Mr Tim Watling
Secretary
Senate Education Employment and Workplace Relations Committee
Canberra ACT 2600

14 November 2012

Dear Mr Watling

FSC submission – Fair Work Amendment Bill 2012

Thank you for the opportunity to provide a submission on this Bill.

The Financial Services Council (FSC) represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, private and public trustees. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please find our submission enclosed. We look forward to canvassing the contents with the Committee.

Yours sincerely

ANDREW BRAGG

SENIOR POLICY MANAGER

FSC SUBMISSION - FAIR WORK AMENDMENT BILL 2012

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1. INTRODUCTION

Context

The Financial Services Council (FSC) welcomes the opportunity to provide comments on Fair Work Amendment Bill 2012.

This Bill contains elements of the MySuper policy proposed by the Government during the 2010 election and subsequently reaffirmed in December 2010 and September 2011. It also forms the Government's legislative response to the recent Productivity Commission review of default superannuation funds in Modern Awards.

We believe the market structure proposed in this Bill for default super / MySuper will limit competition in the $1.4 trillion superannuation industry and result in reduced fee pressure and innovation for consumers.

As stated in the Explanatory Memorandum for the *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011* presently before the Parliament, MySuper is:

> ...a new, simple and cost-effective superannuation product that will replace existing default products. MySuper products will have a simple set of product features, irrespective of who provides them. This will enable members, employers and market analysts to compare funds more easily based on a few key differences. It will also ensure members do not pay for any unnecessary 'bells and whistles' they do not need or use.

MySuper is a therefore a substantial change in the regulation of the default superannuation system which introduces safeguards for members and simplicity for employers (in conjunction with the SuperStream reforms).

The lack of competition as a result of the Fair Work Act superannuation provisions is preventing the operation of a free and efficient market to the detriment of consumers. These reforms go so far as to further lessen the prospect of competition between superannuation funds added to awards.

According to the OECD, open, competitive markets deliver an optimal outcome in all markets:

> All OECD countries rely fundamentally on competition in product markets to organise production. Competition stimulates innovation and efficiency in the use of resources, thereby leading to greater product diversification and lower prices. Therefore, competitive product markets are in the interest of all consumers.[1]

Policy settings can engender competitive tensions at both the retail (employee) and wholesale (employer) level in any market. Competition at the wholesale level in the default superannuation market is presently heavily restricted as a result of the Act. In order to address both the regulatory burdens faced by employers and the consumer protection shortcomings of the Fair Work regime, the superannuation framework must become more open, transparent and easier for employers to engage.

The FSC believes an important outcome of the reforms is that an employer may select any Australian Prudential Regulation Authority (APRA) regulated superannuation fund in relation to its authorised MySuper product as a default fund from commencement on 1 July 2013.

If this were permitted, a designated Fair Work process would not be required as an employer would be free to select any APRA regulated MySuper product. This approach has the benefit of removing conflicted industrial parties from selecting default superannuation funds. It would also deliver the most competitive market structure at the lowest regulatory and compliance cost.

Recommendation: Permit all complying MySuper products to be eligible default funds at all Australian workplaces

The extensive additional regulatory impositions proposed under this Bill for the inclusion of a limited number of superannuation funds in awards calls into question the adequacy of the MySuper regime.

It remains unclear why MySuper is somehow deficient for employees covered by awards but sufficient for employees outside of awards. The FSC does not believe there is anything unique about an employee covered by an award that merits further regulatory requirements being introduced.

[1] The Organisation for Economic Co-operation and Development (OECD) "Competition: Economic Issues" - http://www.oecd.org/about/0,3347,en_2649_34833_1_1_1_1_37463,00.html

The FSC suggests that if the government does not have confidence in its newly created MySuper regime then it should strengthen it rather than create overlapping requirements that only apply to a subset of employees.

Consultation with industry

We note that the Explanatory Memorandum indicates that: "the Bill was developed following extensive consultation with superannuation industry stakeholders….." This is incorrect. There was minimal consultation with the superannuation industry on this legislation. Apart from a single meeting held on 23 October 2012, there was no exposure draft legislation and therefore no consultation on the draft provisions. The first time the industry saw the legislation was when it was presented to Parliament.

