FSRC SUBMISSION – Round 5 Policy Issues

Executive summary

At Round 5 of hearings, the Commission heard evidence of multiple, systemic problems in the retail sector of the superannuation system. The retail case studies examined in Round 5 raise profound issues about the ability of retail superannuation funds that are part of corporate groups to manage the inherent conflicts of interest. These include issues requiring structural reform to protect vulnerable members. The superannuation system is a vital pillar of Australia's retirement incomes policy. It is therefore critical that it is efficient and maximises the return on mandated contributions for the benefit of members. In a compulsory system, superannuation should not drive or prioritise dividends for shareholders over members' interests.

Conflicts of interest

AIST proposes the following reforms to address activity that is not in the best interests of members:

- Introducing civil penalties for breaches of the duty to act in the best interests of members.
- Introducing a mechanism whereby the responsible regulator could remove the default fund status of a fund that has engaged in deliberate, systemic misconduct that is demonstrably not in the best interests of members.
- A ban on retail super fund directors who are also executives of other entities within the corporate group.
- An effective ban on funds and other entities, including banks and payroll providers, offering employers inducements (which are not related to superannuation services) to choose a default fund.
- A ban on an entity being the trustee of an RSE and the RE of a managed investment scheme at the same time.
- A ban on the sale of superannuation through bank branches.
- A ban on grandfathered commissions.
- Requiring APRA to collect and publish data on every choice product and investment option, including data on long term net returns.
- Requiring every fund to produce and publish a dashboard disclosing the long-term net returns for every product and investment option.
- A review of the structure of investment management fees to ensure they are aligned with the best interests of members and reflect community standards and expectations.
- A review of the regulation of advice to enable members to get high quality, affordable, unconflicted retirement advice.
- The publication of the net returns of all super products though a centralised independent provider, allowing consumers to easily compare funds.

Regulators

AIST also proposes a separate, stand-alone review of the roles of financial services regulators in protecting the best interests of members in the superannuation system.

Indigenous members

AIST proposes the following measures to improve the way superannuation funds service Indigenous members:

- Require funds to implement AUSTRAC guidance for verifying the identity of Indigenous members.
- Require the ATO to give funds aggregate data on numbers and location of Indigenous members.
- Require funds to consider whether to collect data on members that identify as Indigenous on an annual basis.
- Standardise access to, and grounds for, early release of superannuation.
- Transfer responsibility for determining applications for early release from funds to the ATO.
- Modify the categories of persons that can be nominated under binding and non-binding nominations to reflect Indigenous kinship structures.

Misconduct and conduct that does not meet community standards in not for profit funds

Counsel Assisting also identified a small number of instances of possible misconduct and conduct falling below community expectations in the profit-to-member sector.

AIST and its member funds take these very seriously. There is no place in our sector, or the superannuation system, for misconduct. However, unlike the problems identified in the retail sector, the issues relating to profit-to-member funds were isolated instances, or nuanced issues, that do not reflect systemic problems.

Where to from here?

While the Commission has examined serious, systemic misconduct in the retail sector, the superannuation system itself is not broken. The Productivity Commission found in its May 2018 Draft Report that millions of working Australians are well served by low cost, high performing superannuation funds. However, the evidence heard during Round 5 has led to widespread adverse media coverage. This has real potential to cause reputational damage to the whole concept of superannuation and the industry generally, undermining public trust and confidence in the system itself.

AIST is mindful that further reputational damage to the super system may increase the risk of members leaving the APRA-regulated sector to establish self-managed superannuation funds. According to the Productivity Commission, self-managed superannuation funds with a balance of less than $1 million perform significantly worse than APRA-regulated funds. A flight to self-managed superannuation funds would not be in the best interests of most Australians who have super balances well below this benchmark.

Advertising

Is political advertising consistent with the intention behind s 62 of the SIS Act? Is any amendment to the SIS Act warranted, and if so, why? (Para 825.1)

Policy and political advocacy by unions and employer associations led to the establishment of compulsory superannuation.

As participants in the superannuation system, profit-to-member superannuation funds have a responsibility to protect and improve the system.

Proposals by the Financial Services Council, which represents the retail superannuation sector, to change the existing default fund allocation system would put members' long term returns and the ability of funds to deliver them at risk.

