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

FAIR WORK AMENDMENT BILL 2012

Thank you for the opportunity to provide feedback to the Senate Education, Employment and Workplace Relations Committees on the Fair Work Amendment Bill 2012 ("the Bill").

Russell Investments is an independent, global financial services firm that provides strategic advice, investment solutions, implementation services and global performance benchmarks that are customised to meet the unique needs of institutional investors, financial advisors and individuals.

Russell has about US$141 billion in assets under management (as of 9/30/11) and works with 2,300 institutional clients, 530 independent distribution partners and millions of individual investors globally. As a consultant to some of the largest pools of capital in the world, Russell has $2 trillion in assets under advisement (as of 12/31/2010) and traded $1.5 trillion last year through its implementation services business. Russell provides leading superannuation administration and member services to over 220,000 individuals through its Australian Member Administration Centre.

As you are aware the Bill includes the Government's legislative response to the Productivity Commission inquiry into Default Superannuation Funds in Modern Awards. The Bill partly adopts the recommendations of the Productivity Commission. Importantly, key recommendations from the Productivity Commission are not included in the Bill. We are concerned that the apparently hurried nature of this response and the failure to adopt the Productivity Commission recommendations as a coherent package will lead to the potential for significant adverse outcomes for ordinary superannuation fund members.

Productivity Commission Recommendations

The Productivity Commission recommended, as a package, the removal of grandfathering and inclusion of a wide range of superannuation funds in awards together with a short list of the best superannuation funds. The Productivity Commission report specifically linked the two recommendations and the potential for adverse outcomes for members. Following is an extract from the Productivity Commission report (our emphasis added):

> *"Where decisions about whether or not to list a product are marginal, the panel should err on the side of listing it even if this creates a longer list. <u>Given the absence of grandfathering</u>, a longer list will reduce the need for employers to change default funds. <u>This will help ensure that the best interests of employees are not undermined</u> by issues of market instability and the potential negative impact of having multiple accounts (unless employees exercise choice to consolidate their existing balances)."*

Summary of Potential Adverse Outcomes

The extract from the Productivity Commission report above identifies two specific adverse outcomes:

- The potential for individuals to hold multiple accounts; and
- Issues of market instability.

In addition to those adverse outcomes we have identified the following further potential adverse outcomes:

- Higher fees for members due to the disaggregation of scale benefits achieved by large employers;
- Loss of members' insurance benefits, and potentially higher premiums;
- Complexity and cost for employers having to deal with a number of different awards;
- Impact of loss of scale where employers meet costs;
- Impact on competition and systemic risk as any MySuper outside the Award system will not be viable; and
- Risk that the selected funds will not be the best performers in future.

Market Instability

We understand that Modern Awards are intended to provide minimum conditions covering most employees in Australia. That suggests that the only superannuation funds that can be used for default members are those allowed under Modern Awards.

At the same time MySuper products are designed for default members and we expect that the majority of members in MySuper products will be default members. MySuper products are subject to a scale test so if a product does not have a sufficient number of members it would appear that the product is not viable and would need to be wound up.

We believe that the combined implication of those requirements is that the only MySuper products that will be viable will be those listed in Modern Awards. If the listing process produces a relatively small number of MySuper products, because the judgment about what is in employees' best interests may be relatively similar across Awards, it would lead to a period of rapid consolidation of superannuation funds that are not listed in Modern Awards.

Rapid consolidation would present a significant burden to APRA and industry participants as they deal with fund closures. It would also mean that administration businesses need to transfer large numbers of members in a short space of time, increasing operational risks and the potential for losses as systems are integrated. This would add to the confusion and complexity faced by members.

The resulting rapid consolidation under the proposed arrangements is in contrast to the MySuper scale test which would be expected to produce consolidation over time in a more gradual and less dramatic fashion.

Multiple Accounts

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.

If the MySuper product is wound up because it is no longer receiving contributions and cannot maintain scale we would expect balances to be transferred to another superannuation fund chosen by the trustee of the original superannuation fund. In many cases that would be the superannuation fund that is receiving this individual's future contributions.

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 not willing to take that action. Auto-consolidation of inactive accounts may have some impact, but plans for auto-consolidation are currently limited to lower balance accounts.

Of course the implication of multiple accounts is that members would pay fees to each superannuation fund, unnecessarily eroding their superannuation balances.

Loss of Scale

The introduction of MySuper specifically recognised that some large employers have been able to use their scale to negotiate fee discounts for superannuation for their employees. The introduction of special large employer MySuper licenses and the option for scale discounts within a MySuper license allowed these arrangements to continue.

We are aware of estimates that, in the absence of the likely fee discounts in MySuper, up to one million Australians would pay higher fees.

