

27 January 2016

Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuation@treasury.gov.au

Dear sir/madam,

Re: Extending superannuation choice to enterprise agreements and workplace determinations

In brief:

AIST supports the principle of choice in superannuation but argues this has to be provided in a way that does not leave consumers worse off, and operates in an environment of meaningful disclosure and consumer protections.

In the event the Government decides to proceed with this legislation, AIST proposes that the existing exemption remain for enterprise agreements where superannuation benefits in excess of the community standard are negotiated between the employer and their employees. This submission suggests ways to clarify transition and the selection of default funds.

Introduction and context

AIST welcomes the opportunity to respond to the exposure draft legislation to extend choice of fund to more employees under enterprise agreements and workplace determinations made from 1 July 2016 both in this submission, and in our discussion with Treasury on 20 January.

As this legislation is the Government's response to recommendation 12 of the Financial System Inquiry Final Report, our comments address both the rationale for this change and the proposed legislation.

The proposed legislation continues some exemptions from an employer being required to offer employees a choice of fund, while removing the exemption where contributions are made in accordance with enterprise agreements or workplace determinations.

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Neither the Government nor the FSI provided a compelling case in support of this recommendation, which is especially significant given it has been established (and submitted to the FSI by AIST) that the performance of superannuation funds nominated in industrial instruments is higher than that of the average performance super funds as a whole.

The retention of some exemptions and not others is therefore somewhat arbitrary. The exemption for defined benefit funds is entirely justifiable, but so should be the exemption of other circumstances where it is superannuation fund members' best interests (e.g., where the arrangement provides these members with additional benefits).

The FSI, the Super System Review before it and ASIC on an ongoing basis, have identified problems with providing meaningful superannuation disclosure to members. However, these problems will be perpetuated by other superannuation legislation currently proposed by the Government in relation to Choice Product Dashboards.

The Government is proposing significantly reduced disclosure of superannuation product characteristics in Choice dashboards than previously contemplated. This inconsistency is not in the interests of good policy nor the public interest: Better disclosure is fundamental to exercising choice in a way that promotes members' interests. Achieving transparency and better consumer comprehension through improved disclosure uniformly implemented across all funds will improve competitiveness of the sector and the ability of members to identify the products and funds that are right for them.

However, AIST recognises the intention of the Government to proceed with these measures notwithstanding these issues. Therefore, rather than opposing the legislation, AIST proposes a legislative amendment protecting these additional benefits by continuing to allow an exemption in such cases.

As it is clear from reading the explanatory memorandum that a purpose of the (existing and ongoing) defined benefit exemption is to protect retirement, resignation and retrenchment benefits that are different from - and in excess - of other superannuation arrangements. AIST's proposition follows this same logic.

The explanatory memorandum is also unclear about the treatment of superannuation matters in enterprise agreements to be made from 1 July 2016, and lacks clarity about the selection of default fund arrangements in enterprise agreements, and we suggest ways to achieve clarity.

Lack of choice does not contribute to multiple superannuation accounts, or higher fees

AIST provided evidence in support of this proposition in our submission in response to the Final Report of the FSI. However, our arguments were neither addressed nor rebutted by the Government and they remain relevant. They are summarised below:

The Final Report came to the view that the absence of choice is a barrier to members engaging with their superannuation, and that this barrier should be removed. In coming to this view, the Final Report approvingly noted submissions that highlighted the benefit of choice in providing flexibility for members and lowering fees through greater competition. The Final Report also asserted that this exemption to choice also contributed to employees having multiple accounts and paying multiple sets of fees.

The *Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2004* became effective on 1 July 2005, almost ten years ago. It allowed many employees to choose which superannuation fund received their mandatory Superannuation Guarantee contribution. The Government at the time argued that choice would result in greater engagement, lower fees, and allow fund members more options to choose the investment strategy that was right for them.