Widespread switching of members from profit-to-member funds which are generally high-performing, low-fee funds, to retail funds that return profits to shareholders and which have consistently underperformed, is not in members' interests.

Political advertising informs members and the community more broadly, about the benefits of belonging to a profit-to-member superannuation fund and the risks of proposals to change aspects of the existing system that protect members. This is a legitimate way for profit-to-member funds to participate in the public and political debate about proposed changes to the system, consistent with the sector's responsibility to protect and improve the system. Political advertising must relate to superannuation to qualify as legitimate fund expenditure. Such advertising is a valid form of advocacy and should continue to be permitted.

APRA can act under existing laws against funds for political advertising that is not in the best interests of members or inconsistent with the sole purpose test. APRA investigated the Fox and Henhouse advertising campaign and did not act.

AIST's advocacy:

Since the introduction of compulsory superannuation, AIST has engaged in advocacy work including the Stronger Super reforms and the Future of Financial Advice reforms.

The focus of AIST's current advocacy agenda is:

- Reforms to address unpaid superannuation which impacts workers who are employed, particularly in the construction and hospitality industries, people employed under sham independent contracting arrangements and genuine independent contractors.
- Increasing Superannuation Guarantee payments to 12% so more members achieve economic security at retirement.
- Implementing the legislated, but stalled, Fair Work Commission default selection process. If this process was up and running, more members would be in higher performing, lower fee default funds and would be better off as a result.
- Improving the way funds service Indigenous members.
- Removing a raft of regulatory carve-outs and exemptions won by the retail sector at the expense of their members.
- Reforms to address the gender superannuation gap so fewer women retire in poverty.

AIST members expect AIST to undertake this advocacy work on their behalf, and rightly support collective advocacy initiatives through industry representation.

Is there identifiable detriment to consumers from advertising by super funds or particular advertising (such as Fox and Henhouse)? Is there identifiable benefit to consumers from advertising by super funds or particular advertising? (Para 825.2)

Advertising that contributes to protecting or improving the system benefits fund members.

Advertising that highlights the benefits of being a member of a high-performing, low-fee, profit-to-member superannuation fund benefits all people with a superannuation interest. It encourages members of these funds to remain members. It also encourages customers of retail financial planners or banks who are members of retail funds, or at risk of being switched to such funds, to consider the benefits of switching to a profit-to-member superannuation fund.

Since the introduction of choice of fund in 2005, most superannuation funds have operated in a competitive environment. Competition exists between profit-to-member funds; between profit-to-member funds and retail funds; and between APRA regulated funds and self-managed super funds.

Advertising aimed at both employers and members is a legitimate response to this competitive environment.

Advertising that aims to protect the existing default system, which sees members defaulted into the higher-performing, lower-fee sector, also benefits members.

This also enables profit-to-member funds to continue to build scale, which is important to continuing high performance and low fees.

Fox and Henhouse is an example of advertising that benefits members. In fact, the Fox and Henhouse campaign highlighted the very issues exposed by the Royal Commission.

Section 68A of the SIS Act

Is it appropriate, as a response to conduct of superannuation trustees that seeks to induce employers to select funds, or affect their decisions as to default funds, to make alterations to s 68A of the SIS Act to widen the prohibition? (Para 825.3)

Broadly speaking, section 68A of the SIS Act prohibits a superannuation fund trustee (or an associate of the trustee) from supplying or offering to supply goods or services to a person (or refusing to do so), on the condition that one or more of the employees of the person will be, or will apply, or agree to be, members of the fund.

The purpose of the prohibition is to prevent employers being offered inducements in exchange for their employees joining the fund, because there is a risk that employers will prioritise their own interests in accessing inducements ahead of the interests of members in being in a high-performing,

low-fee default fund. Over the past 5 years ASIC has examined the provision multiple times.[1] AIST understands it will be explored further in ASIC's 'Employers in Superannuation' project.

There are legislative gaps that may result in:

- Employers receiving inducements from funds that are not in the best interests of members.
- Related entities of retail funds, particularly those within vertically integrated banking structures, offering employers inducements that are not in the best interests of members, with the inducement itself not relating to the superannuation service.

The effect of these gaps is that employers can prefer their own interests over those of their employees.

