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Default Superannuation Funds  
In Modern Awards  
Productivity Commission  
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Dear Commissioners

**Subject:** Productivity Commission Inquiry – Default Superannuation in Modern Awards

NGS Super Pty Ltd welcomes the opportunity to provide a submission to the Productivity Commission in relation to the Fair Work regulatory framework with a specific focus on the criteria used to determine the eligibility for inclusion as a default superannuation fund in modern awards.

NGS Super is strongly of the view that superannuation springs from the employment contract and as such is an “allowable matter” in modern awards. It is a product of an “industrial” relationship and has a direct relationship with wages. We base this view on the *National Wage Case June 1986 (14 IR 187)* and the *National Wage Case 1987 (17 IR 65)* later reinforced in the *Shell Case (174 CLR 345)* with Mason CJ, Deane, Toohey and Gaudron JJ stating:

*“It must now be accepted that the general question of superannuation entitlements is a matter which may form the subject of an industrial dispute. And that question is bound up with and determined by the form of the superannuation scheme involved. It follows that a dispute between an employer and its employees as to the form that a scheme should take is a matter pertaining to the relations of employers and employees.” (at 356)*

We consider an objective assessment of default funds who nominate to be included in Modern Awards to be integral to the selection process for modern awards. In order to maintain the integrity, transparency and objectivity of this process, it would be necessary to use the resources of APRA to collate standard tables which measure fund performance as well as the fee structure and performance of default option. In the light of the recent governmental reforms, the default funds selected for comparison would be MySuper compliant products with a comparison of net returns to members in the APRA -produced comparative tables of the net rate of return over eight years. APRA should also determine if the product moves its members into another product after termination of employment as this practice could lead to higher fees and charges to members who believed in good faith that they were in a MySuper product. This practice should be banned as a pre-condition for inclusion in modern awards.

Once included in the objective assessment of net returns, low fees and the appropriateness of the investment strategy of the default option in terms of risk and expected returns, the second tier of the selection process should have to do with applications made to Fair Work Australia from eligible funds. This process should be transparent and contain no limitations to applicants (assuming the objective assessment is met) to encourage open market competition and the ultimate best result for fund members. Accordingly, the opinions of those most directly affected by the Award such as employer organisations and representative unions should have a strong voice in considering the inclusion of a superannuation fund in a Modern Award. As these industrial parties have standing before Fair Work Australia, it is logical that their views and preferences in terms of a default superannuation fund under an industrial award which services their members should be given weight. The equal representation rule should also be considered as a positive attribute for the applying funds by Fair Work Australia as this mechanism has served large segments of the Australian working population well since the inception of compulsory superannuation and assures some affinity and understanding between the trustees and the members.

Our comments will focus on the potential benefits for the Australian workforce if a selection process is established which considers the following core elements:

- Investment expertise which includes historical returns and acceptable risk;
- Fee structure;
- Default option design;
- Insurance offering;
- Fund governance;
- Fund scale

#### **Investment performance of default option/appropriateness of the investment strategy**

In line with the “sole purpose test” it is clear that superannuation funds have a legal obligation to provide the maximum retirement benefit for fund members and their dependants. As superannuation is a long-term investment, it is important that investment returns are considered over the medium to long term. To enhance healthy competition and avoid placing default members in low performing funds, it is essential that objective measures are put in place to compare funds in a “like to like” manner. This would initially involve APRA confirming that the MySuper product has met the performance criteria, then a compilation of the whole of fund rate of return should be used as a relative measure of net member returns over time. The MySuper option should be classified and compared to other products in the market.

On a broad scale, Fair Work Australia should assess the appropriateness of the default investment option of the fund in terms of risk and expected return. This would include an analysis of medium and long term asset allocation, the manager selection and review process, the over-all investment philosophy in the light of the fund’s demographic composition. The net returns credited to members’ accounts after the deduction of fees, costs and taxes are the key criteria for fund inclusion in modern awards. This is in line with the Minister for Employment and Workplace Relations and Minister for Financial Services and Superannuation, the Hon Bill Shorten’s stated objective of, “A primary focus on returns put into the pockets of members will ensure that members of a MySuper product can have the confidence that they will receive the maximum possible superannuation at retirement”. (Second Reading Speech, Superannuation Legislation Amendment [Trustee Obligations and Prudential Standards] Bill 2012, 16 February 2012.) Both the appropriateness of the investment strategy and the net return to members should be scrutinised before inclusion.

