

ISN SUBMISSION

**PRODUCTIVITY
COMMISSION
INQUIRY –
DEFAULT
SUPERANNUATION
FUNDS IN MODERN
AWARDS**

**ISN SUBMISSION DEFAULT
SUPERANNUATION FUNDS
IN MODERN AWARDS**

5 April 2012

V8



**Industry
Super
Network**

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About Industry Super Network

Industry Super Network (ISN) is an umbrella organisation for the industry super movement. ISN manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of five million industry super members. Please direct questions and comments to:

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| SUMMARY

The Productivity Commission has been asked by the Government to report on a process for the selection and ongoing review of superannuation funds to be included in modern awards as default funds.

ISN submits that default funds should be named in awards by Fair Work Australia in an open and transparent process based on straightforward criteria, the most important of which is long term net returns.

The current system

Under the current system, which has evolved from a structure developed when award and universal super first appeared, Fair Work Australia names default funds in modern awards based on submissions from any parties, including the industrial parties – employer groups and unions. The awards are reviewed every four years.

The current system is criticised by some, but it has produced strong outcomes for workers covered by modern awards. Those funds named in awards have, with few exceptions (notably including the major retail funds), provided above average net returns to members.

Given that superannuation is a public policy focused on providing better retirement outcomes for people (not improved profits for financial institutions), proposed changes to the process must be tied to actual improvements in those outcomes. Abstract and simplistic arguments about a competitive process should have no place in this inquiry. Outcomes must drive any process change.

Moreover, proposed changes to process must take into account the reality of imperfect markets, particularly in the context of the workers covered by modern awards and default funds. This submission proposes a process open to any APRA-regulated fund, but calls for criteria that correct market defects and will further support good outcomes for workers.

Fair Work Australia's role in the proposed process

Awards apply to the most vulnerable workers in the economy – those without the qualifications, skills and bargaining power to achieve pay and conditions above basic socially accepted minimum levels. As the industrial umpire, Fair Work Australia (FWA) is ideally placed to consider facts and arguments from various interested parties related to workplace conditions. These conditions include the default superannuation fund to which workers' retirement savings are directed when they don't express their own choice of fund.

A structure for determination of default funds that did not include FWA would result in these workers being unrepresented in this determination, despite bearing the long-term costs of this decision. This would represent a fundamental misalignment of incentives and could not be relied on to deliver efficient outcomes for workers.

To the extent that in the course of assessment of potential default funds, expert input is required to assess against relevant criteria, FWA could (as it does in relation to other matters) periodically convene an expert panel independent from industry that could assist FWA in its deliberations.

Employer choice

In the absence of a central role for Fair Work Australia it is likely that employers would be required to choose a default fund from any compliant fund (the relevance of MySuper in this context is discussed below).

There is strong evidence that employers generally do not want to choose the default fund for their workplace, and acknowledge that they are not well-equipped to make those choices. According to

research by Colmar Brunton for the ATO, employers demonstrate little knowledge or interest in superannuation and place ease of administration as the priority. Typically employers do not compare the relative performance of super funds and 88 per cent are satisfied with the current arrangements. Putting employers in the position where they choose the applicable default fund will result in degraded retirement outcomes for workers.

MySuper and the proposed process

This referral of this matter to the Productivity Commission has been made in the context of the introduction of a new regulatory compliance regime for workplace default funds – MySuper. The original concept behind MySuper, developed in the Super Review, was to provide a more stringent compliance regime for workplace default funds.

Unfortunately, the regulatory changes actually announced in pursuit of this goal are very limited. In particular, restrictions on the types of fees funds charge have been introduced, and trustees will be required to quarantine MySuper members from the cost of expensive options.

There are no requirements – relative or absolute – in relation to either fees or performance. This leaves any price and performance pressure to be delivered by competition. However, this approach will be unreliable because MySuper will not require cost transparency. Trustees will be able to maintain multiple MySuper brands and options, and even offer varied pricing within products, including discounts to large employers.

There is consequently no reason to expect MySuper will address some of the weaknesses of current default fund arrangements, including:

- the prevalence of high cost corporate master trusts as default funds among small employers; and
- the capacity for relatively low cost corporate master trusts in large workplaces to flip members into more expensive products with reduced insurance cover offered by the same trustee or a related party when the employee leaves the workplace.

While the original MySuper framework proposed by the Super Review would have created a high benchmark for super funds to meet if they wished to become default funds, the current design means that MySuper compliance is a necessary but insufficient condition to establish suitability as a default fund in awards.

Long term net returns as the prime criteria

Superannuation funds invest the deferred wages of workers, generally over a long period of time, to provide an additional source of retirement income to the public pension. As investors, workers' accounts are credited with investment returns (net of all costs and taxes) as compensation for the deferment of consumption and for risk. The level of net returns over time directly determines the rate of accumulation of savings and therefore the contribution of superannuation to retirement income.

In the Australian superannuation industry, the relative returns by sector show a high level of persistence over time. Not for profit funds have outperformed retail funds by around 180 bps pa over 15 years.

At the fund level, APRA analysis has found statically significant evidence of persistent outperformance and underperformance. Specifically, they find that being in the top half of funds by performance in one five year period (1999-2003) gives a 60 per cent chance of being in the top half of funds in a second five-year period (2004-2008).

ISN in this submission presents new research backing the APRA finding. Specifically, being in the top third of funds by performance in one four-year period (2003-2007) results in a 46 per cent chance of being in the top third of funds in a subsequent four-year period (2008-2011) (as opposed to a one-third chance if

random). Similarly, being in the bottom third in the first period gives a 41 per cent probability of being in the bottom third in the second period.

In the context of Australian superannuation, funds with past outperformance have an increased probability of future outperformance.

Recognising that the principal objective of superannuation is improvement in retirement outcomes, long term net returns must, therefore, be the prime criteria on which the suitability of superannuation funds to be named as defaults is judged. ISN also notes previous research by APRA and others showing strong correlation between profit orientation and net returns, and scale (in assets under management and assets per member) and net returns.

No flipping

The practice of transferring a member's interest in a fund when they leave an employer into a higher charging fund is an unacceptable business practice. MySuper as currently constituted will allow the practice of flipping to continue, albeit into another higher priced MySuper product. We show in these submissions and Annexure 1 the real and unacceptable impact of flipping. Funds that actively flip their members into a higher priced MySuper product should not be eligible to be named as a default fund in a modern award.

Other criteria to be considered by Fair Work Australia

During an open and transparent process FWA should consider the applications of any fund that believes it should be named as a default fund within an award. Each application from an eligible fund should be considered in the context of the relevant award and the industry it services. FWA should consider the views of the industrial parties and the ability of the promoters of the applicant fund to service the award demographic. The fund should be able to demonstrate that it can provide relevant services to employers and employees and importantly that its insurance offering is appropriate to that demographic.

These duties are consistent with the MySuper duties upon trustees to consider the investment, risk and insurance strategies in the context of the funds demographic. In this case the test would be against the potential members within the award demographic.

The process proposed by ISN is fair, open and transparent and in the best interests of those serviced by awards.



1. Proposed process for the naming of default funds in awards

1.1 Introduction

The Productivity Commission has been asked to report on a process for the selection and ongoing review of superannuation funds to be included in modern awards as default funds.

This is an important responsibility and ISN wishes to assist the Commission in any way possible. In this submission, ISN proposes an open and transparent framework for the selection and review of default funds in modern awards. ISN proposes a minimum of 2 and a maximum of 6 funds be included in each modern award. The proposed framework seeks to address the many public policy objectives that are present in connection with the naming of default funds in modern awards.

Superannuation is a critically important public policy, notwithstanding that the implementation often is left to commercial parties. As a public policy, supported by a special legal regime, regulatory oversight, and tax concessions, the social objectives of superannuation must always remain prioritised above individual and private interests. At the top of any list of social objectives for superannuation must be that the system, to the greatest extent possible, results in broadly experienced improvement to retirement outcomes.

In the context of default fund selection in modern awards, the achievement of superannuation's public policy goals must be sensitive to the relevant facts and circumstances of the persons protected by modern awards. Modern awards interlace with industrial law to form the safety net for Australia's most vulnerable workers. The workers protected by modern awards, axiomatically, lack the bargaining power and other characteristics to receive rewards for their labour in excess of socially accepted minimums.

This context has a number of important implications, but one key implication is that Fair Work Australia has an important role to play in achieving the social objectives of superannuation for vulnerable award workers. Proposals that rely on the unimpeded choices of employers are likely to result in a removal of input by employees to this aspect of their workplace conditions. For this reason Fair Work Australia remains the central institution in our proposed framework.

1.2 Outline of Proposed Framework

The proposed framework/procedural steps are outlined below. The rationale for each part of the framework is set out in later subsections.

Fair Work Australia currently is expected to review each modern award every four years. ISN proposes that the selection of default funds be made during this review. In particular, FWA would accept applications for consideration to be named as a default fund in a modern award in connection with the review of that modern award.

ISN proposes that during the regular review of the content of modern awards, the members of Fair Work Australia be joined by a panel of recognised superannuation experts to assist Fair Work Australia during its deliberations regarding the naming of default funds in awards.¹

Applications would be open to the representatives of any Regulated Superannuation Entity (RSE) operating an APRA authorised MySuper product. For the purposes of these limited considerations an applicant would not require any formal standing to make application to Fair Work Australia. Applications would be made in

¹ The proposal goes to the naming of default funds in modern awards, not superannuation clauses and related content within awards more generally.

the usual manner in accordance with the timetable and procedures adopted by Fair Work Australia during its award review process.

1.3 Eligibility conditions

For an application to be considered, it must meet certain eligibility conditions:

1. **Be a MySuper authorised product.**

The applicant must be in a position to demonstrate that the proposed fund is a MySuper product authorised by APRA.

2. **Show high relative long-term net performance.**

In particular, a certification from APRA stating that the fund has achieved a relative performance benchmark, such as top half or top two-thirds of distribution, over a rolling ten year period.

3. **Certify compliance with business conduct standards.**

A certification from APRA that the MySuper fund meets certain business conduct standards.

ISN proposes that such standards would currently only require that a fund does not, and will not, “flip” members (or otherwise make adverse changes to the treatment of members) whose employment circumstances change into a more expensive MySuper product². Insofar as other odious commercial practices are identified by APRA or FWA, the published business conduct standards would need to be expanded.

The above eligibility conditions reduce the burdens on FWA, (and therefore Australian taxpayers), to consider an excessive number of applications. In addition, the eligibility conditions set out objective minimum standards of fund quality, thereby enabling FWA to focus on the appropriateness of applicant funds pursuant to the factors set out below.

1.4 Consideration by Fair Work Australia

The “decision standard” to guide FWA’s review – that is, the purpose of the FWA review – is to name default funds “in the public interest, consistent with the interests of employers and employees within the jurisdiction of the award.” FWA’s review would be based on the following factors:

1. Relative long term net performance of the fund;
2. The views of industrial parties relevant to the award;
3. The experience of the trustees and coverage of the fund in the relevant award coverage demographic;
4. Relevant member and employer services, and
5. Appropriateness of insurance offering.

² Including considerations of insurance coverage and cost. Less any direct cost subsidy or additional benefit provided at the employer’s expense to the employee.

1.4.1 Expert panel to assist

It is suggested that a panel of superannuation experts be attached to FWA for the period in which FWA considers applications from funds to be named as default funds within awards. This is not an uncommon process for Fair Work Australia and is undertaken during the tribunal's Minimum Wage Case considerations. We suggest it would be appropriate for FWA to use the discretion available to it to determine the number of external experts and from where they call them. During a period of regulatory change it may be appropriate to consider representation from another Commonwealth agency. The panel would assist the normally constituted FWA panel in its deliberations.

Such arrangements would add an additional level of informed expertise to FWA's deliberations and could be implemented at minimal cost and without the need for legislative change.

1.4.2 Open and transparent process

For the purposes of these proceedings, it will be open to any RSE or fund representative to have standing to make application and appear and be heard in support of their application before FWA.

The process of the naming of default funds within modern awards should be open and transparent. It is recognised that the existing processes adopted by FWA are open and reviewable. Whilst the process should be a matter for FWA to decide; the following would apply:

- Applications would be available for review by the public on the FWA website sufficiently in advance of FWA's consideration of the applications to permit interested parties to express their views to FWA in writing;
- Decisions would be made after a public hearing and would be in writing; and
- Decisions regarding the naming of a fund would be reviewable upon application by a party that has standing before FWA.

The framework outlined above is open and transparent. Applications are public and participation by interested parties is possible. Decisions are made after the opportunity for a public hearing. The reasoning for adverse decisions is able to be obtained. In short, the proposed framework meets or exceeds community expectations for due process. More importantly, the nature of the procedural steps will drive superior retirement outcomes for Australia's most vulnerable workers.

Although the proposed framework will place additional requirements upon funds that seek to be named in modern awards, this is appropriate. Australia's superannuation system must continue its transition into a mature, well-regulated, system. Funds that seek to be named in modern awards should meet heightened public expectations. Being subject to reasonable due process that provides public accountability, and that will result in improved public policy, is to be expected.

1.4.3 Relevance to award

It is likely that there will be a number of complying MySuper funds that meet the performance and business conduct standards proposed herein. However, only those funds that have demonstrated their ability to provide relevant services to the industries and occupations serviced by the modern award should be named in the award.

Beyond the important compliance, performance and conduct measures Fair Work Australia should consider the relevance of the fund to the industry with specific consideration of:

- the views of the parties that have standing regarding the relevant award;

- the experience of the applicant trustees and coverage of the fund in the relevant award coverage demographic;
- relevant member and employer services; and
- appropriateness of the applicant fund's insurance offering.

The expert panel would be a considerable assistance to FWA when assessing these matters.

1.4.3.1 Views of employers and employees

The representatives of employees and employers who have standing before Fair Work Australia in relation to an award are best placed to inform Fair Work Australia of the views of employers and employees regarding the relative merits of a fund and the types of services they value from a fund. Their views are informed and representative of those who will be directly impacted by the choice of fund and should be given weight during the deliberations.

When considering the merits of a default superannuation fund within an award Fair Work Australia should be required to give considerable weight to the views of the industrial parties who have the role of representing the interests of those who are directly affected by the choice of default fund. Such a requirement should be clearly expressed as a requirement upon FWA.

1.4.3.2 Trustee experience and fund coverage

Many MySuper funds will be operated by trustees that have no experience offering workplace based products. Whilst this should not prohibit the trustees offering their product for consideration. The ability of the trustees to deliver should be considered in the light of their past experience.

Fair Work Australia should consider the ability of a fund to service the industry covered by the relevant award. The services should be appropriate to the demographic covered by the award.

It is expected that MySuper trustees will have an obligation to consider the scale of a fund with consideration of the demographic of the fund in the context of their duty to act in the financial interest of members. It is appropriate that an applicant fund be required to demonstrate that they can meet this duty in the context of the industry they seek to serve.

Awards that cover workplaces across the country should only name default funds that are capable of providing services at a national level.

1.4.3.3 Relevant member and employer services

Each of the 122 modern awards operates within a specific industry and occupation. Given the nature of some industries, some awards function within limited geographic boundaries. Industries have very different needs. This is recognised by many of the funds named in specific awards who have tailored their products and service delivery to suit the demographics of the industry they partner. This is particularly the case with industry super funds which have traditionally tailored their services to the needs of their industry sponsors.

Fair Work Australia should be required to consider the relevance of the applicant fund's services to the industry it seeks to service and its capacity to deliver those services. Of significant importance in some industries are workplace services to both members and employers that can be delivered in an accessible fashion. Industry funds have for the past 20 years undertaken workplace visits and information sessions as a service to members and employers.

In some industries the ability to deliver information in an accessible fashion requires translations in a wide range of languages, workplace visits and the provision of basic general and limited personal advice.



In industries dominated by casual and seasonal unskilled award reliant workers there are difficult communication challenges facing a fund. These challenges are often shared with the fund's industry partners, in particular employer and employee representatives.

1.4.3.4 Appropriate insurance

Industries with specific insurance or other needs should have named in their modern awards default funds that can offer relevant insurance services. Insurance is a significant cost associated with superannuation. The Super System Review Panel found that "Insurance cover comes at the cost of foregone retirement savings and earnings. It is a trade-off that has a significant impact on the financial well-being of members. Most members do not specifically consider their insurance needs. The information trustees disclose to members about insurance is not always useful, making it difficult for members to compare insurance options and costs across funds."³

MySuper will require trustees to develop and maintain an insurance strategy. Consistent with the wider duty upon the trustees to act in the financial interests of the fund beneficiaries, this strategy should be appropriate for the fund demographic. However, it may not be appropriate for the demographic of the relevant award. This duty should be extended and tested to ensure the product's associated default insurance offering is appropriate.

1.4.4 Disclosure

In addition, for an application to be considered by FWA it would need to furnish the information requested by FWA regarding the applicant fund. The information called for by the application materials would be at the discretion of FWA, but ISN believes at a minimum it should include material information about the fund's strategy, investment objectives, and the trustee and its personnel.

Importantly, this information would include all relationships, including payments and commercial arrangements other than superannuation, between the fund and its related entities, on the one hand, and employers, employer organisations, and employee organisations relevant to the subject modern award, on the other hand.

1.4.5 Number of named default funds

ISN proposes that modern awards contain a minimum of 2 and a maximum of 6 default funds. FWA could select up to 6 default funds from among the eligible applications and should be guided by the industrial parties and its expert panel regarding the appropriate number. Too high a number would fail to provide guidance to employers and would require employers to actively investigate the relative merits of many, potentially hundreds of funds. It is also suggested that a relatively low number of named funds is likely to add to fund consolidation pressures. ISN's proposal that there be a minimum of 2 default funds named in awards is intended as a risk mitigation exercise by providing employer choice in the unlikely event that a fund loses its MySuper authorisation or other unexpected event occurs. This proposal would add at least 32 funds to the 16 awards that currently do not name a default fund.

1.5 Discussion of Elements of Proposed Framework

As noted above, the conditions that must be satisfied before an application is eligible for review by FWA would have the general benefit of limiting the burdens on FWA to review scores, perhaps hundreds, of applications to be named as a default fund, repeated for each modern award.

³ Super System Review Final Report. Page 141.

More importantly, each condition is designed to advance important public policy objectives.