This outcome has not been realised. It was the conclusion of the Super System Review that:

The Panel therefore accepts that the model of member-driven competition through ‘choice of fund’ (in the form of SG Act choice and consequent portability) has struggled to deliver a competitive market that reduces costs for members.¹

...

A key tenet of the 1997 Wallis Report was that super fund members should be treated as rational and informed investors, with disclosure and market conduct controls being the main regulatory instruments with which to oversee the industry. More specifically, these settings assume that members have the tools at their disposal, and the necessary regulatory protections in the market place, to enable them to make optimal decisions about their investment strategies, about when to enter and exit the market, and about what to do with their super on reaching retirement. In a compulsory system, it also assumes that members have the requisite degree of interest.

¹ Cooper, J., Casey, K., Evans, G., Grant, S., Gruen, D., Heffron, M., Martin, I. and Wilson, B. (2012). *Super System Review Final Report Part One Overview and Recommendations*. [online] Canberra: Commonwealth of Australia, Attorney-General's Department, p.8. Available at: <http://tinyurl.com/njq3wo>

But, for many members, this is not the case.²

After citing the 2006 *Adult Literacy and Life Skills Survey of Australians* published by the Australian Bureau of Statistics (ABS) in January 2008, the Super System Review also concluded:

While these financial literacy statistics are stark, the fact remains that a compulsory system based on informed investors making rational choices fails to confront this reality³.

While the Final Report recycled the arguments used in 2005 to support choice of fund, it did not present any evidence to counter the conclusions reached by the Super System Review in 2010. Six years later, and notwithstanding the introduction of MySuper to further protect disengaged and disinterested members, this remains the case.

Default funds listed in industrial awards generally deliver higher returns than the average

While we have not undertaken an analysis of enterprise agreements, there is evidence that superannuation funds listed in awards deliver higher investment returns than those not listed in awards. An analysis of comparative performance was undertaken by the Productivity Commission inquiry into *Default Superannuation Funds in Modern Awards*.

The investment performance of default funds listed in modern awards has been relatively strong when compared to non-default funds. Over the eight years to 30 June 2011, default funds averaged an annual (after tax) rate of return of 6.4 per cent, compared with 5.5 per cent for non-default funds, and default funds collectively outperformed non-default funds in each year except 2009 (figure 4.1 – see below).⁴

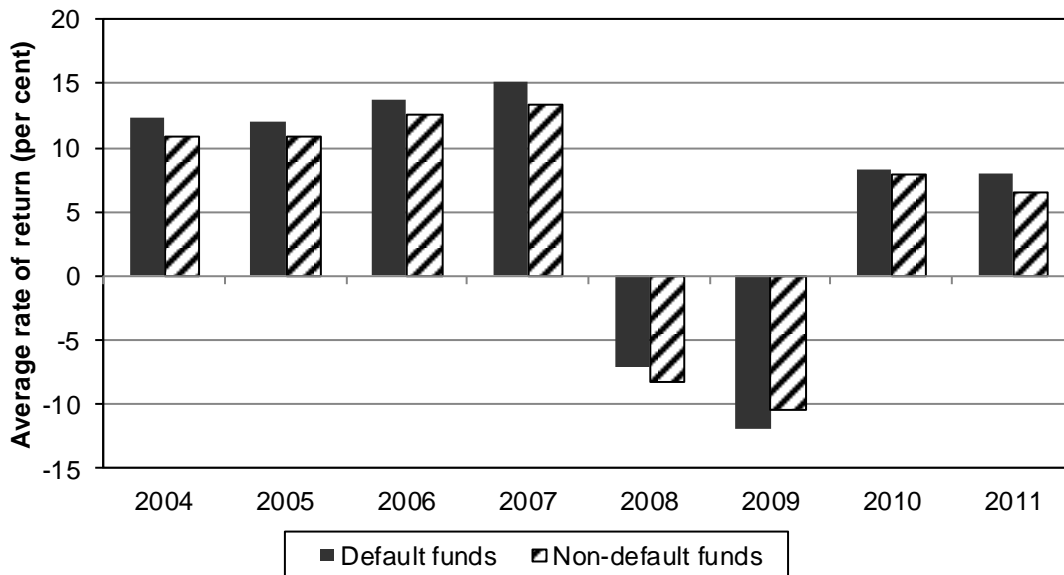
² Cooper, J., Casey, K., Evans, G., Grant, S., Gruen, D., Heffron, M., Martin, I. and Wilson, B. (2012). *Super System Review Final Report Part One Overview and Recommendations*. [online] Canberra: Commonwealth of Australia, Attorney-General's Department, p.8. Available at: <http://tinyurl.com/njq3wo>