Of course arrangements that rely on scale require an employer to direct all of their employees that do not make a choice of fund to the one superannuation arrangement. Where an employer has employees that are covered by several different Modern Awards it may no longer be possible to direct all default employees to one superannuation fund. Even if there is one fund that is common across the Awards, applicable to an employer, it may not offer the best discount or provide the best benefit to employees.

Hence the Modern Award changes appear to contradict and override the fee reduction provisions in the MySuper legislation. It appears inevitable that these changes would lead to many Australians paying higher fees for their superannuation.

We understand that an employer who was particularly interested in retaining the benefit of lower fees for its employees could attempt to enter into an enterprise bargaining agreement to set the default superannuation fund as the fund that provides the best arrangement for employees regardless of the Modern Award. However, as the enterprise bargaining agreement may have to cover multiple groups of employees represented by different organisations it would almost certainly not be possible to do that in the timely manner required for a commercial fee negotiation.

It also adds another barrier for an employer trying to deliver a positive outcome for employees. The addition of barriers makes it more likely that the employer would be forced to give up and decide not to pursue securing a better deal for employees.

Loss of Insurance

This is one of the more serious implications of these changes. Superannuation funds typically provide death, total permanent disability and, in many cases, total and temporary disability income insurance. The level of insurance provided differs across superannuation funds.

While insurance will be a criteria considered for the inclusion of a superannuation fund in a Modern Award it seems unlikely that all the funds listed in Modern Awards will provide the best insurance. That means that if an individual has contributions redirected from an existing superannuation fund to a new superannuation fund listed in a Modern Award they may lose some or all of their insurance cover.

The implications of losing insurance cover can be financially devastating for someone suffering a serious disability, or for the family of a deceased individual.

The table below shows a comparison between the default insurance available for a forty five year old member on Average Weekly Earnings under the superannuation arrangements for three large employers and under one major industry fund currently named in a number of Modern Awards.

	Death and Total and Permanent Disability Benefit	Total and Temporary Disability Income Benefit
Employer Fund A	$257,000	$3,500 per month
Employer Fund B	$140,000	$4,375 per month
Employer Fund C	$350,000	$4,375 per month
Industry Fund	$78,600	$3,000 per month

The figures in the table show there is the potential that the family of a deceased individual could be up to $271,400 worse off if the individual was employed by Employer C and their contributions were redirected to this industry fund because of the operation of a Modern Award.

In addition, through regular insurance tender processes and the provision of information to allow insurers to more accurately judge risks, some employers have been able to deliver competitive insurance premiums to their employees. Under the proposed arrangements the potential for individual members to pay a higher premium for a lower level of insurance cover is a possible outcome.

Complexity and cost for employers having to deal with a number of different awards

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.

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.

It seems inevitable that there is a group of employees that would be worse off because their employer currently meets their superannuation fees, but will be unable to continue to do so under these changes to Modern Awards.

Impact on Competition and Systemic Risk

As indicated above we believe that these changes to Modern Awards have the potential to make any MySuper products that are not listed unviable. 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.

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. 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.

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. This risks the resulting list of selected funds being quite homogeneous in their features, which denies the employer the choice between genuinely diverse offerings.

Risk that the Selected Funds Underperform

By being responsible for vetting and approving the funds in each award, the Fair Work Commission and its expert council will be making an explicit recommendation on what is a suitable superannuation fund for members covered by an award. It is arguable whether the Fair Work Commission, even with the expert panel, has the requisite skill set to select and monitor superannuation providers required to discharge its responsibilities. Moreover, it appears that the Fair Work Commission, by making a recommendation of superannuation funds, is providing financial product advice, as defined in the Corporations Act 2001.

Choosing default funds to list in a Modern Award, effectively recommending a financial product, entails taking responsibility for the performance of the retirement savings of members directed to those funds. For example, if the MySuper options on the narrow list of 10 approved funds have investment returns over a period that average less than a broader universe of MySuper options, then members could rightly argue the amendments in the Bill and the Fair Work Commission have directly caused them to lose some part of their retirement savings over the period.

Resolving these Issues

We believe that there are relatively simple options for resolving these issues. The first is to amend the Bill to include the full package of recommendations from the Productivity Commission. The Productivity Commission foresaw at least some of these issues and included solutions to address them in its recommendations.

Alternatively, if there is a desire to depart from the Productivity Commission's recommendations, we suggest that the grandfathering provision currently contained in Modern Awards should be retained until alternative ways to remove the provision without creating the issues raised in this submission can be developed.

* * *

We would be very pleased to discuss the contents of this submission with you or to provide any additional detail that the Committee requires for consideration of this Bill. We can be contacted on 02 9229 5111.

Yours Sincerely

Tim Furlan
Director, Superannuation
Russell Investments