



# AIST submission

**Response to the Productivity Commission:  
Default superannuation funds in modern  
awards**

**April 2012**



Australian Institute of Superannuation Trustees

## Background

The Minister for Superannuation, Bill Shorten MP and Assistant Treasurer Senator Mark Arbib announced a review into the selection and ongoing assessment of default superannuation funds in modern awards in January 2012. This inquiry was scheduled on the back of legislation to create a new default product for working Australians who do not choose the destination of their superannuation monies – MySuper.

The scope of the inquiry was announced as:

- The Productivity Commission (“the Commission”) is to design criteria for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards by Fair Work Australia.
- The criteria designed by the Commission should be transparent and objective. In considering criteria for determining whether a superannuation fund is appropriate to be nominated as a default fund in a modern award the Commission could have regard to the following:
  - The appropriateness of the investment strategy of the default investment option of the fund in terms of risk and expected return;
  - The medium to long term net-of-costs investment performance of the default investment option;
  - The level of fees incurred by members;
  - The scale of the fund and the level of services provided to fund members;
  - The suitability and cost of insurance provided by the fund;
  - The governance of the fund; and
  - The fees incurred and other impacts on members if they cease employment with an employer.
- While the Commission is to focus on factors that optimise outcomes for members, it should also consider the administrative and compliance impact of its recommendations on employers and their representatives, unions, superannuation funds and decisions of Fair Work Australia (FWA).
- In undertaking its inquiry, the Commission should have regard to the following matters:
  - The interaction with the design and implementation of MySuper, including that only funds offering a MySuper product will be eligible to be included in modern awards;
  - Modern awards will continue to be made and varied by Fair Work Australia; and
  - Modern awards will be subject to a comprehensive public review by Fair Work Australia in 2014, following an interim review in 2012.

This review delivers on the Government's election commitment to ask the Commission to design a process for the selection and ongoing assessment of superannuation funds for nomination as default funds in modern awards. It seeks to develop transparent and objective criteria against which funds wishing to be eligible for default fund status in modern awards can be assessed, on an ongoing basis, to ensure that the best interests of members are met if their superannuation contributions are allocated to a default fund under the modern award.

The Australian Institute of Superannuation Trustees (AIST) provides this submission to the Commission in response to the Issues Paper.

## AIST

The Australian Institute of Superannuation Trustees (AIST) is an independent, not-for-profit professional body whose mission is to protect the interests of Australia's \$450 billion not-for-profit superannuation sector. AIST's members are the trustee directors and staff of industry, corporate and public-sector superannuation funds, who manage the superannuation accounts of two-thirds of the Australian workforce.

AIST is a registered training organisation and has recently expanded its education program to encompass the growing and changing needs of all members of the not-for-profit superannuation sector.

AIST offers a range of services including compliance and consulting services, events - both national and international - as well as member support. AIST also advocates on behalf of its members to relevant stakeholders.

AIST's services are designed to support members in their endeavour to improve the superannuation system and build a better retirement for all Australians.

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## **1 Executive summary**

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AIST believes it is important to have a robust and transparent process for the selection of default funds in industrial awards.

Superannuation as with other employee entitlements is set out in industrial awards. AIST believes this should continue.

The current system has served members well and provides an important safety net. As with other employment entitlements, superannuation issues in awards should be agreed to by industrial parties who have standing before Fair Work Australia.

When it comes to the selection of default funds, the interests of fund members – not competing funds – must be paramount. If the question is about what product is appropriate to a member specifically, this is the role that Choice plays. All funds, whether MySuper authorised or otherwise, are able to compete for members who exercise their right to choose a superannuation fund.

Our main concern is not that a particular sector be included or excluded, but that all default funds listed in awards are solid performers that deliver the best result for members. We think that not-for-profit funds will meet this test, while retail (for-profit) funds may struggle.

Employers must be confident that the fund choices they make for their disengaged employees are the right ones. Employers will be assisted by having a limited number of funds to choose from. The system has to work not just for employees, but also employers. Getting that balance right is the role of Fair Work Australia.

The benchmark for selection of a default fund into an industrial award needs to be higher than the MySuper criteria to ensure that only the very best and most appropriate funds are selected in each industrial award.

AIST is recommending to the Productivity Commission that Fair Work Australia selects the best funds by setting four criteria (additional to MySuper status) for selection:

- Past performance based on 10 year rolling net returns (APRA data), assessed against each fund's investment objectives and target returns
- Cost effective insurance and member services suitable for employees covered in the award
- Transparent fund governance where the role of employers and employees are considered, and assurance that the fund is acting in the best interests of members
- Protecting members by not allowing listed default funds to “flip” members into higher fee products on termination of employment

Employer and employee associations working together under the umbrella of Fair Work Australia should apply these criteria. These parties should draw upon the enhanced super fund performance and other reporting being developed by APRA. The industrial parties and FWA should also be able to seek expert guidance (e.g., from APRA) as they see fit in relation to these criteria.

As the superannuation industry is rapidly changing, the selection process should be reviewed every four years, as part of the ongoing review of modern awards. The actual selection of default awards should then be reviewed on award by award basis.

There are misconceptions and lack of clarity about how the selection process works. We therefore support greater communication from Fair Work Australia as to how the process for selecting default funds works and why funds are both listed and rejected.

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## Introduction

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AIST approaches the selection of a default fund on the basis of the following principles:

- The solution must be demonstrably in the best interests of workers covered by modern awards, as well as their employers.
- The efficient provision of superannuation entitlements should be encouraged through competition.
- It should be simple, transparent and fully disclosed.
- The interests of workers and employers are represented and promoted by the industrial parties before Fair Work Australia.
- The interests of financial service providers should be subordinate to those of workers and employers.
- Superannuation default arrangements do not reduce the opportunity to exercise superannuation choice, but should be clearly identified as an integral part of the safety net and include employee protections.
- MySuper criteria fulfil some, but not all, of the above criteria, and should be supplemented by additional criteria:
  - Cost-effective insurance and other services suitable for employees covered by the award;
  - Transparent fund governance;
  - Fair treatment of employees who cease employment; and
  - Requirements for long term fund performance.
- Recognition of Fair Work Australia's role in providing a balanced framework for cooperative and production workplace relations.
- The selection of default funds should be subject to on-going review as part of the modern award setting process.