³ Cooper, J., Casey, K., Evans, G., Grant, S., Gruen, D., Heffron, M., Martin, I. and Wilson, B. (2012). *Super System Review Final Report Part One Overview and Recommendations*. [online] Canberra: Commonwealth of Australia, Attorney-General's Department, p.8. Available at: <http://tinyurl.com/njq3wo>

⁴ Productivity Commission, (2012). *Default Superannuation Funds in Modern Awards*. Report No. 60, Final Inquiry Report. [online] Canberra: Productivity Commission, p.73. Available at: <http://tinyurl.com/qxct8jo> [Accessed 25 Mar. 2015].

Figure 4.1 Superannuation fund performance

Default funds versus non-default funds



Sources: Productivity Commission estimates based on APRA fund-level profiles and financial performance data 2011 (APRA 2012j); FWA (2012e)

The Final Report also asserted that the absence of choice also contributed to employees having multiple accounts. However, ASIC in its initial submission noted that choice of fund had not resulted in a reduction of duplicated accounts:

These [choice of superannuation fund] changes also made it possible for members with multiple accounts to more easily consolidate these accounts and reduce the amount of fees they pay for maintaining multiple accounts. However, in practice, this consolidation did not lead to a decrease in the number of accounts in the industry. The number of accounts continued to grow to more than 30 million, even though the number of employed persons in Australia is roughly 40% of this number. This means that for every employed person there are approximately 2.5 accounts. A large number of these accounts are small, unclaimed or lost and some are for retirees receiving superannuation in the form of a pension⁵.

⁵ ASIC, (2014). *Financial System Inquiry: Submission by the Australian Securities and Investments Commission*. April 2014. [pdf] Canberra: Australian Securities & Investments Commission, p.227. Available at: <http://tinyurl.com/pptq436> [Accessed 25 Mar. 2015].

Finally, the Final Report asserts that lack of choice contributes to disengagement with superannuation but does not provide any evidence to support this. While the low level of engagement in superannuation is universally accepted (along with the concomitant issue of financial illiteracy mentioned above), there is no evidence of higher disengagement amongst members with no choice of fund compared with members in a default fund environment where other superannuation funds can be chosen.

Better disclosure is fundamental to exercising choice in a way that benefits members' interests.

AIST welcomes the recommendations by the FSI to improve meaningful disclosure, and the positive response made by the Government in response to these recommendations. Unfortunately, however, AIST is concerned that the Government is now giving effect in relation to Choice Product Dashboards in a manner that limits disclosure.

While AIST strongly supports the greater alignment of MySuper and Choice disclosure through the introduction of Choice Product Dashboards, we are concerned many products (including many platforms and legacy products) are excluded.

Alignment of MySuper and Choice is needed to protect members and ensure greater superannuation system efficiency. The extension of Choice of Fund proposed by the Government should be accompanied by more and not less disclosure.

AIST is making a separate submission to Treasury on the Improving Superannuation Transparency measures.

Minimise disruption to employers

Changing enterprise agreements can be contentious and costly. Changes to the rules governing enterprise agreements may be unnecessarily disruptive. This is especially the case as superannuation is a remuneration-related entitlement, and wage-related matters are generally central to the success or otherwise of enterprise-level negotiations.