1.5.1 Condition 1: Compliance with MySuper.

MySuper was proposed in recognition that the implicit assumption of an engaged and informed consumer (that guided the thinking behind much previous financial regulation including the Wallis Inquiry) was misplaced in relation to superannuation.

Most persons who have earned super are not engaged with it. Accordingly improvements to default funds are important to increase the likelihood that the superannuation system as a whole is able to accomplish its social objectives and protect individuals from inefficient super products. By restricting the type of fees that can be charged, including commission fees and introducing change which encouraging comparative cost comparisons, MySuper goes some way toward this objective.

While this eligibility condition requires little explanation for its inclusion, ISN believes more than MySuper authorisation should be necessary for a fund to be eligible for consideration as a default fund.

MySuper will limit fee types but not cost

First, while MySuper-compliant funds are not permitted to charge certain kinds of fees, MySuper does not require fees to be “low,” and it does not guarantee certain levels of performance. As a result, ISN proposes a long term net performance eligibility condition.

MySuper does not prevent flipping

Secondly, MySuper permits odious commercial practices such as flipping. ISN consequently recommends that funds comply with minimum business standards, which should prohibit flipping (see *Condition 3: compliance with minimum business conduct standards*).

MySuper generic and Awards industry specific

Thirdly, the MySuper requirements, such as they are, were designed for a generally applicable default fund. The process at issue before the Productivity Commission is for the determination of default funds in modern awards for workers⁴ with limited bargaining power working with 122 specific industries. Accordingly, the process should facilitate the consideration of relevant industry and/or occupation specific information in connection with determining default funds.

1.5.2 Condition 2: Long term net performance.

Superannuation is a public policy, and its success turns upon outcomes. Chief among them is a higher standard of living in retirement for all Australians. The essential contribution superannuation funds can make to advance this public policy goal is to obtain a high rate of return on the deferred wages entrusted to them over appropriate time horizons.

APRA research has established that there is statistically significant persistence in relative returns among superannuation funds. This research and additional research by ISN supporting this conclusion is described in section 3.4, below.

The existence of this research places demands that in selecting default award funds to maximise the probability of superior future performance, past performance be recognised as an important criteria for selection.

ISN is of the view that an appropriate benchmark should be set that ensures that only those funds which have demonstrated a capacity to delivered superior returns to members over the long-term should be considered for inclusion as default funds within modern awards.

⁴ See section 6.1 for a breakdown of the demographic of award dependant workers.

Into the future the measure of the investment performance of MySuper funds with mandated single diversified investment strategies will be a relatively uncomplicated affair, as APRA will produce returns tables for all MySuper options.⁵

Options for use as a proxy include the APRA whole of fund net rate of return and the net return on a fund's flagship (i.e. largest option), which, for not for profit funds, will almost always be the default investment option.

The advantage of the APRA whole of fund net rate of return is that it is objective, is based on official statutory collections, includes almost all funds for each year (eight years of data are publically available), and provides an accurate indication of the performance the trustee has delivered to all members on average.

The advantages of using the flagship/default option are that it presents the net returns to the option that *either* reflects the investment strategy and asset allocation that the trustees believe is in the best interests of the members, *or* the option that is most heavily adopted by members, including due to recommendations by advisers.⁶

The downside to this approach is that in some cases a marginal decision may have to be made as to whether the default or the flagship is used. This introduces subjectivity into an element of the process that should be objective. Availability of time-series data will also be an issue for some investment options.

There are various views in industry on this question, some of them strongly held; however, the differences between these measures can easily be exaggerated. At section 3.6 of these submissions we present a regression analysis of data demonstrating that APRA's whole of fund rate of return is very closely correlated with the fund's default or flagship investment option.

If the APRA whole of fund benchmark was to be applied to existing funds ISN would argue that it would be appropriate to only allow those funds that have net rates of return within the top 100 funds to be eligible to apply for naming as a default fund within a modern award. If this performance criteria was applied to existing active funds named in modern awards 6 industry funds and 6 retail master trusts would fail to qualify. The make-up of the surviving funds would reflect net performance leaving approximately 2 Public Sector; 39 Industry; 2 Corporate and 1 Retail Master Trust funds. (Note: data is not publically available for all funds.)

ISN believes that it is appropriate that whilst a relative performance benchmark should be established, there should be industry consultation regarding the appropriateness of the benchmark that should be applied to MySuper products. If it transpires that relatively few funds meet the MySuper authorisation requirements or few RSE's apply for MySuper product authorisation; it may be appropriate to limit the number of funds eligible to apply to be named to something considerably less than the top 100 performing funds.

The proposed condition seeks to ensure that default funds named in modern awards generate stronger long-term net returns. It does so in two ways. First, only funds with a track record of relatively strong long term net performance are eligible. It is true that past performance is not necessarily indicative of future

⁵ If the final MySuper outcomes allow funds to provide administrative fee discounts to individual employers and the establishment of separate MySuper funds for large employers, the ability to compare the net performance of MySuper funds will be impeded and may require comparison using returns on the public offer 'rack rate' MySuper offering.

⁶ The default option alone could not be used because the default options in some funds are nominal only; used only as holding funds for new members before they make investment choices.

performance. However, in the context of superannuation, there is empirical evidence of a relationship between past and future performance. See 3.4 of these submissions for a more detailed analysis of performance relationship.

1.5.3 Enhances competition in market

A second way in which the long term net returns eligibility condition is designed to ensure default funds generate strong net returns is that it establishes a market wherein success will be influenced by long term net performance, and thus encourage competition among funds based on long term net performance. Put another way, to the extent that being named in a modern award as a default fund is a desirable outcome for funds, funds will seek to satisfy the eligibility conditions, and this eligibility condition is relative, in that it evaluates funds in comparison to other funds, and thus encourages competition. The success of the competition, i.e., satisfying the eligibility condition, however, will depend on having superior long term net performance in competition with other funds.⁷

ISN believes the length of time over which performance is considered should reflect the public policy objectives of superannuation, in particular to support dignity in retirement and to receive significant benefits to the public in exchange for the foregone tax revenue due to superannuation concessions. As a result, the length of time should be at least as long as the duration embedded in MySuper. The obligations imposed on MySuper trustees to consider investment returns over a period of time is set at ten years. In addition, trustees of MySuper funds are required to focus on *net* returns -- returns after the deduction of fees, costs and taxes.

APRA produces quarterly and annual performance statistics for use by regulators, trustees and the general community.

ISN supports APRA's position that the whole of fund rate of return is a useful measure to assess a trustee's ability to deliver benefits to members over time. APRA's rate of return is the net earnings after tax divided by cash flow adjusted net assets. Eight year rates of return are calculated as the geometric average of the eight year period.

APRA describes the measure as:

The ROR represents the net earnings of superannuation assets towards funding members' benefits, primarily for retirement.

The ROR measures the combined earnings of a superannuation fund's assets across all its products and investment options. The Superannuation Industry (Supervision) Act 1993 (SIS Act) requires that superannuation trustees formulate, and give effect to, an investment strategy that has regard to the whole of the circumstances of the superannuation fund and is in best interests of its members. APRA considers ROR a useful relative measure to assess a superannuation trustee's ability to deliver on the fund's investment strategy for the benefit of all members over time.⁸

⁷ ISN notes that, unlike the regulatory settings from the time of excessive faith in markets, ISN's proposal does not simply assume that competitive forces will focus on social objectives and outcomes; instead it designs the market to accomplish it. Put another way, market forces are deployed as a tool to accomplish the common good. Similarly, by structuring the consideration of long term net performance as an eligibility condition, if for whatever reason the assumed outcomes are not obtained, weak performers would nonetheless not be able to remain in modern awards as default funds (by contrast, when the assumption that "choice" would drive competition based on returns did not result from deregulation, consumers were left in poorly performing funds because there was no objective, outcomes-based, minimum standards).

⁸ APRA. *Annual Superannuation Bulletin* June 2011 (issued 29 February 2012), Important notice Page 4.

The superannuation returns that are credited to a member's account are by far the most important criteria that should be applied to the suitability of a default fund being named in a modern award.

Superannuation is a long-term investment and it is appropriate that the returns be considered over the medium to long-term. ISN believes the length of time should reflect public policy objectives of superannuation, in particular to support dignity in retirement and to receive significant benefits to the public in exchange for the foregone tax revenue due to superannuation concessions. As a result, the length of time should be at least as long as the duration embedded in MySuper. The obligations imposed on MySuper trustees to consider investment returns over a period of time is set at ten years. In addition, trustees of MySuper funds are required to focus on *net* returns -- returns after the deduction of fees, costs and taxes. ISN recognises that APRA data for net performance of super funds currently is only eight years, rather than ten years. Accordingly, the net performance requirement that we propose should have a transition provision setting the length of time as equal to the length of APRA data available, until the APRA data covers ten years of net performance.

In implementing a net performance requirement, at least two transition issues are present. First, the two year gap between (i) available APRA data, which currently shows eight year net performance by fund, and (ii) the ideal of ten or more years of net performance data. Second, the fact there will not be past investment performance data for MySuper products. The gap between current APRA data and the ten years that would be ideal is simply handled by requiring consideration of the available net performance data equal to [the lesser of (i)] the maximum period covered by available APRA net performance data [and (ii) ten years rolling average net performance.

1.5.4 Consideration of new products and market entrants

It is currently planned that as of 1 July 2013 MySuper products can be offered to the market. By 1 October 2013 employer must make all default superannuation guarantee payments to a MySuper authorised product. Naturally it will not be possible to ascertain the past investment performance of a MySuper product that is yet to be offered to the market, let alone the medium term performance.

It is proposed that an RSE offering a MySuper product for consideration to APRA will be required to demonstrate that the MySuper product is a successor of another superannuation product or nominate a product that the same trustees manage with the same or sufficiently similar characteristics.

In the absence of past returns for the MySuper products' past performance the proxy will be a measure of the trustee's past performance for the default investment option within a nominated fund. Without limiting APRA's discretion in these matters it is suggested that any fund nominated for use as a proxy for consideration of past performance, must have the following characteristics:

- Previously been used as a default fund by more than one employer;
- Be of sufficient scale, assets and members to be considered as a MySuper default fund;

After the new MySuper product's first year net returns become available the fund comparison will become a hybrid of the past performance of the nominated proxy and the new fund's actual net rate of return. This hybrid comparison composition will persist until such time as the nominated MySuper product has ten years of standalone net performance data.

ISN's analysis of the default investment options offered by existing default funds find a close correlation between the whole of fund and the default investment option performance. This is not surprising with the majority of members found in the default investment option in almost all the funds named.



1.5.4.1 New award default fund entrants

New MySuper entrants that seek to become default funds within awards should be required to demonstrate to APRA their ability to operate an equivalent fund that would have generally met the new MySuper criteria. It is submitted that new entrants to the superannuation industry with no experience or demonstrated track record should not be entitled to have their new product named as a default fund. While there is a role for innovation and experimentation in superannuation, the risks related to these can only be borne by informed and engaged consumers, not those covered by default settings of modern awards.

In addition, ISN's proposal adds a level of competition into an important section of the market. To be eligible to be considered by Fair Work Australia for inclusion in an award as a default fund a minimum net performance result must be achieved over a reasonable period of time. This qualification benchmark will drive those funds that seek to be named in awards to take such actions as are required to meet the net performance outcomes required. The ultimate beneficiaries of the outcomes based approach recommended by ISN are the fund members and the system itself.⁹

1.5.5 Condition 3: compliance with minimum business conduct standards

Financial market participants can be quite innovative. There will need to be a way in which the workers covered by modern awards are protected from unconscionable practices, particularly as business conduct evolves. At present, however, ISN believes the principal market practice that workers should be protected against is flipping.

MySuper will continue to permit the odious commercial practice by some superannuation providers of flipping. This is where a provider will offer a low cost product, often at a loss, with the intention of recouping the loss and additional profits when the employee leaves the employer and is transferred to another substantially higher price product. In this context a higher priced MySuper product.

Whilst the MySuper provisions only permit the transfer of a members interests to another 'MySuper' product, the diversity of pricing permitted through the proposed employer administrative discounts and large employer arrangements could allow retail product providers to price their public offer MySuper

⁹ We acknowledge that there is some tension between ISN's proposed process and the views expressed by the Australian Industrial Relations Commission in connection with the procedure for developing modern awards. In particular the AIRC stated that "We do not think it is appropriate that the Commission conduct an independent appraisal of the investment performance of particular funds. Performance will vary from time to time and even long term historical averages may not be a reliable indicator of future performance. We are prepared to accept a fund or funds agreed by the parties, provided of course that the fund meets the relevant legislative requirements." [AIRC Full Bench Statement 12 September 2008 (AM2008/1-12)]

ISN agrees that it is not necessary for Fair Work Australia (like the Australian Industrial Relations Commission) to itself conduct an independent appraisal of fund performance. A reference to APRA performance data is sufficient. ISN also acknowledges that historical performance does not always and everywhere provide a reliable indicator of future performance. Nonetheless, for the reasons set forth in this submission, including (i) the fact that there is some empirical evidence that, at least in the context of Australia's superannuation system, there is a relationship between historical and future performance, and (ii) the incentive effects of a net return requirement, ISN believes high net performance should be a necessary condition for a fund to be considered by FWA as a default fund in a modern award. ISN acknowledges the rationale underlying the AIRC's view that funds agreed by the industrial parties should be accepted. Indeed, as shown elsewhere in this submission, these funds have generally served the workers who are to be protected by modern awards quite well.

products uncompetitively in much the same way that they do now with so called ‘personal’ superannuation products. Such arrangements currently deliver fee hikes of 150 or even 200bps – a three to four fold increase - when a member is ‘flipped’ from a corporate master trust to a personal product. The cost and coverage of linked insurance also typically varies significantly. So while employees may join what is seemingly a low cost product on commencing employment – there is a nasty sting in the tail.

ISN does not believe that these outcomes are consistent with the conceptual basis of MySuper.

We strongly believe such practices severely undermine consumer and employer confidence that MySuper products are a ‘safe choice’ as a default fund in a workplace. We would also submit that such practices are completely contrary to the policy objective that MySuper products are simple, transparent, and represent good value for money.

In other industries such ‘bait’ pricing strategies are at best unethical and at worst illegal.

The capacity for MySuper to deliver for default fund members will depend on the strength and enforceability of the core MySuper trustee duties; rules requiring a fair allocation of costs between MySuper products of an Registered Superannuation Entity; SuperStream account consolidation mechanisms; along with the operation of the proposed exemption from single administrative pricing. We do note that MySuper does not envisage price capping or price controls of any sort.

As currently drafted the transfer of interest provisions could permit behaviour that is inconsistent with the proposed introduction of new duties on fund trustees within the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, in particular the duty that trustees act in the financial interests of beneficiaries.

ISN has made a number of suggested amendments to the MySuper legislation which would prohibit the transfer of a member’s interest in a fund without the member’s express consent and other related changes to provide more significant protection to fund members.¹⁰ None of these proposals have been accepted to date.

It is for this reason that we believe that any award default fund selection process that does not exclude superannuation products that permit flipping will be woefully inadequate.

1.5.6 Actual examples of flipping

The following example of the real impact of flipping has been provided by a large industry super fund and involves large employers and the impact on individual employees when they were made redundant, no longer eligible to be a member of the low cost fund and transferred (flipped) to the more expensive product. It is submitted that the example below is both compelling and all too frequent.

This submission outlines two real-life examples of superannuation tailored to large listed companies, both employing many Australian workers, to show the real impact of this mechanism. Further details can be provided on request, including the relevant Product Disclosure Statements, where the interests of employees have been significantly compromised.

¹⁰ These proposed amendments include: changes to the proposed section 29TC of the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011 and changes to the section 52(2) of the Superannuation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 which ensure that different classes of beneficiaries are treated fairly and prohibiting the transfer of a member’s financial interest in a fund without their express consent and amendments to s29VB of the core provisions bill to include a requirement that the level fee subsidies provided by employers be disclosed.

Example 1: Company A

Company A has recently retrenched a large number of employees. Prior to retrenchment, their fees in their sub-plan of the relevant superannuation trust were based on:

- 1.2% on contributions to the fund, and
- a 0.45% Investment Management fee.

The fees for a member with a \$50,000 account balance and \$5,000 annual contributions under this arrangement is \$285.00p.a. The fees for a member with a **\$176,200 account balance** (the average account balance in this fund) and \$5,000 annual contributions under this arrangement is \$852.90 p.a.

When Company A employee gets retrenched they get fund flipped

When Company A employees are retrenched and make no decision about their superannuation, their superannuation benefits get transferred to the personal division of the superannuation trust. On transfer to the personal division of the superannuation trust, the member's fees will be based on:

- An asset based administration fee of 0.70% of the account balance (capped at \$2,000 p.a), and
- A 0.45% Investment Management fee.
- The administration fee is not charged for the first two months of membership.

The fee for a member in the personal division with a **\$50,000 account balance** and \$5,000 annual contributions will be \$516.67p.a. in the first year, and \$575.00p.a. for a member with a \$50,000 balance in subsequent years.

The fees for a member with a **\$176,200 account balance** (the average account balance in this fund) and \$5,000 annual contributions will increase from \$852.90p.a. in the employer plan to \$1,820.73p.a, and subsequently to \$2,026.30p.a.

The table below compares the fee increase for each respective account balance and displays it as a percentage increase as well.

Table 1: Flipping Increase in Costs - Employer A

	Before flipping	After flipping	\$ Cost Increase to member	% increase after flipping
\$50,000 account balance and \$5000 contributions	\$285.00pa	\$575.00pa For ongoing years	\$290.00	101.7%
\$176,200 (average account balance for a member in this fund)	\$852.90pa	\$2026.30pa For ongoing years	\$1173.40	137.6%

Example 2: Company B

Company B is another large employer who has negotiated terms with a superannuation provider so that employees pay:

- no administration fee, and
- an investment management fee of 0.39% p.a. of their account balance.

This fee consists of the estimated Indirect Cost Ratio (ICR) of 0.65%, less a rebate of 0.26% off this fee under a deal struck between the employer and the superannuation trust.

The fees paid by members with a \$50,000 account balance would be \$195 p.a. Members invested in an option with an investment management fee of 0.26% or less would pay no fees.