The inquiry raises questions about the competitive environment for superannuation and financial services more generally.

There are real and important questions about major financial institutions, especially banks and related entities, using their market dominance to eliminate or reduce competition in superannuation. This has already occurred in the banking sector.

This question will be addressed in more detail elsewhere in this submission.

However, while the Commission will be considering if the process is sufficiently open and competitive, and uses transparent and objective criteria, these matters are not the end purpose for the process.

The end purpose (as spelt out in the Terms of Reference) is *“to ensure that the best interests of members are met if their superannuation contributions are allocated to a default fund under a modern award.”* In other words, to provide a safety net in respect of superannuation entitlements.

This safety net should apply when an employee does not make a choice or cedes that choice to their employer. In all instances, this is about the best interests of members as employees, as this question is posed in the context of employment conditions.

A default arrangement continues to be needed, as it remains commonplace for employees covered by modern awards to make *no* active choice of their superannuation fund. A default arrangement is needed to ensure that employees receive their superannuation entitlements from the time they start work.

Default superannuation arrangements have existed in the industrial relations system since prior to the advent of the Superannuation Guarantee. They have operated to ensure universality, fairness and balance, in a way that is supported by the representatives of employers and employees, and by the industrial tribunal itself. This is a role that the Commission should confirm.

The Fair Work Act maintains the key focus on safety net provisions. The Act has the object of providing a balanced framework for co-operative and productive workplace relations, and explicitly identifies the role of safety net provisions (ss.3(b)&(c)).

Default arrangements have operated well, and in the best interests of members, over the past 20 years.

Any lack of attention, or division of priorities that diminishes the key criteria of the “best interests of members” should be consciously avoided by the Commission. This would be a consequence of superannuation industry sector divisions dominating the Commission’s considerations, at the expense of employee interests.

The selection of default funds has to provide real assistance to employers as well. An unintended consequence of Choice of Fund has been the increased administrative burden on employers, as they now often have to send contributions to a larger number of superannuation funds. The level of interest and engagement of employers on superannuation matters is not high, and is even resented in some cases. Selection of default funds from a long list should not add to this burden. Alternately, the default selection of an employee’s previously active superannuation account (assuming they had one, and the employer was able to ascertain its identity) would unnecessarily add to the proliferation of funds with which the employer had dealings.

Employers often do not want to select a default fund, and they often do not want to make a choice from a long and unqualified list. The Commission should explicitly develop a process that is streamlined and simpler for employers. Given that only funds authorized to offer a MySuper product will be able to accept Superannuation Guarantee contributions after the transition period, an outcome that allows *any* MySuper product to be accepted would add no value at all. It would provide no extra support for employers and no extra protection for employees.

If default arrangements did not exist in the current environment, it may also be possible for employers to make default choices for their employees that could result in outcomes not in the best interests of employees. This is because the interests of employers and employees are not necessarily aligned. For example, while an employer might not want to choose a fund that has an effective contributions arrears process, employees might appreciate such a service.

Default arrangements can exist comfortably alongside Choice of Fund by members, and does not diminish competition. Choice of Fund has existed since 1 July 2005, and continues to do so. Not only are employees able to choose the superannuation fund that best meets their needs, they are encouraged to do so. They are able to choose from any complying superannuation fund, and no-one under existing or proposed arrangements is able to deny them choice.

Initiatives being developed as part of the Government’s SuperStream reforms include changes to employee enrolment process, which will further encourage employees to choose their superannuation fund. These may involve combining the TFN declaration form with the Choice of Superannuation Fund form, and the addition of measures to facilitate superannuation account consolidation. This will increase awareness of Choice, and reduce the incidence of fund selection by default.

Competition can also exist within the current default arrangements, and have regard to fund performance. The then Minister for Superannuation, Senator Nick Sherry, specifically addressed this question in an article published in Super Review (“Super myth-busting”, March 2009, p.13):

*“The view has been put that default funds favour a particular sector of the superannuation system, namely industry funds. It is true that many default funds are long-established industry funds, but the Government’s main concern is not that a particular sector be included or excluded from being a default fund, but that all default funds are solid performers that deliver the best result for members. If the parties and the commission agree that it’s an industry fund that fits the bill, so be it. If it’s a different type of fund, again that is a decision for the parties.*

*To aid the process, I have, as Minister for Superannuation, written to the commission and spoken with the parties, urging them to consider the long term performance of default super funds as part of their decision making. Soon-to-be-published data from the Australian Prudential Regulation Authority on long term fund performance will assist them. While the majority of default funds provide a good long-term rate of return, some do not.”*

AIST supports each element in the then Minister’s comments, and note that his approach can be buttressed by work in progress. For example, APRA, is continuing to develop published comparative data on long term investment returns, and will do so for MySuper products.

The next stage then is to propose the additional criteria that should be required when a MySuper authorised fund is nominated for selection as default fund in a modern award or enterprise agreement.



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## 2 Questions examined in the Issues Paper

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### 2.1 Current arrangements

#### 2.1.1 Awards and enterprise agreements

1. *For what proportion of the workforce do the default superannuation provisions in awards directly apply?*

Not known. However, it has been estimated that around 80% of the workforce is disengaged with their superannuation, with the highest levels of disengagement amongst the young and those with low account balances. Conversely, people aged over 50 and those with higher account balances are most likely to be involved with their superannuation.

Notwithstanding this, use of default provisions is not necessarily synonymous with disengagement. As was unanimously acknowledged by participants in the Stronger Super consultation process, there is a large cohort of people who allow their superannuation fund to be chosen for them, and who also allow the fund to choose their investment option as well. This acquiescence is based on the reasonably-held view that the selection of both fund and investment option is a matter that can be left to experts in the field.

