

Productivity Inquiry into Default Superannuation Funds in Modern Awards

INTRODUCTION

Cbus provides superannuation services to construction, building, and allied industry workers and retirees, their families and their employers. Cbus was established in 1984, and is one of Australia's oldest industry funds.

The fund has some 660,000 members and some 90,000 employers. Cbus manages assets valued at over \$18 billion.

Cbus is conducted on a not for profit basis. All returns are used for the advantage of fund members and there are no dividends paid to stakeholders.

The Trustee board provides equal representation as between employer and employee. Master Builders Australia nominates employer representatives including those from other employer associations. Employee representatives are nominated by the ACTU and the major unions representing the construction industry workforce.

Cbus members have a choice of four investment options, Cash Savings, Conservative, Growth and High Growth. The Cbus default option is the Growth option and 94% of all Cbus members are in the Growth fund.

The default scheme also provides an automatic insurance for death and TPD.

Cbus understands this inquiry is to provide advice to government about how Fair Work Australia (FWA) should select default funds in Modern Awards. FWA's role is to select the most appropriate fund(s) for employees' retirement savings in an environment where the employee has not made a fund selection, and by and large where employers are either reluctant to choose, or ill-equipped to choose. That is, FWA's role is to fill the gap that exists where competition has failed to excite the interests of consumers. It does this consistent with its general award-making powers, which set minimum protections for workers who lack bargaining power in the labour market.

SUBMISSION SCOPE AND STRUCTURE

Cbus supports transparency and competition in superannuation, not as an end of itself but as a means to enhance the net benefit available to members.

Cbus is affiliated to Industry Superannuation Network ('ISN'), and Cbus adopts and supports the ISN submission.

In particular, Cbus supports the two tier framework advanced by ISN. Under this proposal, in order to be eligible to be nominated as a default fund in a Modern Award, a fund would need to satisfy three threshold criteria (the first tier).

FWA would then have regard to qualitative measures to select a handful of funds as nominated default funds for each award. These criteria are: the views of the parties; the depth of the trustee's knowledge of the industry or occupation covered by the award, the suitability of the default insurance product, and other member services offered by the fund (the second tier).

This submission supplements the ISN submission, by contextualising it within the construction industry.

INDUSTRY CONTEXT

The construction industry accounts for about 7% of Australia's GDP. The industry is highly fragmented and is dominated by small firms. The practice of sub-contracting to specialist firms is preferred to the direct recruitment of employees. ABS data¹ indicates that construction had the greatest number of businesses of any sector with 351,890 (16.5% of the total). Similarly construction had the highest number of business entries and exits in 2010/11 (52,467 entries and 51,343 exits).

Forty three per cent of business entering the construction industry in the 2007 – 08 financial year did not exist in June 2011. This rate of survival business in construction is in the bottom half of all industries but the absolute numbers - 217,500 business exits in four years, is more than in any other industry. (The industry with the next highest number of business exits was the 'professional, scientific and technical services' industry which had 135,000 exits for the same period).

There are relatively few barriers to entering the industry and combined with the cyclical nature of construction ensures profit margins vary and are always under pressure. As with business survival rates, the profitability of construction business is in the lower half of all industry outcomes but the absolute numbers are significant to the broader economy.

Table 1²

	2007 - 08	2008 - 09	2009 - 2010
Made a profit	81.8	75.9	76.3
Broke even	0.3	1.5	1.2
Made a loss	17.9	22.6	22.5

Over 83% of all participating employers in Cbus have five or fewer members in their workplace.

Employment in the construction industry is often project-based and employment arrangements within the industry reflect this structure. Employment is typically defined by a discrete project and is not continuous. Daily hire arrangements are commonplace.

The construction industry has a relatively high proportion of workers with Certificate III and IV qualifications that the average across industries. The industry employs fewer workers with university degrees than the average. This reflects the central role of a wide range of skilled trades within the construction industry.

¹ Counts of Australian Business, including entries and exits, June 2007 to June 2011, Cat No.8165, released January 2012, pages 11 - 14.

² ABS Catalogue 8155.0 Australian Industry 2009 - 10

INDUSTRIAL AWARDS AND AGREEMENTS

Data collected by the Department of Employment, Education and Workplace Relations (DEEWR) indicates that there were 5,913 wage agreements covering 121,000 employees in force in the construction industry as at 30 August 2011.