Further, we can not verify if the following statement on Regulatory Impact Statements (RIS) in the Explanatory Memorandum 'extends to the changes proposed in this Bill to superannuation' as we have been unable to locate the relevant RIS:

> Regulation Impact Statements on proposed reforms to unfair dismissal and general protections provisions and changes to the selection of default superannuation funds in modern awards were prepared by the Department of Education, Employment and Workplace Relations and assessed as adequate by the OBPR. These Regulation Impact Statements can be found at http://ris.finance.gov.au.[2]

Significant consultation with the superannuation industry on the design and implementation of the MySuper regime occurred during 2011 and 2012. As a central plank of the new MySuper regime, the changes in this Bill will have a major impact on the effectiveness of the MySuper regime and therefore should have been subject to more detailed consultation given their impact on members, employers and the superannuation industry.

In order to help improve dialogue and aid our understanding of what is involved and what might be considered by the Fair Work Commission we would welcome an open consultation process when considering the expert panel.

[2] Explanatory Memorandum page 2

Regulatory structure

This Bill creates an additional layer of regulation in addition to the MySuper product design and approval framework. We believe this will limit competition in the superannuation industry as MySuper products which have been approved by APRA and are compliant with the relevant legislation may have significantly restricted market access if they are not included in an award by Fair Work Australia (to be known as the Fair Work Commission).

The FSC supports and endorses the introduction of the Stronger Super regime and acknowledges that this will define a new level of regulatory oversight, protection, transparency and competition for superannuation members.

As noted, over the past two years, the Treasury has presided over a reform process which has sought to implement the findings of the independent Super System Review (Cooper Review) of 2009-10 which has:

- Legislatively created a heavily prescriptive mandatory default superannuation product in legislation; and
- Armed APRA with an authorisation power for each MySuper product.

This Bill, prepared by Department of Education, Employment and Workplace Relations, suggests that the combination of these two factors would be insufficient and that a third process is necessary – which should occur through the Fair Work Commission with an expert panel requiring:

- Legislative amendments to the Fair Work Act to enshrine criteria for determining default fund eligibility in addition to MySuper;
- A new process where an "expression of interest process…" for MySuper providers seeking to be default funds could occur;[3]
- The creation of an expert panel within the Fair Work Commission which would recommend default fund listings per award; and
- The creation of a process where expert panel recommendations are delivered to the Full Bench of the Fair Work Commission for subsequent approval / rejection and the provision of reasoning.

[3] Page 4 (2.2.4)

- 4 yearly reviews of the default fund terms of awards in which 2-10 funds are specified as eligible to receive employer contributions for employee members under the relevant awards.

Although superannuation is presently an allowable matter, the system has evolved to a point where superannuation funds should no longer be named in awards. We make the following points which reflect the recent de-linking of superannuation and the industrial system:

- Choice of fund legislation permits members to choose their own fund (which is not the workplace fund) which allows employees to step outside of an "award matter" and it is strikingly inconsistent that employers are not afforded the same capacity for choice in selecting (and continuing without external intervention to contribute to) a superannuation fund which is considered appropriate when considering all relevant and specific criteria;
- Superannuation is now solely regulated under the *Superannuation (Industry) Supervision Act 1992, Superannuation (Guarantee) Administration Act 1993*, associated regulations and prudential standards. For example, under Commonwealth statute, the *Superannuation Guarantee (Administration) Act 1992* requires that 9 per cent of wages must be paid into a regulated superannuation fund. This does not differ between industries under Commonwealth law. A minimum of 9 per cent must be paid under every award regardless of which fund it is paid into;
- Nearly all major superannuation funds no longer represent a particular industry or demographic – and have evolved to public offer licence designations. There has also been a significant level of merger activity in recent years which has led to the blurring of workplace representation in industry funds. There were 106 industry superannuation funds in 2004, today there are 65. Of these, 40 are public offer funds;[4] and
- From 1 July 2013, there will be a default superannuation product designed in legislation (MySuper) with distinct trustee obligations, disclosures, and fee and member service rules.

[4] APRA Annual Bulletin 2010 http://www.apra.gov.au/Statistics/Documents/June-2010-Annual-Superannuation-Bulletin.pdf

Accordingly, the FSC does not see a case for maintaining named superannuation funds in awards. This adds an additional, and unnecessary, layer of regulation to the already well-defined expectations in the main MySuper legislation.

Further, the Bill suggests that Fair Work Australia has (and the Fair Work Commission will have) significant expertise in working constructively with stakeholders in undertaking the many functions for which it is responsible under the Fair Work Act.

Fair Work Australia (and its predecessor the Australian Industrial Relations Commission) has demonstrated its disinterest in matters related to superannuation over the past five years.