When Company B employee resigns they get fund flipped

When employees leave the employer, their super is transferred into the fund's personal division and they pay the following fees:

- administration fee: .
 - 0.70% of first \$100,000,
 - 0.55% from \$100,000 to \$250,000,
 - 0.40% from \$250,000 to \$500,000,
 - 0% above \$500,000 and:
- Member fee: \$102.10 p.a. and
- Estimated ICR: 0.65%p.a. (an investment management fee).

On this basis, the annual fees on a \$50,000 and a \$500,000 account balance respectively would be calculated as:

Table 2: Flipping increase in Costs – Employer B

	Admin fee <\$100,000	Admin fee \$100,000 To \$250,000	Admin fee \$250,000 To \$500,000	Investment management fee	Member Fee	Total
\$50,000 account	\$350.00	-		\$325.00	\$102.10	\$777.10
\$500,000 account	\$700.00	\$825.00	\$1000.00	\$3250.00	\$102.10	\$5877.10

The table below compares the fee increase for each respective account balance after a member has been fund flipped and displays it as a percentage increase as well.

Table 3: Flipping Increase in Costs by Account Balance.

	Before flipping	After flipping	\$ Cost Increase to member	% increase after flipping
\$50,000 account balance	\$195.00pa	\$777.10pa	\$582.10	298.5%
\$500,000 account balance	\$1950.00pa	\$5877.10pa	\$3927.10	201.4%

1.5.7 Low cost Personal Master Trust products and flipping

There are a number of superannuation products that are promoted to the market as low cost default fund offerings. In some instances the administration, investment and other fees appear to be competitively priced when compared directly with industry and other not for profit funds which comprise the majority of default funds named within modern awards. A closer examination of the real costs of these products shows

hidden costs within the employer plan and additional charges when an employee is moved to a personal product after completing their employment with the relevant employer.

At Annexure 1 ISN identifies a number of the more popular employer products that are often quoted as being low cost retail products. In reality these products are far from low cost. In many instances the employer plans are only available via financial planners and an additional adviser fee to be added to the quoted price. This price is borne by the employee and impacts on the employee's returns. The introduction of MySuper will require the removal of the commission charges built into these products if they are to be used as default MySuper products by employers in the future.

However, MySuper will not address the significant increases in fees and charges built into these products when an employee is flipped into a personal plan. The figures within Annexure 1 assume the affected employee is a 39 year old, with an account balance of \$50,000 and \$200,000 insurance cover. With the exception of two products where the costs on flipping cannot be sufficiently identified, in every instance there is a significant increase in the cost to the employee who is transferred to the personal plan. These increases range from 10.3 percent to 72.8 percent.

1.5.8 Insurance and Flipping

Annexure 1 identifies changes to insurance costs as a significant factor in the increased cost of superannuation when an employee is transferred to a personal plan. Not only does the cost of insurance increase, the level of cover often falls.

It is submitted that MySuper as it is currently designed will allow a significant degree of 'tailoring' of insurance costs for individual employers covered by the same award. If the existing practice of significantly increasing insurance charges when an employee leaves their employer is allowed to continue within the MySuper regime, it will be a practice, often hidden, that will have a dramatic impact on millions of employees.

MySuper as it is currently devised does not in any effective manner deal with the problems identified above. By allowing, arguably entrenching the practice of flipping MySuper will fail the fairness test. It is entirely appropriate that there be an additional criteria applied to any fund that wishes to be named in a modern award – that the fund does not transfer its members to another product without the member's explicit consent.



2. MySuper and other regulatory reform

On 29 May 2009, following sustained calls for reform of Australia's superannuation system, the Government announced a comprehensive review of Australia's superannuation system. The Review in to the Governance, Efficiency, Structure and Operation of Australia's Superannuation System. The Super System Review or the Cooper review panel of experts released a series of reports which culminated in their final report to Government on 30 June 2010.

The Super System Review panel rejected the underlying assumptions behind the Wallis Report¹¹ that the decisions of superannuation members could generally be treated as rational and informed. The panel found that superannuation investors are not fully informed. The review found low levels of engagement and understanding resulting in some investors paying too much for services, which in some instances they do not receive.

In December 2011 the Government released its response to the reviews' 177 recommendations, 139 of which were supported. Of the 28 recommendations relating to default funds, only 4 were rejected.

In February 2011, the Government established the Stronger Super Peak Consultative Committee chaired by a member of the Commissions' inquiry team Mr Paul Costello. Four consultative groups with the assistance of Treasury, reported to the peak group. The four consultative groups considered issues surrounding the key reform elements, MySuper; Superstream; Governance and integrity and Self-managed superannuation reform.

In September 2011 the Government released its response to key issues considered as part of the policy consultation process.

The Government has since released two of the three expected tranches of Stronger Super legislation, the Legislation Amendment (MySuper Core Provisions) Bill 2011 and the Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012.

The government's superannuation reforms fall within the four areas the subject of industry consultation.

- MySuper
- SuperStream
- Governance
- Self managed super funds

2.1 MySuper

As of 1 October 2013 employers will be required to make default fund contributions to a superannuation product that is a MySuper authorised product.

There are additional duties to be imposed on the trustees of MySuper products, including the requirement to operate the products in the financial interests of the beneficiaries.

MySuper products will have a single diversified investment strategy with an articulated risk and targeted net rate of return over a ten year period.

These new low-cost default fund products will have limitations on the types of fees that can be charged. Insurance fees and coverage can be tailored meet the needs of a specific workplace, industry or occupation.

¹¹ Stan Wallis, *Financial System Inquiry Report*, March 1997

2.2 Superstream

Superstream is described as the Stronger Super 'back office' reform measures. These include the implementation of new data and e-commerce standards; the use of the TFN as the primary locator of member accounts, enhanced reporting to employees, processes to reduce the number of inactive member accounts and returning lost super to members.

2.3 Governance

MySuper includes enhanced obligations on trustees and directors of corporate trustees, including an annual duty to ensure that the fund has sufficient scale to meet its duties to members.

Trustees will be required to exercise the degree of care, skill and diligence as a prudent superannuation trustee; act fairly in dealing with classes of beneficiaries within a class; and to give priority to the interests of fund members when there is a conflict with other duties.

There is a requirement to develop and maintain investment, risk management and insurance strategies in the interests of beneficiaries.

2.4 Self managed super funds

The SMSF sector has grown dramatically to be the sector with the largest funds under management within the superannuation industry. Changes introduced include new independent auditor and related party transaction requirements.

2.5 APRA Prudential Standards

Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 provides APRA with the ability to establish prudential standards for the superannuation industry on a wide range of prudential matters. Prudential standards are disallowable legislative instruments made after industry consultation and having the force of legislation.

In anticipation of the stated intention of the Government to extend APRA's prudential standard making powers to the superannuation industry in September 2011 APRA released a discussion paper suggesting 12 new prudential standards for industry consultation in 2012. Each proposed standard would be the subject of a more detailed consultation paper.

The areas suggested for the development of superannuation prudential standards include:

- Governance;
- Conflicts of interest;
- Fitness and propriety;
- Risk management;
- Outsourcing;
- Investment governance;
- Operational risk financial management;
- Funding and solvency for defined benefit funds;
- Audit requirements;
- Business continuity management; and
- Insurance in superannuation



These prudential standards aim to incorporate requirements arising out of the Stronger Super/MySuper reform process. In addition APRA is seeking, where possible, to harmonise prudential standards applying to other APRA regulated sectors. Whilst recognising that the proposed standards will be the subject of further industry consultation, ISN has made submissions to APRA that some of the proposed standards in their current form are problematic.

2.6 Reform process to continue

Industry, government, academics and others have devoted tens of thousands of hours to considerations relating to superannuation industry reform. This process will continue for the next few years as significant reforms are implemented and further reforms discussed.

2.7 MySuper insufficient protection

There is no doubt the Stronger Super reform process is likely to provide additional protections for those employees that do not exercise choice. The proposals to remove commission payments and reduce costs and fees are important reforms. Particularly welcome is the focus on long-term net returns to members. Trustees will be obliged to consider long-term net returns to members when measuring the success or otherwise of their duty to act in the financial interests of members. A new benchmark has been set for default funds, unfortunately the benchmark remains too low. It is especially inadequate in the context of the country's most vulnerable workers – those covered by the modern award safety net.

The government's Stronger Super reforms, including the introduction of MySuper to improve default super and Superstream to improve the administration arrangements and enhanced governance obligations via new superannuation prudential standards are the government's response to Cooper Review's inquiry into the governance, efficiency, and structure of the superannuation system.

The Cooper review found that while our unique superannuation system is world class and has grown from strength to strength it has not delivered optimal outcomes for members and there is substantial room for improvement.

MySuper is an improvement from the current arrangements. However, MySuper as currently constituted will not address the substantial differences in performance between the APRA regulated sectors. Over the short medium and long term retail funds lagged not for profit funds by an inexcusably large margin. Elsewhere in these submissions we detail the underperformance of the for-profit sector. Whilst it is hoped that MySuper funds will not suffer from many of the problems associated with existing funds that act against the financial interests of consumers. MySuper alone will not resolve all the ills of the industry and, importantly, does not control product prices.

There is no reason to surmise that the substantial performance difference between for-profit and not-for-profit funds will not continue under the MySuper regime.

In making deliberations about the impact of the government's legislative reforms the Commission would be well served revisiting the Cooper review's key observation that superannuation, regrettably, does not operate like a competitive market where consumers make informed and active decisions to place their savings with the best performing funds.

For most people there is a high level of disengagement and failure to exercise choice. Superannuation is seen as complex, pricing is opaque, and industry participants rely on consumer inertia to charge inappropriately high fees or diminish member investment returns through agency costs. Without active consumers who have the capacity in time, expertise and judgment to make optimal decisions there is little incentive for providers to strive to offer the best possible product delivering the best possible returns.



Regrettably, the financial advice industry has contributed to this market failure by advising clients into poorer performing retail funds because of the lure of conflicted remuneration, a matter which the pending FoFA reforms aims to address.

The MySuper Core Provisions Bill sets out the basic requirements for such funds. The requirements set out in the Bill are a substantial improvement on the status quo, however we do believe more can and should be done to ensure there are adequate protections for fund members, particularly MySuper default fund members.

2.7.1 Multiple MySuper products

It is important to note that the Government's proposed reforms in respect to MySuper do differ somewhat from the model proposed by the Cooper review.

For example the Cooper review envisaged a relatively modest number of MySuper products in the market to ensure there were sufficient economies of scale, but perhaps more importantly ease of comparability and price transparency driving vigorous competition.

ISN does not dispute that the Cooper review's efforts to enhance competition among default funds is somewhat illogical – after all, a default fund is axiomatically a fund for persons who have not clearly exercised choice. MySuper does make sense as an effort to remedy the fact that competitive forces in superannuation have been insensitive to fees and other problematic practices, though it is not sufficiently robust to accomplish this.

Even if the objective of enhancing competition amongst default funds was sensible, the current proposals before Parliament are unlikely to accomplish this objective. Under the proposals now before Parliament, the availability of large employer plans, and admin discounts for smaller employers (despite standardised admin processes with SuperStream) will see the potential for literally hundreds if not more than a thousand differently branded MySuper products and so many price points that comparability and competition would be quite limited.

Ostensibly, RSE's offering MySuper products must offer a product with a single investment strategy and standard set of fees. However, it will be possible for employers to negotiate discounted administrative fee arrangements with employers. It will also be possible for RSE's to establish tailored superannuation products for larger workplaces. Tailored workplace specific insurance arrangements (and charges) will also be possible.

As a consequence the ability of employers and others to directly compare MySuper products will now be greatly undermined. This removes one of the stated aims of MySuper.

It is for this reason that we believe it is entirely appropriate that additional rigorous and transparent processes be designed to evaluate the suitability for MySuper authorised funds to be nominated in awards.

It is however entirely probable that there will be significant difference in net performance among MySuper funds. A analysis of existing low cost not for profit funds and low cost retail funds, (most of which are likely to gain MySuper product authorisation on application), currently indicates a significant net benefit differential which is expected, most things being equal, to continue within the MySuper regime.

2.7.2 Flipping

MySuper will continue to permit the odious commercial practice by some superannuation providers of flipping. This is where a provider will offer a low cost product, often at a loss, with the intention of recouping the loss and additional profits when the employee leaves the employer and is transferred to

another substantially higher price product. In this context a higher priced MySuper product. An analysis of the practice of flipping commences at 1.5.4.

3. Performance and market share

3.1 Overview

APRA researchers and others have documented persistent underperformance by retail funds, with returns trailing the not for profit sectors by between 150 and 200 basis points per annum. APRA have also found evidence of persistent outperformance and underperformance within funds grouped by sector (corporate, industry, public sector and retail).

Analysing APRA fund level performance data, ISN has found that profit orientation is the most significant determinant of return performance, but also that amongst not-for-profit funds, scale in fund net assets and assets per member both are statistically significant predictors of performance.

ISN has found strong correlation between the APRA ‘whole of fund’ performance measure and the default or ‘flagship’ (i.e. largest) investment option within both industry and retail funds.

3.2 Performance by sector

The difference in performance of the various APRA-regulated sectors of the superannuation industry has been well documented.¹² Annual returns provided in the APRA *Annual Superannuation Bulletin* and the 10 year statistical summary that accompanied *Insight Vol 2 2007* together provide a record of 15 years of superannuation returns by sector.

The retail sector lags the three not for profit sectors by 1.8 – 2.7 per cent pa (Table 1) over this extended period. Reflecting the impact of compounding over time (Figure 1), \$100 invested with a retail fund in June 1996 would have on average grown in value to \$176 by June 2011, which lags investment in the not for profit super fund sectors by 28-45 per cent, as well as investment in a risk free retail asset such as annual term deposits (after tax and an allowance for administration cost).

Table 4. Annual superannuation returns by sector, 1997-2011

Financial year ending June	All	Corporate	Industry	Public sector	Retail
1997	13.3%	16.1%	12.4%	17.7%	8.3%
1998	7.0%	8.9%	6.8%	7.1%	6.0%
1999	6.9%	8.2%	7.1%	9.4%	4.4%
2000	10.2%	10.5%	9.7%	13.4%	8.0%
2001	3.0%	4.4%	3.3%	3.3%	2.2%

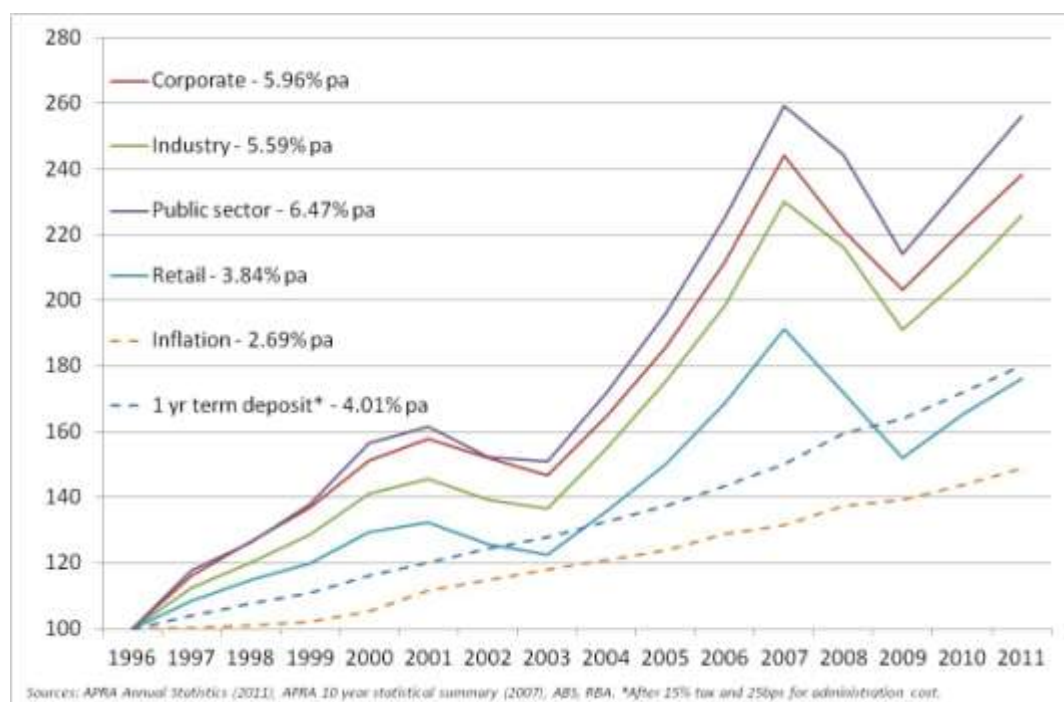
¹² See for example Ellis, K., Tobin, A. and Tracey, B. (2008) *Investment Performance, Asset Allocation, and Expenses of Large Superannuation Funds, Working Paper October 2008*, APRA. Available: <http://www.apra.gov.au/Research/working-papers.cfm>

2002	-4.9%	-3.7%	-4.5%	-5.8%	-5.0%
2003	-2.1%	-3.4%	-1.8%	-0.9%	-2.5%
2004	12.2%	12.2%	13.4%	13.9%	10.8%
2005	12.2%	12.8%	13.2%	14.1%	10.6%
2006	13.3%	14.0%	13.1%	14.9%	12.4%
2007	14.5%	15.3%	16.0%	15.1%	13.4%
2008	-8.1%	-9.3%	-6.0%	-5.8%	-10.2%
2009	-11.5%	-8.2%	-11.7%	-12.3%	-11.5%
2010	8.9%	8.9%	8.5%	9.8%	8.7%
2011	7.8%	7.7%	9.0%	8.9%	6.5%

Arithmetic average	5.5%	6.3%	5.9%	6.9%	4.1%
Geometric average	5.2%	6.0%	5.6%	6.5%	3.8%

Source: APRA Annual statistical Bulletin (2012), APRA Insight Vol 2 (2007)

Figure 1. Return to investment of \$100 in superannuation by sector, June 1996 – June 2011



3.3 Investment volatility and returns

It is sometimes claimed that lower performance by retail funds is a product of a lower allocation to growth assets, reflecting in part an older membership base.

However, APRA fund level data shows that between 2004 and 2011 the bulk of retail and not for profit funds exhibit returns with volatility in a similar range.