While the construction industry accounts for 9.1% of employees, it accounts for 26% off all agreements lodged with FWA. ³The average Agreement covers some 20 employees.

The DEEWR data is broadly consistent with ABS⁴ survey data suggesting that 123,300 employees on the construction industry are covered by agreements. The ABS data also identifies some 53,000 employees in the construction industry employed on Award conditions.

METHODS OF SETTING PAY, CONSTRUCTION INDUSTRY

There are nine Modern Awards in the construction industry. Seven of those Awards list Cbus as a default fund for superannuation.

Cbus is also named as default superannuation fund in two Modern Awards that are not part of the construction industry.

The ABS data in table 2⁵ highlights the earning gap between construction workers on Awards and those on Agreements (individual or collective)

	Award	Collective Agreement	Individual Arrangement	Owner manager of incorporated enterprise	All methods of setting pay
Number of employees ('000)	53.2	123.3	295.1	61.3	532.9
Average weekly total cash earnings	\$612.00	\$1,631.80	\$1,160.80	\$1,006.90	\$1,197.30

While the construction industry has relatively high levels of bargaining, there remain a significant number of employees who are both award reliant and low paid.

FWA ROLE

Before addressing the criteria to be applied by FWA, it is important to recall that, in exercising its powers, FWA is standing in the shoes of those employees who have failed to exercise individual or collective choice in favour of a particular fund or investment choice. As such, its role is a paternalistic role. It is also setting a protective floor of rights for employees, many of whom have limited labour market power.

In this context, it is appropriate that FWA actively examine the nature of the labour market within the scope of each award, the ease with which employees can exercise individual or collective choice,

³ (DEEWR Trends in Federal Enterprise Bargaining September Quarter 2011 at <http://www.deewr.gov.au/WorkplaceRelations/Documents/TrendsSep11.pdf>).

⁴ ABS Employee Earnings and Hours, Cat 6306.0, MAY 2010 at page 14

⁵ Table 2 extract from ABS Employee Earnings and Hours, Cat 6306.0, May 2010 at page 14

the extent of award reliance, labour mobility within the industry, educational attainment and other characteristics of the industry.

It is also appropriate that FWA consider the impact of its decisions upon the employees and employers to whom the award applies.

These considerations are applied by FWA in setting other terms and conditions of employment in awards, and should equally apply when nominating default funds.

FIRST TIER

Cbus supports the ISN submission that, to be eligible to be named as a default fund in an award, FWA needs to be satisfied that a fund meets three pre-conditions. These are:

- that the fund is a MySuper fund is licenced by APRA;
- that the fund has a history of strong investment returns in its default product; and
- that the fund does not engage in sharp practice

MYSUPER

The effect of the amendments contained in the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 to the Superannuation Industry (Supervision) Act 1993 will be that default funds must be licenced to offered a MySuper product and remain compliant with the terms of the licence.

FWA would need to be satisfied, as a matter of fact, that any fund seeking inclusion in a Modern Award was properly licenced, and ensure that, in naming licensees, the product into which employees default is a MySuper product.

BENCHMARKING PERFORMANCE

Cbus submits that only those funds with a record of long term above average net returns to members should be eligible to be named as a default fund in an award.

To be eligible a fund should have a record of investment performance that places it in the upper echelons of performance.

Why should performance matter?

It is not sufficient that a default fund be MySuper compliant.

MySuper is a regulatory tool to manage the inputs into the default fund. The regime seeks to promote better fund and investment governance, exert downward pressure on the fees and charges, enhance risk management and promote transparency. .

While strengthening these inputs should increase the benefit available to workers on retirement, the proof of the fund is the output – principally the investment performance of the fund.

Measuring performance is consistent with FWAs role in setting the safety net

Compulsory superannuation has been prescribed because people are reluctant to defer consumption and apply those savings to their own benefit, after they have finished work. The size of retirement savings will be crucial for low income earners as the absolute quantity saved may not be adequate to sustain them in a modest or comfortable lifestyle.

As we show at Table 2 above, award dependant workers earn approximately half the weekly wage of their colleagues whose wages are set by agreements. Quite simply those workers earning Award wages cannot afford to have their superannuation savings invested in an underperforming fund.