A 2008 letter penned by former Minister for Superannuation & Corporate Law Nick Sherry requested that if the Commission was to prescribe default superannuation funds in Modern Awards, they should establish an appropriate process and criteria for selecting funds rather than doing so on an arbitrary or non-transparent basis.[5]

The Commission chose not to heed the Minister's request and instead prescribed superannuation funds into awards without adopting a process. On 12 September 2008, the Commission stated they would not apply criteria when selecting funds in awards despite the urging of Minister Sherry:

> [29] We have drafted a model superannuation provision to be included in modern awards if those awards deal with superannuation. The clause will nominate a default fund or funds should an employee fail to exercise his or her right to nominate the fund to which employer contributions should be made. We do not think it is appropriate that the Commission conduct an independent appraisal of the investment performance of particular funds.[6]

By the middle of 2009, in a series of tranches, the Commission had furnished Modern Awards with default superannuation funds. Subsequently, superannuation funds have applied to be included in a Modern Award. In the absence of a proper process, applications to include superannuation funds in Modern Awards rely upon the parties to the award. A further comment in the 12 September 2008 Determination is instructive: "*we are prepared to accept a fund or funds agreed by the parties, provided of course that the fund meets the relevant legislative requirements*."

[5] See appendix
[6] AIRC statement on Award Modernisation 12 September 2008 - http://www.fwa.gov.au/awardmod/databases/general/decisions/2008aircfb717.htm

The Commission's refusal to devise a process has highlighted consumer protection, competition and transparency issues as unions and employer groups registered under the Fair Work Act have controlled which funds become default funds for award employees. Its refusal led to superannuation funds under investigation by the Australian Prudential Regulation Authority (APRA) being prescribed as default funds simultaneously. It is therefore critical that appropriate consumer protection mechanisms exist, and that the process becomes appropriately transparent and contestable.

Perhaps most significantly, it highlights the Commission's disinterest in matters relating to superannuation default fund selection in the period before MySuper was conceived. We fundamentally object to current process continuing following the creation of MySuper which establishes a prescriptive regime for default superannuation.

Recommendation: Following the commencement of MySuper on 1 July 2013, remove superannuation default fund provisions from Modern Awards, including the Fair Work Commission process.

2. MAJOR ISSUES

Key departures from the Productivity Commission final report

The Government's response to the PC final report, contained in this Bill has the following key departures:

- The PC's proposed "Default Superannuation Panel" will not be created as recommended - rather it will be subsumed into the existing Minimal Wage Panel as the new "Expert Panel"

- The new independent Expert Panel will not become the final decision maker - the Full Bench of the Fair Work Commission (previously Fair Work Australia) will approve default funds in each award after a recommendation from the Expert Panel (known as the "Default Superannuation List"). The Full Bench of the Fair Work Commission will consider submissions of industrial parties prior to making a final decision.

- There will not be an unlimited list of default funds in each award as the PC recommended to boost competition - this will be restricted to 10 per award, and may in cases be fewer than 10 (with a minimum of 2).

- The process of including funds in awards will only occur every 4 years starting in 2014 when Modern Awards are due for review - as opposed to an ongoing application process.

- All awards must have default funds - currently there are 13 awards that do not list default funds.

Member impacts - grandfathering

We are concerned that the loss of grandfathering will lead to unintended consequences for members. Where future contributions for an individual are directed to a new superannuation fund, because of the removal of grandfathering or changes to the funds listed in Modern Awards, the individual's existing balance will remain in the superannuation fund that is no

longer receiving contributions. Assuming that the original superannuation fund has a MySuper product the member's balance could remain in that product.

The cessation of employer contributions to the original superannuation fund would also lead to either a loss of insurance cover or an increase in insurance costs without member consent.

Given those comments it appears inevitable that a change to a Modern Award would lead to a proliferation of accounts. While the individual could take action to consolidate their accounts as a default member they are not likely to be engaged with their superannuation and therefore are less likely to take that action.

As many employee members of successive generations will have superannuation contributions made over several decades of an expected working life, it is also a concern that changes to the Default Superannuation List and the 2-10 funds specified in the default superannuation terms of awards will lead to further proliferation of member accounts, notwithstanding a given employee may remain with the same employer for a significant duration of their working life.

The loss of grandfathering and the decision not to take the PC recommendation of unlimited default funds is a similar point. The unlimited default fund recommendation was the PC's solution to the removal of grandfathering which has not been adopted in the legislation.

4 yearly review periods

The Bill provides for a 4 yearly review cycle for the default fund terms in modern awards (section 156A), conducted by FWC. One of the potential issues with the proposed 4 yearly review cycle is the potential for volatility in the Default Superannuation List as well as the 2-10 superannuation funds (MySuper products) specified in the relevant award's default fund term.