Removing the EBA exemption from Choice of Fund may result in employees losing benefits.

A common characteristic of many of these environments not providing choice of fund is that they often provide benefits in excess of that provided by the *Superannuation Guarantee (Administration) Act 1992*, including additional employer contributions (or their equivalent in the case of Defined Benefit funds), insurance, and , in the case of some government funds, guaranteed levels of retirement benefits. It is therefore not in the interests of members of such funds to switch into superannuation funds that offer lesser benefits and may remove certainty and security.

AIST disagrees with the underlying assumption of the Final Report that choice of fund will result in members becoming more engaged and making decisions that are in their financial best interests, and that this benefit should therefore be made available to all superannuation fund members. The experience of the past decade does not support this.

Excess benefits provided under enterprise agreements should be protected

There is no evidence that the Government's proposed extension of the Choice of Fund regime to enterprise agreements will improve outcomes for the affected. Rather, some Australian employees could be worse off as a result of the proposed changes losing benefits such as additional employer contributions, enhanced insurance arrangements and guaranteed retirement benefits.

In some instances, insurance cover has been provided on a basis and at a rate reflecting that all or most employees of an employer will be in a fund. These arrangements are compromised if the fund does not cover these employees. Bespoke insurance arrangements and automatic acceptance may be threatened, and higher premiums may result.

These additional benefits arise as a result of enterprise bargaining, where the respective claims of employees and their representatives and the employer are negotiated. These negotiations may involve the removal of existing conditions and the addition of new conditions. It is the outcome of these negotiations, and the trade-offs they may entail, that are voted on in enterprise agreements.

On a collective basis, enterprise agreements allow employees to decide which super fund(s) – the recipient(s) of their deferred wages - are best for their circumstances. This is particularly important where the outcome involves the provision of additional superannuation benefits.

AIST proposes that the provision of additional superannuation benefits should be protected, and that these be allowable as circumstances that satisfy the Choice of Fund requirements.

Amend the legislation to allow the continuance of the Choice of Fund exemption where additional superannuation benefits are provided

In effect, this will operate as a type of 'no disadvantage' test. In the words of the Explanatory Memorandum, this would be an "other circumstances" exemption.

AIST has identified a range of specific additional superannuation benefits that are provided under enterprise agreements, and proposes that this list of additional matters be listed in section 32C (*Contributions that satisfy the choice of fund requirements*) as the other circumstances that meet the requirements for the exemption.

AIST proposes the insertion of the following after proposed subsection 32C (6AA):

Contributions under a workplace determination or enterprise agreement on or after 1 July 2016 which prescribes additional benefits for employees

(6AB) A contribution to a fund by an employer for the benefit of an employee under a workplace determination or enterprise agreement made on or after 1 July 2016 is also made in compliance with the choice of fund requirements in circumstances where a term of the workplace determination or workplace agreement provides that:

- (a) employer contributions paid to the fund are in excess of those required under section 19(2) of the *Superannuation Guarantee (Administration) Act 1992* from time to time; or
- (b) employer contributions are payable to the fund during prescribed periods of paid or unpaid leave where such payments are not normally required; or
- (c) fees, costs, or spreads charged by the fund are paid either in full or in part by the employer in addition to or independently of employer contributions to the fund that already satisfy section 19(2) of the *Superannuation Guarantee (Administration) Act 1992*; or
- (d) any part of a premium intended to pay for insurance benefits available to employees as a result of membership of the fund is paid either in full or in part by the employer in addition to or independently of employer contributions to the fund that already satisfy section 19(2) of the *Superannuation Guarantee (Administration) Act 1992*; or
- (e) under an arrangement between the employer and the fund:
 - (i) fees, costs or spreads charged by the fund are discounted by the fund, either in full or in part; or
 - (ii) insurance benefits available to employees are improved relative to ordinary membership eligibility; or
 - (iii) normal underwriting, assessment or policy limitations are waived or reduced; or
 - (iv) normal underwriting, assessment or policy restrictions are improved or increased; or
 - (v) specified discounts or other entitlements are available with respect to other goods or services provided by third parties other than the employer or the fund;
 - (vi) any other benefit is available to an employee in excess of ordinary superannuation benefits;