Evidence suggests that this does in fact happen. In 2015 research by UMR for Industry Super Australia revealed that some banks had attempted to cross-promote superannuation funds to their Small and Medium Business Enterprise (SME) clients. In the process, some banks had offered incentives to their SME employer clients, including lower insurance premiums for the business, free financial advice for employees, and discounted interest rates on overdrafts and loans or fees for the business.

How wide should the prohibition be – should it extend to prohibiting providing benefits to employers for the purpose or with the intention of inducing the selection of the fund as the default fund for employees, or affecting the decision, or being likely to induce or affect? (Para 825.4)

The following inadequacies of s 68A need to be addressed:

- The provision does not capture conduct of entities other than superannuation fund trustees, with entities including banks and payroll providers associated with banks not captured.
- The provision is neither a civil nor criminal penalty provision. Employees would need to initiate a civil action against the employer alleging loss or damage because of a contravention. There has never been a civil suit by an employee against an employer for a breach of s 68A. This is unlikely to happen as the employee, as a default member would not have visibility of the arrangements between the employer and trustee or provider of the superannuation product, nor do employees generally like to question their employer for fear of losing their job. This also limits ASIC's ability to act against a trustee where it identifies a contravention. The Productivity Commission has concluded this means the provision is of 'limited effect'.
- It would be difficult for an employee to prove that the benefit was 'on condition' that an employee join the fund. This is an extremely high evidentiary threshold.

To increase the effectiveness of the provision, it should be:

[1] [1]https://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-038mr-asic-guidance-to-employers-about-super/ ; http://www.aph.gov.au/~/media/Committees/economics_ctte/estimates/bud_1516/Treasury/answers/BET294-303_Dastyari.pdf ; https://www.pc.gov.au/__data/assets/pdf_file/0019/230680/subdr206-superannuation-assessment.pdf

- Expanded to cover inducements that are not related to superannuation offered by superannuation funds and other entities that induce employers.
- Reclassified as either a civil or criminal provision so ASIC can act and to relieve individual members of the burden of initiating proceedings against the employer.
- Expanded so that the test is whether the benefits were provided to the employer to affect the decision, or to be likely to induce or affect the employer's decision on default fund selection.

Funds should be permitted to offer employers incentives related to superannuation such as improved superannuation service delivery as an incentive for the employer to choose the fund as the default fund for employees. This is in the best interests of members.

Corporate hospitality that is consistent with community standards and expectations should be permitted.

Are there matters of principal that would justify such a change? Are there problems that would arise in the application of the law? (Para 825.5)

Employers are not required to act in the best interests of their employees when choosing a default fund. As a matter of principle, s 68A should be amended so ASIC can adequately protect members from the risk that their employer may choose a default fund that is not in the best interests of their employees, but is in the interests of the employer.

Payments from external responsible entities of managed investment schemes

Is it appropriate for the trustee of a superannuation fund to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money? (Para 825.6)

Payments derived from the investment of members' savings must be used for the benefit of members. Trustees have an unambiguous responsibility under the SIS Act and trust law to prioritise the interests of their beneficiaries over all other interests. This clearly applies to circumstances where the trustee exists within a conglomerate that includes a managed investment scheme.

The existence of competing responsibilities, including competing legal responsibilities, does not diminish a trustee's responsibilities to its members nor support the concept of 'balancing' these responsibilities. An absolute responsibility cannot be balanced against another. Rather, it is the responsibility of the trustee to ensure that the interests of the beneficiaries are paramount in the structure and operation of the fund.

The IOOF case study raises serious questions about the capacity of an entity to be both the trustee of a superannuation fund and the responsible entity of a managed investment scheme. In this situation, there is a responsibility to prioritise the members of both regulated entities.

However, practically, and especially in the event of administrative and other errors, it is almost impossible to achieve this. In this case, the parent company did not, nor did it consider, making compensation for loss to members from its assets. However, even if it had, the problem of

simultaneously prioritising the needs of two entities at the same time remains. There are differences of structure, legislation, taxation, business rules and size between the super fund and the MIS. To equally prioritise both in the face of these differences will not be possible, and the tensions associated with this will jeopardise the interests of both entities.

Allowing a single entity to be the trustee of an RSE and the RE of a MIS in not the best interests of members and should therefore be not permitted.

