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21 January 2009

Committee Secretary
Senate Education, Employment and Workplace Relations Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Subject: Inquiry in the Fair Work Bill 2008 and Default Superannuation Funds

Dear Committee Secretary

Mercer (Australia) Pty Ltd welcomes the opportunity to participate in the Senate Standing Committee on Education, Employment and Workplace Relations inquiry into the Fair Work Bill 2008.

Mercer is a leading global provider of consulting, outsourcing and investment services to more than 25,000 clients worldwide. Mercer helps employers design and manage retirement, health and other benefits, and optimise their human capital.

Mercer also provides consulting and administration services to a large number of employer clients and superannuation funds (including industry plans, master trusts and employer sponsored corporate superannuation plans). We also operate our own master trust, the Mercer Super Trust, which has approximately 270 participating employers, over 230,000 members and $11.8 billion in assets under management. In the aggregate, Mercer has 650,000 members, 400 superannuation plans and $32 billion of funds under administration.

Our comments focus on the provisions in the Fair Work Bill 2008 that provide that terms about superannuation may be included in modern awards, the outcome of which is that the AIRC currently, but to be replaced by Fair Work Australia, will have the power to create awards which deal with superannuation matters. Mercer is concerned the standard superannuation clause included in many of the initial group of modern awards released in December 2008 nominates a limited number of superannuation funds that can be the default fund for employees covered by that award.

In October 2008 Mercer made a submission to the Australian Industrial Relations Commission on the exposure drafts of the modern awards issued for comment in September 2008. Our submission focussed on the model superannuation clause proposed for inclusion in the modern awards and expressed our concerns with the nomination of default funds in awards. We are pleased to note the standard superannuation clause was amended to include transitional arrangements which allow existing default funds to remain in place in certain circumstances. However, while these transitional arrangements will work well in some circumstances, there are a number of situations where the transitional arrangements will not apply and which will result in changes to existing arrangements which may not be in the best interests of employees.

In summary our main concerns include:

- The apparent anti-competitive nature of nominating of default funds in awards. There is the potential for a significant reduction in competition. Many of the superannuation funds not included as a default fund may be unable to remain viable as they are effectively prohibited from obtaining new employer clients. This includes funds from all sectors including industry funds, employer sponsored corporate funds, master trusts and retail funds, and includes many efficiently run funds which have been able to offer very competitive pricing and conditions. This will ultimately be to the detriment of employees as reduced competition is likely to result in higher fees and/or lower quality services.

- The limitations of the clause dealing with the transitional arrangements. While this clause will work well where the superannuation fund is the default fund to which the employer was contributing before 12 September 2008, it:

  - excludes default funds arrangements put in place since that date;
  - effectively prohibits employers from changing an existing default fund to seek a better outcome for its employees, for example lower fees, better member services unless this can be done via an industrial agreement which overrides the Award (the costs of this make such an option unlikely for all except very large employers); and
  - means employees may be worse off if the default funds nominated in the award do not offer the best available benefits, competitive fees, member services etc., when compared with other funds in the market.

- The apparent lack of an adequate due diligence or risk management process in the selection of the superannuation funds that are specifically named in the awards (both initially and on an ongoing basis). We believe that if specified funds are included in awards, then an objective process needs to be established for determining their initial suitability and for reviewing their continued inclusion. As an example, we are aware of the naming of a terminated fund, the Victorian Racing Industry fund. This punctuates the potential for redundant or uncompetitive funds with limited consideration to be beneficiaries due to a lack of due diligence or competition.

Mercer's view is there is the potential for a number of adverse outcomes (for employees, employers and the superannuation industry in general) with the standard superannuation clause including:

Loss of valuable benefits, including lower fees

- While the transitional arrangements in the standard clause appear to permit "grandfathering" of existing default fund arrangements, an employer's ability to ensure the best possible outcome is achieved for its employees is restricted.