2. *To what extent do default superannuation provisions in awards influence which superannuation fund (or funds) is listed in enterprise agreements?*

The existence of default fund provisions in enterprise agreement requires consideration of superannuation as a matter for negotiation, and agreement upon a specific fund or funds. This does suggest at least a modicum of interest as an industrial matter, and a level of confidence amongst industrial parties in choosing a finite list of default funds.

3. *Does the superannuation fund nominated in an enterprise agreement in any way impact on the assessment of the 'better off overall' test?*

Yes. A default fund nominated in an enterprise agreement should be required to meet all of the criteria for selection as a default fund in an award. If, in the comparison of long-term net returns and other key comparators, a default fund is demonstrably superior in comparison to the funds nominated in the award, this should contribute to the "better overall test".

#### 2.1.2 The current process for nominating default funds in modern awards

#### 2.1.3 Superannuation funds listed in modern awards

4. *How do employers currently choose between funds when there is more than one default fund listed in an award?*

Employers can choose between a limited number superannuation fund options. A range of sources assist employers in making a choice. These include employer associations, government publications and websites, superannuation ratings agencies and superannuation fund documentation and representatives. This is a simple and straight-forward process that does not require employers to be familiar with the whole universe of superannuation products.

5. *How do employers currently choose a fund when there is no default fund listed in an award?*

This is a difficult, time-consuming and onerous responsibility for the employer. Without the filter of listed default funds, the task of choosing the default fund for employees is a risky proposition.

Furthermore, employers are under no obligation to choose a fund that best meets members' needs. An employer might choose a fund on the basis of administrative convenience or priority super fund services for employers (e.g., a dedicated account manager). While these are legitimate, they are not necessarily important to the member of a fund. An employer should be able to receive these additional services provided there are no financial incentives being provided being made to employers.

There should be an express prohibition on super funds (or a related entity) making financial incentives to employers to encourage them to select a specific fund as the default fund for that employer.

6. *To what extent have employers made use of the grandfathering clause as opposed to choosing a fund from those listed in the relevant modern award?*

While there may be widespread use of the grandfathering clause in practice, the actual usage is unknown and the extent to which these funds represent a good superannuation outcome for workers is also unknown. As this practice is unregulated and unreported, there should be no grandfathered arrangements from the time that new fund selection processes are implemented.

#### **2.1.4 MySuper**

7. *What are the anticipated effects of MySuper on the superannuation industry in the short and long term, particularly in relation to the pace and extent of consolidation?*

The superannuation system is workplace-based. This will continue and be increased under MySuper. With some exceptions, funds will need to offer a MySuper product by 1 October 2013 in order to be able to accept default superannuation contributions.

This effectively means that all superannuation funds wanting to remain active in the market will have obtained MySuper authorisation by that time, and will have made all of the changes necessary to obtain that authorisation. This will include an annual review of scale (member and assets under management) that will accelerate the pace and extent of consolidation.

The additional requirements of MySuper will also result in funds assessing if they have sufficient resources to meet these requirements, and if it is in their members' best interests to consider a merger into another fund.

## **2.2 Are the criteria for MySuper sufficient?**

8. *Are the criteria required of MySuper products sufficient for the selection and ongoing assessment of superannuation funds eligible for nomination as default funds in modern awards? If so, why? Does the picture change over time, as the MySuper reforms drive change and consolidation in the industry?*

No. The criteria required of MySuper products go some but not all of the way necessary for the selection of eligible funds.

MySuper products will set the basis for the provision of simple, value-for-money superannuation products. Offering a MySuper product is an appropriate first step in meeting the criteria to be listed as a default fund in a modern award.

However, the areas not fully covered by MySuper are as follows:

- The level of services provided to members;
- Cost-effective insurance suitable for employees covered by the award;
- Aspects of fund governance; and
- Treatment of employees who cease employment (i.e. prohibition of ‘flipping’ to more expensive products).

In addition, while the pursuit of targeted long-term net fund performance is a criteria for MySuper, the achievement of strong long-term net fund performance as measured by APRA should be specific criteria in the selection of default funds.

Once transition to MySuper is complete, this situation will not change markedly over time.

*9. Is there a case for introducing a set of criteria over and above those required for MySuper products for funds to be eligible for nomination as a default fund in modern awards?*

Yes. We have answered this question throughout this submission and support further eligibility criteria.

## **2.3 Selection criteria for default superannuation funds in modern awards**

### **2.3.1 Investment strategy**

*10. To what extent do workers covered by different awards have different investment needs? Should any such differences be taken into account in the selection of default superannuation funds for inclusion in awards? If so, how?*

Just as the demographic profile of funds is different, so is the demographic profile of people employed under different awards. Health workers are more likely to be female; construction workers are more likely to be male; hospitality workers are more likely to be young.

These are matters taken into account by superannuation funds in determining an appropriate default investment option for their members. As a result of these factors, reasonable assumptions (often supported by objective assessments of member needs and expectations) can be made about remaining years in the workforce, account balances, and risk tolerance. These superannuation fund considerations will often translate into an appreciation of the different investment needs of workers in different awards.

*11. Should the investment strategy, investment return target and level of risk of the default investment option be factored into the selection of default superannuation funds for inclusion in awards? If so, how?*

This will be included as part of the authorisation process for a MySuper product. The ultimate determinant of the success of an investment strategy is the funds long term net returns, and return targets/risk profile will be a factor contributing to this. It should not be separately assessed during the selection of funds in modern award.

*12. Should lifecycle investment strategies be considered? If so, how?*

This may be included as part of the authorisation process for a MySuper product, noting that the provision of a lifecycle investment strategy is optional. The inclusion or non-inclusion of a lifecycle strategy should be regarded as neutral in regard to the MySuper authorisation process. The ultimate determinant of whether or not a super fund is looking after a member's best financial interests is the fund's long term net returns, regardless of the strategy employed. It should not be separately assessed during the selection of funds in modern award.