The overwhelming majority of funds have volatility of annual returns between 8 and 13 per cent around a median volatility of about 10.5 per cent (Figures 2b).

The exceptions to this rule are a small number of retail funds with *extremely* low volatility – seemingly with assets allocated entirely to cash or near cash assets. This small group of funds are entirely distinct from the general population of funds, retail and otherwise (Figures 2a).

The dramatic difference in performance is apparent not in the volatility of returns but in average returns.

Figure 2a. Average and standard deviation of returns, including extreme low volatility funds

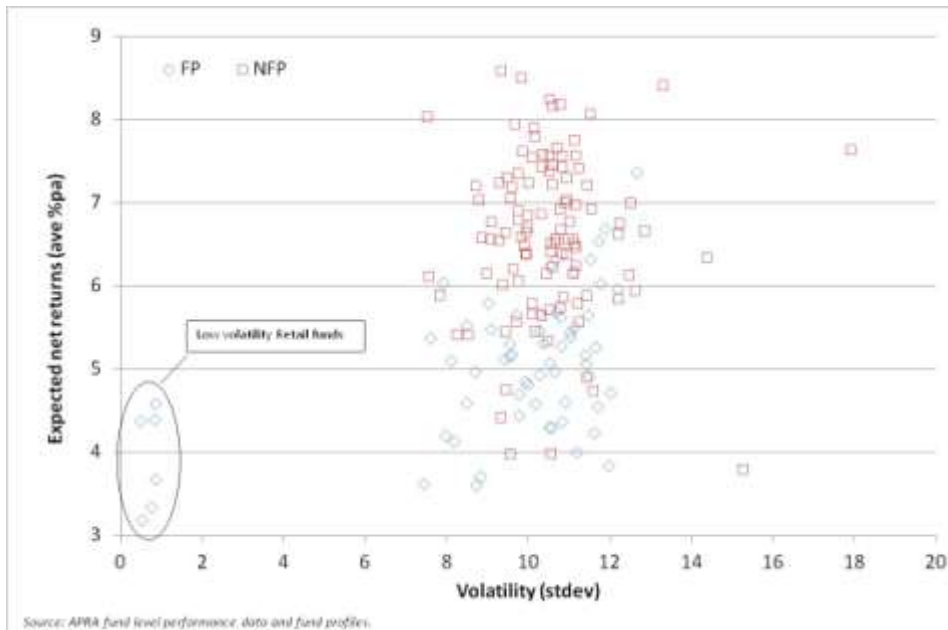
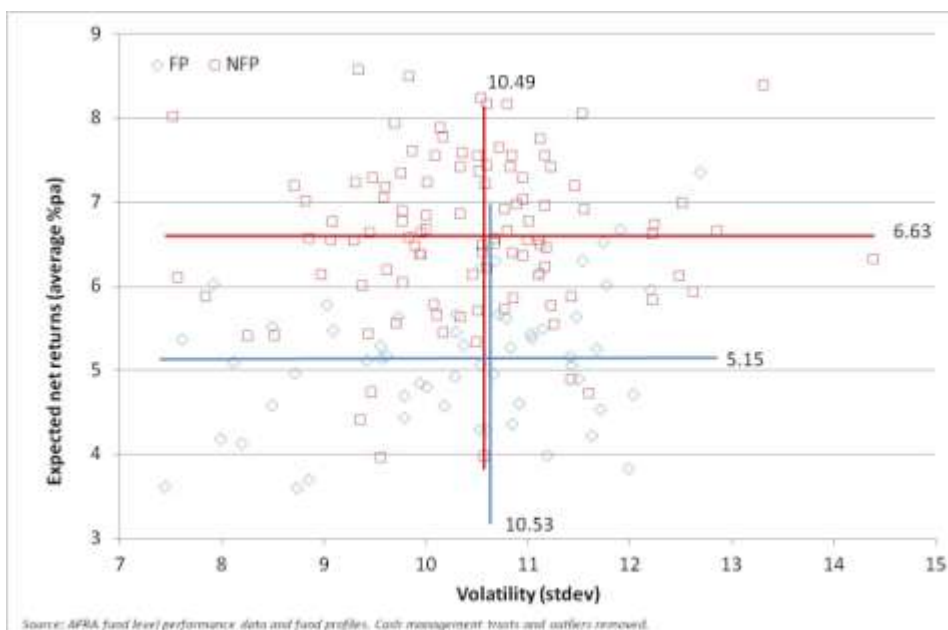


Figure 2b. Average and standard deviation of returns, excluding extreme low volatility funds and other outliers



3.4 Persistent performance at sector and fund level

APRA researchers have found clear evidence of persistence in superannuation fund returns (2009, 14-19).

Of 271 funds for which returns were observed in two five year periods, 1999-2003 and 2004-2008, 64.5 per cent of funds were either in the top half of the distribution in both periods or in the bottom half of the distribution in both periods, far higher than the 50 per cent expected if past performance did not predict future performance.

The finding of persistent performance is statistically significant across all sectors at the 99% confidence level.

Table 5. Persistence in fund performance

	Funds	Per cent
Lose/Win	57	21%
Win/Win	90	33%
Lose/Lose	85	31%
Win/Lose	39	14%
Total	271	100%

3.5 Economies of scale

Scale is an important determinant of returns, at least amongst not for profit funds.

Detailed econometric analysis of APRA's fund level returns data shows that amongst the pool of not for profit funds, all else equal, net returns to members increase with fund assets and with fund assets per member.

Figure 3. Net returns by profit orientation and scale (line)

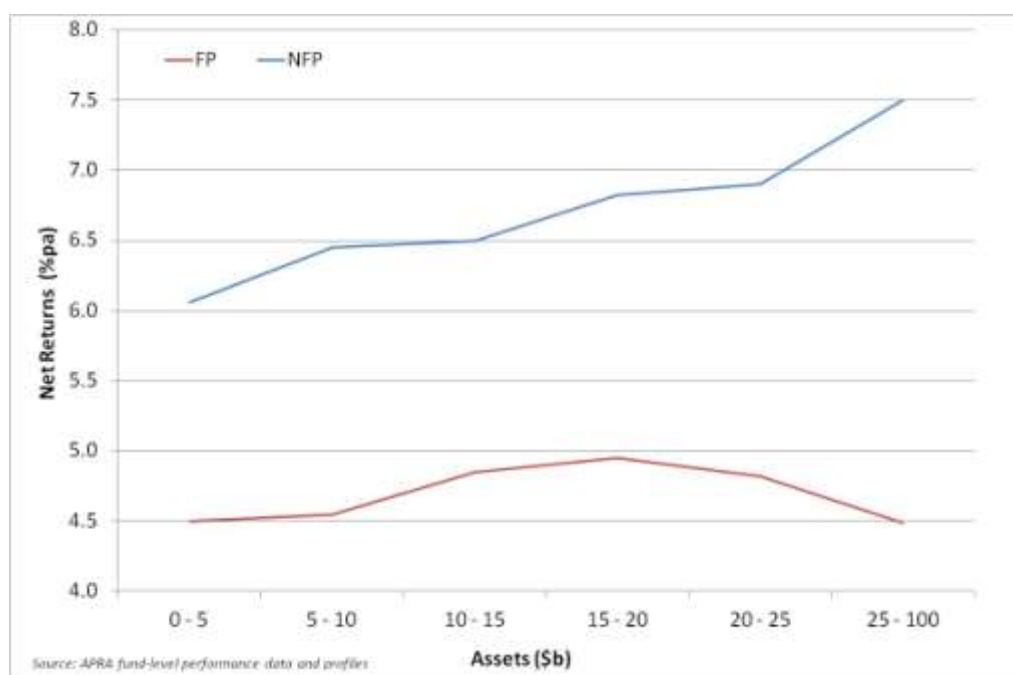
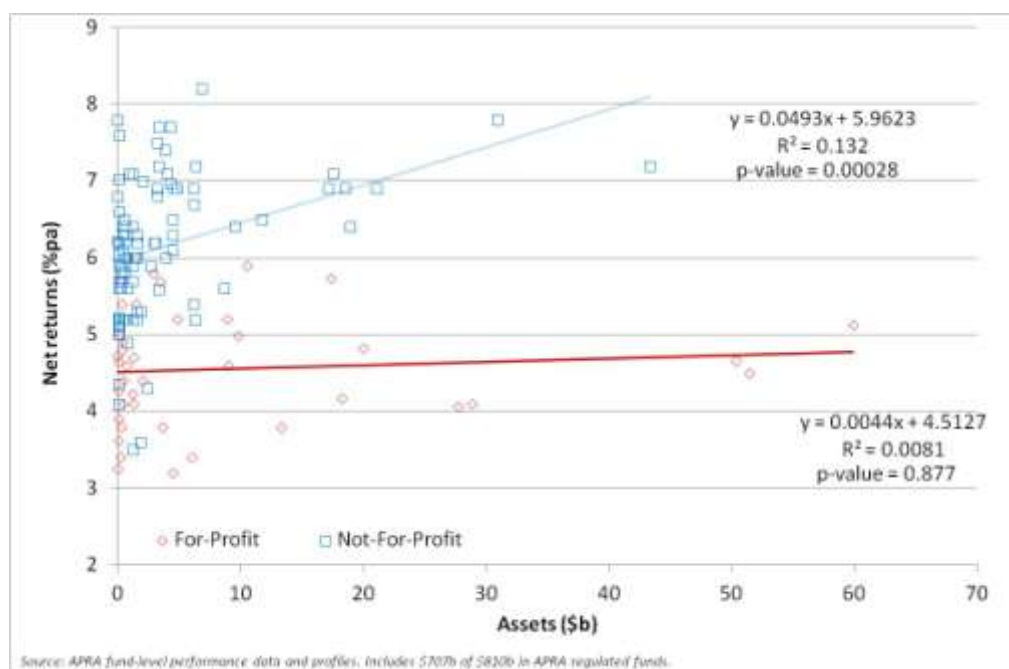


Figure 4. Net returns by profit orientation and scale (scatter)



3.6 Whole of fund returns and individual investment option returns

In this section, and in research published elsewhere, ISN has utilised APRA fund level performance data. Some industry commentators have criticised APRA data because a ‘whole of fund’ measure does not necessarily reflect the experience of an investor in any particular fund option with any accuracy.

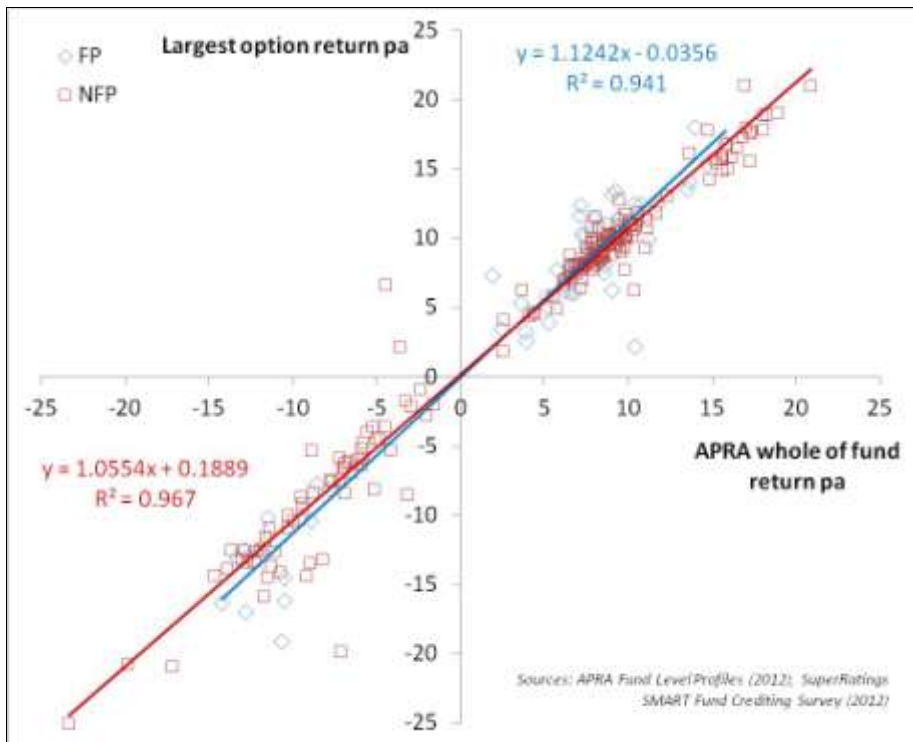
In fact, APRA fund level data shows very strong correlation with the performance of the largest investment option offered by a fund.

ISN has compared the APRA fund level returns to the returns of the largest investment option within a fund listed in the *SMART Fund Crediting Survey*, a proprietary dataset compiled and published by SuperRatings, a private ratings agency.

The return from each dataset has been included for all APRA-regulated funds wherever an annual return figure is available from both data sources between 2007 and 2011.

The value of a whole of fund return figure evidently ‘explains’ over 90 per cent of the return figure of the largest investment option (Figure 5), both for retail and not-for-profit funds. The result is statistically significant at the 99 per cent confidence interval. In only two, seemingly aberrant, cases (both not for profit funds) do the returns from the two datasets show different signs.

Figure 5. Whole of fund returns and largest option returns, 2007 – 2011



3.7 Rates of Return of funds named in awards

An analysis of the performance of those funds named in modern awards mirrors the general industry outperformance data between for profit and not for profit funds. The evidence is that the existing process for the selection of default funds within awards has served workers well. Not for profit funds named within awards have generally outperformed.

Table 6: APRA average rate of return by fund type for funds named in modern awards to 30 June 2011¹³

	1 year	5 year	8 year
Industry Funds	8.35	2.1	5.9
Corporate Funds	7.97	2.35	6.4
Public Sector Funds	9.75	2.90	6.2
Retail Funds	6.69	0.60	4.5

Source: APRA *Superannuation Fund-Level Profiles and Financial Performance*, June 2011.

¹³ APRA returns data is available for 70 of the 87 active funds currently named in modern awards. The data relies upon returns from the default investment option.

4. Governance and equal representation

The Productivity Commission sought comment from interested persons regarding whether governance matters should be considered in connection with selecting default funds in modern awards.¹⁴

If governance is considered in connection with the naming of default funds, it should be based on the best available empirical information about what structures produce good outcomes for members, and what structures do not.

It is not clear that the additional trustee duties owed in respect of a MySuper product are likely to have a significant impact on the performance of a MySuper product. Analysis of superfund performance suggests that governance affects performance, but that the loyalties and perceived role of directors are the crucial factors.

In Australian superannuation, there are “two distinct models of pension fund governance with one based on non-profit trustees taking more direct responsibility in portfolio construction for pension beneficiaries in their funds, and the other based on for-profit retail trustees passing the portfolio construction tasks to related service providers in conglomerate structures.”¹⁵

“[R]etail pension trustees see themselves mainly as coordinators of activities such as administration, custody and investment of the fund assets by various related companies in their groups, rather than stand alone providers of pension products. Many of the directors are likely to be professional fund managers providing investment and other financial services to the funds.”¹⁶ As a result, retail trustees “tend to leave most of the inputs to key decisions associated with investment management to executives.”¹⁷

The retail structure generates conflicts of interest that have adversely affected performance: retail fund boards are populated by persons who have interests aligned with the financial conglomerate that is affiliated with the fund. “In the case of a retail fund ... the trustee (or the corporate group to which it belongs) has the strong expectation of profiting from its superannuation business. That retail trustees must reconcile their (group’s) profit motives with their fiduciary duty to act in the members’ best interest gives rise to agency risk.”¹⁸

In particular, “Unlike non-retail trustees who negotiate the best possible terms for investment management services for their funds, retail trustees with investment managers as executive directors on their Boards have impaired incentives to negotiate the best terms for investment management services.”¹⁹

APRA researchers specifically investigated service provider fee arrangements to determine whether these impaired incentives/conflicts of interest on trustee boards translated into harm to members.²⁰ Concerns

¹⁴ Specifically: What impacts are the additional trustee duties likely to have on the performance of MySuper products? 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? Would being selected as a default fund in an award affect fund governance and operations?

¹⁵ Wilson Sy, *Pension Governance in Australia: An Anatomy and an Interpretation*, International Journal of Pension Management, Fall 2008, at 31.

¹⁶ Ibid. at 33.

¹⁷ Ibid.

¹⁸ Kevin Liu and Bruce R Arnold, *Australian Superannuation Outsourcing – Fees, Related Parties and Concentrated Markets*, APRA Working Paper, 12 July 2010, at 6.

¹⁹ Wilson Sy, *Pension Governance in Australia: An Anatomy and an Interpretation*, International Journal of Pension Management, Fall 2008, at 36.

about these impaired incentives were confirmed. In comparing related-party fee arrangements to those with independent service providers across the for-profit and not-for-profit sectors, the research found that:

[R]elatedness *per se* is not detrimental to fund members. However, when we consider whether the fund has been established on a not-for-profit basis, or as a retail commercial endeavour, we find that trustees of retail funds pay significantly higher fees to related-party service providers. In contrast, the fees paid by trustees of not-for-profit funds to related parties are not significantly different than those to independent service providers.²¹

This result prompted the researches to note that:

“[T]rustees of not-for-profit and retail trustees using independent service providers are generating near-identical value propositions. In contrast, some retail trustees using related-party administrators, are paying significantly higher fees, effectively almost doubling the median member’s cost load. Reconciling this finding with the superannuation trustee’s fiduciary duty to fund members will bear further investigation.”²²

Good governance is about enhancing the quality of the decision making of the trustee such that it produces superior risk-adjusted net returns to members (and otherwise supports good retirement outcomes).²³

Eliminating the pernicious effects of conflicts of interest – namely, the effects of conflicts of interest that undermine performance and otherwise undercut the ability of the fund to maximise retirement outcomes – is a critical part of accomplishing this goal.²⁴

Accordingly, any consideration of governance in connection with naming default funds in modern awards should be tied to the available research, which demonstrates that the representative trustee model employed by not-for-profit funds has best served the public interest and member interests.

