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Default Superannuation Funds in Modern Awards
Productivity Commission
LB2 Collins Street East
MELBOURNE VIC 8003

Email: default.super@pc.gov.au

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Subject: Default superannuation funds in modern awards

Dear Sir/Madam

Mercer (Australia) Pty Ltd welcomes the opportunity to provide our view on the specification of superannuation funds in modern awards as default funds.

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 institutional clients worldwide. Mercer consultants help employers design and manage health, retirement and other benefits, and optimise human capital.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds. Mercer's outsourcing business in Australia/New Zealand has \$55 billion in funds under administration, provides services to more than 1.2 million super fund members and 15,000 private clients and is part of a global consulting, outsourcing and investments firm which operates in 42 countries.

We provide our own master trust, the Mercer Super Trust, in Australia which has approximately 270 participating employers, 240,000 members and more than \$15 billion in assets under management. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.

Mercer's reach into the Australian superannuation industry is broad and our clients therefore represent all types of superannuation funds (including corporate, industry, public sector and retail funds). Therefore the views expressed in this submission are Mercer's alone and do not necessarily represent the views of our clients. Furthermore, where our clients have made a submission to the Productivity Commission, their submissions should be relied upon as expressing their view.

Executive Summary

Modern awards currently specify that default Superannuation Guarantee (SG) contributions must be made to one of a number of funds specified in that award.

We consider these arrangements can be improved so there is greater transparency in how the funds are both selected and monitored on an ongoing basis to encourage greater competition and innovation within the industry and to ensure, as far as possible, that members receive the best retirement benefit possible.

Under a Bill currently before the Commonwealth Parliament, it is proposed that the *Superannuation Guarantee (Administration) Act* (SG Act) will be amended to require all employers, from 1 October 2013, to contribute to a fund offering a MySuper product for employees who do not choose another fund. The trustee of the fund must then ensure that the contributions are credited to the MySuper product, unless directed by the employee to use another investment option.

This means that only funds which have a MySuper product (as well as eligible defined benefit funds) will be eligible to receive SG contributions in the future. Furthermore, each MySuper product will be subject to APRA scrutiny. Indeed, this will be the first time in APRA's history that APRA will be required to approve a particular product.

Therefore all MySuper products will be required to satisfy numerous legislative requirements and be subject to ongoing monitoring under the *Superannuation Industry (Supervision) Act 1993* (SIS). Under these new regulatory arrangements, employers can safely make default contributions to any MySuper product and hence there is no need to provide reference to nominated funds within modern awards.

We therefore recommend removal of the superannuation provisions relating to default superannuation funds in modern awards.

We recognise the removal of nominated superannuation funds from awards could provide difficulties for some employers, particularly small to medium sized enterprises. Therefore to cater for those employers who do not want to assess the market in order to choose an appropriate default fund for their employees, we recommend that a process be established to maintain a list of appropriate superannuation funds for each award (but outside the award), taking into account the specific demographics and characteristics of the relevant employee group. This list should contain a variety of funds and be subject to regular review and monitoring.

Should the Productivity Commission determine that superannuation provisions should remain in modern awards, we recommend that each award contain several superannuation funds and that there exists a transparent and objective process for the selection and maintenance of the nominated funds in each award. Furthermore we recommend that should an employer wish to select another MySuper product for the SG contributions of their employees, then such an outcome should be permitted. After all, it is likely the employees of some employers covered by each award will have particular demographic features or be within a particular location(s), where it may be preferable for them to join another superannuation fund. In other cases, particularly for larger employers, the employer may be able to negotiate superior superannuation arrangements for their employees.

Our issues and recommendations are discussed in more detail in the Appendix to this submission.

Mercer would welcome the opportunity to discuss our submission in more detail.

Yours sincerely,

David Anderson
Managing Director & Market Leader
Australia/New Zealand

APPENDIX – Detailed comments relating to our recommendations

1. Let's promote innovation and competition

Competition drives efficiency and innovation in all industries and as such needs to be maintained and encouraged within the superannuation industry. In particular, innovation and competition is likely to drive better retirement outcomes for employees. The specification of particular default funds in modern awards can be a serious restriction on innovation and competition and mean that some employees do not receive the optimal outcome.

The Government has announced that only funds with a MySuper product will be able to be nominated in the future. All MySuper products will be required to satisfy numerous legislative requirements and will be subject to ongoing monitoring by APRA. This in itself will provide appropriate protection for employees and it should therefore be possible for an employer to make SG contributions to any MySuper product for their employees.

It should also be recognised that many employers have a genuine desire to provide the best possible superannuation arrangements for their employees and will go through an open market tendering process taking into account fees, insurance and investment options, service levels etc. Larger employers also have the opportunity to use their size and scale to negotiate lower fees and tailored arrangements with providers.

The removal of the superannuation provisions in Modern Awards, which specify a limited number of funds which can be used for Award employees, would remove a significant barrier to innovation and competition. This would enable employers to simply choose a MySuper product that best suits their employees, potentially with lower fees or better value than those available from funds which may have been nominated in a particular Award.

2. Let's recognise the effects of the new MySuper regime

From 1 October 2013, employers will be required to make SG contributions to funds offering a MySuper product for those employees who have not chosen a fund. MySuper arrangements will be closely monitored by APRA and subject to numerous restrictions on fees, how any fees are determined and will not permit commissions. The high level of prudential supervision already provided under SIS and the related prudential standards being introduced as part of the Stronger

Super reforms suggests that there is no need to have another process to select funds for all award employees.

