

Award Modernisation

If the mere mention of the 3R's (recession, recession, recession) has you running for the hills lately, brace yourself for two new words – Award Modernisation. Love it or despise it, the latest overhaul to superannuation by the Federal Government has begun. With numerous industry participants up in arms over the current structure of the modernisation process, industry response has been vocal and strong in urging changes to the existing format. This special issue of SuperFocus discusses the detail of the Award Modernisation process to date and its potential implications for the super industry.

What is an industrial award?

In its simplest terms, an industrial award is like a generic employment contract.

It documents a formal set of clauses that define the terms of employment and wages for all employees within a specific industry (eg hospitality).

Awards can be Federal (under the jurisdiction of the Australian Industrial Relations Commission*) or State (governed by the relevant state industrial relations commission), with the relevant industrial union and award employers generally agreeing to the terms stipulated within the award.

*To be replaced by a new industrial umpire, Fair Work Australia, in July 2009.

Background to Award Modernisation

In our final issues of SuperFocus in 2008, we highlighted the Government's decision to modernise existing industrial awards as part of their overhaul of Australia's superannuation system. This process will also involve major consolidation, reducing the existing 4,300 awards to just 70.

At the outset, one of the Government's key objectives of this process was to ensure that employees covered by an award, had access to a default super fund(s) which was on par with industry standards.

To emphasise this point, the Government pointed to the lacklustre performance of many award default funds.

With less than 15% of award employees exercising choice, Minister for Superannuation and Corporate Law, Senator Nick Sherry, argued that thousands of individuals were consequently penalised upon retirement – up to a potential shortfall of \$100,000 – as the existing default fund had continued to underperform industry averages.

The Government further argued that the default funds in many awards were out-of-touch with modern requirements, with numerous funds having been chosen decades earlier by agreement between their union and employer.

Thus, the Australian Industrial Relations Commission (AIRC) was duly appointed the task of modernising both federal and state awards.

The entire process is scheduled to be finalised by December 2009, with commencement of the new awards slated for 1 January 2010.

Understanding the facts

Before we address some of the more vocalised concerns from industry participants about Award Modernisation, it's important to understand a number of points from the outset:

1. Award Modernisation does not apply to non-award employees.
2. Award Modernisation is only relevant to employees earning up to \$100,000 pa.
3. Enterprise Bargaining Agreements at the employer level override modernised awards.
4. Award Modernisation only impacts the default super fund in the award and does not override Super Choice. Awards that allow employees to choose their super fund, will continue to do so. If an employee does not exercise their choice, their contributions will automatically be invested into the default super fund.
5. Grandfathering provisions allow any default fund(s) named in an award into which an employer was contributing on or before 12 September 2008, to remain as a default fund(s). This applies to current and future employees. If the employer is subject to a modernised award, the AIRC will still nominate a specific default fund(s) for that award.
6. Any new employer established after 12 September 2008 and operating under the award system, will be subject to the relevant modernised award.
7. Generally, when an existing award does not cover superannuation, the modernised award will follow suit.

The process to date

On 19 December 2008, the first tranche of modernised awards (17 in total) was released. Of note was the fact that numerous awards nominated only one default fund. Overall, the clear winner was the larger, national industry funds – in particular AustralianSuper and REST (Retail Employees Superannuation Trust) – with AMP the only retail fund making the cut.

The relevant extract following the release of the first tranche is included below:

“Unless, to comply with superannuation legislation, the employer is required to make the superannuation contributions provided for in clause 21.2 to another superannuation fund that is chosen by the employee, the employer must make the superannuation contributions provided for in clause 21.2 and pay the amount authorised under clauses 21.3(a) or (b) to one of the following superannuation funds:

- (a) _____ or
- (b) _____ or
- (c) any superannuation fund to which the employer was making superannuation contributions for the benefit of its employees before 12 September 2008, provided the superannuation fund is an eligible choice fund.”