In setting minimum standards, FWA has regard to the financial impact on individuals and businesses, and it is appropriate that it take this into account when nominating default funds.

While past performance is no guarantee of future performance, FWA should be required to only nominate funds with a demonstrated history of strong long term net outperformance. To allow underperforming funds access to default status within Awards is inconsistent with the logic for compulsory superannuation.

How should performance be measured?

FWA should rely upon APRA collated performance data for default funds. APRA is best placed to provide FWA with independent and robust performance data, which genuinely compares net performance on a like for like basis. The industry is working with APRA to ensure all participants have confidence in APRA's fund comparison data.

In time, we would expect only those funds that are in the top 100 MySuper funds on a 10 year rolling basis should be eligible to be nominated as default funds in awards. However, while MySuper is being phased in, while the number of licenced providers is unknown, and until the industry has confidence in the APRA comparisons, we will need a transitional benchmark.

Cbus does not anticipate that FWA would "de-certify" funds which fall below the benchmark immediately. Rather, at each four year review of Modern Awards, the list of eligible funds would be refreshed.

It's important that my super is invested well. When I get too retirement age - working an extra couple of years - to top it up, is not going to be an option – you don't see many old construction workers - when you have to give it away, its over

Cbus member Gary Pettifer

SHARP PRACTICES

ISN submit that funds that engage in sharp practices should not be eligible to be nominated as a default fund.

The ISN submission focuses on the practice of 'flipping'-

"Flipping is a practice where employees who leave a job are automatically moved out of the corporate super fund into a personal superannuation account. In many cases employees are unaware they have been moved into a fund that usually attracts higher charges, in most cases nearly double the fee.⁶"

Cbus regard the practice of predatory flipping as unconscionable and support the Government's attempts to stop the practice. If the drafting of the proposed legislation leaves open the possibility

⁶ *The Age*, 20th Jul 2009, Eric Johnson, Financial Services Editor.

of an 'innocent' flipping then mechanisms should be established which ensure the practice is identified and quarantined rather than allowing the exception to drive a regime which would allow the odious practice of flipping.

Regrettably the incentives to create opportunities to engage in 'sharp practice' of flipping are high.

High labour mobility and short job tenure in the construction industry expose workers to being unknowingly moved into funds with a high cost structure.

The detrimental impact on vulnerable workers is significant. Cbus supports the ISN submission that in order to be eligible for nomination as a default fund, the applicant fund must have a clean bill of health from APRA in relation to its business conduct.

TIER TWO

GENERAL APPROACH

Having satisfied itself that a fund meets these three criteria, FWA should then consider other qualitative matters to ensure that the fund(s) nominated in the award are best able to meet the needs of the employees and employers covered by that award.

ISN suggest four matters which FWA should consider in addition to any other matters it considers relevant to the tier two approach

- the views of the parties that have standing regarding the relevant award;
- the experience of the trustees and coverage of the fund in the relevant award coverage demographic;
- relevant member and employer services; and
- appropriate insurance offering.

Cbus supports these criteria and provide brief comment in relation to each of them.

VIEWS OF THE PARTIES

Cbus submit that FWA should be required to have regard to the views of the industrial parties regarding which superannuation funds should be nominated as a default fund.

Our argument recognises the industrial relations heritage of award superannuation, but is not reliant upon that.

Unions and employers, and their peak bodies, have intimate specialist knowledge of the labour force, labour mobility, the capacity of employers to manage payroll and others systems, employee financial literacy, the insurance needs of the workforce and the investment preferences of the workforce.

Furthermore, FWAs role is to making a decision where the employees have failed to exercise a choice, either individually or through bargaining.

FWA is essentially charged with trying to uncover the views of the workforce. Representative industrial parties, especially unions, are best placed to provide FWA with the views of the workforce as to the fund attributes and features that are valued by workers in a particular occupation or industry.

Super is really just a deferred wage the nine per cent would otherwise be paid as a wage, it's a forced saving for retirement, I just have to give my Cbus number to my employer and tell him that I want the money to go to Cbus. I know Cbus is the construction industry fund. It has the support of my union and the employers and if they can agree it must be ok

Cbus member Mick Schofield

I have never been interested in super but I trust Cbus to do the right thing – having unions and employers to keep each other honest is important. I don't read the financial papers or have strong views about investing money but obviously I am going to need that money when I stop working and retire.. its important that the people who manage it are looking after my interests – I trust the union to look after my interests'

Cbus member Brendon Coppinger

"Because superannuation is owned by the members and run by the union and employer reps it provides a level of trust – they will keep each other honest and do what's in our best interest"

Cbus member Maurizio Rossignolo

How many funds should be named in an award?

