

3 August 2012

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

Email: default.super@pc.gov.au

Dear Sir/Madam,

DEFAULT SUPERANNUATION FUNDS IN MODERN AWARDS – RESPONSE TO PRODUCTIVITY COMMISSION DRAFT REPORT

AustralianSuper provides this submission in response to the Productivity Commission's Draft Report on Default Superannuation Funds in Modern Awards issued on 29 June 2012.

As noted in our original submission, AustralianSuper is run only to benefit members. We don't pay commissions to anyone to recommend us, nor do we pay dividends to shareholders. AustralianSuper has over 1.9 million members, we manage \$46 billion in members' assets and over 170,000 employers contribute to the Fund. The Fund's sole purpose is to help members achieve their best possible retirement outcomes.

We welcome the Productivity Commission's conclusion that current default superannuation arrangements have delivered stability and above-average investment returns for superannuation fund members. We note the Report states that:

*"Investment returns of default funds listed in modern awards have been relatively strong, when compared to returns of non-default funds. Over the eight years to 2011, default funds averaged an annual (after-tax) investment rate of return of 6.4 per cent, compared with 5.8 per cent for all funds, and default funds outperformed non-default funds in each year over that period except in 2009. This would suggest that the current default system has, overall, delivered above-average returns for members."*¹

This acknowledgement of the outperformance of default funds is particularly welcome in light of the Commission's recognition that:

*"Small improvements in the annual performance of a superannuation fund can lead to a significant increase in returns for members, given the long time frames over which superannuation assets are typically accumulated."*²

¹ Productivity Commission Draft Report, June 2012 Default Superannuation Funds in Modern Awards page 63

² *ibid*

AustralianSuper also welcomes the Commission's acknowledgement of the importance of fees in stating that, "*the level of the fees can make a significant difference to the ultimate retirement benefit received by fund members*"³. In that context, it is noteworthy that the Report finds that:

*"the average MER of default superannuation funds has consistently trended below that of all superannuation funds."*⁴

Given the benefits delivered to members by the current arrangements, as stated by the Report (i.e. higher returns and lower fees by Award default funds compared to non-default funds), it is imperative that any proposal to change the system builds on the success of the current system, and does not result in increased fees or reduced investment performance for default fund members. We are concerned that an inescapable outcome of implementing many of the recommendations in the Commission's Draft Report is a system that would include more underperforming, higher cost funds.

AustralianSuper agrees with the Commission's assertion that the best interests of members should be the overarching principle for any system for the nomination of default funds under Awards and urges it to ensure that the final recommendations are not based on unsupported assumptions that reflect the interests of the providers of superannuation services rather than members' interests.

Fair Work Australia

We reiterate our belief that Fair Work Australia (FWA) is the appropriate body to make informed decisions about all workplace, industry and Award matters and the parties of standing to FWA are best positioned to understand the needs of employees, employers and the workplace. In addition, we believe there are a number of legal and practical challenges associated with some of the options currently being considered by the Commission.

With respect to the Commission's draft finding⁵ that MySuper compliance should be the only mandatory criterion, AustralianSuper reinforces its contention that this is insufficient and that net long term performance and no 'fund flipping' should also be mandatory criteria.

We reaffirm our belief that the Australian Prudential Regulation Authority (APRA) is the appropriate body to determine performance, issues of scale, governance, conflicts and administration efficiency. APRA is best placed to provide performance and other data that will assist the parties in identifying appropriate default funds. In our opinion, it is not efficient or appropriate to create new bureaucratic structures to address these issues and, as such, they do not need further consideration by another Government body for the purpose of default fund selection.

Feedback on draft recommendations

In the context of the above, we provide comment on some of the recommendations made by the Commission in their Draft Report.

³ Productivity Commission Draft Report, June 2012 Default Superannuation Funds in Modern Awards, page 9

⁴ *ibid*

⁵ *Ibid*, page 9

1) *Draft Recommendation 4.2 – Expected ability to deliver on the MySuper product’s investment objectives*

AustralianSuper agrees that this should be a primary factor for default fund selection, as this factor has the largest impact on a member’s retirement outcome.

AustralianSuper would be very pleased to be involved in discussions with respect to the factors likely to impact on future performance and submit that they primarily revolve around asset allocation, sector tilts and manager selection. These primary factors are significantly influenced by net cash flows and the ability to extract cost, tax and other efficiencies from the portfolio. The absence of an internal profit margin and the effective use of scale have also repeatedly demonstrated themselves as having a positive impact on net performance.