as a result of membership of the fund under an arrangement between the employer and the fund made either in addition to or independently of employer contributions to the fund that already satisfy section 19(2) of the *Superannuation Guarantee (Administration) Act 1992*;

whether or not the fund is a chosen fund for the employee.

For the purposes of paragraph (e)(iii), **normal underwriting, assessment or policy limitations** for insurance benefits include (but are not limited to) limitations such as waiting periods for income protection benefits, qualifying periods for benefits, occupational limitations, total and permanent disability criteria, policy loadings and policy exclusions.

For the purposes of paragraph (e)(iv), **normal underwriting, assessment or policy restrictions** for insurance benefits include (but are not limited to) restrictions such as benefit periods for income protection benefits, default levels of coverage for new fund members, automatic acceptance limits for new fund members, and maximum levels of coverage available.

In the alternative, AIST proposes a more general formulation to the effect that a contribution to a fund for the benefit of an employee is made in compliance with the choice of fund requirements if the employer contributions paid to the fund are in excess of:

- (a) those required under section 19(2) of the *Superannuation Guarantee (Administration) Act 1992* from time to time, or
- (b) the minimum requirements for a MySuper product.

Continue the Defined Benefit exemption, and seek clarification that it applies to both existing and newly eligible defined benefit members.

While the current and proposed legislation provides an exemption from the Choice of Fund requirements for defined benefit members of super funds, the explanatory memorandum should be amended to clarify that the exemption applies to both existing and future defined members of super funds.

It is not necessarily clear that the draft legislation provides an exemption for both new employees who become eligible to join the defined benefit fund and existing employees who become newly eligible. This creates uncertainty and potential inconsistencies that can be resolved by the clarification sought.

Clarify relationship between Choice of Fund and selection of default funds

While Choice of Fund and the selection of default super funds are related, they can be conflated and confusing.

AIST propose that there be specific clarifications in the Explanatory Memorandum as follows. While AIST understands that this is the case (and does not require legislative change), such clarification would assist in reducing confusion and uncertainty.

- (a) The exemption in pre-1 July 2016 enterprise agreements and workplace determinations can continue for new employees (and newly eligible existing employees) covered by the enterprise agreement;
- (b) The exemption will continue after the nominal expiry date of an enterprise agreement or workplace determination, pending replacement by another enterprise agreement or other industrial instrument;
- (c) Post-1 July 2016 enterprise agreements and workplace determinations can continue to specify superannuation matters, including the nomination of a default fund; and
- (d) Post-1 July 2016 enterprise agreements and workplace determinations can continue to provide additional superannuation benefits.

The Choice of Fund regime must be supported by a process for the selection of default funds that provides high levels of consumer protection.

This submission has already identified the disconnect between the extension of Choice of Fund by this legislation, and the diminution of comprehensive disclosure requirements by the Improving Superannuation Transparency legislation.

The other and related area of policy imbalance is between this legislation and the processes for the selection of default super funds. It is reasonable to suggest that an extension of Choice of Fund arrangements should be preceded by the implementation of a process for the selection of default funds that safeguards members' interests.

AIST confirms our support for the implementation and operation of the legislated (but not operational) Fair Work Commission processes for the selection of default funds.

If you have any further questions regarding this submission, please contact David Haynes, Executive Manager Policy & Research on 03 8677 3800 or at dhaynes@aist.asn.au.

Yours sincerely,



Tom Garcia
Chief Executive Officer

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$650 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.