default (whether through exclusion from awards if continued, or exclusion from a broader class of specified default funds) is unlikely to be in the best financial interests of the members, and goes against the Government's declared objective of retaining stability in the superannuation system. There is further consideration to be given to hybrid funds. In one of our member funds, for example, there are 400 defined benefit members and about 16,000 other members in accumulation divisions. The continued viability of the defined benefit division relies on the economies of scale resulting from running a common trustee, web site, and other administrative structures. To maintain the viability of the defined benefits, it needs to be possible in such contexts to maintain the default status of the entire employer-sponsor fund provided that it meets MySuper criteria.

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[1] For comparative performance statistics for the broad sectors, see Table 9, APRA *Annual Superannuation Bulletin*, June 2015.

Employee best interests

Our employer-sponsored funds have been established with the specific interests of the employees in mind, and employee best interests are safeguarded by employee sponsor and employee involvement in the running of the funds via trustee boards. Our funds provide benefits that are often more generous than the minimum requirement, insurance arrangements which are tailored to the workforce and not necessarily available elsewhere at favourable rates, low (oftern subsidised) administrative costs, and returns that APRA statistics (referred to in footnote 1) indicate are highly competitive[2].

Any altered default arrangements that have the result of excluding our funds, whether from a panel of default funds outside of employment contracts and awards, or by way of exclusion from awards, will not be in the best interests of our members.

If award default arrangements remain, we urge that the current grandfathering arrangements in relation to default funds to which the employer was contributing before 12 September 2008 be preserved.

Proposal in the event of removal of superannuation from awards

Alternatively, if the decision is eventually made that superannuation should be excluded from the award process, we urge that a wider discretion be provided to employers to make decisions regarding the default fund for their employees.

Our suggestion for implementation of the latter would be as follows:

1 In the first instance the employer, after negotiation with the work force, should be able to nominate a "default fund". This would need to be a MySuper fund, or a defined benefit fund.

   This should be the arrangement of first choice, because an arrangement arrived at after negotiation with the work force has proved to work extremely well. The fund can be chosen to suit the circumstances of the particular employment and its environment. The employee profile and the particular risks and preferences of the employees, given their occupations, can be catered for. Insurance can be tailored to the particular risks faced by the workforce, and higher levels of cover negotiated as appropriate to the employees' circumstances.

   We recognise that this process may not be appropriate for very small employers.

2 In the second instance, if the employer does not wish to nominate a fund, the default fund should be the fund in which the employee was most recently receiving contributions, if that fund can accept contributions from the new employer. New employees other than new entrants to the work force will already have a fund, and to respect the employee's prior decision or default arrangement, and to minimise the fragmentation of superannuation account balances, this should be the secondary default option.

3 In the final instance, where the employer does not nominate a fund, a structured default process could be established for employees who do not have an existing

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[2] The APRA statistics for corporate funds are favourable despite the distortion in the APRA reporting due to incorrect segmentation and classification of employer-sponsored funds with professional trustees as "retail": this misclassification results in higher return statistics for retail and reduction in the reported returns of corporate funds as a group.

account or whose existing account cannot accept contributions from the new employer.

Single default or panel of default funds: exception for corporate funds

If a policy decision is made that all contributions for new employees are to be directed to a single default fund, or panel of defaults, we urge that the particular benefits of corporate employer-sponsored funds be recognised by a carve-out for these funds.

In the discussion above, we have highlighted benefits of the existing corporate-sponsored funds that are outstanding and serve the interests of the employees in a way that would not be done in a plain vanilla MySuper plan (no matter how carefully selected as default). These include:

- defined benefits, where still available;
- employer-sponsor subsidy and support of administrative arrangements;
- employer-sponsor and employee interest and cooperative participation in the running of the fund;
- benefits tailored to the profile of the employees;
- insurance tailored to the profile of the employees, and negotiated as a group and using resources not available for negotations related to a single life or group without common features of accupation and risk.

Questions for response

We have focused on questions we consider of key relevance to our funds. The page references below are to page numbers in the Issues Paper.

Page 8

How should the principles and considerations in the terms of reference be operationalised? Are the Commission's proposed criteria suitable? What trade-offs might arise between criteria and how should these be handled?

What regulatory impediments to optimal competition might be relevant?

We agree with the criteria for assessment of proposed models listed on page 7.

We accept the baseline of "no defaults" (Page 5) as intended purely as a reference point rather than a recommended position. It is not possible for the compulsory superannuation system to work without default arrangements. It is a matter of defining the preferred arrangements. We understand that the Commission is indicating that it wishes, in the abstract, to consider a clean slate as regarding default arrangements, without award defaults, collective or individual agreements, or decisions by employers as to the fund to which default contributions are to be made.

W*hat lessons arise from models used in other countries and sectors? How applicable are these to Australia's superannuation system?*

We consider that the following aspects of overseas models should be treated with caution:

- Choice of a single fund as default for new employees for a defined period would result in reduced competition over the period in force unless the process were carried out very frequently.

- Over-frequent process of choice of default fund(s) would reduce stability and would involve significant administrative cost.

- The selection criteria would need to cover a range of matters rather than a single criterion (as in Chile's case) to avoid undue focus on one aspect of competition to the exclusion of other important criteria.

- A government run default fund, as in the Swedish example, has the advantage of avoiding commercial interest and other conflicts in the default fund, but misses out on the benefits of competition.

- Complexity including retirement date funds as under the UK's default NEST arrangements should be avoided.

- In New Zealand's system, there is a panel of default funds and the taxation office (IRD) directs default contributions amongst them. This process works well, but there are aspects which Australia might prefer to avoid. All contributions are sent by employers to the IRD which redirects to the relevant fund. The clearing house system operated by the local tax office is quite different from the Australian model and would involve significant and probably unwanted change.