Cbus resists an argument which suggests that all MySuper compliant funds should be listed as greater choice would of itself deliver a superior outcome for the worker.

Cbus submits that FWA should generally refrain from naming any more than ten funds in each award, and in some industries even fewer funds is warranted. These should generally be public offer funds, or otherwise capable of providing services to all employees covered by the Modern Award⁷.

First, it is arguable that introducing a large number of funds from which an employer can choose will fragment the provision of default superannuation services within an industry to the detriment of consumers, particularly through multiple account holding. This is particularly relevant for the construction industry, where job turnover is high.

The original rationale for industry funds was to ensure employee's superannuation was both fully vested and portable between jobs. Employees could move from job to job without having to leave superannuation behind with their previous employer. Despite this, we now have 28 million accounts for 11 million workers. Annually, 1 million new accounts are created for a net workforce growth of around 200,000 employees. The default system should be designed to minimise the risk of multiple account holding.

It also needs to dovetail with the proposed auto-consolidation regime. This means that only those funds that are capable of accepting contributions from all employees covered by the award should be eligible to be named in the award.

⁷ For example there may be different considerations in a Modern Enterprise Award

Multiple account-holding not only affects administration fees, it can have an impact on the costs of insurance, particularly if new members need to be underwritten. Cbus automatic acceptance levels have been priced based on the mobile nature of the labour market.

I have worked 4 or 5 jobs in the last two years - there are any number of employers out there and unless there is some coordination about superannuation I'd have money all over the place. It would be impossible to check whether people are paying the right amounts – it's hard enough as it is at the moment. Nobody likes paying fees and anything that keeps fees down has to be worthwhile

Cbus member Greg Keyte

The thing about Cbus insurance is that when I joined I am covered twenty four hours a day seven days a week, it doesn't matter – if I am at work or not I'm covered. I don't have to fill out forms about my parents health or my heart or my neck – I'm just covered

Cbus member Fioreentino Graziana

"There are any number of small employers who come and go, unless superannuation is paid monthly and checked by my union the likelihood that is that sooner or later a company will disappear owing superannuation to its workforce, its happened to me, nobody can afford to lose money that from their super"

Cbus member Robert Brown

Second, providing employers with a large range of funds from which to choose undermines the purpose of the award default system, which is to ensure an employee voice in the choice of fund, and to control the risk of a poor choice.

Dr David Gruen of the Commonwealth Department of Treasury and Finance has remarked on the emergence of behavioural economics (since Wallis) and its impact on choice theory and its adoption in the approach of the Cooper Inquiry –

“...the standard theoretical result that more information and choices make people better off – and certainly no worse off – has also been questioned. Large choice sets appear, in some circumstances, to degrade the quality of the decisions people make.

The relevant literature suggests a range of behavioural responses to 'choice overload'. Choice overload increases the likelihood that people (particularly those with low levels of financial education) will choose a default option, or leads people to pick simpler options regardless of their suitability or, finally, degrades people's capacity to make optimal decisions...”⁸

The ATO commissioned Report ‘Investigation Superannuation: Quantitative Investigation with Employers’⁹ suggests that, while employers are generally motivated to choose a fund that has strong

⁸ See Thinking Seriously About the Default Option, Dr David Gruen and Tim Wong on 28/9/10, http://www.treasury.gov.au/documents/1877/HTML/docshell.asp?URL=MySuper_ACE.htm

⁹ Colmar Brunton, 20 January 2010

investment performance and low fees, their decision to stay with a fund is motivated more by administrative ease.¹⁰

Further, a small but worrying number of employers (4% of businesses) were aware of inducements or benefits offered by their default fund to reward or incentivise the choice of default fund.¹¹

An open and transparent process administered by FWA should ensure that the interest of employers and employees is considered openly. The payment of incentives has no legitimate place in a proper decision making criteria. Administrative ease is a relevant consideration but it must be balanced against a range of more significant matters.

