



12 February 2014

Manager
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Dear Sir / Madam

Default Superannuation – Superannuation Discussion Paper

We welcome the opportunity to provide comment on the Discussion Paper of 28 November 2013 relating to “Better regulation and governance enhanced transparency and improved competition in superannuation”. While we are supportive of the Financial Services Council’s response to the Paper as a whole, the focus of this submission is on Part 4 of the Discussion Paper relating to “Enhancing Competition in the Default Superannuation Market”.

The particular focus of this submission is to ensure that the process for selecting default funds in modern awards under the Fair Work Commission should be competitive and in the best interest of all employers and employees.

Background

The issue of default superannuation market has been the subject of numerous reviews and inquiries including the Cooper Review which eventually led to the Stronger Super reforms. The issue was also considered by a Productivity Commission Inquiry that was followed by amendments to the Fair Work Act which formalised a new two stage review process for the selection of default funds in modern awards (“**Fair Work amendments” or “amendments”**).

ANZ has argued in previous submissions that due to the rigorous application, approval and licensing process recently undertaken by APRA, all APRA approved MySupercompliant products should be able to compete equally in the default superannuation market.

Our recommendation effectively means there is one criterion for inclusion as a default fund under Modern Awards – APRA approved compliance with MySuper. Funds are either eligible because they are MySuper compliant, or they are not.

Our key rationale for this recommendation has been that the default superannuation market should remain an open competitive market, and that employers and employees should benefit from that increased competition. Moreover, the Stronger Super reforms have already led to significant innovations within default superannuation funds. The MySuper reforms, for example, have made superannuation products for members who do not choose their fund simpler, cheaper and more transparent. ANZ’s APRA approved MySuper compliant product, ANZ Smart Choice Super, is a good

example. ANZ Smart Choice Super is an innovative, new age default superannuation and insurance solution designed specifically for the new reforms. It employs state of the art technology and with one of the lowest fee structures in the market. We believe that employers (and their employees) should not be prevented from accessing and benefiting from ANZ Smart Choice Super by the current 'closed market' dynamic achieved via the Modern Award regime.

The Fair Work amendments unfortunately do not support an open competitive market. Instead, the amendments provided for a two stage review process to be undertaken at a 4 yearly review to determine the default fund terms of Modern Awards. While super funds can apply to the Fair Work Commission ("**FWC**") for listing, they will have no standing. Also there will be a limit of 15 funds in relation to generic MySuper products in each award (s156H). We note also that there is no grandfathering of pre-existing default fund arrangements.

The lack of grandfathering means that employers will no longer be able to retain a fund as the default fund for their award employees if the fund is not listed in an award at the end of the two stage review process. This will give rise to substantial change and cost for many employers.

Reasons for our recommendation

We are concerned that the Fair Work amendments described above do not appear to meet the principles set out in the final Productivity Commission Inquiry Report ("**final report**") into Default Funds in Modern Awards. We strongly agree with the Discussion Paper that "These amendments went far beyond what was recommended by the Productivity Commission".

We accept that the principles as set out in the final report are, on balance, reasonably sound, although we have reservations about some details. These principles as listed below have been provided as guidance on how best to meet the interests of employers and employees in the selection of default funds, they are not prescriptive. The main difference between ANZ's recommendation and the Productivity Commission's specific final recommendation is the Commission's view about the need to apply a "quality filter". We have argued in our previous submission that the Stronger Super reforms, and the extensive work undertaken by our regulator APRA in approving MySuper licences, already meet the requirements for a quality filter in designing a new default product, and also requiring that funds meet a higher standard of operational efficiency. The principles however, remain excellent benchmarks for comparing the merits ANZ's recommendation as against the two stage review process under the Fair Work amendments:

1. *An explicit focus in meeting the best interests of employees who derive their default super product in accordance with Modern Awards.*

We believe at a minimum that all the other principles must be adhered to before the best interest test benefiting employees can be met (see our comments in principles 2 to 8 below). Additionally, we submit that the two stage default fund selection process is unlikely to be the most appropriate outcome because neither the Fair Work Commission, nor any of the participants that have standing under the two stage review process, have an explicit best interest duty in respect of superannuation fund members. Given this, we are of the view that the Fair Work amendments do not meet this first principle.

In contrast, trustees of superannuation funds already have an explicit fiduciary duty under SIS law to act in the best interest of superannuation members, trustees are also liable for failing to meet their duties. For this reason, ANZ believes that that the Fair Work amendments add little to advance the interest of superannuation members and ought to be removed.

2. *Contestability and competition.*

To achieve contestability and competition of the default fund market, the final report was clear that no express limit should be placed on the number of products that may be listed in any given award. The Fair Work amendments place a limit of 15 funds per award. There are currently around 90 APRA approved and authorised MySuper funds that are public offer funds competing in the default fund market, down from approximately 160 funds pre-reform. It seems clear that limiting the number of funds to just 15 will significantly reduce competition by restricting it to small sub-sets of the market per award.

This reduced competition could lead to poorer outcomes for employers and employees as fewer competing funds increasingly lose the scale or the incentive to innovate and improve. ANZ's recommendation does not contain a limit. This is because in our experience, funds that provide good value should have nothing to fear from competition.