Selling of superannuation

Is it appropriate for that superannuation be sold through bank branches? Is it reasonable to think that there is any prospect that this is likely to produce an outcome that is in the best interests of members? (Para 825.7)

An impact of the FoFA reforms has been for bank-owned funds to direct sell superannuation to customers in place of their previous reliance on advisers to distribute their superannuation products. This is a deliberate strategy designed to avoid the best interest duty imposed by FoFA. It is not appropriate that superannuation be sold through bank branches as a deliberate strategy to circumvent duties on advisers and funds to act in the best interests of members.

It is not reasonable to think there is any prospect that this is likely to produce an outcome that is in the best interests of members.

The Productivity Commission recently observed that cross-selling customers into higher fee or underperforming products is a symptom of unhealthy competition, stemming from a conflicted business model.

The Productivity Commission also identified numerous indicators that this practice drives poor member outcomes including poor returns, higher fees, poor comparability of products and product offers that do not meet members' needs.

Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient? What is the nature of the 'advice' that a customer of a bank receives when told by a bank branch staff member about the availability of a superannuation product offered by a bank? (Para 825.7)

Any attempt at cross-selling by branch staff in circumstances where the springboard for the interaction is some knowledge of their customers' personal financial circumstances, will likely be the provision of personal financial advice. Cross-selling efforts are designed to influence customers to switch. A reasonable person might expect that a branch staff member who knows one or more of their objectives, financial situation or needs, has considered this.

The use of a general advice warning and efforts to de-link the switching recommendation from other aspects of the interaction with the customer explored during the Round 5 case studies are contrivances.

Even if a bank were able to structure its customer interactions so as to be able to cross-sell customers into bank-owned choice superannuation products under a general advice model, this would not be in the best interests of members for the reasons set out above.

The Productivity Commission recommended this be addressed by requiring funds to report annually to regulators on levels of switching from MySuper products to choice products, and comparative disclosure to members.

Additional disclosure obligations will not prevent members being cross-sold choice superannuation products that leave them with less money at retirement. A complete ban on the sale of superannuation through bank branches is required to protect the best interests of members.

Engagement by superannuation funds with Aboriginal and Torres Strait Islander people

Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members? (Para 825.9)

If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground?

If those procedures are not appropriate, which should be changed?

Aboriginal and Torres Strait Islander peoples (First Australians) face hurdles in satisfying superannuation fund identification requirements for multiple reasons. Examples include:

- Limited or no identification documents. From colonisation until 1970 First Australian children were forcibly removed from their families and communities,[2] and identity documentation was destroyed or lost.[3] The impact of this is that some First Australians do not possess documentary evidence of their identity.
- Many births are not recorded in the official register of births, resulting in no birth certificate being available for these individuals. In Queensland today approximately 15% of births to First Australian mothers are not recorded.[4] This is a consequence of remoteness and a response to generations of forcible removal of children.
- Practical difficulties. For example, names can be misspelt, and birthdates recorded incorrectly.
- Identification documents may contain conflicting information.[5]
- Remoteness, which makes it difficult to physically access financial services, technology such as on the internet, a registry of births, deaths and marriages to register births or government offices to obtain a driver's licence.
- Community members sometimes do not have identification documents readily available as they are stored with a family member that may live in a very remote area.[6]

Australia's Anti-Money Laundering /Counter Terrorist Financing Regulations require funds to take a risk-based approach to proof and verification of identity of members. Funds have adopted a worse-case scenario process to protect the fund from fraud and accidental payment to the wrong person.

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[2] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/0708/BringingThemHomeReport

[3] Page 300 https://www.humanrights.gov.au/sites/default/files/content/pdf/social_justice/bringing_them_home_report.pdf

[4] https://www.ombudsman.qld.gov.au/improve-public-administration/reports-and-case-studies/investigative-reports/the-indigenous-birth-registration-report vii

[5] http://www.austrac.gov.au/aboriginal-andor-torres-strait-islander-people

[6] 2016 summit report page 11.

The lack of flexibility in these processes, adopted by most funds, means that members who are First Australians, are prevented from accessing their own money.