As for the specific questions raised by the Productivity Commission:

(i) It is unclear whether the additional trustee duties in respect of MySuper products will have any beneficial effect on performance. Additional duties would not appear to correct for the fundamental problems presented by retail fund governance, namely of intrinsically divided loyalty and a perception that the trustee exists to allocate service contracts.²⁵ By contrast, the directors of not-for-profit fund trustees

²⁰ See, Kevin Liu and Bruce R Arnold, Australian Superannuation Outsourcing – Fees, Related Parties and Concentrated Markets, APRA Working Paper, 12 July 2010, at 2 (explaining that “When trustees of superannuation funds enter into arrangements with related service providers, there is a risk that the terms favour the trustee’s affiliate at the expense of fund members. To test whether this occurs, we compare related-party fee arrangements with those of independent service providers.”)

²¹ Ibid at 2.

²² Ibid at 6.

²³ See, Fiona Stewart and Juan Yermo, Pension Fund Governance: Challenges and Potential Solutions, OECD Working Paper on Insurance and Private Pensions No. 18 (June 2008) (“Good governance goes beyond [the] basic goal of [of minimizing conflicts of interest] and aims at delivering high pension fund performance while keeping costs low for all stakeholders.”).

²⁴ It is acknowledged that there will always be conflicts of interest in superannuation given that funds cannot be governed by the membership as a whole (and, even then, the membership is not homogenous). Accordingly, governance should focus on the pernicious effects of conflicts of interest – that is, the kinds of conflicts that undermine retirement outcomes.

²⁵ Even if the directors were not employees of affiliated financial institution, and thus were “independent,” the fact that these directors would be appointed by the financial institution does not mean their loyalty will be toward members. These directors would of course realise that the opportunity to continue to receive directors fees and the prestige of a directorship depends entirely upon the satisfaction of the entity that appoints them, not the satisfaction

consider themselves to be responsible for overseeing the fund. Such directors also have superior loyalties: they seek to represent the interests of employers and members.

(ii) Other than the Stronger Super reforms, the particular aspects of fund governance that may be worth considering in the selection of default superannuation funds for inclusion in awards is whether the fund has a representative trustee or not. The rationale for doing so is the empirical research summarised above.

(iii) It is not clear at this time how being selected as a default fund in an award would affect fund governance and operations.

of members or member representatives. . There are structural reasons why the risk of loyalty to the appointing party rather than to members empirically does not manifest itself in not for profit trustee directors: not for profit trustee directors are appointed by different parties (typically $\frac{1}{2}$ of the directors are appointed by employer groups and $\frac{1}{2}$ of the directors by unions), and decisions require a majority of $\frac{2}{3}$ of the directors. As a consequence, even if a director or group of directors wished to take action in the interests of an appointing organisation rather than members, the directors appointed by other organisations would be well positioned to prevent and punish this action. No rational director would even attempt it. Importantly, the effectiveness of this structure has been empirically demonstrated in APRA research.



5. Employers

There have been persistent calls from sections of the superannuation industry to allow employers the ‘freedom’ to choose a default superannuation fund for their employees, an outcome it is argued, employers desire. It is also argued that an unlimited choice of MySuper product will result in increased competition amongst superannuation funds driving down costs and encouraging ‘tailored’ services to employers. It is further argued that the protection offered to workers by the scrutiny of Fair Work Australia and the parties to awards is no longer required as the MySuper regime will provide sufficient protections for workers.

We submit that the available evidence shows that all these propositions are incorrect. The evidence is that the vast majority of employers are satisfied with the existing default fund arrangements and that allowing an employer to choose any MySuper default fund will not add to competition in the industry or reduce costs to employers and employees. Elsewhere in these submissions we argue that the MySuper and other regulatory reforms affecting default superannuation funds, whilst a step forward, do not offer sufficient protection to justify the removal of the protections offered by the existing system and the system proposed by ISN.

It is submitted that the clear evidence is that with few exceptions, employers, particularly employers who rely upon modern awards, do not have a high engagement with issues relating to the superannuation of their employees. Where employers do consider choice of default fund the determinative considerations relate to those which impact the employer directly such as cost to the employer and ease of interface with the product provider and in a small number of cases incentive received by the employer.

5.1 Importance of superannuation to employers

Most employers consider superannuation and retirement income to be important matters, however, the best available evidence is that employers do not see superannuation as a priority for their business. Superannuation is considered by many employers, especially those with limited human resource and payroll resources, to be an inconvenience.

In 2010 the Australian Taxation Office released the results of the largest quantitative and qualitative survey of the attitudes of employers to superannuation released to date. The quantitative²⁶ and qualitative²⁷ research undertaken by Colmar Brunton Social Research on behalf of the ATO was released in early 2010. Further more recent work from Colmar Brunton Research has been undertaken on behalf of the Commonwealth and is yet to be released. Industry consultation indicates that the results of the more recent survey are consistent with the 2010 research results.

At 3.1.3 of the qualitative survey the researchers report:

“Superannuation is not seen as being a particularly important aspect of running a business. For most it is just another compulsory bill and more compulsory administration. Relative to other aspects of running a business, superannuation payments and the associated administration are seen as things

²⁶ Colmar Brunton Social Research prepared for Australian Taxation Office. *Investigating Superannuation: Quantitative Investigation with Employers*, 20 January 2010.

²⁷ Colmar Brunton Social Research prepared for Australian Taxation Office. *Understanding Superannuation: Preliminary Report: Qualitative Investigation with Employers, Consumers and Industry*, 25 March 2010.

that “just have to be done”. They are not considered to be important in their own right and are lumped in with similar obligations such as WorkCover and GST. Consequently employers spend very little time dealing with superannuation unless their role is specifically relevant to its administration. Most employ book-keepers or office managers to administer contributions to superannuation funds and so spend very little time themselves in relation to superannuation. Employers estimated that they would spend between an hour and 4 hours on superannuation in a typical 3 month period.

“In terms of importance, for me superannuation is right down the bottom...you’ve got to make money first.” (Employer, less than 20 staff)

“There are things that are more important and more fundamental.” (Employer, less than 20 staff)

“The only time it comes up is when a new employee comes in and does not use the company fund.” (Employer, 20 or more staff)”²⁸

The quantitative survey of over 1000 employer reflects the above with employers declaring they didn’t have the skills, resources or time to make key decisions relating to superannuation on behalf of their employees.

5.2 Default fund satisfaction levels

One of the reasons employers have not turned their minds in detail to default superannuation arrangements is the high level of satisfaction with existing default fund arrangements. Research by newfocus on behalf of ISN in 2009 found that 86 per cent of employers at workplaces where the default fund was determined by an Award reported strong satisfaction with the current arrangements.²⁹

The quantitative survey undertaken by Colmar Brunton mirrored this result with 88 per cent of employers expressing satisfaction with their default fund.³⁰

Of the 88 per cent of employers who stated they were satisfied with their default fund, 45 per cent cited the main reason for satisfaction was the fund was easy to contact, deal with and provided good customer service. The next most popular reason was that the employer had never had a problem with the fund at 23 per cent. With approximately 88 per cent of employers expressing satisfaction with their default fund arrangements, there appears to be no obvious unmet demand for change from employers.

The indications are that most employers will not seek to change their default fund arrangements if given a free hand in the choice of default fund.

5.3 Employers role in nominating a default fund

The impact of an employer changing a default fund is obviously more significant than the impact of an individual employee; especially if the employer is a large one. Whilst employee disengagement may have influenced the impact of choice of fund legislation, it is more likely that a combination of employer satisfaction³¹, disengagement and incentives will drive default fund choice.

²⁸ Colmar Brunton qualitative survey results page 20.

²⁹ Newfocus Pty. Ltd (prepared for Industry Super Network). *Employer Default Fund*. December, 2009

³⁰ Colmar Brunton quantitative survey page 48.

³¹ We stress, as shown above, that employer satisfaction is based on criteria different from the objectives of members and public policy; in particular that employer satisfaction is not based on net returns to members as discussed in more detail below in section 5.4.

The Colmar Brunton qualitative survey found that the majority of employers were adamant that it is not their role to provide superannuation advice or assistance to employees and that some employers were reluctant to even provide information regarding the company's default fund.³² Some employers expressed a reluctance to provide information on the company's default superannuation fund as they considered this financial advice that could leave them susceptible to litigation. The quantitative survey found that 56 percent of businesses ask a new employee to nominate their superannuation fund without mentioning the default fund that applies to the business. These findings are not surprising as the survey also found that most employers have only a basic understanding of the superannuation system which is compounded by the perception of frequent change to the system.³³

Importantly, the survey found that the smaller the business, the less likely the business is to mention the default fund to employees. Most award reliant workplaces are small to medium sized businesses.³⁴

The Colmar Brunton survey found that most employers have only a basic understanding of superannuation issues.

"All employers in the groups were aware that they are required to contribute 9% for each employee into a superannuation fund of the employee's choice. Beyond this basic information more detailed knowledge is highly variable; some employers demonstrate a high level of engagement and involvement with superannuation, yet most have only a basic understanding of the system. For those with a greater level of understanding this is resulted generally from investigation into their own personal superannuation."³⁵

It is suggested that it is highly likely that during the current period of significant regulatory change regarding an employers' superannuation obligations, the general level of employer understanding of those obligations will have reduced from the low level that existed at the time of the Colmar Brunton survey.

5.4 Employers and fund performance

The Colmar Brunton surveys found that the majority of employers did not compare the relative performance of superannuation funds. Sixty Six percent of employers not compare the performance of their default fund with any other fund or relative performance measure. At 22 percent the largest reason given for not comparing funds was current satisfaction with the fund performance. However, only 6 percent of those employers surveyed who were satisfied with their default fund stated that the reason for the satisfaction was returns to fund members. Mirroring this result only 6 per cent of satisfied employers gave the level of fees and costs to employees as a reason for their satisfaction.

Other reasons given for not comparing default fund performance was that the task was too time consuming (17%), the task was thought to belong to another (14%) or that the employer simply didn't care about the fund's performance (12%).³⁶

When examining an employer's propensity to compare fees and charges attached to a default fund, similar results were found with the two most common reasons provided were don't care and satisfied with the existing fund, both (13%), followed by too time consuming (9%), not my role (8%) and no point (6%).

The survey also found that 49 per cent of employers had no or little knowledge of the default fund's performance over the past year.³⁷

³² Colmar Brunton qualitative survey page 20.

³³ Ibid Page 21.

³⁴ ABS Cat. No. 6310.0 Employee Earnings, Benefits and Trade Union Membership, August 2010

³⁵ Colmar Brunton qualitative survey Page 21.

³⁶ Colmar Brunton quantitative survey Page 68-70.

The qualitative survey found:

“Among some there is a perception that investing time and effort into reviewing superannuation fund performance and reconsidering default funds will only end up in lost time and productivity with no conceivable gain.”³⁸

The compelling evidence is that employers do not have the skills or inclination to focus on returns to members and other factors which are likely to have a significant influence on the retirement incomes of employees.

The evidence is that where employers have had the option of choosing a workplace default fund they have often done so on advice from an accountant or financial adviser. Disturbingly the Colmar Brunton qualitative survey found that most employers after receiving advice of choice of fund did not make any of their own investigations.

5.5 What employers are looking for?

Ease of use and convenience appears to be the overwhelming driving force for employers. Key industry super funds have confirmed that their in-house research or experience reflect the findings of the Colmar Brunton surveys.

Employer representatives have expressed considerable backing for the existing arrangements. In discussions with ISN one employer representative stated that:

“The most heat we get from our members is when things change and more paper work is required. In our industry we are up to our necks in regulation driven paper work. The simpler the better, that usually means one good fund that both employees and employers are happy enough with.”³⁹

The above comment reflects the Colmar Brunton survey results. The survey provides some insight into the needs and concerns of employers when it comes to default fund selection. The results indicate that a good working relationship backed up by good customer service and efficient systems will assist in the attraction and retention of employers. Fees, cost and performance are more of a concern with larger employers, but nonetheless they appear to be secondary considerations behind practical issues associated with customer service and ease of interface.

The survey also found that employers remain relatively ill-informed and confused regarding the different types of superannuation funds and the difference between for profit and not for profit funds and those funds that have paid commissions and those that do not. As the employer does not bear these costs directly the employer focus appears to be on cost and convenience to the employer.

Superstream reforms will be relevant in that the standardisation and streamlining of superannuation contributions, including future mandatory electronic processing, should ensure that there is a level playing field regarding ease of interface between funds and employers when making contributions.

5.6 Employer conflicts

Where employers have a number of competing default fund options; either a limited number of named funds within an award or an unlimited choice of funds, there is a potential for conflicts to arise. The

³⁷ Ibid Page 64.

³⁸ Colmar Brunton qualitative survey Page 30-31.

³⁹ Notes of discussion with employer Association representative November 2011.

business environment raises these potential conflicts with large banking corporations which businesses are reliant upon dominating the retail superannuation options.

Section 68A of the SIS Act prohibits the offering of inducements from a superannuation provider to an employer regarding the employer's choice of default fund. The Act prohibits conduct by fund trustees that amounts to offering goods and services to employers as an inducement to their employees becoming members of the fund, or refusing to supply goods and services, such as banking services, because employees have not agreed to become members.

However the following are goods and services that are exempt from the inducement prohibition and therefore can be provided to any person by the trustees of superannuation funds or related entities are:

- supply of a business loan on a commercial arm's length basis;
- supply of a clearing house service for the forwarding of contributions and information to other funds or RSAs on behalf of the person in relation to employees of the person who have chosen those funds;
- supply of advice or of an administration service to a person or the employees of the person where the supply relates to the payment of contributions to the fund; and
- supply or offer to supply goods or services to a person only if the supply or offer is available to the employees of the person who are members of the fund, and the terms of the supply or offer are not less than the terms supplied or offered to the person.

The Colmar Brunton survey found that 13% of employers admitted to receiving a direct or indirect benefit from a superannuation provider.⁴⁰ This revelation is not surprising as many employers appear to be unaware that the SIS Act prohibits the receipt of inducements. What is surprising is that such a large number of employers have admitted to the practice, including some large employers.

The Colmar Brunton qualitative survey found that:

“Employers would be more inclined to consider changing their default superannuation fund if it was clear that membership of one fund would provide financial or resource benefit to the company.”⁴¹

The evidence is that the inducements offered included financial discounts to business and individuals offered by the banks.

It is suggested that most employers do not accept or seek inducements when considering a choice of default fund. However, there appears to be sufficient evidence to warrant additional attention to this area, including anecdotal evidence within the industry.

ISN is of the view that there is a case for further regulatory reform to provide a level of comfort that when a default fund is selected by an employer that the selection has not been influenced by direct or indirect inducements. It should not be possible to ‘package up’ or ‘bundle’ a range of financial services, including default superannuation, when the benefit is obtained by one party and the cost of an inappropriate decision, borne by another.

ISN believes that when choosing a default fund an employer should be required to declare that there is no conflict arising from the choice. Such a declaration could form part of other reporting processes undertaken by the employer and need only be undertaken when a new default fund is chosen.

⁴⁰ Colmar Burton quantitative survey Pages 55-57.

⁴¹ Colmar Brunton qualitative survey Page 28.



Consideration should be given to monitoring and reporting of the declarations made by employers to ensure there is a proper understanding by employers and regulators of the potential conflict between superannuation decisions by an employer and other financial dealings and relationships.

In the event that the Productivity Commission and the government were not mindful to adopt the process suggested by ISN which would ensure all default funds named in modern awards have high net returns and acceptable business practices, it is suggested that additional regulation may be required to ensure an employer's choice of default fund is not a conflicted one.

5.7 Employers and industry super funds

Employer and employer associations have worked with employee associations for over twenty years in a collaborative effort to improve the superannuation arrangements for employers and employees. There is considerable bi-partite support for a system for the selection of default funds that has as its primary consideration the needs of those using the system, not those seeking to benefit from it.

Industry super funds being jointly operated by employer and employee trustee representatives have developed a character of service that aims to deal with the practical needs of employers and employees across a multitude of workplaces.

Employers generally support arrangements that allow the employer or their representatives to jointly govern a fund whilst also having a level of comfort that there is support for the fund amongst employees and their representatives. This provides an oversight that individual employers cannot in most cases provide.

5.8 Lessons of the past Trio and Astarra

The collapse of Astarra and Trio saw a not inconsiderable number of workers lose their accumulated superannuation savings. In most instances the employees affected did not actively choose Trio as an investment vehicle to safeguard their retirement savings. The scheme was chosen by their employers as the workplace default fund to invest the employees compulsory 9 percent superannuation contributions.

Prior to the introduction of choice of fund legislation Astarra management actively targeted workplaces with a view to convincing employers and employees to choose Trio/Astarra superannuation products.

Those employers that chose Trio or Astarra related plans as the default funds for their employee's superannuation contributions in hindsight no doubt regret the choice. The Colmar Brunton research discussed in this section of the submission indicates that most employers do little if anything to examine the merits of a default fund. These employers rely on the regulator to ensure a fund has an acceptable level of risk associated with it. Employers who used Trio and Astarra were entitled to believe there was a sufficient level of regulatory oversight of these funds.

It is suggested that had the processes ISN proposes in these submissions be in place at the time both employees and employers are likely to have been spared much angst.

An example of the impact on employees are those employed by Tabcorp at the NSW TAB. Half of the 500 casual employees of Tabcorp exercised choice and most joined or were already a member of an industry super fund. None of these employees were affected by the Trio collapse. However 250 of the most vulnerable casual employees did not exercise choice and were placed in the Astarra default fund by their employer. All of these employees were affected.

The Astarra/Trio collapse highlights the importance of the continued regulation of default funds to ensure they meet minimum standards. The introduction of MySuper and other regulatory reforms will go some

way to adding to these protections, unfortunately too late for those directly and indirectly affected by the Trio collapse.

The Parliamentary Joint Committee on Corporations and Financial Services is inquiring into the funds collapse and is due to table a final report on 9 May 2012.



6. Modern Awards

Superannuation is one of Australia's greatest public policy success stories. Its success has its foundations in the unique public/private partnership understandings that were originally reached within the industrial relations system. Annexure 2 contains a brief summary of the evolution of superannuation within Australia within Australia's industrial relations system.

The Fair Work Act 2009 dramatically changed Australia's industrial relations landscape. The Act removed certain components of the previous government's industrial relations reforms, but it did not return to the previous system.

The Fair Work Act provided for a new national federal award system. The new modern awards are streamlined common rule minimum rates awards applying across state boundaries to all employees within the industry and/or occupational jurisdiction of the award. The modern awards are read in conjunction with National Employment Standards (NES) which detail minimum employment conditions which apply to all employees.