### 2.3.2 Fund expertise and performance

#### 13. *Should a fund's investment management expertise be factored into the selection of default superannuation funds for inclusion in awards, and if so, how?*

This will be included as part of the authorisation process for a MySuper product. The ultimate determinant of whether or not a super fund is looking after a members best financial interests is the funds long term net returns, and investment management expertise will be a factor contributing to this. It should not be separately assessed during the selection of funds in modern award.

#### 14. *How relevant is a fund's past net performance as an indicator of its potential future performance? What weight, if any, should be placed on the past performance of a fund in assessing its suitability for inclusion as a default fund in awards?*

Funds should be required to meet a minimum level of past performance to be selected (having regard to their target return and risk profile).

Past performance is a relevant indicator if measured over a suitably long period, preferably 10 years or more. This will be included as part of the authorisation process for a MySuper product. The ultimate determinant of whether or not a super fund is looking after members best financial interests is the ability of the fund to provide long-term net returns that meet its investment targets. The focus of this exercise should be on the ability of funds to meet their investment promise to members, rather than comparing themselves to industry peers.

This criteria should be linked to the APRA performance tables, and reviewed every four years. Funds should, however, be given the opportunity to explain below average performance so as to not cause unnecessary disturbance to employers and employees. Naturally, if a fund cannot justify below average investment performance then they should be removed from the award.

#### 15. *If past performance is considered important in assessing a fund's suitability for inclusion as a default fund in awards*

##### *a. Over what time period should past net performance be assessed?*

10 years rolling net returns, as assessed and published by APRA.

##### *b. How should funds with no net performance record (for instance, newly merged funds or new entrants to the market) be assessed?*

Newly merged funds should be required to produce an APRA-endorsed indicative comparison rate of return

A proxy performance rate should be provided under guidance from APRA. For instance, where a default investment option has become a MySuper product the return for this option should be used as the proxy. It is

noted that where funds have merged and investment structures are not dissimilar, the APRA has allowed weighted average returns to be used.

- c. Should net performance be assessed in absolute or relative terms? That is, should the top performing funds be selected (regardless of their absolute returns), or would funds be required to meet a particular target level of performance?*

Net performance should have regard to a fund's target return and risk profile.

### **2.3.3 Fees**

- 16. Should fees be factored into the selection of default superannuation funds for inclusion in awards and if so, how? For instance, are there circumstances in which paying higher fees could serve the interests of members of default funds? Does this differ across industries? Should maximum fees be set for funds that are selected for inclusion as default funds in awards?*

Net returns rather than fee levels should be the prime consideration in the selection process. Fees should only be a consideration when a fund is demonstrably charging an unreasonably high fee for administration, or where investment fees are unreasonably high on a like-for-like basis. APRA will be reporting on fees in their enhanced statistical collection process, and this information should be drawn upon by FWA and the industrial parties in the selection process.

### **2.3.4 Life and total and permanent disability insurance**

- 17. Should default superannuation funds be required to provide maximum or minimum levels of life and TPD insurance? How should the cost of this insurance be factored into the selection of default funds for inclusion in awards?*

Rather than insurance being assessed on a minimum or maximum basis, it should be assessed on the basis of fitness and appropriateness for the workers covered by the award. This is an issue that will be determined by the industrial parties involved and forms part of their decision-making process. The industrial parties should be required to explicitly choose a fund that allows members access to appropriate levels of cover.

Most super funds offer a default level of cover which is automatically allocated to a member upon entry. Usually, members will have the choice to select higher levels of cover, lower levels of cover or cancel cover by choice at the time of entry, and without extensive underwriting. Higher levels of cover are also able to be accessed outside of these times subject to underwriting.

Some funds require that members must have a minimum level of cover while receiving contributions into the fund e.g. Cbus, but most will allow members to cancel cover altogether. The more important issue here is access to cover. Industrial parties will tend to want to allow members flexibility in choosing their cover needs while at the same time providing a base level of cover and protection.

Cost of insurance will be factored into the selection as all stakeholders are usually conscious of the relationship between the cost of insurance and the final retirement benefit available to members. Final cost will be dependent on the makeup of the fund's membership and their inherent risk profile as well as the type of cover provided and default levels chosen.

*18. To what extent do workers covered by different awards have different needs for life and TPD insurance? How should any such differences be factored into the selection of default superannuation funds for inclusion in awards?*

The industrial parties involved will be driven by the specific needs of their membership and will want to ensure that the default fund nominated in the award delivers the best value for their members. This includes cost, extent of coverage, exclusions, and occupational basis of cover as well as any limitation of cover with respect to certain occupations.

For example, unions representing workers within the construction industry are more likely to support a construction based fund such as Cbus or BUSS(Q) than other funds because these funds are seen to represent the interests of their member group. From an Insurance view point unions see the benefits that have been able to be delivered for construction members by pooling together and having arrangements that specifically cater for the needs of their members and which provides universal cover to all members and for all occupations within the sector. Some of the occupations covered under Cbus and funds like BUSS(Q) for example would normally not be insurable in the retail insurance environment and perhaps in some group arrangements as well.

This association with the relevant industry also applies to employer organisations. For example, the interests and activities of the Master Builders Association in representing the interests of employers in the building industry is not necessarily the same as employer associations in other industries.

In addition some industrial parties will be keen to look broadly at how the fund can assist their particular industry and membership. For example funds that are able to identify with a particular industry can indirectly support the creation of employment within that industry by reinvesting into it, e.g. Cbus Property Trust reinvests back into the construction industry.

### **2.3.5 Income protection insurance**

*19. Should income protection insurance be factored into the selection of default superannuation funds for inclusion in awards and, if so, how?*

Income protection is an optional feature of a MySuper product. Where it is offered as default cover, it will generally be provided in place of TPD cover. While either TPD cover or IP cover is a prerequisite feature for a MySuper product, both should be considered from the perspective of appropriateness for the workers covered in a particular award.

There are alternative structures in place within industries such as EBA arrangements which may cater for this need, with insurance typically covered under a general insurance policy with the cost of the premium generally covered by the employers as a condition of employment.