We therefore recommend that any MySuper fund be eligible to be used as a default fund.

3. Let's not forget that defined benefit (DB) funds can be default funds

The Government has announced that only funds which have a MySuper product will be able to be nominated in modern awards in the future. The Commission must ensure that there is some provision for the continued use of DB funds as default funds under modern awards. We understand that the SG Act will allow certain DB arrangements to continue to be used as a default fund.

We therefore recommend that any reference in modern awards should be to any APRA regulated fund rather than specifically to MySuper to ensure the continued ability to contribute to defined benefit (DB) funds.

4. Let's recognise the role of some employers

We understand that some employers would prefer funds be specified in awards as they do not wish to undertake the analysis necessary to choose an appropriate fund for their employees.

The Government has stated that MySuper is aimed at lowering the cost for employers in selecting a default fund, as they will have better information to assist with their choice, and the confidence that any MySuper product will meet minimum standards and offer a cost-effective superannuation plan for their employees.

APRA will produce league tables of MySuper products which could be utilised by employers in choosing an appropriate fund. The use of league tables is not necessarily appropriate, on its own, for choosing a fund as the tables may place undue emphasis on fees and not recognise the needs of different groups of employees. Nevertheless the tables will be a tool which unsophisticated employers can use.

Given some employers would prefer to choose from a limited list, we recommend a non-exclusive list of 'standard default funds' list be prepared, regularly reviewed and monitored in relation to each award. This list must be maintained outside of the award system, in order to facilitate

updating of the list as funds wind-up, merge, change their names, lose MySuper authorisation or are added/deleted for other reasons. This structure would also permit larger employers, who are interested in providing the best outcome for their employees, to run a tender process to select the most appropriate default fund for their employees.

5. Let's develop a sound selection and review process

Should the Productivity Commission determine that the superannuation provision should continue in modern awards, it is essential the listing of any superannuation funds be subject to a robust and transparent process.

The selection process of default superannuation funds under modern awards should therefore be carried out under a public set of criteria. These selection criteria should take into account several factors which affect the benefits received by the employees as well as recognising any particular features relevant to the particular industry.

Furthermore, there needs to be a regular review process so that the listed funds are not guaranteed long term recognition within an award. Such a result can lead to less innovation and a poorer result for the employees covered by that award.

It is also important that any employer should be able to choose another MySuper product. After all, it is often the employer that is best able to determine the most appropriate default fund for its employees, taking into account their particular characteristics. We therefore recommend employers have the ability to review the marketplace rather than be restricted to a list of nominated funds, thereby giving them the ability to obtain the best benefits for their employees and ensure an appropriate fund selection.

6. Let's recognise problems arising from removing funds listed in awards

The provision of a robust review process for default funds naturally raises the potential that a superannuation fund could be delisted from an award. However it needs to be recognised that a decision to remove a fund from the list of default funds in an award can have major implications for that fund and its members. For example, severe liquidity issues are likely to follow as contribution inflow would be significantly reduced and some members are likely to want to transfer their accrued benefits to their new default fund.

As new contributions are paid to a different default fund, disengaged members will incur two sets of fees and potential doubling up of insurance cover and associated costs.

Due to these potentially severe consequences, a decision to remove a default fund from an award would tend to be made only in extreme circumstances. Therefore the integrity of any proposed monitoring and review process would be limited by these potential consequences.

We therefore recommend that it is preferred that default superannuation funds are not listed in modern awards and employers be permitted to contribute to any MySuper product. This outcome would also generate greater diversity within a particular industry which would also reduce the risks for the employees covered.

7. Let's review the successor fund rules

The current successor fund and grandfathering provisions in modern awards are inadequate, particularly in the case of corporate mergers and de-mergers.

Whilst it appears to be clear that the current provisions would allow a new fund to be used as a default fund if it is:

- A transfer from a corporate fund to a master trust; or
- A merger of two funds

there is considerable doubt in the following circumstances:

- An employer wanting to transfer from one master trust to another, or one industry fund to another to obtain better benefits for members;
- The sale of a subsidiary where the new owner wants to continue using the old employer's 12 September 2008 default fund for the transferring employees;
- A takeover where the new employer wants to continue using the old employer's 12 September 2008 fund for all its employees;
- A takeover where the new employer wants to use the old employer's 12 September 2008 fund for a period of time; and
- A corporate restructure where the ongoing entity is a new entity.

We recommend that the wording relating to grandfathering provisions in modern awards be amended to provide greater flexibility to accommodate circumstances similar to those outlined above.

Our recommendations

We recommend the removal of the superannuation provisions in modern awards which specify a limited number of default superannuation funds that are allowed for award employees.

This would encourage innovation and competition and enable employers to have greater flexibility in choosing an appropriate default fund for their employees. It would also enable employers to select funds for their employees with lower fees or better value than those available from funds nominated in a particular award.

To assist employers, we also recommend a non-exclusive list of standard default funds for each award be maintained. This list would contain a range of funds that may be suitable for each group of award employees. Employers must also have the ability to select the most appropriate default fund (including a fund not on the list) and thereby obtain a better outcome for their employees.