The award modernisation process has resulted in fewer federal awards within an expanded Federal system. The development of the new modern awards saw an expansion of named funds within awards as awards were consolidated and state awards were subsumed by federal award coverage.

The expanded coverage of the new modern awards is tempered somewhat as high income earners are exempt from award coverage. Those earning more than \$118,100 (indexed each financial year) as a guaranteed sum per annum are exempt from the jurisdiction of federal awards. Enterprise agreements can cover these individuals. It is assumed that the incidence of individuals at this income level exercising choice will be relatively high.

Award rates of pay and national employment standards are set at a level which encourages bargaining at a local level and also ensures that those who are not in a position to bargain have a minimum level of protection.

6.1 Modern Award demographic

In May 2010 only 15.2 percent of the workforce were employed solely under the terms of an award. It is important to note that whilst 15.2 percent may appear to be a small number, 37.3 percent of employees have their terms and conditions individually negotiated are being paid award rates of pay plus additional conditions or pay. These employees typically remain price takers and receive an additional payment above the statutory minimum wage. A further 43.3 percent had their terms set by an enterprise agreement.

Those industries that have high levels of irregular employment have higher levels of award dependency. This includes the accommodation and food (291,600 award-reliant workers); Retail (204,900); Health care and social assistance (193,600) and Administrative and support services (161,000). In addition areas of employment not surveyed by EEH agriculture, forestry and fishing have high levels of award and default fund reliant workers.⁴² Casual, part-time and female workers are over represented amongst those who rely on award only conditions and are more likely to be employed in smaller businesses. Approximately 85 percent of award-reliant employees are over the age of 21.

⁴² There are high levels of non-compliance in these industries, including cash in hand work that does not involve superannuation payments. For further details regarding superannuation non compliance see Inspector General of Taxation. Review into the ATO's administration of the Superannuation Guarantee Charge. March 2010.

6.2 Default funds in awards

Industry super funds dominate those funds named in modern awards.⁴³ There are currently 122 modern awards, 109 of which name at least one default super fund. The majority of awards name more than one default fund with some funds offering the employer a choice of up to 18 default funds.

Superannuation is a dynamic industry at this time. Although the 122 awards name 103 funds the number of active funds has been reduced to approximately 86, with 6 funds wound up; 7 funds merged and the status of 4 funds is unknown but not active. A number of funds do not exist as named in awards. It is expected that the number of active funds named in the awards will continue to fall with further mergers and fund wind-ups.

As discussed elsewhere in these submissions, not-for-profit funds have outperformed for-profit funds in any time period taken since the commencement of award superannuation. APRA performance data is publicly available for 70 of the named funds within modern awards.

During the process of the making of modern awards the Australian Industrial Relations Commission inserted in most awards a grandfathering provision that allowed an employer who was making a contribution to superannuation fund on behalf of their employees as of 12 September 2008 to use that fund as a default fund for future employees. The grandfathering arrangements are discussed at more length at the beginning of these submissions.

As of February 2012, 112 of the 122 modern awards included grandfathering provisions. There is no data available to indicate the types of funds, numbers of employees, workplaces or funds under management that fall within the grandfathering provisions. Nor consequently is there any data to assess the performance of the funds or the services they offer to members and or employers.

There is no way of knowing if these funds are capable of or intend to covert to MySuper compliant funds in the future. At section 6.6 we make further comment on the grandfathering arrangements.

6.3 Agreements

In May 2010 43.4 percent of the workforce were employed under the terms of an enterprise agreement. Enterprise agreements are collective agreements made at an enterprise level between employees and their employer. Once approved by Fair Work Australia, an enterprise agreement is enforceable and provides the terms and conditions of employment that apply at the workplace to which it applies to the exclusion of the award. An enterprise agreement will generally remain operative until replaced by another agreement.

ISN, (as do other commentators), considers modern awards to be a safety net. Enterprise agreements like industrial matters more generally, sit within a safety net established by the modern award system. The terms of an enterprise agreement must not be less beneficial to an employee than the National Employment Standards and overall must be better than the relevant modern award. It is mandated that certain matters are included or excluded from enterprise agreements whilst other matters are only limited by the level of agreement between the parties.

⁴³ It should be noted that a number of smaller funds categorised as industry funds within the APRA data do not describe themselves as industry funds. Whilst others that describe themselves as industry funds appear not to have equal representation requirements within their trust deeds. Most of these funds have poor long-term performance records when compared to those industry funds operating under the equal representation model.

There is no readily available data on the percentage of mentions as default funds or actual funds within enterprise agreements by fund type. The superannuation arrangements within enterprise agreements are not easily analysed as some agreements do not nominate a fund and name a default fund or funds for circumstances where an employee does not exercise choice; whilst other agreements mandate the fund or funds that will be used.

In some instances enterprise agreements do not deal with superannuation directly and seek to incorporate the provisions within the award while other agreements do not deal with superannuation in any form and consequently the provisions of the Superannuation Guarantee Act apply and the choice of default fund is left to the employer.

Internal research undertaken by industry super funds indicates that over 43% of enterprise agreements leave the selection of default superannuation fund to the employer. This data was collected across Australia from a range of industries.

The treatment of superannuation within industrial agreements is inconsistent across industries. In some industries there is both a high level of enterprise agreement making and propensity to name a default fund within the agreements reached. Whilst in other areas of high agreement-making superannuation is often ignored in agreements.⁴⁴

The limited available evidence indicates that where funds are named, at least three quarters are industry funds and the superannuation clauses found in enterprise agreements, more or less, reflect the arrangements within the underpinning award or awards.⁴⁵

It is possible for an enterprise agreement to specify the funds that can receive contributions, reflecting employee choice at a collective rather than individual level. It appears to be increasingly common for individual employee choice of fund to be accommodated within enterprise agreements. Where individual employee choice is resisted, it often the result of the legitimate concern of employers who do not wish to devote additional time to making superannuation contributions to funds beyond those named in the agreement.

6.4 Agreements and MySuper default funds

There have been consistent calls for legislative change to require the parties to industrial agreements to either not name a default or any other fund in an enterprise agreement or to justify the selection of a named fund within an agreement. The loudest of these calls have come from the representatives of superannuation funds that are generally not selected when the parties to agreements turn their minds to these issues.

ISN notes that the terms of reference for the Commissions' inquiry do not extend to considerations regarding enterprise agreements. Outside of the limitations on industrial bargaining that are imposed by the industrial relations system and the existing superannuation requirements imposed by the *Superannuation Industry (Supervision) Act 1993* and the *Superannuation Guarantee (Administration) Act 1992*. The legislation sets out the parameters of bargaining within the industrial relations system. These parameters reflect the heavily debated and well-considered judgements of public authorities. ISN approves of these parameters.

⁴⁴ The public service and public sector are examples of employment sectors with a high incidence of agreement making with reference to superannuation.

⁴⁵ If 57% of Enterprise Agreements nominate a superannuation fund or funds and approximately ¾'s of the arrangements reflect those found in awards then the superannuation arrangements in approximately 43% of Enterprise Agreements reflect those found in the relevant award.

If this or any future government was to take the policy position that certain matters, including matters relating to superannuation, should be prohibited from being the subject of binding enterprise agreements, those political and policy considerations should be placed within the industrial relations policy discussions.

If the parties to an enterprise agreement exercise collective choice by voting for a clause in an agreement that stipulates that employer contributions will be placed in particular fund or funds or names a default fund or funds when choice is not exercised or is silent and leaves the selection of default fund to the employer; these are properly matters for the industrial parties.

The prevailing superannuation legislation will continue to apply. Where default funds are selected they must be an authorised MySuper product and payments must be made in accordance with the Superannuation Guarantee Act.

It is unwise to attempt to enter the heads of negotiators to enterprise agreements. It is not known if 43% of enterprise agreements do not name a superannuation fund because it was an agreement outcome that the employer would choose the default fund or the parties' attention was engaged on other matters the subject of negotiation. It is presumed that the negotiators and those employees voting for the 57% of agreements that do deal with superannuation have considered and negotiated the terms.

Recommendation 1.4 of the super system review panel recommended:

"In 2012, the Productivity Commission should conduct a review of the process by which default funds are nominated in awards to assess whether the process are sufficiently open and competitive."

There was no mention in the recommendation of enterprise agreements.

Although the Government's response to the recommendations in December 2010 included reference to enterprise agreements. It is proper that the legitimate bargaining processes between industrial parties not be interfered with.

6.5 Transitional arrangements

The Government has stated that transitional arrangements will need to be put into place to ensure that funds (one presumes default funds) nominated in enterprise agreements, are MySuper compliant.⁴⁶ This is not necessarily the case.

It is suggested that where collective choice is exercised and a fund is named in an enterprise agreement, there is no default fund. There is merely a named fund that it is agreed employer contributions will be made to.

Where there is more than one fund named by the collective decision making process, none of the funds named should be properly classified as a default fund.

Where an enterprise agreement, rather than naming funds as a collective choice instead names funds to be defaults when individual employees do not exercise individual choice, it is expected that there will need to be transitional arrangements in place to ensure that the named default fund is an authorised MySuper default fund product.

⁴⁶ Commonwealth of Australia, *Stronger Super: Information Pack*, September 2011 Page 3

6.6 Grandfathering arrangements

6.6.1 Existing funds named as default funds in awards

Of the 103 funds currently listed in the 122 modern awards, approximately 86 continue to operate. Subject to the MySuper transitional arrangements⁴⁷ and the relevant named funds or their nominated successors meeting the APRA performance and other requirements, these funds should continue to be named as default funds within awards.

These funds would not, in the first instance, be subject to consideration by Fair Work Australia until the next full award review process. This limited form of grandfathering will provide a level of certainty for employers and protection for employees.

6.6.2 Award grandfathering provisions

During the award modernisation process, (the award consolidation process creating modern awards), the precursor to FWA the Australian Industrial Relations Commission dealt with applications by retail funds to be named in awards or alternatively that no funds should be named.⁴⁸ The AIRC decided that any fund that an employer was contributing to as of 12 September 2008 at the time could be used as a default fund by that employer.

At paragraphs 89-90 the Commission's decided:

"Superannuation

[89] The model superannuation provision included in the exposure drafts was the subject of a large number of submissions and comments. While some suggestions were made that there should be no superannuation provision in awards at all, we think that it is appropriate to deal with the subject in the limited terms proposed in the draft but with some modifications.

[90] The terms of the exposure draft concerning the default fund provision were the cause of a number of submissions from employer and employee interests, from superannuation funds and the superannuation industry. We have decided to allow as a default fund any fund to which the employer was making contributions for the benefit of employees on 12 September 2008. This approach is likely to minimise inconvenience for employers. While funds other than those provided for will not qualify as default funds employees may still exercise their right to choose in favour of these funds."

It is not known how many grandfathered funds are currently being used by employers as a result of the grandfathering arrangements inserted in superannuation clauses as a result of the 2008 decision. Nor is there any data on the number of employees, size of contributions or the type of fund being utilised. There is some anecdotal evidence that some employers are utilising the grandfathering arrangements to extend the use of a preferred default fund named in a one award to other award dependent employees. However, it is suggested that the grandfathering arrangements are primarily used to allow continued contributions to retail or master trust funds.

A literal reading of the decision should enable an employer who was making a superannuation contribution for the benefit of a single employee or a class of employee to either continue making default superannuation contributions to the grandfathered fund on behalf of that employee or class of employees. The decision should also allow the employee to extend the use of the grandfathered fund beyond the single

⁴⁷ At the time of writing the 3rd tranche of the MySuper legislative arrangements containing MySuper transitional arrangements had not been released.

⁴⁸ Australian Industrial Relations Commission Award Modernisation (AM2008/1-12) Decision 19 December 2008

employee or class of employees to all employees under the jurisdiction of the relevant award. Insofar as the employer may employ staff under another award or awards, provided the other award or awards have similar grandfathering arrangements, the grandfathered default fund could be applied to those employees as the need arose.

It is the opinion of ISN that a not insignificant number of employers were prior to 12 September 2008 utilising default funds not named in awards, notwithstanding the legal obligation on those employers to utilise the default fund or funds within the relevant award or awards. ISN estimates that as many as 20-30 percent of employers in small to medium sized businesses were not meeting their superannuation obligations by either incorrect payment or payment to a fund other than that which was required by law.

The Inspector-General of Taxation's review into the ATO's administration of the superannuation guarantee charge in March 2010 found that whilst most employer's met their superannuation obligations there was a 'high risk' to employees of either having insufficient superannuation contributions made or of being misclassified, in business types and industries that were heavily award dependent such as small businesses in recreation, transport, food and accommodation and agriculture.⁴⁹

The grandfathering arrangements as they currently stand are inconsistent with the new MySuper regime. It is suggested that it is inappropriate to allow the grandfathering arrangements introduced in 2008 to continue. The introduction of the requirement that all default funds must be MySuper authorised products and that the new products have certain characteristics requires the identification of all default superannuation products to ensure compliance with the new regime. Whilst there will be a level of grandfathering of default funds within MySuper until 2017, these grandfathered funds are capable of being identified. The general grandfathering provisions that apply within an award are of a different character. To ensure confidence in the system and an acceptable level of compliance with the new processes, the grandfathering provisions within modern awards should be removed.

In the event that an employer is utilising the grandfathering provisions to make contributions to a default fund for the benefit of employees, there must be an assurance that the fund being used is a MySuper authorised product. If ISN's performance criteria is adopted, there must also be an assessment by APRA that the fund has appropriate returns and the trustees are not 'flipping' members of the grandfathered fund into a higher cost MySuper product when the employee is terminated.

The MySuper requirements alone necessitate the identification of the MySuper successor of funds being used by employers under the existing grandfathering arrangements. In the circumstances it is entirely appropriate that the grandfathering provisions cease and those funds that are capable of being named as default funds in awards seek to be named.

⁴⁹ Inspector-General of Taxation. *Review into the ATO's administration of the Superannuation Guarantee Charge: A report to the Assistant Treasurer*, March 2010 Page 4.

7. Issues paper questions

The issues paper released by the Commission in February 2012 asks a number of questions. It is hoped that ISN's submissions go to these questions. For the purposes of clarity and to ensure all of the Commission's questions are fully dealt with in this section of ISN's submissions, ISN answers the particular questions raised in the Commission's issues paper. We answer the questions directly and by reference to material contained elsewhere in these submissions.

7.1 Awards and enterprise agreements

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

In May 2010 15.2 percent of the workforce were award reliant in so far as they have all their terms and conditions set by a modern award. See section 6.1.

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

There is a relationship between the naming of a default fund within a modern award and the naming of a fund within an agreement.

It is not possible to ascertain the reasoning behind the selection of a superannuation fund within an agreement between employers and employees at an enterprise level as there may be many factors influencing this decision. Nor is data available on this question.

ISN's internal research indicates that approximately 34 percent of enterprise agreements fail to deal with superannuation in any way and consequently leave the default fund decision to the employer. It is more likely that the failure to deal with superannuation within the agreement is a reflection of the lack of engagement of employers and employees on the question of default fund election, than a conscious agreement to leave such a decision to the employer.

Where superannuation is included in an agreement it appears that this level of engagement rises only to the point of reflecting the terms found in the award, often only by reference to the relevant award clause. It appears that where superannuation is dealt with in an agreement, approximately ¾'s of the arrangements reflect those in the underpinning award. See section 6.3-6.4.

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

Where improvements in superannuation payments, either direct or by subsidy, are included as a term of the agreement, the better off overall test is applied. Notwithstanding the choice of default fund within an agreement may have a significant impact on net returns to members, in ordinary circumstances the choice of fund is not considered to be part of the test.

Even where it can be shown that an employee would suffer considerable loss as a result of exit, entry or other fees incurred when their interest in the fund is terminated, i.e. when they are flipped, it is not clear that the test would apply to ex-employees no longer covered by the agreement. The greatest challenge facing those who would seek to apply the test is the difficulty in quantifying the merits of a fund over the

short life-time of an agreement. The test is not retrospective.

7.2 Superannuation funds listed in modern awards

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

At section 5 ISN explores the available evidence regarding employer interface with superannuation issues, including fund choice. Employers have consistently indicated that whilst they recognise superannuation as an important component of wages, it is not a business priority.

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

Section 5 of these submissions deal with this question. Research has found that employers are not equipped to choose a default fund and in the most part do not wish to take on the responsibility. When employers do take on the task, considerations of fund performance are well behind considerations of administrative ease and cost to employers.

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?

The extent of use of the grandfathering clauses within awards is not known. Nor is it known if the funds used are appropriate for use as default funds. ISN deals with these issues in section 6.6.1.

7.3 A new default investment product: MySuper

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 MySuper reforms will cause some RSE's to convert their existing products to MySuper authorised products, whilst other funds will replicate investment options within existing products and seek MySuper authorisation for the new MySuper product/investment option whilst continuing to operate the existing product in the non-default sector of the market.

It is not known if the final form of MySuper reforms will encourage fund consolidation or add to the number of funds in the market. The legislative context of the proposed duty on trustees to consider scale is not as yet settled. If separate pricing options to large employers are to be treated as separate MySuper products, it is possible that there will be a proliferation of default products in the market.

Other related regulatory reforms are likely to be greater drivers of consolidation, including the significant compliance burden and additional duties and liabilities upon trustees to be introduced as part of a suite of regulatory reform associated with APRA's new superannuation prudential standards. These issues are further explored in Section 2 of these submissions.

7.4 Are the criteria for MySuper sufficient?

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?



The criteria for MySuper is not sufficient protection for the retirement incomes of workers or provide the required guidance for employers.

Whilst these submissions deal with this central question throughout, Section 1 of these submissions is devoted to this question.

We note that the question assumes that MySuper reforms will “drive ... consolidation in the industry.” ISN expects consolidation, though the degree is unclear, and would not necessarily attribute much weight to MySuper in the momentum for consolidation.

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?

ISN strongly believes that, because the criteria would apply to default funds for Australia’s most vulnerable workers, it is essential that MySuper compliance be supplemented with strong requirements around net long term performance and prohibitions on business conduct that can exploit the disengaged, such as flipping. MySuper will not produce one homogeneous superannuation product. It is expected that significant variances in performance and product will continue. In these submissions ISN makes an argument for the need for additional criteria, suggests the criteria and the means by which they should be implemented. See section 1.