Cost is another factor that also needs to be considered as IP tends to be quite expensive therefore industrial parties will be concerned with the cost benefit analysis when comparing benefits received to impact on retirement benefits.

Benefit structure available under default arrangements will also be a factor to be considered. A default structure with a 90 day wait may in some circumstances be of little benefit to members if they are unable to choose lower waiting period when first joining without the need to provide health evidence. In addition consideration will need to be given as to the level of cover available under default when compared to the average income of members



being represented. For example a default arrangement based on a benefit of 75% covering a salary of \$20,000 p.a. may be of little assistance to a group of members who have an average salary of \$100,000 p.a.

### 2.3.6 Other member services

20. *Should the scope and cost of the member services offered by a superannuation fund be factored into the selection of default superannuation funds for inclusion in awards and, if so, how? Should default funds that are selected for inclusion in awards be required to provide a particular standard of service?*

The member services themselves should be appropriate to their member base. It is reasonable to conclude, for example, that a fund that is dedicated to clerical professionals is going to need or expect a different level of service to those working in the manufacturing industry. Some working Australians are more financially literate than others, and so the level of communication and services need to be tailored to the level of literacy amongst members covered by different awards.

Obviously, different services are going to be more (or less) costly than others. We recommend that these services be appropriate to the Australians covered by each award on an award by award basis.

21. *To what extent do workers covered by different awards have different service needs? Should any such differences be taken into account in the selection of default funds and, if so, how?*

We discussed in our answer to the previous question that some Australians are going to have different needs to others. We are aware that funds already tailor their services to suit the members that they have in different industries and this can be illustrated by examples.

For example, a financially savvy member-base may be more interested in having a fund staff-member direct them to available investment options, whereas a less financially savvy member-base may predominantly prefer to be advised on appropriate investment options.

### 2.3.7 Governance

22. *What impacts are the additional trustee duties likely to have on the performance of MySuper products?*

The design of MySuper is such that any additional duties that are prescribed for trustees will result in a lifted standard of governance across the board. This is important, as the majority of Australians have had their superannuation credited to the default option of their superannuation fund.

The links between improved governance and higher performance is well documented and we expect that with the improved level of governance come improved returns.

23. *Beyond the Stronger Super reforms, are there any particular aspects of fund governance that should be considered in the selection of default superannuation funds for inclusion in awards?*

We believe that it is important that employees and employers have a say in the choice of funds available to them. Representation on trustee boards is the logical extension of a system where employers and employees are required to agree on default arrangements for workers in the industry that an award covers.

The representative trustee model takes this consensual approach and extends it beyond the mere choice of which fund to use. It extends this concept to the stewardship of assets used.

We believe this model follows on logically from the concept that employers and employees should be in charge of their own destiny and ensures that the interests of the parties are aligned. More importantly, it is a right that the parties have or ought to have: It is the industrial parties who determine how their superannuation should be invested and to deprive these parties of any level of decision-making throughout the process would cripple this both this right, and any responsibilities that are associated with them.

*24. Would being selected as a default fund in an award affect fund governance and operations?*

A fund will have deliberately embarked on a path of increased fund governance and operations to meet the additional criteria required for MySuper status. Additionally, funds are likely to make a conscious decision to offer enhanced members services and operational capacity to be selected as a default fund in an award. Selection will, in part, be a result of greater fund governance.

**2.3.8 Scale**

*25. Is there an ideal 'fund size' for default superannuation products?*

No. Funds will be required to make their own assessment of scale to ensure that they are able to offer a MySuper product that is in their members' best financial interests. As this process is a threshold MySuper criteria, it should not be a criteria that is duplicated in the selection of funds in awards.

*26. How do factors like the ability to market and communicate with industry participants impact on the question of scale?*

Larger funds may have access to economies of scale, ensuring that the costs of marketing and communicating to members are less burdensome to members when calculated at the 'per member' level. However, marketing of services and performance should always be subordinate to the actual delivery of superior performance and services.

The recent APRA report on scale demonstrates that scale has not delivered outperformance amongst retail funds. Presumably, increased scale has resulted in increased profitability for shareholders rather than increased returns for members.

*27. Is there a need for fund scale to be factored into the selection of default superannuation funds for inclusion in awards beyond that already implicit in the MySuper rules?*

There are costs and benefits associated with scale, some of which cannot be quantified in financial terms. Although the Stronger Super reforms make it clear that scale is a projected outcome and would have beneficial outcomes from economies of scale, a detrimental outcome may be a sense of intimacy and knowledge that customer service personnel have with a smaller member base.

This criteria may be considered more or less important in certain industries as well and as such we believe that the best assessment of the appropriateness of such a measure would come from the parties to an industrial agreement.

*28. Is there a clear relationship between fund scale and returns for members?*



As mentioned above, APRA has recently released the results of research into the relationship between fund size and the performance of APRA-regulated superannuation funds. The APRA Working Paper “Effect of fund size on the performance of Australian superannuation funds” examined the potential benefits of scale: better gross investment returns, lower investment expenses and lower operating expenses. They concluded:

*“The results of the research indicate that the performance of not-for-profit funds (corporate, industry and public sector funds) improves with fund size. The greatest benefits accrue when not-for-profit funds grow to a multi-billion dollar size. Therefore, there is reason to believe that further growth in fund size and member balances will result in further economies of scale in the not-for-profit sector. However, fund size does not have an overall positive impact on the performance of retail superannuation funds”.*

### **2.3.9 Other criteria**

*29. Are there any other criteria that should be used to assess whether a fund is suitable for inclusion in modern awards?*

MySuper provides for a member to be moved (without their consent) from a large employer-sponsor MySuper product to the generic or standard MySuper product in the same fund (or an ERF) if they no longer meet the membership requirements of the large employer-sponsor MySuper product. This may result in a member being moved from a lower priced fund to a higher priced fund.

This is not a desirable policy outcome and the government has itself conceded that additional rules may be needed to protect members being transferred to a substantially higher-priced product without their knowledge or consent. Notwithstanding the possibility of further government initiatives in this area, the current structure of MySuper can result in this outcome.