The annual returns provided in the *APRA Annual Superannuation Bulletin* provide a clear statistical summary of the performance of funds by sector and is a useful tool for making objective assessments of relative fund performance. Both the benchmark averages and specific fund averages will provide Fair Work Australia with an objective measure to determine the eligibility of funds applying for default status in industrial Awards. The medium to long term net-of-costs investment performance of default options can be objectively compared using the available data produced by APRA.

### **The level of fees incurred by members**

The level of fees correlates to the net investment returns to members to a degree in most cases and an open and transparent disclosure of fees should be considered by Fair Work Australia prior to selection as a default fund in any modern award. Fund members are often unable to determine the exact fees they are paying so a fully transparent table of fees should be provided for the consideration of Fair Work Australia prior to any inclusion as a default fund in a modern award.

The mechanism by which this could be achieved could be a fairly simple and straightforward comparative table requiring applicants to fully disclose all fees deducted from investment returns prior to distribution to members. Ongoing fees and charges should also be disclosed and a total fee illustration should be provided (say based on a member with a \$100,000 account balance). Obviously, the fee structure should be considered in the light of actual returns to members and it is significant that ongoing commissions paid to advisers will be banned in MySuper products. However, full transparency in terms of what members pay should be a criterion for inclusion as a default fund in any modern award approved by Fair Work Australia.

It should be noted that “flipping” or the practice of moving members from MySuper products to more expensive products should be banned as this practice is antithetical to the spirit of the MySuper reforms. “Flipping” is used by some in the industry when a member is retrenched and makes no decision about their superannuation. By transferring this class of members into a “personal” division, the member’s fees will increase (without the knowledge of disengaged members), which impacts on returns. This is clearly not in the member’s best interest and is contrary to the stated intentions of the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill* which states (at paragraph 1.16): “As most members will be expected to remain in the MySuper product for a considerable period, it will be generally appropriate for trustees to aim to manage returns to those beneficiaries (after the deduction of fees and charges) over the longer term”.

### **Scale of the fund and level of services provided to fund members**

MySuper products require enhanced member focus and this is reflected in the obligations of trustees to consider net investment concerns over the long term (say 10 years). Scale is important in this respect as research indicates that there is a correlation between fund size and investment returns. The APRA fund-level performance data and profiles confirm that net returns to members increase with the scale of funds under management.

Further to the enhanced fiduciary duties imposed on trustees under the MySuper regulations, is the provision that trustees are required to determine whether they are acting in the best interest of members in terms of the scale of the fund. An important criterion for Fair Work Australia will be whether the actual size of the applying fund allows it to provide competitive returns to its members as well as the services which larger funds are able to provide. In short the question centres around whether the applying fund operates in the best interest of the membership or does it serve the self-

interest of its principal parties and trustees. If the applying fund is a “niche” fund, the net returns to members would of necessity have to compare favourably to funds with the benefit of more scale.

Scale enables the costs of services to be divided among more members with a result of lower cost per member. This would be an important consideration in areas of fund administration including staffing, member financial education, the call centre, brand development, internet services, social media services and fund publications. Scale should enable a fund to provide more workplace visits to its members improving member understanding of, and engagement with, superannuation.

### **Suitability and cost of insurance provided by the fund**

The provision of low cost life, total and permanent disability and income protection insurance via a superannuation fund has always been a topic of debate. On one hand, superannuation fund trustees are obliged to adhere to the “sole purpose” test, and on the other hand sound public policy dictates that universal insurance cover benefits everyone. However, every insurance premium deducted from a member’s superannuation account could be viewed as a reduction of their retirement benefit.

It is acknowledged that Australians face a serious under-insurance problem. The majority of the population are under-insured and only realise this fact when a medical problem or accident manifests itself.

The provision of low cost insurance through a superannuation plan goes some way to redress this problem. As specific industry funds can tailor the insurance products to suit the needs of their industry, it is appropriate that insurance is considered in the selection of default funds in modern awards. The capacity of the group to negotiate better terms and conditions and the favourable tax treatment of insurance purchased through superannuation funds, enable members to access products such as Death cover at reasonable premiums.