It is the submission of Cbus that to allow more funds to be listed as default funds for superannuation in Modern Awards would not of itself benefit the interest of employees. The commercial interest of those seeking to expand their market share should not be a sufficient reason to expand the number of funds listed in Modern Awards.

Finally, Cbus rejects the contention that limiting the number of funds named in any award constitutes an unwarranted restriction on competition.

It is important to remember that people involved in this process can readily exercise a right to change the 'default direction' – a worker by exercising a choice individually or collectively through enterprise bargaining. An employer can seek to initiate a bargain or engage in the bargaining process and pursue preferred options. Accusations of monopoly practice give insufficient recognition to the ease with which players can exercise a right to prefer a competitor.

THE EXPERIENCE OF THE TRUSTEES IN THE RELEVANT AWARD INDUSTRY, AND THE RELEVANT MEMBER AND EMPLOYER SERVICES

ISN propose that FWA consider the depth of the Trustees knowledge and experience of the relevant industry or occupation covered by the award, and the extent to which the fund offers relevant services to employees and employers covered by the award.

Cbus supports these criteria, and sees them as opposite sides of the same coin. A trustee with deep understanding of an industry or occupation will tailor its default products to provide innovative products and services that meet the needs of the participants in that industry.

The construction industry has an unusual set of characteristics – it is particularly susceptible to economic cycles, the industry is fragmented with many employers of relatively few employees, employment is project based and episodic, over 50,000 businesses leave the industry every year, it is a highly unionised industry and most employees are male.

The construction industry has been the subject of a number of government inquiries,¹² that have noted the complex nature of the industry. The unique nature of the employment relationship in the

¹⁰ at pages 34 – 83. Figure 32 (on page 42) indicates that low management fees (83%) and investment performance (81%) are important in choosing a default fund. However the key driver of satisfaction is identified as being easy to contact / deal with / good customer service (45%) (figure 41 page 51).

¹¹ See Figure 47 on page 56

¹² By way of example - Royal Commission into the Building and Construction Industry 2001 - 3, Australian Building and Construction Commissioner (ABCC) Sham Contracting Inquiry 2011, Wilcox report 'Transition to Fair Work Australia for the Building and Construction Industry' followed by the 'Senate Standing Committee on Education, Employment and Workplace Relations Inquiry into the Building and Construction Industry Improvement Amendment (Transition to Fair Work Bill 2009)', the public policy development including release of an exposure draft and public comment around

construction industry has been variously reflected in industry-specific industrial relations legislation, an industry specific workplace inspectorate, unique long service and redundancy arrangements, and unique health and safety regulations.

The industry has been a focus of investigations into phoenix activities, tax avoidance and sham contracting.

Cbus has responded to high labour mobility, short job tenure, and the precarious financial position of many smaller businesses in the industry by promoting monthly payment of contributions and funding an arrears collection service. Compliance activities involve working with employer associations and unions, for example in NSW, Cbus works with the MBA (NSW) and the CFMEU to provide information (consistent with privacy legislation and principle), which is sufficient for members to verify the employers payment of superannuation. This limits the potential losses in the case of fraud or bankruptcy.

Cbus has tailored its insurance product which provides high levels of cover for death and TPD without underwriting or questions around occupation. Most retail funds require underwriting or specific and detailed medical questionnaires to be completed. The Cbus product has a low access threshold so workers can readily move from site to site.

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A less appreciated hazard relates to the prevalence of suicide in the construction industry. On average one hundred people working in the construction industry commit suicide each year. The Cbus insurance policy does not contain exclusion clauses for suicide. The insurance offerings of most retail funds have time based exclusions. Of course it would be open to Cbus to recast its insurance policies to avoid potential pay outs to families but believe that the potential cost (and moral hazard) is best mitigated by education and support programs of the type initiated by Cbus in conjunction with employer organisations and unions.

Cbus invests back into the building and construction industry both directly and indirectly as part of its considered investment strategy. This also allows us to create jobs and opportunities for members and employers.

These illustrative examples are not detailed to assert a preference for a monopoly or claim ownership of a market share but rather point to the application of criteria which values industry knowledge and experience.

This is important because it will assist funds develop a service approach and product development which will increase the net benefit to members.