In response to these issues in 2016 the Australian Transaction Reports and Analysis Centre (AUSTRAC) issued new guidance making it easier for Aboriginal and Torres Strait Islander people to access their superannuation entitlements:[7]

> *AUSTRAC recommends that, where appropriate, reporting entities consider adopting a flexible approach to the identification and verification of persons of Aboriginal and/or Torres Strait Islander heritage, while remaining mindful of social and cultural sensitivities.*

Notwithstanding the guidance, issues remain because some superannuation funds have not adopted the guidance and developed alternative processes that implement the changes. In March 2017, AIST met with several member funds to assess the extent to which they had adopted the guidance. In that meeting several funds indicated they were in the process of implementing the rules, and some administrators noted the ability of their staff to carry members through an alternative identification process was limited as many members did not identify as First Australians.

For those funds that have implemented the guidance, member facing staff are not necessarily aware of the alternative process. This was identified by Mr Nathan Boyle's evidence before the Commission on 3 July 2018 that the AUSTRAC guidance may have been adopted by the head office but has not 'filtered down to the customer facing staff or to the telephone staff'.[8] Ms Lynda Edwards provided evidence of a similar nature on the same day.[9]

The identification procedures are appropriate if funds adopt the flexible approach outlined in AUSTRAC's guidance. However, in the majority of cases the procedures are not understood nor implemented by member facing staff. Funds should be required to do this.

Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people? (Para 825.10)

In 2016 there were approximately 650,000 First Australians in Australia,[10] with diverse backgrounds, language groups, family structures, geography, age and so on. The needs of each First Australian is therefore different and will largely be informed by their individual situation rather than simply being a member of a group.

Therefore, it is not appropriate to require super fund trustees to record Indigeneity of their members particularly in situations where the fund does not have a clear reason to collect that information.

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[7] http://www.austrac.gov.au/aboriginal-andor-torres-strait-islander-people

[8] https://financialservices.royalcommission.gov.au/public-hearings/Documents/transcripts-2018/transcript-3-july-2018.pdf page 3727

[9] https://financialservices.royalcommission.gov.au/public-hearings/Documents/transcripts-2018/transcript-3-july-2018.pdf page 3727

[10] http://www.abs.gov.au/ausstats/abs@.nsf/MediaRealesesByCatalogue/02D50FAA9987D6B7CA25814800087E03?OpenDocument

While trustees should not be compelled to collect the information, they should be required to consider, on an annual basis, whether it would be in the best interests of their members for the trustee to collect Indigeneity data.

Collecting data on people who identify as First Australians has improved outcomes in the education and health sectors.

A positive obligation on trustees to regularly assess whether it would be in the best interests of members to collect this data preserves the discretion of trustees to consider what is in their members' best interests, while encouraging an ongoing assessment of the outcomes of their First Australian members. The value in understanding the needs of these members will continue to increase as communities and populations continue to expand.

An ongoing duty, accompanied with a regular assessment, is essential because the ability for funds to improve outcomes is influenced by member data and an understanding of their members. Having a strong understanding of members also improves the trustees' ability to provide opportunities for First Australian members, such as increased engagement through initiatives like targeted outreach projects.

If a fund does collect data on Indigeneity, the data should not be able to be used by the fund's group insurer to re-price the insurance premiums of First Australians. This data should only be used to benefit the member, not to disadvantage them.

The Australian Taxation Office (ATO) also has access to member data, including where a member lives (postcode) as well as whether they identify as a First Australian (through cross correlation of data with Centrelink). To promote positive industry action the ATO should provide superannuation funds with aggregate data on how many First Australian members that fund has and where they live.

Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so? (Para 825.11)

All superannuation funds should allow early release on the grounds of severe financial hardship and the Australian Taxation Office (ATO) should be responsible for assessing whether the member is in severe financial hardship using a simple application process.

Under current arrangements the application process differs from fund to fund because each fund is likely to have different business rules, processes and evidentiary requirements. This results in:

- Inconsistent application processes.
- Inconsistent decisions.
- An incentive for members to switch from a fund that does not offer early release to one that does.
- An incentive for businesses to engage in predatory for-profit businesses selling services to members to complete early release application forms. In recent times, we have seen a growth in the number of businesses that fall into this category. These services can cost a significant amount of money and are sold to vulnerable members experiencing financial distress.
- Member confusion.

Requiring all funds to allow early release on grounds of financial hardship and requiring the ATO to perform this assessment will address these issues.