This is due to the nature of the first stage criteria (section 156F). The first stage criteria includes appropriateness of and capacity of a fund to deliver on its long term investment return target given its risk profile; appropriateness of fees and costs given quality of services; net returns; governance practices; insurance offerings; quality of advice for members; administrative efficiency; and other relevant matters.

Assessments of these criteria, in particular the capacity to deliver on targets and net returns, if considered relative to other funds on the Default Superannuation List, may lead to a situation where the FWC will need to make significant changes to the 2-10 funds specified in the default fund term, and even the Default Superannuation List. Changes to these lists would seem to be inevitable given the capacity for relativities to change between funds in relation to performance and other criteria.

The focus on performance records may well lead to a focus on short term as opposed to longer term decisions which are at odds with MySuper products having longer term investment horizons and objectives.

The prospects of continuing competition and innovation in the superannuation and investment management industry both locally and internationally will also have an impact on which funds may be eligible and in the best interests of relevant members. As the superannuation industry transitions into the MySuper environment, there may be many new MySuper products that would not have a performance track record which are specifically designed to offer employees optimal results in their best interests. Depending on how performance criteria are assessed, there may actually be a disincentive to innovate and offer new product solutions for the benefit of employees covered by modern awards.

Funds on the Default Superannuation List and specified in the relevant award default fund terms will be reviewed over a relatively short period of time (4 years) when longer term investment strategies and risk profiles are considered. Funds may find themselves compromised before having enough time to prove themselves. We would expect that generally MySuper products with longer term oriented diversified investment strategies will have a longer investment horizon than 4 years.

The 4 yearly review model has the potential to introduce volatility into the default superannuation arrangements specified in modern awards. This will have implications for employees in affected funds and employers who are contributing to affected funds. Importantly, extending the time between reviews is not the answer. This would only further impose restrictions on openness, transparency and contestability. During the period between

reviews, access to product improvements, innovation and other developments will be limited. More so if the intervening period is extended beyond 4 years. The disruption involved with changes to the Default Superannuation List and the award default fund terms won't be avoided. With many employee default fund members remaining passive investors, the reduced scope for competition combined with the potential volatility over time will be detrimental and additionally complex for employees and employers alike.

While there is provision for transitional authorisations to be made by the FWC to allow for continued contribution to a fund which may be removed from a default fund term (section 156K), the problem of affected employees and employers having multiple funds and accounts to manage will be unavoidable unless transitional authorisations are made indefinite. If transitional authorisations are time limited, as we would normally expect, the problem of account proliferation for the same employee and multiple funds for employers and the attendant administrative complexity would persist.

While employees and employers may avail themselves of the opportunity to make alternative arrangements to continue using an affected fund (enterprise agreements or choice of fund), the requirement to make alternative arrangements is an additional administrative impost, and may not be achievable if there are other industrial relations issues or disputes associated with the relevant employee/employer relationships at the relevant time.

Employer impacts

<u>Complexity and cost for employers</u>

Many large employers have different groups of employees covered by a number of different awards. That potentially increases cost and complexity for that employer as they have to direct default contributions to a number of different funds.

Alternatively the employer may try to choose a fund that is common across the awards, to reduce their costs. If a large number of employers were to act that way and funds were chosen purely on the basis of commonality that would further concentrate the superannuation system

with a few large superannuation funds and increase the risk associated with rapid consolidation.

The Bill will force employers to institute an enterprise agreement at their own cost in order to contribute to their own corporate superannuation fund or large MySuper product as 149D does not permit corporate or large employer MySuper products to be award default funds.

If an enterprise agreement is not obtained, workplaces with long-standing corporate superannuation funds will no longer be available to staff. This point has already been noted by Qantas and other employers in this inquiry process.[7]

Impact on competition and systemic risk

A significant reduction in the number of MySuper products outside those listed in awards would remove most of the value of making the listing in awards contestable. A loss of competition would be expected to lead to higher fees for members over time. Australians continue to benefit from decreases in superannuation fees in markets which are not subject to award regulation, as witnessed in the latest Rice Warner Actuaries Superannuation Fees report (see table below) showing a clear downward trend since the study commenced in 2002.

According to the report, over the past decade, industry wide average fees have declined by 12 per cent from 137 basis points (bps) in 2002 to 120bps in 2011.

The report highlights the impact of restricting superannuation competition in Modern Awards. Fees in large employer (default) Master Trust superannuation funds are amongst the lowest at 083bps. Such employers are typically not restricted by Modern Awards and are free to select any superannuation fund, often via a competitive tender process. Members are clearly benefiting from the highly competitive dynamics in this segment.