Cbus submits that, by requiring FWA to have regard to the industry expertise of the trustee seeking to be nominated as a default fund, the Tribunal will identify those funds that have tailored their offering to the needs of the employers and workers in the industry.

This does not advantage industry funds over retail funds; it advantages funds that develop deep knowledge of the market within which they seek to operate.

phoenix legislation – ‘Tax Laws Amendment (2011 Measures No. 7) Bill 2011: Companies’ non-compliance with PAYG withholding and superannuation guarantee obligations)’.

APPROPRIATE INSURANCE OFFERING

It is anticipated that each MySuper product will be required to have default insurance, and Trustees will be required to document a detailed insurance strategy.

It is appropriate that, as insurance will be a compulsory component of the default offer, FWA has regard to the quality of the insurance offer.

Benchmarking insurance is complicated by the range of variables included in default insurance (automatic acceptance levels, medical questions, automatic increases in level of cover associated with significant events, opt in or opt out income protection cover, etc.).

Ideally FWA would have access to a reliable independent agency to provide insurance comparisons. However, unlike investment performance (where APRA is charged with publishing robust like for like comparisons) there is no reliable independent insurance comparison available to FWA.

Thus, Cbus submits that FWA should have regard to the insurance strategy of the fund seeking inclusion as a default fund in an award.

FWA should satisfy itself that the default insurance product offered to members is designed with an eye to the characteristics of the employees working in the industry.

The potentially hazardous nature of work in the construction industry, transient work patterns of members arising from cyclical nature of the industry mean that tailored insurance product is valued offering.

Cbus would be concerned at any insurance comparison which compared product design without regard to premium levels. Insurance premiums are always deducted at the expense of retirement savings.

I know someone whose partner died and they had heaps of trouble trying to get insurance paid out, it was not an industry fund. I have death and TPD insurance with Cbus and know that if I or my family had to claim I would get assistance from a Cbus coordinator who works closely with my union and would make sure I was looked after. You never think much about insurance but if you need to claim you would hope that it was not much trouble getting it paid out

Cbus member Paul McCarten

REVIEWS

Cbus supports the need for Modern Awards to be reviewed including arrangements for default superannuation.

If at any time a nominated fund was no longer able to satisfy the first limb (for example if it lost its MySuper licence) FWA should remove that fund from the award, either on its own motion or on application of any person. APRA could be tasked with responsibility for making such an application or advising FWA of the fact that a fund was no longer eligible for nomination as a default fund.

Further, the Fair Work Act 2009 provides a regular opportunity for FWA to review its application of the second tier criteria.

FWA, sitting as a full bench, is obliged to review Modern Awards every four years pursuant to s 156 of the Fair Work Act 2009. The first of these formal reviews is scheduled to occur in 2014.

In making the initial Modern Awards FWA indicated that it would conduct a review of Modern Awards in 2012.

These periodic reviews provide an opportunity for funds that satisfy the first limb to seek to be listed by FWA (against criteria specifically identified in the second limb). At the time of review FWA would also consider whether the funds previously listed in the Modern Awards were properly included in a revised Modern Award, having regard to the applied criteria.

CONCLUSION

If a construction worker on a Modern Award worked every week of the year, they would be entitled to be paid a little over \$31,000.

It is a modest platform from which to make savings for retirement.

Employees work across a number employers and projects to maximise their access to work.

The criteria proposed by ISN and supported by Cbus is in the best interests of those who have earned and paid their Superannuation Guarantee contribution.

The fund should be properly licensed, perform to an above average standard and refrain from sharp practice. Having met those criteria FWA should inquire further - what is the experience and knowledge of the trustees? What services do they offer employers and employees that represent a benefit? How relevant and valuable is the insurance product to (potential) members of the fund? These are not exhaustive criteria but FWA should look to these matters as a minimum before selecting a default fund for a Modern Award. Workers in the construction industry deserve superannuation funds that have a specialised knowledge that can be applied for their benefit.

Moreover, the default system should be limited to high performing, well managed funds. The paternalistic nature of the task justifies constraining competition to only those funds that meet the highest standards of quality and performance.

The default system should be designed to complement the objective of account consolidation, to reduce the fee burden on fund members, and to promote portability.

Finally, it should complement the modern award system, which recognises the different demands of different occupations and industries, by appropriately acknowledging the industry differentials in fund and product design.