- Insurance is important in this context. The New Zealand system does not include any insurance while the Australian system defines minima, with most Australian schemes providing far better cover than just the minimum.

Page 10

Which employees should be covered by the new default allocation model? Should any employee groups be exempt?

For reasons outlined below under the next question, we advocate the use of any new default arrangements for new employees of an employer only. In addition, we consider that employers providing defined benefits to new employees should be exempt from default arrangements for new employees which would involve payment of defined contributions into an accumulation plan. These arrangements would not be compatible with arrangements where collective funding is adopted for promised benefits. Where such arrangements are provided to new employees, it makes sense to treat the defined benefits as the default, with opt-out offered.

Should there be any flow-on effects for existing default members from any new default allocation model?

It would be hugely complex and disruptive to extend a new allocation model to employees who have already been allocated by default (whether under award, employment agreement or through an employer decision). These employees will have been members of the default fund under these arrangements for a number of reasons including, in many cases, an active decision to accept default arrangements.

Even where there has been no implicit active choice on entry, there will have been time since entry for member communication, seminars and webinars as well as written communication.

The absence of active choices after these processes should be taken to indicate no specific objection to the status quo.

Page 11

What key services (or features) should be provided by default superannuation products? Should they all have to be MySuper products?

We accept that MySuper criteria are generally minimum criteria for default superannuation. The major exception arises where the new employees would be provided with defined benefits. Our reasons for excepting defined benefits are provided in the opening discussion above under "Current default arrangements for our employer-sponsors".

What are the advantages and disadvantages of allocating insurance through a separate competitive process? What should be the key features of this default insurance product?

Corporate funds provide insurance that is chosen to be appropriate to the needs of their employee group. The provision of this insurance through the superannuation fund is administratively efficient and current policy also provides tax efficiency. Administrative efficiency is gained through group arrangements whereby costs are spread and economies of scale are gained.

Trustees are experienced in dealing with the issues that are relevant to choosing insurance for their workforce, running competitive tender arrangements and evaluating offerings. There is value in making arrangements relevant to the particular work force, where specialised risks may exist, and this is an area where our funds add particular value.

The running of a tender process is expensive, with costs $20,000 and up for a typical corporate fund. The preferred strategy is to act when it is believed that the existing arrangements are no longer suitable and/or competitive. We believe that this is the most efficient way to determine insurance for a specific group of employees, and the group negotiation results in cost savings.

To scrap these benefits and require employers to insure via a default or panel of defaults would destroy the advantage of tailoring to the workforce. It would result in each person receiving cover of a uniform nature instead of the carefully negotiated current arrangements.

We do not see the advantages of a separate competitive insurance arrangement. As indicated above, we see advantages in the integration of insurance arrangements with superannuation, from the administrative point of view (one set of records) and in cost efficiency.

Page 12

Within a particular allocative model, should employees be segmented into groups for the purposes of allocating them to default products? If so, how should they be segmented? What are the benefits and costs of this approach?

Segmentation of employee groups would add to costs and complexities for employers. We would not recommend segmentation.

Who should decide on which employees are allocated to which products, where multiple default products are chosen by the new allocative model?

In the event of a new process for default allocation, we consider that existing default allocations should stand.

The process for allocating new employees to defaults should be as argued in our introduction, with employer decision primary, defaulting to employee's existing fund, defaulting finally to a generic default fund.

Page 14

What are the relative merits of using a single filter that covers the entire system versus a more segmented approach? What are the key practical considerations and challenges in implementing each approach?

We would be concerned about a single filter covering the entire system. Not every work force has the same needs. It would be prejudicial to use the same assessment tools in respect of everyone, with the result that uniform benefits and uniform insurance cover was provided for all regardless of their occupation and preferences.

It is not expected that each person in the community will want identical banking arrangements (same type of bank account, loans on identical terms, one credit card apiece) and we contend strongly that homogeneity needs to be avoided in superannuation and related insurance. At least at company level, it should be possible to provide tailored arrangements.

In what ways could employees be allocated to eligible products in an administrative model? What are the advantages and disadvantages of each approach? What costs and responsibilities would fall on employees, employers, regulators and superannuation funds under each approach?

Our preferred approach is set out in the introductory section: employers and employees should agree on a default fund in the first instance, then the employee's last used existing fund if any, then an overall default if the first two approaches fail.

Page 16

What would be the likely effects of a tender on competition between successful funds and in the superannuation system more broadly? What would be the implications for product innovation and system stability? What would be the likely effects on long-term member outcomes?

Assuming a tender would result in new employees only being allocated to a successful fund, we remain concerned about the fate of the existing default funds. Without default new entrants for a period of years, the stability of funding will be prejudiced. At the least, momentum would be lost, and product innovation would reduce. There would be implications for competition in the market, and the selection of a small panel of funds would result in an oligopoly. We already see the effect of a limited number of banks, and of large supermarket chains, on the market. The limited number of fund administrators already reduces competition.

What metric(s) would be most appropriate to include in a tender, and why?

How should the bids be assessed against the metric(s)?

Where there are multiple metrics, how should trade-offs among them be assessed?

The choice of metric should definitely not be limited to one factor such as fees, investment returns or insurance costs, given the complex interplay of costs and benefits, and the variability of product needs in the work force.

Conclusion

We are happy to provide further information as required.

Our particular experience lies with employers' continuing involvement in the management of their corporate funds, the particular governance strength in these arrangements, and in defined benefits.

Yours sincerely

Mark N Cerchė
Chairman
Corporate Superannuation Association