Should the lower life expectancy of Aboriginal and Torres Strait Islander people be taken into account in the decision-making processes of superannuation funds when considering how to administer or release the funds of Aboriginal and Torres Strait Islander people? If so, how? (Para 825.12)

The current regulatory regime permits early access of superannuation on the basis that a member has a terminal medical condition. For a member to meet this condition of release, two registered medical practitioners must certify that the member has an illness or injury that is likely to result in death within the next 24 months. This is an example of a release condition that considers an individual's life expectancy.

However, in this situation longevity is assessed on a case by case basis, reflecting an individual's circumstances, and does not apply to a cohort of members. This is an important distinction. While it is appropriate for decision makers to assess an individual's life expectancy, it is not appropriate to reframe any early release condition to consider the life expectancy of the cohort of which the individual applicant is a member.

The life expectancy of First Australians as a cohort should not be contemplated when the ATO (responsible for assessing compassionate grounds of release) or superannuation funds is considering the release of funds and the focus should instead be on improving life expectancy.

Outcomes for First Australians would be best improved through effective, coordinated, and continued efforts by state and Federal governments to 'close the gap' and improve the life expectancy of First Australian members. In 2010-2012 the life expectancy of First Australians at birth was 10.6 and 9.5 years lower than the life expectancy of other Australian males and females respectively.[11]

Modifying the preservation age or introducing additional assessment criteria for early release applications will not address the underlying causes of why First Australians have a lower life expectancy. Accessing monies prior to retirement may also have adverse consequences, including:

- lower retirement incomes;
- lost insurance cover; and
- distracting Governments from sustained focus on improving the life expectancy of First Australians.

11 http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/412AB412E190136FCA257C230011CA6F/$File/ABS%20Life%20Expectancy%20Fact%20Sheet.pdf

Should the categories of person permitted by legislation to be the subject of a binding nomination be changed to reflect Aboriginal and Torres Strait Islander kinship structures? If so, how should the categories be broadened? (Para 825.13)

Yes. The legislative definition of dependency should be extended to recognise cultural adoption and reflect First Australian kinship structures, which can differ from the kinship arrangements of other Australians.

Currently, fund members can only nominate their personal representatives or a dependant, as defined in Section 10 of the SIS Act, to be the recipient of their death benefits. Ms Lynette Melcer, gave evidence before the Commission that the definitions be expanded to better accommodate the cultural structures and practices of First Australians.[12]

Engagement with the First Australian community is required before a detailed proposal can be developed regarding the modification of SIS Act definitions. It may be appropriate to modify the definition of 'dependant' or 'interdependency relationship' or create a new, separate definition as an additional class of dependant.

Modifying these definitions may make it easier for First Australian members to adequately provide for their dependants if they should pass away.

Discretion to appoint and remove directors

Is it appropriate for shareholders of RSE Licensees to retain a broad discretion to appoint and remove directors? Or should there be an obligation imposed on shareholders to exercise such powers in the best interests of the members? (Para 825.14)

AIST members adopt the equal representation governance structure. This structure consists of equal numbers of employee representative and employer representative directors, with the flexibility to appoint up to one-third independent directors. APRA approval is required to appoint more than one independent director.

In appointing directors to a board, the most important consideration is that the board as a whole is comprised of individuals who collectively have the requisite skills and experience to ensure the super fund delivers optimal results to members, maximizing their retirement outcomes.

From 1 July 2018, AIST member funds are required to adopt AIST's Governance Code. Under the Code, each Board must conduct all appropriate enquiries to ensure that nominees have the appropriate skills and experience before appointing a person as a director. For the appointment of representative directors, this includes engagement with nominating organisations.

Each AIST member fund must report to an independent Governance Code Monitoring Panel each year on an 'if not, why not' basis. The Panel will report its findings to the AIST Board and also issue a public report.

It is common for retail superannuation funds to appoint executives employed in other entities within the corporate group to the board of the superannuation fund. Evidence by retail fund directors and

[12] Page 173 https://financialservices.royalcommission.gov.au/public-hearings/Documents/Round-5-closing-submissions/Round-5-Closing-Submissions.pdf

executives during Round 5 demonstrated that many directors of retail funds face conflicts of interests that render the director unable to act in the best interests of members. A director who is an executive in the group faces profound conflicts of interest, which are very difficult to reconcile with their duty to act in the best interests of members. A director who attempts to act in the best interests of members, at the expense of profits or the interests of related entities, could risk losing remuneration and even their job. The appointment of executives employed in other entities within the retail conglomerate should be prohibited.

