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19 August 2008

The Hon Justice Geoffrey Giudice
President
Australian Industrial Relations Commission
GPO Box 1994
Melbourne Vic 3001

Dear Justice Giudice

Award Modernisation AM2008/1 – superannuation default funds

The Financial Planning Association of Australia (FPA)[1] welcomes the opportunity to provide input to the Award Modernisation process conducted by the Australian Industrial Relations Commission. This submission focuses on superannuation default funds relating to case number AM2008/1 as it applies across all modern awards.

The existing industrial awards are inconsistent in the treatment of superannuation default funds – some industry awards nominate the default fund for a particular industry; other awards do not; while some awards are explicitly exempt from any award provisions which specify the fund(s) into which superannuation contributions are to be paid. However, it is important to note that many of these award requirements were put in place prior to the introduction of superannuation choice in July 2005.

Recent research shows that superannuation choice is working. Many Australians are exercising choice by remaining in their current fund when they change employment. They are choosing not to move into the default fund of their new employer which goes largely unrecorded and remains invisible[2].

The FPA believes that prescribing or nominating the selection of a superannuation default fund within the modern awards would have potentially adverse implications for employees, employers and the financial services industry, and would significantly impact retirement outcomes for Australians. It could produce an outcome whereby employees covered by awards who opt for the default fund were significantly worse off than those exercising choice.

We have outlined a set of high level principles by which we consider the operation of superannuation choice and the limited use of default funds within the broader superannuation environment would best be served.

1. Choice should be made at the organisation level

Different population demographics have different superannuation needs. When considering how to provide for the superannuation needs of a group of people, age, gender and job type, and other considerations must be taken into account. For example, traditional thinking would indicate that a high growth default fund may be appropriate to achieve the retirement needs of a group of young people,

[1] The FPA is the peak professional organisation for the financial planning sector in Australia. With approximately 12,000 members organised through a network of 31 Chapters across Australia, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with a collective investment value of more than $630 billion.
[2] A Multi Billion Dollar Battle, Deloitte Superannuation industry analysis report, August 2008.

where a more conservative investment option may be more appropriate for employees closer to retirement. Conversely, an individual with exposure to a range of cash and fixed interest assets at age 55 could well benefit from diversifying into more high growth investments.

The FPA believes the complexity of matching demographic profiles and retirement needs with appropriate default funds cannot be effectively achieved at the industry level. However, if default funds are to be used to assist employees who simply cannot make a decision, then the default fund would be best selected by the employer.

Many employers seek professional financial advice to ensure they select the most appropriate fund for their employees. Prescribing default funds in the modern awards would prohibit an employer to act on that advice and would force organisations to choose a default fund that may not suit the needs of their employees.

Many employers see the selection of the default superannuation fund as an integral part of providing competitive employee benefits. Limiting employer choice by prescribing default funds in the modern awards or through the use of an approved list of default funds for particular industries, would have significant and potentially adverse implications for employees.

Choice has introduced competitive pressures into the superannuation market, which have driven innovative customer service offerings, reduced pricing, and created a larger and more diverse product range for employees and employers. Limiting employer choice would erode these competitive pressures to the detriment of employees covered by the award. Employers should be encouraged to change poor performing default funds provided the definition of “poor performance” was meaningful and of itself did not create adverse consequences.

Superannuation choice has also given employees the flexibility to select, monitor and review their fund based on their individual needs and circumstances. Limiting employer choice of default fund would create a formalised and inflexible mechanism which would restrict access to the associated benefits and innovative opportunities of the broader superannuation market. A review mechanism would also be needed to ensure the prescribed default funds can be assessed in line with market and regulatory developments in the superannuation industry, in a timely manner.

Employees and their families could end up paying for inappropriate insurance cover. The Superannuation Guarantee (Administration) Act 1992 requires a default fund to offer a minimum level of life insurance cover. However the cover that people may have in their superannuation fund often gives them a false sense of security as many believe they have more protection than is actually the case. The cost of insurance provided by a superannuation fund varies depending on whether the risk profile for the cover is based on the overall industry or only on the organisation. These factors often result in employees paying for inappropriate and often inadequate cover.

To determine the appropriate level of insurance, consideration should be given to the debt levels, financial dependants (both children and dependant adults), occupation details, health history, income amounts, and residence information (or type of residence). It is a complex matter and employees should be encouraged to seek financial advice to determine the level and type of cover required to provide adequate protection for their circumstances.

The FPA does not believe the nomination of default funds in modern awards or the creation of an approved list of default funds would achieve the Government’s aim to increase consumer protection and improve retirement outcomes for Australians.

The FPA believes that a limited range of default funds would lead to less competition, less education of employees as there would be no incentive to make a decision, and possibly even an 'opt out' for employers when selecting an appropriate default fund as they would not have to conduct due diligence across the broad spectrum of products on offer. Indeed, one could argue that excessive moral hazard would apply through the AIRC by offering a limited range of funds, any of which could potentially suffer and negatively impact employees down the track.

2. Consistency with Government's financial services agenda

The Government is currently undertaking a number of reviews relating to superannuation and financial services regulation including:

- Australia's Future Tax System – This includes an extensive review of Australia's taxation and pension systems. Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, has also indicated this Review will consider issues of superannuation and retirement adequacy.
- Reducing red tape – Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, and the Hon Lindsay Tanner MP, Minister for Finance and Deregulation, have committed to reducing red tape in the financial services sector as part of the Government's deregulation agenda.
- Simple advice on choices within an existing superannuation account – The Financial Services Working Group (FSWG)[3] is overseeing this Government initiative which is aimed at increasing access to affordable superannuation advice. The FPA believes adopting recommendations raised through the 'simple advice' consultation process would address many of the superannuation concerns raised in submissions to the AIRC for employees covered by an award and significantly improve retirement outcomes.
- A number of other initiatives in the superannuation arena, including the examination of the structure, operation and cost of superannuation.