Allowing flipping will result in financial disadvantage for the member, and provide an incentive for financial product providers to direct members from lower cost to higher cost products.

### **2.3.10 Are there net benefits to having additional criteria?**

*30. What would be the costs, the benefits and the net benefits of introducing a set of criteria over and above those already set out for MySuper products for funds to be eligible for nomination as a default fund in modern awards?*

The costs of introducing additional criteria are minimal, and should be borne by the fund. The benefits of scale should ensure that such costs are minimised across a larger member base.

The benefit of requiring additional criteria will be a reduced burden on employers when selecting a default fund, as well as the knowledge and comfort that the funds listed will have members’ best interests as their primary goal.

The benefits to members will be to have the effect of a strengthened safety net in place where members have not made a choice as to which superannuation fund to join.

The net benefit to members will no doubt be positive, as the additional criteria benefits significantly outweigh the costs.

*31. Who would incur the costs?*

This has been covered in question 30.

32. *Who would the benefits accrue to? Would they be confined to those for whom a modern award applies? Or would they flow through to other MySuper products and/or choice products to drive widespread improvement in the superannuation industry? Would they flow through to taxpayers by lowering the burden on public funding for pensions?*

The direct benefits accrue should accrue to members through improved net performance. These additional benefits should subsequently flow through to both MySuper and Choice products and should raise the bar for superannuation funds.

We believe that the question relating to the interaction between super and publicly funded pensions is highly complex and is not simply answered within the context of this inquiry.

33. *Would the criteria need to vary by industry?*

No. The additional criteria should be the same across the board and should form an objective way for trustees to know whether their fund is eligible.

34. *Are these criteria needed now, or would it be better to wait to see the full effects of MySuper on the industry? If so, how long might this take?*

Yes. Because the additional criteria are over and above initial MySuper authorisation, it should be reviewed as part of the four year assessment process.

## 2.4 Implementation issues

### 2.4.1 Transparency & Contestability

35. *Are transparency and contestability desirable features of a default fund selection process?*

Transparency and contestability are desirable features of a default fund selection process. The default fund selection process must be transparent, to ensure that the reasons of the industrial parties can be correctly surmised when agreeing on a default fund arrangement.

The selection process should be contestable. This would encourage competition between default fund providers, therefore providing a better product for the members. In addition, it would ensure that the objectives to be satisfied by successful funds are known better ahead of the selection process in a way that funds competing can know what they are competing for.

36. *Is the current process for listing default superannuation funds in awards transparent? Is it competitive? Is there a level playing field between industry and retail funds? Is there a level playing field between domestic and international funds and should there be?*

The existing processes do not appear to be sufficiently transparent, understandable and accountable to an external observer. While the industrial parties should be ultimately responsible for the selection of default funds in awards, they should also be required to provide an explanation for their choice.

FWA should publish information about the selection process in simple language, and be able to refer inquirer to the explanation for the inclusion of particular funds at an award level.

Both industry and retail funds are product providers from the perspective of modern awards, and should not of themselves be able to select themselves. That obligation should remain with the industrial parties.

Only APRA-regulated funds that are MySuper compliant are able to be considered for selection. An internationally based fund is almost certainly unable to meet these criteria from an international location. However, an internationally based fund is not prohibited from setting up an Australian operation that could establish regulated superannuation funds. This already occurs.

*37. If not, what are the barriers to transparency and contestability? What are the effects of these barriers on member outcomes?*

Not applicable. See above.

*38. Will expected superannuation fund consolidation have any impact on the current process for selecting default superannuation funds? Will it affect competition in the superannuation and default superannuation markets? Is it expected to improve performance and cost-effectiveness? If so, how?*

When superannuation funds consolidate, this creates greater economies of scale. It may strengthen the transparency and contestability of superannuation default fund selection, thus ensuring that the best interests of the members are met.

Where super funds consolidate, the successor fund should be automatically included in the list of default funds listed in the award. The list of default funds, including changes to the list through this process, should be reviewed as part of an ongoing four yearly review of default funds by FWA.

A smaller number of larger funds should improve overall cost-effectiveness and performance, and therefore enhance competition in the market.

### **Trade-offs between criteria**

*39. When considering whether a fund is eligible for nomination as a default fund in a modern award, how should its overall performance be assessed?*

As discussed in section 3.3, performance should be assessed on the basis of long term net performance (i.e. rolling 10 years after taxes and fees). Funds that have delivered such performance on or above average according to APRA league tables should be considered as passing the eligibility criteria. The other eligibility criteria should be considered separately to this performance criteria.

*40. How should trade-offs between different eligibility criteria be made? Should different weights be placed on certain criteria?*

Each eligibility criteria should stand alone and have equal weighting, and not be allowed to be compromised by another criteria. A fund should have to satisfy each eligibility criteria to be listed in a modern award.

*41. Should there be a 'two tier' process where a fund must meet certain eligibility criteria, while other criteria are optional?*

Where certain eligibility criteria apply, then these criteria should be mandatory and not optional. If a fund offers additional features and services above these criteria, then the industrial parties will be best placed to consider this for the benefit of the members.

#### **2.4.2 A target number of funds**

*42. Should all funds deemed eligible for nomination as a default fund in a modern award be listed? If so, why? How would this affect the administration costs for employers choosing one fund among those listed in awards?*

Throughout this document, AIST has proposed a number of criteria for inclusion in a modern award. It is appropriate by way of context that these steps be summarised:

- (i) Superannuation funds named in awards should be authorised to provide a MySuper product; and
- (ii) The MySuper product provided by the superannuation funds named in the awards should meet additional criteria over and above basic MySuper compliance, such as no 'flipping', or the meeting of pre-determined performance criteria.

Only after meeting these two requirements, should funds be considered by the industrial parties to the modern award. Following from this, it should be entirely up to those industrial parties as to which funds end up being selected as default funds within an award.

In this context, the first part to the question above can only be answered in circumstances where the industrial parties are unable to come to an agreement regarding the funds that are to be listed, or in circumstances where the parties name an unworkable number of funds to an award.