Relationship between trustees and financial advisers

Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not? (Para 825.15)

The ability to pay conflicted remuneration was the leading contributor to all cases involving fees for no service identified by ASIC.

Grandfathered commissions incentivise advisers and retail funds to recommend that members remain in legacy products rather than moving to contemporary products when this would be in the members' best interests. For this reason, grandfathered commissions should be banned.

The profit-to-member sector AIST represents has never paid commissions to advisers and hence does not pay grandfathered commissions.

Grandfathered commissions are an example of a broader pattern of regulatory carve outs and exemptions that benefit retail funds and related entities, at the expense of their members. This is discussed below.

During Round 5, the Commission also heard evidence that many members were paying ongoing advice fees out of their superannuation account yet did not receive any advice. This is not in the best interests of members but does serve the interests of advisers who receive income without providing any services to members. The payment of ongoing advice fees out of members accounts where the member does not receive any advice should also be banned.

The payment of ongoing advice fees out of a member's superannuation account should continue to be permitted where advice is provided, the fee is clearly disclosed, and the member authorises the payments every two years.

Are there possible detrimental effects on the provision of high quality advice by such changes? If it is said that there are such detrimental effects, then the detriments and the reasons for the detriments should be precisely identified. For example, if it is said that it is unlikely that consumers will be willing to pay for the true value of financial advice then, amongst other things, it ought to be explained how the 'true value' of financial advice is to be determined, why consumers will pay for the true value of other services but not for financial advice and why it is not sufficient to allow consumers to make an informed choice as to the specific price that is to be paid for a specific service.(Para 825.16)

Members should be given the opportunity to decide for themselves whether advice is worth the cost. Members may decide advice services are valuable, in which case the advice industry will flourish. On the other hand, members may decide advice is not worth the cost.

It is not defensible to continue to allow funds to pay advisers conflicted remuneration which is not in the best interests of members on the basis of an untested, hypothetical argument that is designed to preserve conflicted remuneration which is demonstrably not in the best interests of members.

The removal of grandfathered commissions may promote price-based competition driving innovation including the use of technology to deliver advice.

Managing conflicts

Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties. For example, where a trustee is a dual-regulated entity, that would seem to raise an inherent conflict of interest, or the potential of a conflict of interest. Are there other structures such as investment of funds in insurance policies issues by related party insurers or the integration of a superannuation trustee into an advice business that also raise inherent problems? Is it possible to say that these conflicts are ever manageable? (Para 825.17)

For-profit ownership

The Round Five hearings brought into stark relief the extent to which the commercial ownership structure of for-profit retail funds has led to problems for trustees complying with their fiduciary duties.

Unlike profit-to-member funds, for-profit retail funds were established to return profits to their shareholder owners. For-profit retail funds exist to generate profits for the corporations, such as banks, that own them. This puts the retail trustee in a position where directors are effectively serving two masters – fund members and shareholders.

Evidence presented at the Royal Commission showed that this commercial ownership structure was a fundamental barrier to retail trustees complying with their fiduciary duties and exercising independent judgement in the best interests of members.

The evidence revealed that the needs of the commercial shareholders took precedence over members' interests, leading to decisions that were not in the best interests of members including decisions to delay transitioning members to MySuper and decisions to avoid transitioning members to MySuper altogether.

During Round 5, the Commission also heard evidence of instances where retail trustees did not even have the power to make decisions, effectively acting as rubber stamps to executive managers squarely focused on returning dividends to shareholders. Some trustees didn't even have access to the information they needed to make decisions. Within this structure, even well-intentioned directors cannot act in the best interests of members.

Related parties

The ownership structure of for-profit retail funds is further conflicted where the fund uses related parties. The Royal Commission hearings reinforced the findings of APRA's landmark research into related party transactions during 2009 and 2010. This research (noted in our previous submission to the Royal Commission) found retail funds generally pay more for external services, particularly where those services are provided by other entities within the same corporate group.

In the area of administration fees, for example, APRA found that some retail trustees using related-party administrators were paying significantly higher fees, "effectively doubling the median member's cost load".