7.5 Investment strategy and funds management

To what extent do workers covered by different awards have different investment needs?

MySuper trustees will have an obligation to ensure that the investment, risk, and insurance strategies adopted are suited to the demographic of the fund to ensure they meet their wider duty to provide a product in the financial interests of the fund’s beneficiaries.

The demographic within different industries and occupations covered by the 122 modern awards vary considerably. See section 6.1.

Should any such differences be taken into account in the selection of default superannuation funds for inclusion in awards? If so, how?

ISN proposes a process for the selection of default funds within awards that will require Fair Work Australia to consider the relevance of a fund strategies and services to each award the applicant fund seeks to service with reference to the demographic within the jurisdiction of the award. This is a means by which the holistic statutory duty upon trustees is applied to the particular industry and occupations affected by the application to be named as a default fund.

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?

The actual net return delivered to members is the relevant factor. Consistent with the different demographics covered by an award, the level of risk is a pertinent factor for consideration.

The annual consideration of these matters by trustees is properly a matter within the framework of the wider MySuper obligations and should not be duplicated. These issues are however, relevant within the context of a fund being named within an award and regular testing of the appropriateness of the continued

naming. This should be done by Fair Work Australia to ensure alignment of the needs of the demographic within the relevant award.

Should lifecycle investment strategies be considered? If so, how?

The decision by trustees to offer or refrain from offering lifecycle investment strategies is a matter that is properly dealt with within the MySuper regulatory regime. Trustees will be required to demonstrate that they have properly come to the view that such offerings are in the financial interests of beneficiaries.

7.6 Fund expertise and performance

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

The management expertise of trustees is properly a matter within the MySuper authorisation process. The ability of trustees to offer relevant service and product is a separate issue that is worthy of consideration.

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?

If measured over a suitable period of time, past performance is a reliable indicator of future performance. See 1.5.2 and section 3 of these submissions for a detailed analysis.

If past performance is considered important in assessing a fund's suitability for inclusion as a default fund in awards:

- *over what time period should past net performance be assessed?*

Over a rolling 10 year period. See section 1.

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

All MySuper products will technically be new products with no past performance. A relevant proxy should be considered. ISN makes proposals regarding this matter. See section 1 and in particular 1.5.4.

- *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?*

Establishing a fund return target is problematic, particularly if the return target is not over a sufficiently long period. If an absolute return target was set, it may be set sufficiently low so as not to instil competition amongst funds to compete for a limited number of default fund positions. See section 1.

7.7 Fees

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 delivered to members are the primary consideration within MySuper. Net returns are sensitive to fees, but a better and more comprehensive measure in the interest of members. A separate consideration should not apply to default MySuper funds within awards. Cost and fee considerations are properly a matter for trustees and regulators not another body.

7.8 Insurance and other member services

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? – See below.

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? – See below.

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

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? – See below.

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?

Outside of the requirements of MySuper insurance and member services are matters that should be open to trustees to determine, provided they do so in the financial interests of the beneficiaries.

The cost of insurance is a significant factor to the net benefit delivered to fund members. The type of industry and occupations covered by an award will have an impact on the cost of and type of insurance offered. Typically the default insurance offered by industry super funds is less costly and provides greater coverage and benefits to members. Importantly many insurance offerings are tailored to the industry needs.

The treatment of an employee's insurance cover and cost when they leave their employer is also of significance and should be considered. See section 1.5.8 and Annexure 1 for further detail.

Members within different industries will have different experiences and needs. As such it would not be appropriate to set a minimum level of service to be provided across all industries and or awards. However, when Fair Work Australia is considering an application by a fund to be named as a default fund within an award, the type and relevance of the service offered to members should be considered. See section 1 and in particular 1.4.3.

7.9 Governance

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



It is not clear that the additional trustee duties owed in respect of a MySuper product are likely to have a significant impact on the performance of a MySuper product. Analysis of superfund performance suggests that governance affects performance, but that the loyalties and perceived role of directors are the crucial factors. See section 4.

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?

Any consideration of governance in connection with naming default funds in modern awards should be tied to the available research, which demonstrates that the representative trustee model employed by not-for-profit funds has best served the public interest and member interests. See section 4.

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

It is not clear how being named as a default fund in an award would affect governance and operations.

7.10 Scale

Is there an ideal 'fund size' for default superannuation products? See below.

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

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? See below.

Is there a clear relationship between fund scale and returns for members? See below.

The issue of scale is a matter for consideration by trustees in accordance with the duty to consider scale imposed as part of the MySuper reforms. There is evidence that scale has an impact upon returns to members. There is also compelling evidence that for profit superannuation funds that have scale do not pass the benefits of scale on to fund members. It is for this reason that scale should not be considered in isolation. The primary duty imposed on trustees is to act in the financial interests of fund beneficiaries as expressed by their ability to provide net returns to members. It is this duty that should be replicated in the processes that determine the naming of default funds within modern awards.

Fair Work Australia should be required to consider scale in the context of the trustee's ability to service industry covered by the relevant award. Other considerations of scale are properly a matter for the trustees and the regulators.

7.11 Other criteria

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

ISN provides a detailed list of criteria that should be applied to assess whether a fund is suitable for inclusion in modern awards. These are found in section 1. These include eligibility conditions found in Section 1.3 which outlines (i) a requirement that the fund be MySuper authorised; (ii) that the trustees can demonstrate high long-term net performance; and (iii) that the MySuper fund meets certain business conduct standards, at this stage the only condition to be included in this criteria is the absence of flipping.

Section 1.4 outlines ISN's proposals for matters that Fair Work Australia should consider with the assistance

of an expert panel. Including the views of the industrial parties, the experience of the trustees and coverage of the fund in the relevant award demographic, the provision of relevant member and employer services and the appropriateness of the insurance offering.

7.12 Are there net benefits to having additional criteria?

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 setting of additional criteria will ensure that Australia's workers who are award dependent and do not exercise choice of fund will be further protected. ISN's proposals will ensure that only those funds that deliver superior returns and relevant services to members and employers will be used as a default fund in awards.

Who would incur the costs?

ISN's proposed approach dove-tails into the existing processes adopted by Fair Work Australia. This approach reduces cost. There will be additional costs borne by FWA and those funds that seek to be named in awards. It is suggested that the costs associated with ISN's proposals are minimal. These costs will be borne ultimately by the taxpayer and members of a fund that makes application to be named in an award.

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?

Section 3 of these submissions details the relative outperformance of those funds currently named in modern awards. It is suggested that ISN's proposals will ensure that this relative outperformance will improve further. The resulting benefits are provided directly to members and employers. The resulting increase in benefits to members is provided to those sections of the workforce that are more likely to rely on public pensions. The higher the retirement benefit the lower the burden on taxpayers.

Raising the bar for default funds both through MySuper and the requirements to be named as a default fund in a modern award might increase pressure on choice products to match any net returns provided to members of default funds. Historically, however, the opportunity to choose a fund (and the theoretical potential for competitive pressure around net returns) has unfortunately not resulted in observable improvements in performance or fees. Regulation has been required.

Would the criteria need to vary by industry?

The criteria and factors considered by Fair Work Australia, including those relating to a fund's ability to provide relevant and sufficient service and appropriate insurance to the industries and occupations serviced by the award should be considered award by award. See section 1.4.

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?

ISN believes this criteria is required now. It is unclear what time frame such issues would be revisited, if ever, and if applied at some date in the future what action would be taken if some funds were found not to



meet the criteria when applied.

7.13 Implementation issues

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

These features are desirable, notwithstanding that the current system has generally served workers well. ISN's suggested process is both open and transparent. Any fund or their representatives can apply to be named in an award. The process would be open to all funds and the consideration process a public one.

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? See below.

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

ISN suggests that the current process is more open and transparent than has been suggested by some. If one considers the provision of default superannuation to employees an integral component of the wages system and superannuation payments themselves as deferred wages the answers to these questions may differ from the answers from those that consider default superannuation as no more than a financial product.

Industry and not for profit funds dominate those funds named in awards because they were instigated to provide a service to employees via the award system. A service that did not exist or was seriously inadequate. The desire to maximise benefits to members has seen the not for profit funds favoured by employee and employer representatives. Those for profit funds that are named in awards have consistently underperformed their not for profit competitors. This performance differential has justified the choices made to date.

Notwithstanding this, ISN's proposed process provides a level playing field and unrestricted access to all those that seek to be named as default funds in awards, provided these funds meet the reasonable and fair criteria proposed.

There are regulatory barriers to the operation of an internationally owned fund that seeks to operate within the confines of the SIS Act. ISN believes these restrictions are appropriate.

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?

It is unclear that MySuper as currently constituted will assist the current trend towards fund consolidation. In so far as fund consolidation will continue, it should improve the ability of a fund to service an award and the industry and occupations covered by the award. The increased ability to offer competitive insurance premiums is one example of the benefits of fund consolidation.

There are a significant number of funds currently named within modern awards that have either merged or are considering a merger with one or more funds. It is expected that this trend will continue and that those funds will be more competitive. ISN's proposed process will add to the competitive pressures by ensuring that only those funds that have adequate performance and services to members and employers will be



selected as a default fund within a modern award.

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

*How should trade-offs between different eligibility criteria be made? **See below.***

*Should different weights be placed on certain criteria? **See below.***

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

Net returns to members should be the primary consideration. Aligned with net returns is a prohibition on the practice of flipping workers covered by awards. Flipping allows a commercial fund to undertake loss leader activities which results in the promotion of an artificial return to those fund members who remain in the fund until such time as they draw a benefit. These two criteria must be applied together and are of paramount importance. This is consistent with the MySuper legislation which raises net returns to members above other considerations, but provides supplemental protections that are important in the context of workers covered by awards.

Other considerations made by Fair Work Australia are likely to be more holistic and should be considered award by award to be consistent with the duty upon trustees within MySuper to consider investment, insurance and risk strategies in the context of member demographic. Weight should be given to the views of the representatives of those who are paying (employers) and receiving (employees). It is not clear how 'optional' criteria would be of assistance. FWA should consider a range of matters as outlined in section 1.4.

7.14 A target number of funds?

*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? **See below.***

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

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

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

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

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

In section 1 ISN proposes a target number of funds between 2-6. Given the application of additional criteria to ensure a named fund has satisfactory performance and product offering, there appears to be no benefit associated with offering unlimited fund choice to employers. In fact the research discussed in section 5 indicates that employers are not equipped to evaluate the merits of various funds and do not see it as their responsibility to shoulder the cost and moral responsibility of doing so. Importantly to the extent that employers exercise choice of fund, the criteria they apply is inappropriate and centres on their interests and concerns rather than that of the worker that the choice is applied to. The greater the choice available to employers the greater the cost imposed on employers with no apparent policy benefit.

In section 1 ISN proposes a process within Fair Work Australia where those funds that are eligible to be

named in modern awards are considered. The process is open and transparent and applies a duty on FWA to apply similar considerations to the duties imposed on MySuper trustees under the new MySuper regime. FWA will apply these considerations in the context of each of the 122 modern awards. This would ensure that the demographic covered by the award is serviced by appropriate funds from the eligible applicants. The views of representative employers and employees should be given weight when funds are being chosen from those that meet the eligibility criteria. Separate from the performance and other eligibility criteria discussed in section 1.3, the other considerations such as appropriate insurance and industry service capability should be concerned in the context of the relevant award and the industry it services. In some industries insurance considerations will be a more significant consideration than others. These are matters best left to FWA with input from the industrial parties and applicant funds and are discussed in section 1.4.

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

Where a fund that is named within an award merges with another fund that is not named, it is suggested that the merged entity would be the successor fund for the purposes of award management. Where a name changes application could be made to change the named fund. Where two funds that are named in different awards merge, the merged entity would be named in each relevant modern award.

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

At section 6.6 these submissions deal at length with the existing grandfathering provisions and argue that they should be removed.

7.15 Administrative issues

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

*What would be the steps involved in the process? **See below.***

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

Section 1.4.1 we suggest that an expert panel may assist FWA in its deliberations. The makeup of such external assistance would be a matter for FWA to determine. FWA would maintain control and responsibility for the decisions made.

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

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

The process suggested by ISN is discussed in detail within section 1 of these submissions. The process suggested by ISN is open and transparent and utilises existing systems within Fair Work Australia. We suggest that for the purposes of consideration of the naming of default funds within awards alone, the requirements for standing in relation to the award be suspended to allow any party to make application to

have a fund named in a modern award.

The hearings would be public and rely upon an established set of eligibility criteria as measured by publically available data. The industrial parties have a special role and duty before Fair Work Australia. Their activities are regulated by the *Fair Work Act 2009* and their views regarding the respective merits of eligible funds should be given weight by Fair Work Australia.

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

The Australian superannuation and award system is sufficiently unique to suggest that whilst overseas experiences may be valuable, they are not likely to assist in the design of a process.

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?

It may or may not be appropriate to name within an award a MySuper default fund tailored to the needs of a large employer. Currently there are employer specific corporate funds named in modern awards. Where these funds are defined benefits funds they will be considered MySuper compliant. It may be appropriate to continue to name the default fund in the award and factors that will need to be considered will be the presence or otherwise of an enterprise agreement which names the fund and the size of the employer in relation to the coverage of the award. It is unclear how a proliferation of tailored MySuper funds for large employers would impact on the choice of default fund in an award more generally.

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?

If a fund was not capable of meeting the eligibility requirements e.g. its net long term returns to members failed to meet the benchmark set. The fund would be removed as a named fund within the relevant award. It is not immediately obvious how grandfathering arrangements would benefit employers or employees who are existing members of the underperforming fund.

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?

Any fund listed within an award must be MySuper authorised. In the event that it is not, an employer cannot continue to use the fund as a default fund. In the ordinary course of events the fund would be removed from the list of funds named in the award.

Subject to normal fair process requirements for the relevant fund and the parties that have standing before FWA, FWA should be in a position to remove the fund from the award list without resorting to a hearing. The fund affected would be in a position to argue that it was taking steps to address the authorisation deficiency and that it should not be removed until that process was completed.

7.16 Ongoing assessment of eligibility

Who should perform this assessment?

Section 1 of these submissions argues that it would be appropriate for the assessment of eligibility to take place within the award review process undertaken by Fair Work Australia that is currently expected to occur every four years.

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



It does not appear necessary to have a different selection process following the initial selection of a default fund. It maybe that subsequent processes are more streamlined. This should be a matter for FWA to determine.

How should the assessment account for consolidation in the industry?

It is not immediately clear how fund consolidation issues impact the consideration of the merits of a particular fund. The scale of a fund and the ability of the fund to deliver services to the relevant industry are relevant.

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?

With the exception of those funds that do not meet the MySuper criteria, it is appropriate that the eligibility question be addressed every four years. It is envisaged that in the context of a limited number of funds being named within an award, only high performing stable funds would be named as a default fund within a modern award. When considering the merits of naming a fund within an award FWA and the parties to awards should consider the risk of a fund failing to meet the criteria set at some date in the medium term future.

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

With industry regulation and practice changing over time it would be appropriate to review the eligibility and other criteria during the regular award review process.

7.17 Choosing a default fund among those listed in modern awards

Are employers best placed to choose one default fund among those listed in awards? If so:

- *do employers need assistance in choosing between funds listed in awards? What type of assistance do they require and who should provide it?*
- *is some mechanism required to ensure that employers act in the best interests of their employees when making this decision? If so, what?*

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

Section 5 of these submissions deals with the above questions in some detail. As we state in 7.14 above, the research discussed in section 5 indicates that employers are not equipped to evaluate the merits of various funds and do not see it as their responsibility to shoulder the cost and moral responsibility of doing so. Importantly to the extent that employers exercise choice of fund, the criteria they apply is inappropriate and centres on their interests and concerns rather than that of the worker that the choice is applied to. The greater the choice available to employers the greater the cost imposed on employers with no apparent policy benefit.

At 5.6 we discuss employer conflicts and propose a requirement that an employer when choosing a new default fund, they should declare that there is no inducement provided and that there is no conflict impacting on the choice of fund. This declaration would be made whilst completing other business and/or superannuation reporting requirements. The process that should be followed is that discussed throughout these submissions and detailed in Section 1.