Naturally, this means that in all other situations, the answer to the question, 'should all funds deemed eligible for nomination... be listed?' will be 'no'. It will always be no, as an ideal solution requires, in addition to the two steps proposed by AIST, the following steps to ensure that the list of default funds is reasonable and well chosen:

- (iii) The industrial parties to the award agree on the funds chosen to be named as defaults in a modern award from a list of funds that meet the criteria listed in steps (i) and (ii); and
- (iv) The total number of funds named should come within pre-determined guidelines drawn up that are appropriate to the industry where the modern award is to apply.

Failure to set an appropriate limit as per point (iv) will create administration costs for business, in particular, small business in selecting a default fund from an unnecessarily large list.

*43. Should there be a target number of default funds listed in modern awards? If so, why?*

Yes. A limit should be set that is appropriate to the industry where the modern award is to apply. As remarked above, an unfeasibly large list of default funds, or even open-ended criteria, such as, 'all funds meeting condition Y...' imposes administration costs on business looking to reduce their compliance costs and seeking to streamline the payment of default contributions.

At the same time, there should be choice available to businesses who are subject to the modern awards. We do not support the mandating of one fund as a default, except in circumstances where that fund is the only appropriate choice, however it should be re-iterated that the employer and employee groups who negotiate awards are the most knowledgeable as to what is most appropriate to their industry.

*a. What number of funds should be targeted? Should this number differ by industry? If so, on what basis?*

As discussed above, numbers should be appropriate to the industry in question. However, that is not to say that an ‘anything goes’ situation should be in existence either. For example, if industrial parties were to agree after consideration of eligibility requirements that 50 funds should be named in awards, this would be a less than optimal outcome in most situations.

FWA should endeavour to limit the number of default funds as far as practicable, to give useful guidance to employers. It is noted that at present the largest number of awards list between two and seven funds, and suggest that this provides guidance as to the useful and appropriate number of funds that should be listed. While we do not think that this range should be mandatory, we nonetheless think that parties should be required to specifically justify a number of funds outside of this range.

Existing default funds listed in awards should be considered by the industrial parties against the new (and above MySuper) criteria for selection, along with any other super funds that may be considered by the industrial parties.

FWA, after discussion with the parties, might agree that a different outcome may be appropriate to the industry in question. This could only work where the onus rested with the industrial parties to defend the position where this outcome might be appropriate.

We propose that broad guidelines be implemented, such as the agreement should ordinarily include between two and seven funds and agreements that lie outside these guidelines be justified by the parties to the tribunal on an ‘if not, why not’ basis.

*b. How would this affect the administration costs for employers choosing one fund among those listed in awards?*

As has been explained, a smaller number of funds will aid the administrative efficiency of employers and help reduce costs.

*c. Who should make the decision to restrict the number of funds in cases where more than the limit is found to be eligible, and how should this decision be made?*

As we proposed above, Fair Work Australia should request justification from the industrial parties where outlying consensus is reached.

*d. Should the same criteria and trade-offs between criteria as for eligibility be applied, or should they differ?*

We have proposed that criteria regarding eligibility be applied over and above basic MySuper compliance. We believe that this criteria is appropriate to all Australians and should therefore be applied to all decision-making bases prior to the discretionary consensus of the industrial parties.

*44. How should expected consolidation in the superannuation industry be taken into account? What would happen in the event of product mergers?*

As discussed previously, when superannuation funds consolidate, greater economies of scale are created which may strengthen transparency, contestability and the ability of a fund to meet the best interest of their members.

Where super funds consolidate, the successor fund should be automatically included in the list of default funds listed in the award. The list of default funds, including changes to the list through this process, should be reviewed as part of an ongoing four yearly review of default funds by FWA.

Whilst we see a smaller list of default funds as an advantage for business when determining an appropriate fund for default contributions, a reduction to a very small list should be continually examined by industrial parties to determine the appropriateness to that industry.

*45. Should some type of grandfathering clause remain in modern awards? What are the advantages and disadvantages of retaining such a clause?*

AIST is opposed to grandfathering continuing in its present format. We believe that a 'day zero' must be implemented to ensure that the considerations of employees subject to default arrangements are at the very heart of future arrangements.

**2.4.3 Administrative issues**

*46. What should be the process for applying the criteria for the selection of superannuation funds eligible for nomination as default funds in modern awards?*

The process for selection should be open and transparent, and clearly be the responsibility of one regulator, that is, Fair Work Australia. Responsibility for the prudential regulation of super funds rests with APRA, and both the RSE licensing of a fund and their authorisation to offer a MySuper product will be a prerequisite for being considered as a default fund in a modern award.

*a. What would be the steps involved in the process?*

The process for the selection of default funds should be specifically included in the scope of the review of modern awards scheduled to be undertaken during 2013. The Government should ask FWA to consider the report produced by the Productivity Commission in the context of the Objects of the Fair Work Act, and the Objects of modern awards as defined in the Act.

In the first instance, it should be the responsibility of industrial parties to each award and enterprise agreement to nominate the super funds to be included on the list. The hearings in relation to the selection process should be publicised, and funds should be able to approach industrial parties with standing before FWA for selection, and to provide a written submission in support of their selection. The industrial parties and FWA would then be able to consider whether or not they meet the criteria for selection.

At the moment, standing to make an application rests with industrial parties. so Importantly, this reflects that the focus of FWA is upon getting the right balance of interests between employers and employees. To give other parties standing without good reason is a distraction, and not in accordance with the objects of the act, other than in exceptional circumstances.

This is a principle that is relevant to the operation of FWA writ large, and is not just specific to superannuation. To relax this rule in this case would ultimately undermine the operation of FWA in providing a balance framework for the consideration of issues pertaining to employers and employees.



Super funds do not have standing before FWA but it is open for them to directly approach an industrial party to seek to be included as a default fund in an award.

*b. Is there a case for an organisation other than FWA to assess the eligibility of funds against any selection criteria?*

No, the ultimate responsibility for assessing eligibility against selection should be the responsibility of FWA. A division of selection criteria between regulators would be disruptive and lack clarity, although of course, FWA is able to draw upon the expertise of others as required.