Following numerous submissions by outraged industry participants, the release of the **second tranche** in April 2009, revealed that the majority of modernised awards nominated more than one default fund. Again, the large industry funds dominated, although a handful of standalone corporate funds were also included in this tranche.

Noticeable by their absence were retail funds and – in both tranches – the state-based, multi-industry funds and smaller industry funds. However, the grandfathering arrangements should generally protect those funds which have been omitted from the process thus far.

It is presumed that the process used to date to modernise awards will continue for tranches three and four. However, as to what the selection process involves remains unclear, as highlighted later in this document.

Submissions for tranche three were due on 6 March, with the final cut likely to be released in the coming weeks. The fourth tranche is slated to be completed by 4 December 2009.

How many Australians are impacted?

According to ASFA, only 20% to 30% of employees are covered by awards relating to superannuation. This translates to about 6.8 million employees who will be affected, according to figures published by AMP.

With the number of employees exercising choice at less than 15% and annual compulsory super contributions totalling around \$50 billion, it’s not difficult to calculate the amounts that could potentially flow into these default funds. And this has caused major contention within the super industry.

Industry concerns and implications

Numerous industry participants, including the Investment and Financial Services Association (IFSA), ASFA and retail funds, have vocalised their concerns over the modernised awards process. We’ve detailed the most common arguments on the following pages.

1. Reduced competition

Reduced competition is a major bone of contention within the industry, as the Award Modernisation process impacts what’s on offer and who can offer it. The knockon effects of having a finite number of funds to choose from are considerable, as we’ve discussed below.

a. Monopolisation

According to APRA, contribution inflows amounted to about \$17.5 billion in the September 2008 quarter, broken down across the different super fund categories as follows:

Retail funds	\$6.8 billion
Industry funds	\$5.3 billion
Public sector funds	\$4.6 billion
Corporate funds	\$881 million

With the first two tranches of modernised awards favouring the larger industry funds, there is concern that a virtual monopoly or oligopoly will be created. Of significance is the fact that this appears to fly in the face of the Federal Government’s policy of encouraging competition and choice.

As the first tranche of awards included several where only one default fund was nominated, this removes any incentive for the nominated fund to lower costs, improve product offerings and ensure performance remains favourable for members.

b. Upward pressure on fees

The nomination of a select few funds potentially reduces the competitive pressure on fees.

In their Superannuation Fees Report 2008, Rice Warner Actuaries highlighted that total fees across all categories of super funds averaged 1.21% in 2008, compared with 1.26% in 2006, translating to a saving of almost \$600 million pa.

The same report also revealed that large corporate master trusts have led the way in fee reduction since 2002, slashing 0.45% from overall fees. This segment is effectively the third cheapest in the marketplace, after government funds and corporate funds. However, corporate master trusts have largely been excluded from the modernised awards, with the exception of the mining, horse and greyhound training, racing and rail industries.

c. "One size fits all" product offerings

Reduced competition can potentially lead to a one size fits all product offering. Employers often search for a default fund which will offer extensive features (eg investment choice, insurance), a range of services (eg online access and call centre assistance) and servicing (eg financial education and advice).

Prescribing specific default funds removes the employer's ability to ensure the nominated fund(s) best suits its employees' needs and, as an employer, their overall requirements.

d. Elimination of best practice?

It has become common practice and some argue, best practice, for many employers to implement a tender process for the selection of a default fund. This process usually enables employers to secure attractive benefits and fees for members.

Competitive pressure aside, removing the ability of employers to utilise this process could introduce inefficiencies and, consequently, work against members' best interests. For example, if only one default fund is specified and that fund experienced problems such as governance issues, poor continued performance, administrative difficulties or liquidity issues, it would be the members who suffer.

e. Shrinkage of marketplace

The Australian super fund industry is one of the most dynamic and sophisticated in the world, comprising hundreds of products, extensive product offerings and service providers.

The reduction in competition and diversity effected by Award Modernisation could lead to significant loss of funds under management for certain super fund participants and potentially threaten their viability and existence.