We contend an investment return objective should focus on returns in the member’s hands. This means returns must be measured as net of all fees, costs and taxes. This measurement is consistent with the definition of a MySuper product under the Stronger Super reforms, and is consistent with APRA measurement of investment performance for MySuper options in the future. This would negate the need to have a separate consideration of fees as a factor in default fund selection as proposed under Draft Recommendation 4.3.

2) *Draft recommendation 5.5 – likelihood of default members being fund flipped.*

AustralianSuper remains concerned that, despite the MySuper reforms, default fund members can be ‘flipped’ into a higher cost MySuper option without their consent once they cease employment with a sponsoring employer. There is no prohibition on this practice in the legislation before Parliament.

We strongly urge the Commission to recommend that this practice be prohibited in relation to funds applying for nomination as a default fund under modern awards.

3) *Draft Recommendations 4.4, 5.1, 5.4, and 6.4 - Issues of scale, governance, conflicts and administrative efficiency*

AustralianSuper is of the view that these issues are being dealt with extensively under the Stronger Super reforms, which are in Parliament presently, or in the consultation stage.

In addition, APRA has advanced its development of Draft Prudential Standards ahead of this legislation. APRA’s draft Standards deal extensively and substantively with issues relating to governance of superannuation funds and conflicts management.

We are confident that as a prudential regulator of superannuation funds, APRA will be appropriately equipped to deal with these issues once the relevant enabling legislation passes through Parliament. Superannuation funds already pay levies to fund APRA’s performance of this role.

4) *Draft Recommendation 8.2 – Allows employers selecting default fund for employees to choose a fund not listed in the Award*

AustralianSuper is opposed to this recommendation as it is inconsistent with the findings and arguments already presented by the Commission. This proposal would undermine the Award process and does not allow for member representation in the decision-making process. As an alternative, enterprise agreements already provide effective arrangements for alternative fund choice in a manner that directly incorporates the views of members affected.

We reject option one or the ability for employers to "opt out" of the Award safety net, as contemplated by Recommendation 8.2. Neither of these options provide adequate protection for members' best interests.

Option three has considerable advantages over option four given that it would leverage a number of the systems current strengths.

AustralianSuper's preferred option is option two, incorporating the positive recommendations the Productivity Commission has made about improving the selection process.

Matters for clarification in the Productivity Commission Draft Report for the record

1) *AustralianSuper supports contestability*

Page 128 of the Commission's Report erroneously said that AustralianSuper "*did not consider the concept of contestability to be relevant.*" The AustralianSuper submission of 5 April stated on page two that "*the notion of a 'level playing field' between different types of funds, whilst relevant to the funds themselves, is not relevant when determining what is in the best interests of employees*". We did not state that contestability was 'not relevant' to default fund selection only that it was of far less importance and relevance than the best interests of employees.

2) *AustralianSuper supports the FWA*

Page 132 of the Commission's Report states that "*participants did not comment directly on whether FWA is, or is seen to be, an impartial decision maker.*" AustralianSuper did not assume that the FWA was a subject of inquiry as this was not mentioned in the terms of reference. We reaffirm the central relevance of FWA in determining all workplace conditions, including superannuation, in a manner which accords due process and properly includes the views of the workplace participants.

Page 168 of the Commission's Report states that "*Some issues with contestability and procedural fairness might remain to the extent that one or more of the FWA panel might be biased, or perceived to be biased, towards the views of any party that they were, or remain, affiliated with.*"

We were perplexed by these comments as we have not observed, nor are we aware of, any occasions where FWA has acted in anything other than an impartial manner.

The success of the current system

The Productivity Commission's Draft Report acknowledges the current system is serving members' best interests in nominating default funds that are superior in terms of investment performance and fees to those not nominated in Awards.

The Commission has made a number of positive recommendations in relation to improving the default fund selection process in Awards. These include: introducing selection criteria, the requirement for the parties to declare any conflicts of interest, the consideration of a wider array of providers for inclusion, and an ongoing review process.

It has not, however, made the case that fundamentally changing the parties involved in the decision-making process, or abandoning the core of the current arrangements that are enshrined in law, would improve the outcomes for members.

Indeed changing the system to include funds not currently named in Awards – that the Commission itself has found to produce lower returns and higher fees – would seem, on the basis of the Commission's own findings, contrary to the best interests of members.

The ultimate test of any changes to the system is whether they benefit members, not the impact they have on superannuation providers.

Yours sincerely,

IAN SILK

Chief Executive