  There are a number of situations where the transitional arrangements will not apply and we have included examples in the attachment to this letter. In essence, where an employer has chosen a new default fund since 12 September 2008, unless this fund is one of the default funds named in the award, the transitional arrangements will not apply. This means that the employer will be required to commence paying contributions to one of the default funds named in the relevant award unless the employer is able to undertake the significant costs of establishing industrial agreements with its employees that override the Award.

- As well as creating significant disruption for the both employees and employers, there is the potential for members to lose valuable benefits such as access to defined benefits, insurance, member education and free financial advice provided in the current default fund which cannot (or will not) be replicated in the default fund named in the relevant award or in an alternative fund chosen by the employee.

- There is also the potential for fees to increase – particularly for employees of larger employers as it is less likely that "bulk buy" discounts negotiated by the employer, for example in a corporate division of a master trust, will be available or provided by the default fund specified in the Award.

- Few employees would be able to adequately assess the relative benefits/disadvantages of the new default fund or any another fund. Some may rely on what appears to be a non-existent due diligence process and assume that the default fund named in the relevant award best suits their needs and circumstances, which may not be the case.

More fees for members and more lost members as a result of multiple memberships

- Employees, who through these changes find that they are members of two superannuation funds – the default fund previously chosen by their employer (which is no longer valid under these new provisions because the transitional arrangement do not apply), and the “new” default fund required under this new clause, will incur fees from both funds unless they use the portability provisions to individually request a transfer of benefits from one fund to the other. They are also likely to incur withdrawal fees in relation to this transfer and in the case of some older contracts, an early termination penalty.

- Multiple memberships inevitably lead to an increase in the number of lost accounts, in particular the benefits which have accrued in the existing default fund and left behind when the employer commences contributing to the default fund specified in the award.

Reduction in competition

The default funds currently chosen by employers are from all segments of the superannuation industry and include funds from the ‘not-for-profit’ and ‘commercial’ categories.

In each category there are a large number of providers competing for employer and employee superannuation contributions. This level of competition has benefited, and will continue to benefit, both employers and employees. To attract new business each fund needs to be competitive on a number of criteria including investment performance, fees and the services and benefits available to members.

Nominating specific funds as default funds will lead to a reduction in competition, at both the member/employee and employer levels, which will reduce competitive pressure on fees and the services and benefits available to members.

Many funds, unless they can be included as a default fund, may be unable to remain viable as they will be prohibited from obtaining new employer clients and will need to rely on individual members choosing the fund. This will occur despite the fact that these may currently be efficiently run funds which offer competitive fees and services.

There are also potential liquidity issues for funds not included as a default fund if a significant number of members transfer their accrued benefits to default fund specified in the Award.

Employers may have to pay contribute to more funds

There is a greater likelihood employers whose employees are covered by a number of different awards will be required to operate multiple default funds in order to satisfy different award requirements for different employees.

This can create significant administrative issues and further problems when employees change roles and may become covered by a different award.

Conclusion

For the reasons outlined above, we believe that the default superannuation funds should not be nominated in awards.

We also support the submission lodged by IFSA dated 9 January 2009, including the various alternative solutions it has put forward.

At the very least, we recommend that the transitional arrangements in the standard clause be amended to allow some flexibility in relation to the default fund chosen by the employer. In the best interests of members, to ensure that valuable benefits are not lost, we recommend that the transitional arrangements also permit continued use of successor funds as default funds, as well as funds that were in existence on or before 12 September 2008.

If you have any queries on our submission please do not hesitate to contact John Ward, Manager Research & Information on (03) 9623 5552.

Yours sincerely

Peter Promnitz
Chief Executive

Copy: The Hon Julia Gillard MP, Minister for Employment and Workplace Relations

Attachment to Mercer Submission to the Inquiry into the Fair Work Bill 2008

Examples of situations where the transitional arrangements in the standard superannuation clause in the modern awards released in December 2008 will not apply

Example 1: Default fund has been changed post 12 September 2008

The transitional arrangements will not be available to any employer who has selected a new default fund since 12 September 2008 as the new fund is not the one to which the employer was contributing prior to that date.