2. Methodology not apparent

With disclosure now a prevalent and valuable aspect of the financial services industry, it is bewildering to note that the AIRC has not released any methodology or explanation of their selection process for the modernised awards.

An initial complaint of Senator Sherry's was the underperformance of many of the default funds in awards. One would, therefore, quite naturally have surmised that long term performance would have been one of the criteria considered during the modernisation process. However, links to any selection criteria remain a mystery.

By their own admission, the AIRC stated that it was "inappropriate for them to conduct an independent appraisal of the investment performance of particular funds, that performance varied from time to time and that even long-term historical averages might not be a reliable indicator of future performance. It would be completely inappropriate and beyond its expertise for an industrial tribunal to try and assess the competing merits of individual superannuation funds."

AXIS' concern is that if a review of performance has not been conducted, does this suggest that other risk assessments (eg investment strategies, benchmarking of risk/return weightings, services and servicing) have also been overlooked? It is also not apparent as to the level of financial services expertise, experience or knowledge of the panel of AIRC members involved in the modernisation process.

3. Implications of the "grandfathering" clause

The grandfathering arrangements were incorporated following strong promotion by numerous industry participants during the hearings on the draft first tranche awards. Without this provision, many employers would have been forced to use a different default fund from 1 January 2010.

This would have had a significant impact on employers and funds that were previously named as a default fund, but were not specifically named in the equivalent modernised award.

Currently, there are legal uncertainties as to how the grandfathering arrangements will work in practice. For example, if the fund was in existence as at 12 September 2008 but is later subsumed due to successor fund transfer, what happens to the default fund? ASFA's interpretation of

the standard clause is that the successor fund would not qualify. Does this then infer that neither fund can remain as a default fund?

There is also concern that the grandfathering provisions may restrict movement in default arrangements from those in place at September 2008.

Where to now for employers?

a. Enterprise Bargaining Agreements

Since Enterprise Bargaining Agreements override modernised awards, it may be in the best interest of employers (and employees) to consider negotiating the inclusion of a specific super fund as the default when developing an EBA – particularly if there is a preferred super fund.

This course of action naturally needs to be considered relative to financial and human resources.

b. Group master trust arrangements

In a small number of awards, group master trusts have been nominated as default funds. Under the grandfathering provisions, these funds will continue to be included in the modernised awards.

However, if a group master trust arrangement was previously nominated as a default where the employees covered by it were non-award employees, an employer will generally be able to select another default fund.

c. Seek advice on Collective Agreements

Collective Agreements may not provide a simple solution under the new industrial relations arrangements. They need to include a range of aspects regarding the employment relationship, including wages and conditions, and usually involve union participation. These factors can make it difficult to override default fund arrangements and AXIS recommends that you seek professional and comprehensive advice in this area.

Options open to super funds

Uncertainty currently remains as to the available options open to providers of super funds under the Award Modernisation process.

Continued lobbying for legislative change is likely to be the main catalyst in revising the current structure before year end.

However, one must not overlook how instrumental the vocal and written process has thus far been in providing entry for more super funds to be nominated. This was, after all, the underlying reason why the second tranche of default funds included more than one nominated super fund per industry.

It is especially important for funds that believe they have been inappropriately excluded from the process to approach the employer organisations and unions involved in the negotiations of specific awards going forward. Support from both parties is essential in the determination of default funds.

Therefore, if a super fund offers attractive employer and employee benefits, and has not been included in the previous tranches, it is the responsibility of the fund to ensure its arguments for inclusion are submitted in a timely fashion before the fourth tranche is finalised.

Ask AXIS Financial Group

As with most superannuation legislation, Award Modernisation is complex. If your company is affected by the legislation and you need guidance or advice, AXIS would be pleased to assist.

With over ten years' experience in the corporate super fund area throughout Australia, AXIS is well placed to advise you and your employees on the most appropriate course of action.

Please feel free to contact our Advisory Group or Technical Services team on **(08) 9426 5800** or **1800 111 299** or email us at: **mail@axisfg.com.au**

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- **www.anz.com.au**

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