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SUBMISSION TO THE EDUCATION, EMPLOYMENT AND WORKPLACE RELATIONS LEGISLATION COMMITTEE

FAIR WORK AMENDMENT BILL 2012

NAB WEALTH (MLC)

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Senate Economics Committee

Committee Secretary

Senate Education, Employment and Workplace Relations Committees

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About Nab Wealth (MLC)

MLC is the wealth management division of the National Australia Bank. MLC provides investment, superannuation, insurance and private wealth solutions to individual, corporate and institutional customers.

MLC is one of the largest providers of financial services, including superannuation, in the market and manages $123.5 billion on behalf of individual investors and corporate customers in Australia (as at March 2012).

Clients of the superannuation funds which we administer (employers and employees) will be affected by the changes emanating from MySuper including decisions about selecting and naming funds (or MySuper products) as 'defaults' in modern awards.

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1. Main recommendations

1. Provide that any MySuper product may be used by an employer in addition to any named fund in an award.
2. If 1. is not possible, and to avoid significant adverse consequences for all participants, grandfather existing arrangements provided they are MySuper compliant at the time the modern awards are amended to name between 2-10 funds by the FWC Full Bench.
3. In conjunction with 2., but as a minimum, ensure the initial phase is deferred until MySuper products have been running for a reasonable period of time in order for the expert panel and the Full Bench to make informed decisions.
4. Clarify that those MySuper products satisfying section 29TB of the Superannuation Industry (Supervision) Act 1993, while not being named in awards, will be able to cater for employee members subject to the awards.
5. Provide express guidance on what occurs at each 4-yearly review if a MySuper product is de-listed.

2. Broad position

MLC supports a superannuation system that is 'open, contestable and transparent'. We strongly support robust standards for fund governance and procedural fairness for all affected parties.

Our primary position remains:

- the MySuper regime is a framework that provides significant protection in the prudential management of retirement benefits for Australian workers; and
- employers should be able to select any MySuper option and be afforded protection from claims given the extensive regulatory requirements imposed upon trustees (fiduciaries), ongoing reporting to, and regulatory oversight by, APRA (and ASIC).

This position:

- minimises costs for employees and employers;
- promotes competition and transparency by fully utilising the MySuper framework;
- avoids the cost of a parallel framework; and
- does not force changes to stable and often longstanding arrangements at a time of significant and ongoing market volatility combined with extensive and expensive regulatory change driven by Stronger Super.

Despite the above, we have limited our submission to key issues emanating from the Fair Work Bill 2012. Due to the collapsed timeframe for comments our submission is, by necessity,

thematic and raises a number of issues/questions which we believe need to be addressed or be the subject of further consultation.

We note that the Explanatory Memorandum indicates that:

"The Bill was developed following extensive consultation with superannuation industry stakeholders….."

MLC is unable to verify this statement. Apart from one meeting on 23 October 2012 which did not explicitly address the content of the Bill, we were not a party to any consultations and did not see an exposure draft – either directly or via our primary industry bodies being the Financial Service Council (FSC) and the Association of Superannuation Funds Australia (ASFA).

We acknowledge the Productivity Commission conducted an inquiry open to submissions and consultations but this canvassed different options and not the final approach that has been incorporated into the Bill.

Further, we have not been able to locate the Regulatory Impact Statements which the Explanatory Statement indicates should be available at http://ris.finance.gov.au.

In terms of this Bill, our main, but not sole, concern is the extensive disruption likely to occur without ongoing 'grandfathering' of existing arrangements or an appropriate transition period.

The consequences of the removal of grandfathering were not adequately canvassed by either the Productivity Commission or in consultation on a draft of this Bill.

3. Core comments and issues

Below we have outlined our comments but the timeframe precludes substantive technical comment.

Disruption

While we understand the drivers to a clean sweep and re-application process, particularly given limited funds to be named, MLC is concerned that this will, in the current environment, be destabilising, expensive and risk disrupting both employers and employee members without sufficient validation of an upside benefit.

There are a range of implications for both employers and employee members where their current default fund is not named in a modern award or awards. The following is not exhaustive.

Employers

When collapsing the awards into the new modern award structure, the AIRC addressed the issue of superannuation and existing arrangements.

[1] 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[1].

This is just as relevant, if not more so, today given the need for employers to participate in and develop the SuperStream e-commerce initiatives of the Government's Stronger Super policy.