In the last twelve months a number of a stand-alone corporate superannuation funds have wound up and undertaken a successor fund transfer to a master trust. A number of the new clients which joined the Mercer Super Trust in this period were successor fund transfers. Where a new default fund was put in place after 12 September 2008, when the modern awards take effect in January 2010, the employer will be required to change its default fund to one of the funds nominated in the relevant award (or multiple funds if its employees are covered by a number of awards each with different nominated default funds). This is the case even if the default funds in the award charge higher fees and the employees lose access to valuable benefits, for example defined benefits, better insurance options etc. that are not provided in the new default fund.

Changing a default fund for existing employees is not necessarily a straightforward matter. It can have significant administrative implications on an employer as well as numerous implications for employees.

Example 2: Decision made to change default fund, change to be effective 1 January 2009

Company A currently operates a stand-alone corporate superannuation fund which is the default fund and the fund to which it was contributing before 12 September 2008. In recent months the company has decided to merge with a master trust following a rigorous process to select a default fund providing the best possible outcome for its employees in terms of performance, fee, benefits and features provided. The transfer to the new default fund will be carried out under the successor fund provisions and will be effective from 1 January 2009.

The decision to transfer to the master trust was made in October 2008 and work on setting up the new fund commenced shortly after the decision was made. Members were informed of the decision in early November 2008.

As the new fund is not one to which the transitional arrangements in the standard superannuation clause will apply (because it is not the fund to which the employer was making contributions before 12 September 2008) the employer is now faced with the prospect of having to select another default fund in the coming months if the current default fund is not one of the funds nominated in the awards covering its employees. It must select one of the default funds listed even if the funds listed are not the best available and contributing to these funds in not in the best interests of its employees.

Employees will also be faced with yet another change and while ideally they would assess the relevant merits of the new fund or any other fund – few employees would be able to do this adequately.

Example 3: Employer wishes to change the default fund at some time in the future

Consider the case where an employer, who provides superannuation through a corporate fund, determines that it is no longer viable to continue to maintain that corporate fund, or an employer who provides superannuation through multiple corporate funds and wishes to rationalise its arrangements.

Currently, under the successor fund provisions, the employer can select another default fund, e.g. a master trust, which can deliver equivalent or even better benefits and member services but at a lower cost to members. Multiple funds can be merged into one fund while still maintaining the benefits of each, with the new single fund generally providing lower fees and better member services than each individual corporate fund due to greater economies of scale.

However, post January 2010 when the modern award provisions take effect, the same employer will be unable to take seek to provide members with the best superannuation offering available as the transitional arrangements will not apply and the employer will be required to choose one of the default funds named in the award (or awards if its employees are covered by more than one award) even if this means that it employees lose access to valuable benefits, such as defined benefits, better insurance options, etc.

The result may be that the employer is forced to retain its existing default fund in order to protect existing entitlements rather than taking an opportunity to improve the superannuation provisions for its employees.

We note that the Minister for Superannuation and Corporation Law included the following statement in his 16 January 2009 Press Release in relation to proposed capital gains tax changes:

> *"Superannuation fund mergers can lead to improved economies of scale, including provision of more cost effective services to members and the Rudd Government is keen to remove barriers that would prevent such cost efficiencies from being achieved."*

This statement was further backed up in the Treasury Discussion Paper on capital gains tax issued on the same date. This Paper states:

> *In the current financial climate, it is important that potential barriers to a robust and efficient superannuation industry are minimised. Industry consolidation can assist by improving economies of scale and enabling the more efficient provision of services to members.*

The current superannuation clauses in the Modern Awards will raise new barriers to improved economies of scale and a robust and efficient superannuation industry.