This Bill provides an opportunity to extend the benefits of competition to workplaces that are currently constrained by Modern Awards. This research shows that employees under Modern Awards cannot afford to miss this opportunity.

[7] https://senate.aph.gov.au/submissions/comittees/viewdocument.aspx?id=f3ed79ad-e20b-46c7-a4b9-f87aa2925ab7

Table 1. Fees 2011

Fees by superannuation segment – Year to 30 June 2011						
Sector	**Segment**	**Operating**	**Investment management**	**Operating & investment management[1]**	**Advice**	**Total Fees[1]**
		(%)				
Wholesale	Corporate	0.30	0.47	0.77	0.02	0.79
	Corporate Super Master Trust (large)	0.24	0.58	0.82	0.02	0.83
	Industry	0.43	0.66	1.09	0.04	1.13
	Public Sector	0.22	0.56	0.78	0.04	0.82
Retail	Corporate Super Master Trust (medium)	0.87	0.71	1.58	0.25	1.83
	Corporate Super Master Trust (small)	1.04	0.77	1.81	0.39	2.21
	Personal Superannuation	0.84	0.60	1.44	0.43	1.87
	Retail Retirement Income	0.62	0.67	1.30	0.45	1.75
	Retirement Savings Accounts	0.60	1.70	2.30	-	2.30
	Eligible Rollover Funds	1.95	0.45	2.40	-	2.40
Small Funds	Self-Managed Super Funds	0.33	0.52	0.85	0.15	1.00
Total		**0.45**	**0.58**	**1.03**	**0.17**	**1.20**

[1] Components may not add up to totals due to rounding.

Narrowing the diversity of superannuation providers would also lead to an increase in the fragility of the superannuation system and so vastly greater systemic risk borne by members. Among many authoritative studies on the topic, Haldane & May ("Systematic risk in banking ecosystems", Nature, vol 469, pp 351—355, January 2011) argue that lack of diversity in financial systems, like ecological systems, has fundamental implications for "the state and dynamics of systemic risk", and it is essential for public policy makers to consider these factors when designing regulations and the structure of financial systems.

Further, narrowing the number of superannuation funds available to members would increase the risk of catastrophic failure of the system that would be borne by members and society in the years to come. It also introduces risks for the Commonwealth Government as it will be endorsing the chosen MySuper products as appropriate default funds.

Related to this is the real possibility that the Fair Work Commission, through its selection process, will (consciously or unconsciously) weigh certain criteria exhibited by funds more

highly than others; for example, funds with low fees or higher performance given these criteria are easily (rightly or wrongly) compared. This risks the resulting list of selected funds being quite homogeneous in their features, which denies the workplace the choice between genuinely diverse offerings.

Impact of loss of scale where employers meet costs

In some cases employers meet the cost of administration fees for employees. That may be part of a defined benefit arrangement but it also occurs where employers pay the fees for members with accumulation superannuation.

In the same way that members who meet their own fees stand to be adversely impacted by the loss of discounts negotiated by their employers on the basis of scale, employers that meet superannuation fees for their employees will be similarly adversely affected.

This is an extension of the broader point on scale, i.e. if employees are sent to a number of different funds under different awards then the scale discount that the employer can achieve for their employees will be less than if they were all together in one fund.

There are some cases where the employer pays the administration fees or insurance for their employees as an additional employee benefit. In the same way that members that pay their own fees will lose out from the loss of scale, employers that pay the fees could suffer the same loss.

Inconsistent and unclear terminology

The changes to the *Superannuation (Industry) Supervision Act* (SIS Act) under the MySuper changes refer to two types of employer products which can become default funds. “Generic MySuper products” and “MySuper products for large employers” are proposed in the SIS Act amendments (S29TB *MySuper Core Provisions Bill 2011*).

However this Bill introduces new concepts such as “tailored MySuper product” under 23A(2) “corporate MySuper product” under 23A(3).

FSC suggests that the inconsistency of the terminology in legislation is confusing and unnecessary – especially where a "tailored MySuper" is presumably identical to a "MySuper product for large employers".

Accordingly we recommend that "tailored" references are replaced with "MySuper products for large employers" to allay confusion for employers and funds.

We also would welcome greater clarity as to the intended application of this provision given the goodwill exemption and its use where a MySuper product is issued via a white label arrangement.

Transparency

We are concerned about transparency and timing of the process for industrial parties to make submissions on superannuation funds. FWC is required to publish written submissions from parties (many of which bear conflicts which must be disclosed) outlining their views on default fund applications (156D(3) and 156G(4)). We seek clarity on the timeframe this is to occur in.