A range of statistical and other reports will be available from APRA on fund performance, target returns, meeting of prudential standards, and provision of other services. It is suggested that FWA be required to have regard to this information in all instances, and to provide an explanation for its decisions in relation to each award.

*c. What should be the role of the industrial parties to the awards? What should be the role of FWA?*

The role of the industrial parties in this matter, as with all matters, is to represent the interests of members and employers, and to ensure the best outcome for them. In the context of default superannuation, this means expressing a position in relation to members who have not made an active choice, but who, either actively or passively, have let their employer choose a fund for them.

It is important that legitimate interests of employers to choose a fund that provides some benefit to them (e.g., in relation to ease of administration or not badgering the employer about unpaid contributions) be balanced with the interests of less engaged members (e.g., who benefit from a fund that follow-up on unpaid contributions).

*d. What would be the administrative and compliance burden of such a process on employers and their representatives, unions, superannuation funds and FWA?*

The enhanced statistical and other reporting framework being developed by APRA will provide all of these parties with the tools to make a reasonable and informed selection. The base criteria of requiring MySuper authorisation followed by the application of other criteria will filter the number of funds available selection to a reasonable level.

*e. Is there any international experience to draw from in designing the process?*

AIST has not been able to consider this question at this time.

*f. How might MySuper products that are tailored to the needs of particular large employers affect the selection of default funds eligible for nomination in awards?*

On the face of it, a large employer MySuper product would be advantaged in relation to the selection of that fund for an enterprise agreement covering that employer.

However, it is critical that a large employer MySuper product is also able to meet the requirement prohibiting flipping. That is, a super fund listed in an award should not be able to transfer a member leaving the employment of the large employer to another super fund that charges higher fees without their knowledge and consent, even if that other fund is a MySuper product.

*47. If funds currently listed in awards were unable to meet a stricter set of criteria, what would be the consequences for members, employers and their representatives, unions, superannuation funds and FWA?*

The removal of a default fund from a list in a modern award would have immediate consequences, with employers continuing to make default contributions to a removed fund being in breach of award requirements. FWA should follow a similar process in regard to losing my super authorisation.

*48. What would happen in the event that a listed fund had its MySuper product license revoked by APRA for no longer meeting the MySuper requirements?*

A super fund that loses authorisation for its MySuper product will not be able to accept default SG contributions; as a consequence, an employer seeking to make default contributions to a fund without a MySuper authorisation will not be meeting its obligation to make superannuation payments on behalf of its employees.

In the event of a fund losing its MySuper authorisation, APRA should require the fund to notify its members and the employers contributing to it of this event. They should also forward the employers information from APRA about the significance of this, and the steps that employers need to take, including the name of alternate default funds available to them.

APRA should also be required to advise FWA of this event. In turn, FWA should convene a hearing to consider the removal of the fund in question from the list of default funds from all modern awards and enterprise agreements where it is listed.

#### **2.4.4 Ongoing assessment of eligibility**

*49. How frequently should eligibility be assessed?*

Eligibility should be assessed every 4 years as part of the ongoing FWA assessment of the provisions of modern awards process.

*50. Who should perform this assessment?*

FWA should perform this assessment, and should use its existing powers to draw upon external expertise as required.

*51. Should the assessment process differ from the initial selection process? If so, in what way?*

No, the process should be no different from the initial selection process, as no fund should assume that once they are in the award that they have a right to remain in perpetuity. Similarly, other funds may wish to be listed on the award and should be given the opportunity to be listed in a structured and orderly manner.

*52. How should the assessment account for consolidation in the industry?*

As mentioned in Section 3.4, where funds merge, the successor fund should automatically remain listed in the modern award until the next assessment period. At this point the merged fund should be removed from the award. If industry consolidation results in a significantly reduced number of listed options within the award, then the industrial parties or FWA on its own motion should have the discretion to invite other funds to apply for selection between assessment periods. This should be the exception rather than the rule.



*53. What would be the consequences of funds transitioning in and out of meeting the eligibility criteria for employers, members, the funds and FWA? Is there a way to manage this transition?*

Funds will necessarily have to meet the MySuper authorisation criteria on an annual basis with APRA. If a fund does not pass this test, then they cannot except default monies and consequently will not be able to be listed in a modern award. There are transition arrangements in place should this occur with APRA.

Funds that are listed in modern awards should be required to demonstrate that they still comply with the eligibility criteria on an annual basis and be given the opportunity to explain why they do not meet the criteria should that be the case and put forward a solution to meet the criteria. The industrial parties should be notified of this process which will give them the opportunity to review the most suitable fund for their members.

*54. Should the criteria for fund eligibility themselves be reviewed or changed over time? If so, how often and by whom?*

This should be at the discretion of FWA as part of the 4 yearly assessment process and should be function of whether the criteria are seen to be relevant and sufficient. Additional criteria should be included if such will be in the best interest of members.

#### **2.4.5 Choosing a default fund amongst those listed in modern awards**

*55. Are employer best placed to choose one default fund among those listed in awards? If so:*

- a. Do employers need assistance in choosing between funds listed in awards? What type of assistance do they require and who should provide it?*

Employers will have access to the APRA MySuper league tables which will list the performance, features and services associated with each MySuper product. Employers will also have access to listed fund staff and communication to assist their decision making process. This is where it is apparent that the number of funds listed in an award should be limited to a reasonable number so it does not become a burden on employers or they do not become bombarded by funds for business.

- b. Is some mechanism required to ensure that employers act in the best interests of their employees when making this decision? If so, what?*

The fact that the selected funds are MySuper compliant and then have to satisfy additional criteria and be selected by industrial parties, should be sufficient for employers not to have make such a decision. By default the listed funds will all satisfy the best interest test and the employer and can choose the most suitable fund for his business and employees.

*56. If not, why not? Who or what other organisation could be better placed to make this choice? What process should be followed?*

Not applicable, see 55b.