3. *Transparency.*

The Productivity Commission believes that a good system for selecting default funds requires relevant information made publicly available and potential conflicts of interests are declared. The Stronger Super and Future of Financial Advice reforms have already significantly raised the transparency measures for default superannuation funds for the benefit of members and for prudential reasons. Many transparency measures are additional to the MySuper and SuperStream reforms, subsets of the Stronger Super reforms, which are more qualitative and operational in nature. Transparency measures include, among other things, a new fee disclosure measure, disclosure measures for fund performance and increased transparency for funds' investment portfolio. These measures lend support to ANZ's recommendation that all MySuper compliant products should be eligible to compete in the default fund market and not just funds listed in an award given funds are likely to be far more competitive in a more transparent market.

4. *Procedural fairness.*

The two stage review process under the Fair Work amendments do not provide procedural fairness for superannuation funds that are applying for listing for two reasons:

- The final Productivity Commission report recommended that superannuation funds should have standing. This was not met under the legislated position.
- There is no right of appeal in respect of the decisions of the Fair Work Commission in relation to a decision to not list a fund / MySuper product on an award.

In contrast, procedural fairness is enshrined in the legislation in respect of APRA's role as the regulator of superannuation funds. For these reasons, we believe that the Fair Work amendments for default fund arrangements are unnecessary and inconsistent with the existing SIS regime for regulating superannuation funds.

5. *Minimum regulatory burden.*

The Productivity Commission believes each party involved should incur the minimum cost and inconvenience compatible with achieving the aims of the process. ANZ's recommendation would avoid the need to reshape the role of the Fair Work Commission for the purpose of administering a set of selection criteria for default funds when APRA is already experienced, independent and capable of doing this.

Our recommendation also means that employers would not be required to abandon their existing compliant default funds that have already met the higher regulatory threshold of the Stronger Super reforms. However, given current default fund arrangements are not subject to grandfathering, the cost and operational impost upon an employer who is satisfied with their existing provider (and is not looking to change funds) could be substantial.

Moreover, 'Award' employees who may be issued a new superannuation account in a named fund following the two stage review process, could avoid the inconvenience or impost of having to consolidate multiple accounts or pay multiple fees, or have their insurance cover altered. We note that many existing insurance cover inside MySuper is often tailored to the specific age and demographic needs of a particular workforce within an employer. We are concerned that the lack of grandfathering could also mean that these tailored insurance arrangements could be adversely impacted, and possibly even extinguished.

Moreover, the Fair Work amendments could also add further cost to Government to review, monitor and regulate employers and ensure that they are complying with the need to shift and change their default fund provider for Award employees.

ANZ's recommendation would cause the least amount of regulatory burden. If a fund complies with MySuper and the employer and employees are happy to remain in that fund, their superannuation arrangement would remain unchanged. However, if an employer (or their employees) is not satisfied with their existing provider, and 'wish to test the market' for a new provider (for the benefit of all employees, not just award employees) then they should also be able to do so, in an open market, with a wide choice of competing participants, and from a full list of products approved by APRA.

6. Market stability.

The final report provides "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. Given the absence of grandfathering, a longer list will reduce the need for employers to change default funds. This will help ensure that the best interests of employees are not undermined by issues of market instability and the potential negative impact of having multiple accounts."

The legislated position of 15 funds per award, in our view, does not achieve the aspirations of the final recommendation of the Productivity Commission and is likely to cause significant disruption to employees and employers. ANZ's recommendation would place no arbitrary limits on the number of funds.

7. Consistency with other policies.

The Productivity Commission believes the fund selection process should align with other relevant policy directions, including the Stronger Super and Future of Financial Advice reforms. The Fair Work amendments that place arbitrary limits on competition of 15 default funds in each modern awards, when compared with no limit on the number of APRA authorised MySuper products under the Stronger Super reforms, are clearly not in alignment. ANZ's recommendation does not place an arbitrary limit on competition.

8. *Regular assessment.*

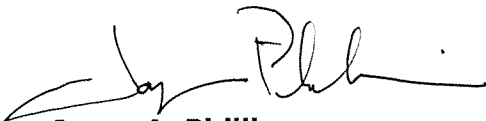
While regular assessment by the Fair Work Commission of default fund arrangements may be seen to mitigate the reduced competition of having a limited number of funds as listed on awards, it is a poor substitute to market competition, where funds are constantly assessed and scrutinised by employers, members and a host of market participants. Legislating for regular assessment is therefore redundant for these reasons given ANZ's recommendation allows for a more open competitive market which better meets this principle.

For the reasons above, we have strong reservations as to whether the Fair Work amendments for selecting default funds would lead to improved outcomes for employers and employees. We believe that APRA's role as regulator of the superannuation sector should remain paramount, that no additional quality filter is needed for the selection of default funds, and only one criterion for inclusion as a default fund under Modern Awards is relevant – i.e. compliance with MySuper. As stated earlier, superannuation funds ought to be eligible either because they are MySuper compliant, or they are not.

Our recommendation would ensure that the default superannuation market has the benefit of enhanced competitive tension as a result of the Stronger Super reforms. The recommendation remains the most cost effective as additional regulatory burden will be minimal, disruptions to existing employers and employees will also be kept to a minimum, Government would not need to fund a whole new regime for selecting funds and superannuation providers can use the compliance costs that would otherwise be incurred to meet the new FWC requirements to continue to improve, innovate and market their products in a competitive environment.

If you would like to discuss this submission further please do not hesitate to contact myself at 03 8654 5555 or Li Chang at 02 8937 7738.

Yours faithfully



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