Annexure 1

Fund	Member fee (\$/pa)	Investment fee (%pa)	Admin Fee (%pa)	Misc Expense Fee / Expense Recovery / Member Protection	Fees	Fee Difference	Withdrawal Fees	Entry Fees	Buy/Sell Spread	In-built commission	Fee and Commission Notes	Death	TPD	Insurance Cost	Insurance Cost Difference	Total Fees	Total Fee Diff	Insurance Notes
AMP CustomSuper - Balanced Growth	\$ -	2.02%	0.00%	0.16%	\$ 1,090		-	-	n/av	0.4% \$0-\$2mil, 0.2% \$2-\$5mil, 0.1% > \$5mil	CustomSuper: No withdrawal or termination fee applies. Buy/sell spread is said to be determined by a range of factors and not predictable. PDS says it will not exceed 1%. Commissions may be altered by agreement.	\$ 0.78	\$ 0.36	\$ 228		\$ 1,318		0.9% rebate on \$10m plan and family insurance. Offers M/F Smoker/Non-Smoker Insurance
AMP Flexible Lifetime Super - Balanced Growth	\$ 98.40	2.02%	0.00%	0.16%	\$ 1,188	\$ 98	-	-	n/av	0.40%	Flexible Lifetime Super: Up to 4.5% contribution fee; Members without a financial planner will pay the maximum rate.	\$ 0.92	\$ 0.58	\$ 300	\$ 72	\$ 1,488	\$ 170	
AMP SuperLeader - Growth	\$ 76.44	1.19%	0.00%	0.64%	\$ 991		-	-	n/av	up to 0.44% of 30 June Member Account Bal	AMP SL: \$44 for each employee who joins when plan is formed. Commission of 1.1% of the first \$50,000 of transferred benefits and 0.55% on the balance of the transfer. \$22 one off payment for subsequent members.	\$ 1.01	\$ 1.01	\$ 406		\$ 1,397		Upon leaving an employer, you are transferred to personal section within SuperLeader. Information is about this product is not available.
AMP Super Leader - Growth (Personal Section)	\$ -	-	-	-	-	-	-	-	n/av	0.11% of 30 June Member Account Bal						-		
Aon Master Trust - Balanced - Active	\$ 72.72	0.80%	1.10%	0.00%	\$ 1,023		\$ 80.00	-	-	upto 0.60% of assets		\$ 0.63	\$ 0.22	\$ 170		\$ 1,193		Quoted insurance rates are the same between the products
Aon Master Trust - Personal Division - Balanced (Active)	\$ 72.72	0.80%	1.30%	0.00%	\$ 1,123	\$ 100	\$ 80.00	-	-	upto 0.80% of assets	Upto 0.6% of the member's account is paid to the adviser	\$ 0.63	\$ 0.22	\$ 170	\$ -	\$ 1,293	\$ 100	

Fund	Member fee (\$/pa)	Investment fee (%pa)	Admin Fee (%pa)	Misc Expense Fee / Expense Recovery / Member Protection	Fees	Fee Difference	Withdrawal Fees	Entry Fees	Buy/Sell Spread	In-built commission	Fee and Commission Notes	Death	TPD	Insurance Cost	Insurance Cost Difference	Total Fees	Total Fee Diff	Insurance Notes
ASGARD Employee Super - SMA Balanced	\$ -	0.44%	1.23%	0.35%	\$ 1,012		\$ -	-	0.23%	0.31% of assets	25% of the administration fee is paid to the adviser	\$ 0.74	\$ 0.51	\$ 250		\$ 1,262		Employer product does not differentiate between smoker and non-smoker and default would be smoker rates, unless provider notified otherwise
Asgard Super Account - SMAF - SMA Balanced	\$ -	0.44%	1.23%	0.35%	\$ 1,012	\$ -	\$ -	-	0.23%			\$ 1.44	\$ 0.71	\$ 430	\$ 180	\$ 1,442	\$ 180	
AXA Super Directions for Business - Multi-manager Balanced	\$ 68.40	0.76%	1.53%	0.00%	\$ 1,213		\$ 85.00	-	0.46%	0.41% of assets	The plan may qualify to have the investment fee rebated, depending on the level of commission being paid to the plan's financial adviser, on the size of the employer's plan and the estimated annual contributions. Employer plan size rebate is excluded due to non-disclosure.	\$ 0.99	\$ 0.33	\$ 263		\$ 1,476		Members are moved into the Rollover Section of the Personal Super Plan. Any insurance cover is ceased once AXA is notified you have left your employer.
AXA Super Directions - Rollover Section - Multi-manager Balanced	\$ 10.20	0.76%	1.53%	1.10%	\$ 1,707	\$ 494	\$ 28.00	-	0.46%	0.41% of assets						\$ 494		
BT Lifetime Super Employer - BT Multi-Manager Balanced	\$ 78.60	0.75%	0.30%	0.00%	\$ 604		-	-	0.40%	up to 0.45% <1mil, 0.4% 1-5mil, 0.3% 5-10mil, 0.15% 10+mil	Contribution and Commission can be negotiated with your adviser. Premium service fee up to < 1mil 0.35%, 1-5 mil 0.4%, 5-10 mil 0.50%, 10 mil+ 0.65%	\$ 0.73	\$ 0.56	\$ 259		\$ 863		Personal members are eligible for cover on the same terms and conditions as members of employer plans, but Automatic Acceptance of cover does not apply and all cover will be subject to approval by the Insurer.
BT Lifetime Super Employer - BT Multi-Manager Balanced (Personal Section)	\$ 78.60	0.75%	1.15%	0.00%	\$ 1,029	\$ 425	-	-	-	-		\$ 0.73	\$ 0.56	\$ 259		\$ 1,288	\$ 425	

Fund	Member fee (\$/pa)	Investment fee (%pa)	Admin Fee (%pa)	Misc Expense Fee / Expense Recovery / Member Protection	Fees	Fee Difference	Withdrawal Fees	Entry Fees	Buy/Sell Spread	In-built commission	Fee and Commission Notes	Death	TPD	Insurance Cost	Insurance Cost Difference	Total Fees	Total Fee Diff	Insurance Notes
Colonial FirstChoice Moderate - Employer	\$ 60.00	1.22%	0.00%	0.00%	\$ 670		-	-	0.15%	up to 0.44%	Employer PDS states that the adviser service fee negotiated with your financial adviser will not change following a move to First Choice Personal Super. Employer Plan Balanced rebate applies. 1st \$1mil : Nil; Next \$4mil : 0.50%; Over \$5 mil : 0.60%.	\$ 0.78	\$ 0.51	\$ 258		\$ 928		Insurance in the personal product assumes that members are smokers.
Colonial FirstChoice Moderate - Personal	\$ -	1.82%	0.00%	0.00%	\$ 910	\$ 240	-	-	0.15%	up to 0.60% but capped at employer level		\$ 1.72	\$ 0.77	\$ 498	\$ 240	\$ 1,408	\$ 480	
IOOF PS Employer - Multi Series Balanced Trust	\$ 60.00	0.65%	0.60%	0.00%	\$ 685		\$ 77.95	-	-	0.5% <250k, 0.45% 250-500k, 0.35% 500-1000k, 0.15% 1 mil+	Upon transfer to IOOF PS Personal, no establishment or upfront fees are payable and assets are not liquidated. Benefit Payment fee expected to be applied. Employer plan size rebate is negotiable for plans over \$2mil.	\$ 0.61	\$ 0.41	\$ 205		\$ 890		If transferred, you are assumed to be a smoker unless you notify IOOF.
IOOF PS Personal - Multi Series Balanced Trust	\$ 84.00	0.65%	1.35%	0.00%	\$ 1,084	\$ 399	\$ 77.95	-	-	0.5% <100k, 0.45% 100-500k, 0.25% 500-1000k, 0.20% 1 mil+		\$ 1.61	\$ 0.66	\$ 454	\$ 249	\$ 1,538	\$ 648	
OnePath Corporate Super - OptiMix Balanced	\$ 60.00	1.14%	0.00%	0.24%	\$ 750		\$ 83.86	-	0.36%	0.60%	OnePath Corporate Super: Withdrawal fee is waived upon transfer to personal product. Ongoing fees may be negotiated. Lower fees, rebates or discounted management costs agreed upon may be waived upon transfer.					\$ 750		Insurance is tailored for individual clients and information is not published within the PDS.
OnePath Corporate Super Personal - OptiMix Balanced	\$ 65.88	1.14%	0.00%	0.24%	\$ 756	\$ 6	\$ 83.86	-	0.36%	0.60%						\$ 756	\$ 6	
Mercer Super Trust - Corporate Super - Mercer Growth	\$ 97.63	0.82%	0.52%	0.05%	\$ 793		\$ 131.58	-	n/av	see notes	Mercer Corp: Adviser service fee of up to 0.5% of contributions and up to 1% of plan assets, negotiable with adviser. Any reduced commission will carry over to personal account. No buy/sell spread available as it is built into unit price.	\$ 0.56	\$ 0.39	\$ 190		\$ 983		Does not explicitly say members will be treated as smokers, however Corporate Insurance does not differentiate between M/F Smoker/Non-Smoker
Mercer Super Trust - Personal Super - Mercer Growth	\$ -	0.82%	1.15%	0.05%	\$ 1,010	\$ 217	\$ 131.58	-	n/av	0.45%		\$ 0.95	\$ 0.44	\$ 278	\$ 88	\$ 1,288	\$ 305	

Fund	Member fee (\$/pa)	Investment fee (%pa)	Admin Fee (%pa)	Misc Expense Fee / Expense Recovery / Member Protection	Fees	Fee Difference	Withdrawal Fees	Entry Fees	Buy/Sell Spread	In-built commission	Fee and Commission Notes	Death	TPD	Insurance Cost	Insurance Cost Difference	Total Fees	Total Fee Diff	Insurance Notes
MLC Employer Super - Pre Select Growth Fund	\$ 156.00	0.70%	0.75%	0.00%	\$ 881					0.75%	An adviser service fee of upto 0.75% of assets applies, subject to rebates. Fee of 1.9% is charged each day but 1.15% is re-credited to your account at the end of the month.					\$ 881		No indicative insurance rates available.
MLC Employer Super - Employer Option - Pre Select Growth Fund	\$ 260.00	0.70%	0.75%	0.00%	\$ 985	\$ 104				0.75%						\$ 985	\$ 104	
MLC Masterkey Business - Horizon 4 - Balanced Portfolio	\$ 77.64	0.58%	0.85%	0.00%	\$ 793		\$ 76.47	-	n/av	up to 0.33% p.a.	When transferred to the personal plan, MLC will pay your plan adviser an asset based commission out of the Admin Fee charged 0.44% <50k, 0.50% 50-100k, 0.55% 100-200k, 0.60% 200-400k, 0.66% 400k+. Commissions capped at \$2,200 or 2% p.a, whichever is greater. The withdrawal fee is waived where the personal member's account remains open for at least 1 year.	\$ 0.83	\$ 0.34	\$ 234		\$ 1,027		Insurance for Personal Productis tailored by the financial adviser depending on the clients needs
MLC Masterkey Personal - Horizon 4 - Balanced Portfolio	\$ 77.64	0.58%	1.53%	0.00%	\$ 1,133	\$ 340	\$ 76.47		n/av	see notes						\$ 1,133	\$ 106	
Spectrum Super Employer - IOOF MultiMix Balanced Growth Trust	\$ 53.30	0.85%	0.77%	0.00%	\$ 864		\$ 75.00	-	0.25%	up to 0.80%	Emp: \$60 withdrawal fee and \$75 termination fee waived for transfer between products. Commission composed of up to 0.8% management remuneration. Employer plan size rebate is negotiable for plans over \$5mil.	\$ 0.64	\$ 0.40	\$ 208		\$ 1,072		Does not explicitly say members will be treated as smokers, however Corporate Insurance does not differentiate between M/F Smoker/Non-Smoker
Spectrum Super Personal - IOOF MultiMix Balanced Growth Trust	\$ 53.30	0.85%	1.54%	0.00%	\$ 1,248	\$ 385	\$ 75.00	-	0.25%	up to 0.80%		\$ 1.00	\$ 0.60	\$ 320	\$ 112	\$ 1,568	\$ 497	



Assumptions	
Employer Plan Size	\$ 10 Million
Account Balance	\$ 50,000
Insurance Cover ('000)	\$ 200
39 Years Old (40 Age Next Birthday) White Collar, Non Smoker	

Assumptions:

Where a person is transferred to a personal division, it is assumed that they have not filled out a form notifying the fund that they are a non-smoker.

Those funds where insurance information is unavailable, the cells are highlighted red.

All entry fees, exit fees and commissions are based on figures listed in the PDS and usually are the highest level charged. All funds state that these figures can be negotiated between the adviser and client but provide no further detail.

Buy/sell spreads listed as n/a are either not disclosed by the fund or built into the unit price.

Effective Date of Fund returns and fee structures: **31-Jan-12**

Date of Calculation and Delivery: **23-Mar-12**

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Annexure 2

Super in awards

Compulsory superannuation payments made by employers on behalf of employees find their origin in the wages and industrial relations systems and are properly seen as a form of deferred wages. It is appropriate that safety net default superannuation arrangements are contained within safety net awards and employer and employee representatives have an influential role in the choice of default fund.

With industry wide coverage; universal access to membership and equal representation of employers and employees, industry super funds were the primary vehicles used to accommodate agreements reached by the union movement, government and employer associations to extend superannuation from a minority to the vast majority of working Australians.

Whilst the industrial relations system and superannuation legislation have changed since the introduction of the first industrial agreements relating to superannuation over twenty years ago, the system remains anchored in the industrial relations system. It is submitted that this is appropriate given the nature of the payments being made.

The continued involvement of the representatives of employees and employers, those that pay and receive superannuation contributions, is good public policy because it ensures those that are directly affected by decisions are part of the decision making process.

Prior to the introduction of the Superannuation Guarantee (SG) in 1992 and the National Wage Case decisions that preceded it, superannuation was the preserve of a minority of Australian workers who were employed in the public sector or who were highly paid executives in the private sector. Today almost all Australian workers can look forward to a better standard of living than can be provided by the Age Pension alone.

A slow start

Policy makers turned their attention to superannuation at an early stage and there were several aborted attempts to introduce national retirement schemes, however no comprehensive and universal policy was adopted until the late 1980's.

In 1900 the New South Wales Government was soon followed by Victoria and Queensland in providing for a £26 a year means tested age pension, funded from general revenue. Section 51(xxiii) of the *Commonwealth of Australia Constitution Act 1901* gave the Commonwealth the power to legislate for the provision of old age and invalid pensions, which they did so in 1908 with the passage of the *Invalid and Old Age Pensions Act 1908*.

As early as 1915 the Commonwealth provided tax deductible status to employer superannuation contributions.⁵⁰ The Bruce Government established a Royal Commission into the merits of establishing a national retirement insurance scheme in 1923⁵¹ and introduced the National Insurance Bill in 1928 which lapsed with the defeat of the Government in 1929. A 1938 National Health Pensions Bill was passed but was allowed to lapse with war priorities gaining precedence.

The period between the mid 1960's and the mid 1980's saw little expansion in the percentage of the workforce that had access to superannuation⁵². In 1976 the *National Superannuation Committee of*

⁵⁰ *Income Tax Assessment Act 1915*

⁵¹ Royal Commission on National Insurance 1923-1927, Chaired by Senator J. D. Millen.

⁵² The ABS Year Book Australia 1974 found that only 32% of the workforce received superannuation payments. Whilst 36% of male workers were part of the system only 15% of female workers benefitted. The public sector dominated the system with 58% of public sector workers part of what was primarily defined benefits schemes and only 24% of all workers in the private sector receiving any superannuation. In addition most schemes in the private sector favoured executive staff, were not portable and benefits were often lost when employees changed their place of employment.

*Inquiry*⁵³ recommended a part contributory universal pension scheme. The Fraser Government⁵⁴ rejected the recommendations of the inquiry in 1979.

Pressure continued to grow to expand access to superannuation and in 1983 the Hawke Labor Government expressed general support for the principles of universal superannuation and the May Economic Statement of that year introduced concessional taxation arrangements that encouraged the expansion of superannuation coverage in Australia.⁵⁵

Wage superannuation trade off

Prior to 1983 only 39%⁵⁶ of the working population (and 25% of women and “blue collar” employees) received superannuation contributions from their employer. Most of the schemes existing at the times were not portable, had strict vesting rules and were generally restricted to public servants and senior management.

Within certain industries there was growing pressure to transform superannuation from a salaried privilege to a wage right.⁵⁷ Industrial pressure grew to improve the retirement savings of ordinary working Australians and in September 1985 the Australian Council of Trade Unions (ACTU’s) sought a 3 percent employer contribution to superannuation in the National Wage Case. The claim was supported by the Commonwealth following the successful recognition of the Prices and Incomes Accord.⁵⁸ Within the context of the Prices and Incomes Accord with the Federal Government, the claim was.

In February 1986 the Conciliation and Arbitration Commission allowed for approval of agreements that allowed for superannuation contribution of “up to” 3 per cent to approved superannuation funds. These funds were generally multi-employer industry funds jointly sponsored by trade unions and employer associations.

The 1986 Wage Case decision saw superannuation coverage dramatically increase from approximately 40 per cent of employees to 79 per cent in the four years following the Commission’s decision. The percentage of employees in the private sector with some form of superannuation increased from 32 per cent in 1987 to 68 per cent in 1991.

In 1991 the Australian Industrial Relations Commission⁵⁹ rejected an ACTU claim to increase compulsory superannuation from 3 to 6 percent despite the acceptance of the claim from the Commonwealth.

The Industrial Relations Commission recommended a national superannuation conference to deal with what it perceived as fundamental structural problems. Not least of which was an acceptance between the parties that a 3 per cent contribution was insufficient to significantly improve retirement incomes. These problems included the non application to one third of the private sector workforce; massive non-compliance; confusion and underpayments; the lack of portability and flexibility and the lack of application to part-time and casual employees.

Superannuation guarantee

Rather than hold a conference on superannuation the Commonwealth, using its taxation powers, introduced the superannuation guarantee via the *Superannuation Guarantee (Administration) Act 1992*.

⁵³ Chaired by Sir Keith Hancock.

⁵⁴ Interestingly the Fraser Cabinet discussed a proposal and ultimately decided against the establishment of a contributory national superannuation scheme in 1977.

⁵⁵ Paul Keating, Economy – Ministerial Statement, May 19 1983.

⁵⁶ ABS. Year Book Australia 1983.

⁵⁷ Examples are the campaigns to extend superannuation entitlements by the Federated Storeman and Packers Union (now known as the National Union of Workers) and journalists and print workers in the early 1980’s. These campaigns eventually saw the establishment of the industry super funds LUCRF and Mediasuper.

⁵⁸ The first Statement of Accord (Prices and Incomes Accord) between the ALP and the ACTU was endorsed in February 1983.

⁵⁹ The Australian Industrial Relations Commission replaced the Australian Conciliation and Arbitration Commission in 1988.

The Act required employers from 1 July 1992 to make tax-deductible superannuation contributions on behalf of their employees. Commencing 1992/3 with a 3 percent employer contribution (4 percent for employers with an annual payroll of over 1 million).

Contributions increased until 9 percent was reached in 2002/03. The Superannuation Guarantee (Administration) Amendment Bill 2011 currently before the Senate, provides for a gradual increase in the SG rate with initial increments of 0.25 percentage points on 1 July 2013 and on 1 July 2014. Further increments of 0.5 percentage points will apply annually up to 2019-20, when the SG rate will be set at 12 percent.

Employers who did not provide the required amount of superannuation payments would be liable for a non-deductible Superannuation Guarantee Charge, equivalent to the individual employee shortfall in contributions, an interest component and an administrative charge. The guarantee extended superannuation coverage to the majority of employees (excluding employees earning less than \$450 per month, part-time employees under 18 years of age and employees aged 65 or over).⁶⁰

Since the inception of the SG, the system has gone from strength to strength. Today the superannuation system comprises over \$1.2 trillion in assets and this is estimated to almost triple in size to \$3.2 trillion by 2022, a long way from the humble and more often than not, aborted attempts to establish a national retirement system over a century ago.

⁶⁰ The contributions guarantee was extended from 65 to 70 from 1 July 1997 provided the employee was employed for ten hours or more each week.