As different industries have different insurance needs and underwriting, Fair Work Australia should consider each fund’s insurance product in relation to its membership. The dichotomy between blue and white collar industries could be a starting point for the examination of the appropriateness of the insurance product of any fund applying for default status in modern awards.

Various tools such as the Chant West tables which compare premiums deducted and the insurance benefits provided to members are useful tools for ascertaining the suitability of a fund’s insurance products. As MySuper will require trustees to maintain an insurance strategy, it is important that funds applying for default status in modern awards reflect the demographic as well as any other requirement for a particular industry.

In considering applications for default status on the basis of insurance offerings, it is also important to consider what happens to the insurance after a member ceases work with a particular employer. This becomes a question of whether there are provisions to maintain insurance cover after a member has left an employer, or whether the insurance remains with the member after employment ceases.

Universal insurance coverage via superannuation funds is good public policy which has helped to alleviate the pressure on the social security system when members experience illness, accident or death.

## **Governance of the fund**

The introduction of MySuper brings with it increased fiduciary responsibilities for fund trustees. Trustees will have to exercise the skill, care and diligence of a prudent superannuation trustee; they will have to give priority to the interests of members in the case of a conflict or potential conflict of interest; they will have to act fairly when dealing with classes of beneficiaries within a class. It is clear that strong corporate governance focussing on the promotion of members' best interests in improving the superannuation system is a priority. This includes maximising retirement incomes for all superannuants while reducing business costs. As the Stronger Super reforms focus on the governance, integrity and regulation of the prudent management of member assets, it is critical that fund governance is scrutinised by Fair Work Australia before inclusion in modern awards as a default fund.

As iterated in the Cooper Review, "...turning the governance spotlight on trustees' own operations is... critical to the long term sustainability of the superannuation system" (Cooper et al, Super System Review: Final Report; Part Two, p44). This has been legislated into a higher level of governance in respect of super fund members which includes the provision that the trustee act solely for the benefit of members, avoid conflicts of interest, act honestly and exercise independent judgment, exercise the degree of care, skill and diligence as an ordinary prudent person of business when dealing with the property of another and have specific regard to the likely long term consequences of any decision made in relation to the membership of the fund.

Trustees will have to ensure the fund has sufficient scale to provide the maximum benefits for members and will be required to report to APRA whether it continues to have sufficient scale to deliver optimal benefits to members.

Other trustee obligations put in place to strengthen fund governance include a specific duty to deliver value for money (measured by long term net returns) and the provision of a single diversified investment strategy which is suitable to for the majority of members in the default option.

It will be incumbent upon Fair Work Australia to determine if the above criteria are met before including applicant funds in modern awards as sound corporate governance coupled with prudent investment and risk management are integral for the long term benefit of members.

## **In Summary**

As superannuation payments are the product of the contract of employment, it follows that it is an "allowable matter" in industrial awards and should be under the regulation and scrutiny of Fair Work Australia. In an era of choice of superannuation funds, the reality is that many Australian workers are disengaged with superannuation for a variety of reasons. This is the cause underpinning the Cooper Review and the resulting legislative changes which were brought in to further protect members working under Awards and Agreements, many of whom are disengaged.

The MySuper legislative changes have imposed heightened fiduciary obligations on trustees of superannuation funds for the ultimate purpose of providing better retirement outcomes for all Australian workers. It is clear that Award provisions, including default funds named in Awards, have served the national workforce well by placing them in low cost, relatively high performing superannuation funds where employers and unions have had a strong voice in their selection as well as a detailed knowledge of the needs of the industry which includes an understanding of the

demographics, aspirations and economic circumstances of the member group, all of which informs the design of retirement solutions and engagement strategies for the group in question.

This system should be maintained with the added requirements of the MySuper/Stronger Super legislation and the added scrutiny of Fair Work Australia in terms of the selection of default funds in modern awards. As outlined above, both the objective criteria in terms of eligibility to be included in modern awards, and the more subjective considerations such as scale, insurance offering, fund governance, services and knowledge of the industry should be reviewed by Fair Work Australia to ensure that all superannuation fund members, including the large segment of disengaged members, receive an appropriate retirement benefit. The performance of a default fund in modern awards is vital for those workers who make no choice in relation to their superannuation and the onus is on Fair Work Australia to ensure that those workers are placed in a fund which can prudently manage risk and produce good net returns for their members.

Yours faithfully

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