Without grandfathering of existing arrangements employers are, amongst other things, faced with:

- Reviewing the modern award structures and identifying the award(s) applying to affected employees within their business (including related entities);
- Selecting a new fund(s) from the relevant modern awards for their employees;
- Reviewing employment contracts and commitments that may be in place within the workforce to determine the implications. For some workplaces, the named funds will have different fee and benefit structures and these will need to be reviewed against existing arrangements particularly if there are workplace contracts/agreements in place;
- Adopting the administrative processes required to enrol existing and new employees and for paying contributions to these funds; and
- Potentially having to re-negotiate administrative discounts and insurance designs.

It is also the case that workplaces with multi-disciplinary workforces are not guaranteed that a single fund will be named across all relevant awards or, that if there is such a fund, it will be suitable across the wider workforce taking into account employment commitments and

[1] 19 December, 2008, [2008] AIRCFB 1000

demographics. In both scenarios this necessarily has implications from a cost and engagement perspective for employers and certainly complicates the re-pointing of contributions.

Employee members

There are a number of issues that may lead to negative outcomes for the members where a fund is not named in a modern award.

Insurance arrangements are not readily ported or replicated in different funds due to the insurance underwriting process and pooling of risk. This can mean that employee members are enrolled in arrangements with different and lesser insurance benefits and/or higher premiums or with exclusions that may affect their cover.

This is generally more problematic for older workers or those who have developed health issues. Of particular concern are 'grandfathered' arrangements for those who may have been insured under terms and conditions to be constrained by imminent changes to the regulations for disability insurance.

There are also scale implications for the funds from which contributions for award members are to be re-directed where that the fund is not named in the relevant award(s). Not being may well have nothing to do with the suitability or competitiveness of the fund's MySuper offer – it could be a 'tailored' MySuper product (satisfying section 29TB of the Superannuation Industry (Supervision) Act 1993) which seems to be excluded, or a fund which is carved out due to the arbitrary 10 fund limit (see Process/Criteria for selection section below).

In contrast to limited discussions, the Bill and Explanatory Memorandum do not appear to accommodate s29TB tailored MySuper arrangements other than to preclude them from being named in a modern award. While there is a provision allowing the FWC to make a transitional provision, there is nothing explicit in the Bill or even the Explanatory Memorandum to provide any certainty in this regard.

Without change, this suggests that any employee members subject to an award must have their SG contributions transferred to another fund that will be named in the award if the employer is to avoid an SG charge.

This is in direct contrast to our understanding of the intent and provisions in the MySuper laws accommodating 'large s29TB employer' MySuper arrangements. In the Government's Stronger Super Information Pack, released 21 September 2011, Minister Shorten stated:

"Funds will also have the flexibility to offer employers with more than 500 employees a MySuper product tailored to the needs of the particular workplace;"

If the SG contributions of employee members subject to an award must be transferred this compromises both corporate and master trust arrangements that cater for these large employer funds and also contravenes the contestability arguments posited for the approach to naming funds in awards.

Naturally scale is an important driver of price and large clients are offered lower prices due to the lower costs of servicing them. By denying these arrangements, the policy and this Bill effectively penalise the remaining employee members (and possibly even those whose contributions are forced into another fund's MySuper arrangement).

Stability

There are implications for superannuation funds and the system generally.

Pricing, insurance and investment arrangements have been established with regard to anticipated member and contribution flows (as well as exits) over time. This can be based on both historical data and forward analysis of the industry(s) or relevant workforce demographic and the economy. By forcing contributions (and potentially balances – see below) for a proportion of the arrangements to another fund(s), these parameters are undermined.

This is likely to see an increase in fees more widely across the industry – this is in contravention of the stated policy intent of Stronger Super and particularly MySuper:

"The key elements of the reforms are….expected to reduce the average fees paid by members by up to 40 per cent"[2].

MLC contends there is a very real risk of recent fee reductions (excluding the impact of the GFC) to be lost to the combination of the implementation of the significant Stronger Super regulatory agenda and disruptive forced changes to awards where there is no grandfathering or a reasonably long transition period. This is particularly the case for large corporate arrangements – standalone or in master trusts. The overall fee levels in these funds is 0.83%p.a

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[2] 21 September, Stronger Super Information Pack, p1

which compares favourably with all other segments including industry funds at 1.13%p.a. and an overall industry average of 1.28%p.a[3].

A major omission in the Bill and policy are details about what happens with the existing 'default balances' for employee members whose SG contributions must be redirected to named funds in modern awards.

If these balances don't transfer with the contributions; members will be forced into paying multiple fees in the different arrangements. On the other hand, if these balances must follow the contributions other than by organic choice or opt-in consolidation activities (for balances above $1,000) there are significant systemic issues to address.