The FPA believes the decisions regarding the inclusion of prescribed default funds or the use of an approved list of default funds within the modern awards, should be consistent with the Government's financial advice agenda and with Treasurer Swan's commitment to a competitive and open economy. While modern awards consider the arrangement between the employer and employee, issues relating to superannuation also involve the financial services sector as a third party which sits outside the award process. The FPA recommends all matters relating to superannuation are also dealt with in the above reviews and not in isolation through the Award Modernisation process.

3. Access to transparent and reliable data

There has been considerable public debate about the transparency and accuracy of data on which decisions regarding the performance of superannuation funds are based. Comparison of funds should be based on accurate, reliable and transparent data, on a like with like basis, to allow for clearly evidenced comparisons of funds. The selection of a fund should be based on the characteristics of the individual fund rather than the category of fund. Improvements around the construction and transparency of data would be welcomed in response to the need for accurate data.

[3] Senator the Hon Nick Sherry, Minister for Superannuation and Corporate Law, and the Hon Lindsay Tanner MP, Minister for Finance and Deregulation announced the formation of the Financial Services Working Group (FSWG) in February 2008.

4. Value of advice

The choice of superannuation fund can significantly impact the retirement savings of Australians. However, the most common financial difficulty experienced by Australians is "not understanding superannuation" (39%)[4].

Financial advice from a qualified adviser can help employers and employees understand superannuation and other financial matters, to improve retirement savings. Research released in February 2008 by Rice Warner Actuaries found advice from a qualified financial planning professional unlocked $1.7 million in collective financial value for eight Australians. In most cases, the financial advice led to immediate savings. Financial education was the component of financial advice most valued by consumers. Other benefits valued by consumers included:

- Future cost avoidance arising through more planned cash and debt management;
- Reduction in lifestyle instability arising through appropriate insurance coverage, securing ownership of a home, and obtaining appropriate support from government agencies for disabled dependents;
- Enhanced life opportunity due to more focused business management, return to work strategies, lifestyle instability reduction, and acquisition of lifestyle assets; and
- Helping people to understand their situation, navigate the financial market place and gain control of their finances[5].

Those employees who opt for the employer's superannuation default fund because they are not sure about which fund or investment option to select, are at most risk of poor retirement outcomes and are in most need of financial advice.

The FPA suggests that access to advice through default fund options would benefit employees and would be in line with the Government's FSWG *Simple advice within an existing superannuation account* objectives.

5. Cost of advice

In its recent submission to the FSWG's consultation on 'simple advice' the FPA highlighted the need for employees to have different options available to them to help pay for professional financial advice. Payment options recommended included the ability for employees to deduct advice fees from their superannuation account for advice which supports retirement savings; using part of the Government's co-contribution to pay for advice on superannuation matters; the use of salary sacrifice arrangements to pay for advice; and the tax deductibility of advice fees.

The FPA supports employees' right to choose their preferred method of payment for advice, between a fee or a commission, or both, as long as fees are clearly and transparently disclosed. It should be noted that the FPA has enforceable Conflict of Interest Principles which set standards of behaviour and disclosure directly related to remuneration and ensure employees are informed of any potential conflicts of interest. Our members must adhere to the Principles which include[6]:

[4] *Consumer Attitudes to Financial Planning*, Galaxy Research, May 2007
[5] *FPA Value of Advice Research*, Rice Warner Actuaries, November 2007
[6] The full set of the FPA *Conflict of Interest Principles* are available at www.fpa.asn.au

- Principle One: The cost of financial planning advice should be separately identified as a financial planning advice fee in the Statement of Advice provided by FPA Members to clients, and the total fees paid for ongoing advice should be disclosed to clients on a regular basis.
- Principle Three: No Remuneration or benefits paid by a FPA Principal Member to one of their financial planners should be biased against or not in the interests of the client.

6. Improving financial capability and engagement

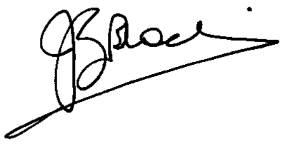
Australians are less confident when it comes to complex issues like investing and ensuring enough money for retirement. 86 per cent of Australians do not believe that the age pension will be sufficient for retirement, and 73 per cent say employer funded superannuation will not meet their retirement needs. However, 77 per cent of adults are interested in learning more about how they could plan for and achieve a more financially secure future[7].

'Unhealthy' ways of thinking about finances such as 'living for today', 'financial disengagement' and 'aspirational' spending, have been identified as core issues causing financial difficulty. The FPA suggests the Government focus its efforts on educating employees about how to select a suitable superannuation fund, encouraging Australian's to select their own fund, and ensuring employers do not restrict employees' ability to choose their superannuation fund or access financial advice.

Advice has been proven to increase financial literacy and engagement. The FPA suggest that superannuation funds and employers should be more active in encouraging employees to seek financial advice. This would significantly improve retirement outcomes for employees and could continue to be delivered through employer superannuation funds.

If you would like to discuss any of the issues raised in this submission, please contact our Policy and Government Relations Manager, Gerard Fitzpatrick (02 9220 4505; gerard.fitzpatrick@fpa.asn.au).

Yours faithfully



Jo-Anne Bloch
Chief Executive Officer

[7] *Financial literacy: Australians understanding money*, September 2007