If a forced transition proceeds, many superannuation funds will incur significant direct and indirect costs including:

- the costs of communicating with all default members advising them of the change;
- the cost of managing the transfer process;
- investment transition costs for moving substantial amounts of accumulated balances to a new fund; and
- potential losses arising from early termination of advice and service provider contracts; and
- system and process changes.

These costs could be in the millions to tens of millions of dollars (above the already tens of millions being spent to implement Stronger Super). This also does not take account of the risks associated with realisation of assets and movement of funds particularly in volatile markets.

Transferring members to another fund's MySuper option introduces several issues, including:

- "Implementation" Investment Risk - moving members from their current option will expose members to transactions undertaken without regard to their investment merit (i.e. potentially selling low, buying high);
- Volume of transactions - if all transitions occur within a restricted period, there is the potential for volume of transactions to significantly increase. Moving large sums of money is expensive and will have an impact on members account balances particularly if there are industry wide moves taking place. Of further concern is the potential for arbitrage in the market place at an industry-wide level;

[3] RiceWarner Actuaries, Superannuation Fees Research June 2012, prepared for the FSC, p25

- Existing default arrangements may now have post GFC illiquid/toxic assets and/or some funds may have quarantined assets for particular members that cannot be transferred otherwise it contaminates the investments of other members unfairly. This is not to mention that some receiving funds may not have the capacity to manage the assets. If these must remain, the consequence is that the member wears the cost of multiple accounts and potentially higher fees due to lower balances; and
- There are also tax implications for members if balances are forced to move including, but not limited to, capital gains and losses. The rollover relief introduced by Government does not apply to a class or cohort of individual members where their balances have to be transferred to another fund. As a result, members will lose the benefit of carry-forward losses or be subject to early crystallisation of gains in relation to assets backing their superannuation entitlements.

Timing of reviews and assessment

The Bill provides that the first review of modern awards for the purposes of naming appropriate superannuation funds under the new process must commence as soon as practicable after 1 January 2014.

MLC questions how it is possible for an expert panel to assess the efficacy, relevance and appropriateness of a MySuper product before it has been running for a reasonable period of time. Employers are only compelled to contribute to a complying MySuper product from 1 January 2014.

How is it possible to have reasonable data about the offer, the performance, claims rates and assess what may be new services before the offers have been running for, at the very least, one year?

The Explanatory Memorandum provides that:

"the FWC ….will make determinations in relation to such applications and publish a list of generic MySuper products that it considers are in the best interests of default fund employees covered by modern awards, having regard to a number of criteria relating to the performance and governance of superannuation funds".

Even one year is an extremely short time to be assessing performance of the investment option(s) designed for MySuper. While some funds may use an historical portfolio this is still not

a MySuper product and many funds will be revising the investment option to be used for MySuper (and for some this may include, for the first time, a lifecycle option).

The 4-yearly review cycle also creates issues particularly for trustees adopting longer term investment horizons. But, there are also practical implications. Arguably the expert panel and the Full Bench of the FWC must remove MySuper products that are no longer in the ‘best interests’ of the members or there are other MySuper products that have better overall features, returns and services which should replace the incumbents. This then raises the question (as with the initial phase) as to when and how contributions are re-directed and what this may mean for existing account balances. The only remedy to this appears to be section 156K which allows for transitional authorisations. Arguably these would need to operate much like a grandfathering clause to avoid these problems.

Process/criteria for selection

MLC acknowledges that, contrary to the current situation, funds will have the capacity to at least apply to be named in relevant awards.

We note however, the process for actually selecting and naming a fund in a modern award is ultimately in the hands of a Full Bench of the FWC. The Full Bench merely has to select between 2 and 10 funds (with limited capacity for more) from a list prepared by an expert panel.

Our concern with this approach is that the Full Bench has no demonstrated capacity to make such determinations and the limitation of funds will arguably mean perfectly reasonable and suitable arrangements are not named simply due to the preferred 10 fund limit. There is no justifiable evidence for such a constraint. Those who have argued that it makes it difficult for employers to select a default arrangement ignore the desire of employers to be provided with a clear statutory protection when selecting any MySuper where their employee(s) fail to make their own choice.

Dispensing with the fact that any complying MySuper product should be a reasonable selection, MLC is unable to determine why the Full Bench must separately determine which funds can be named once a list has been prepared by an expert panel.

We cannot subscribe to the view that this is a transparent contestable process which significantly opens up competition. It is a construct which constrains competition particularly over time and is likely to see emerging and innovative providers or products shelved and incumbents becoming blasé - this inevitably compromises longer term consumer outcomes.