Despite repeated calls from AIST and others for APRA to follow up on the question of fiduciary duties and to update the research, no action has been taken.

The hearings also laid bare a worrying lack of insight among many retail trustees about what it really means to have a fiduciary duty to members. Instead they talked of the need to balance the interests of members against those of the shareholders and related parties, demonstrating ignorance of the law requiring them to put members first. The fact that banks do not have a fiduciary duty to their customers may be a driver behind this lack of appreciation of the trustee's role in prioritising member interests.

In the very worst instances, trustees and fund staff had complete disregard for members, regulators and the law.

Would it be preferable to extend the obligation to act in the best interests of members of a superannuation fund so that:

(i) Contravention of the obligation attracts a civil penalty; and

(ii) The obligation (and the civil penalty for breach) extends to shareholders of trustees and any related bodies corporate (within the meaning of the Corporations Act) of the trustee in respect of any conduct that will affect the interests of members of the superannuation fund? (Para 825.19)

The responsibility for ensuring that related party arrangements serve the best interests of members should lie with funds themselves. Under AIST's Governance Code, funds must ensure due process in all transactions, and ensure that any related party transactions are conducted under market conditions, with full transparency and disclosure.

To ensure that related party service arrangements are in the best interests of members, funds should be required to engage related parties at arms-length, use contracts that specify clear,

measurable service levels, actively oversight service delivery quality and terminate arrangements where service levels are not met.

Given the prevalence of related party arrangements that are not in the best interests of members in the retail sector, APRA should actively monitor these arrangements on an ongoing basis and take enforcement action where funds enter related party arrangements that are not in the best interests of fund members.

AIST also supports reform to attach civil penalties to failure by a fund to act in the best interests of members of the fund. Civil penalties would introduce much needed specific and general deterrence.

System changes

Is one way of addressing and discouraging misconduct on the part of superannuation trustees to seek to encourage improvements to outcomes for members whose contributions are made to MySuper products or is the link too tenuous to justify recommending any system changes to the default system? (Para 825.21)

Default fund status is a privilege and a responsibility. It should only be available to funds that deserve it. A fund that has admitted or been found to have engaged in deliberate, systemic misconduct that is demonstrably not in the best interests of members should be barred from default fund status. A mechanism for a regulator to ban funds from default fund status in this situation should be introduced.

Regulators should also rethink their responses to misconduct, to better address and discourage misconduct.

One response by ASIC to misconduct by superannuation trustees explored during Round 5 is 'stopping the conduct'. This was explored through the case study examining enforceable undertakings ASIC entered into with CBA and ANZ, under which these banks agreed to stop distributing super products through bank branches and paid modest community benefit payments.

The ASIC Media Release announcing this outcome (ASIC 18-206 MR) did not state that either bank had broken any law or that any members were worse off as a result.

This approach does not:

- compensate members who have been switched from a high-performing, low-fee MySuper product into a poor-performing, high-fee, bank-owned product for loss of retirement savings;
- warn these members that this may have happened; or
- deter ANZ, CBA or others from engaging in future misconduct.

Where a fund has engaged in misconduct, and it is likely that victims of that misconduct will be worse off at retirement because of the misconduct, the fund should be required to transfer those members to a high-performing, low-fee MySuper product in addition to compensating the member for loss suffered as a result of the misconduct.

A second regulator response to misconduct by superannuation trustees explored in Round 5 through the case study relating to fees for no service insisted that the trustee remediate members for loss.

This does compensate members but has little if any specific or general deterrent effect. This would be achieved by the imposition of substantial civil and criminal findings and penalties, and the resulting adverse publicity. ASIC has now commenced court action in relation to fees for no service problems.

Is it appropriate, as a response to misconduct of superannuation trustees, to apply an additional filter to MySuper authorisations so as to require outcome assessments? If so, what are the general parameters for such a system change and who is appropriate to apply the test? (Para 825.22)

Development and administration of an outcomes assessment for MySuper products could be undertaken by APRA or the Fair Work Commission as part of the legislated but stalled default fund selection process.

AIST supports mandatory outcomes assessments, provided the primary focus of the assessment is on promoting members' best interest and optimising members' retirement outcomes through the delivery of optimal long-term net returns.

In addition to outcomes assessments for MySuper products, all funds should also be required to complete outcome assessments for every choice product they offer. As the evidence in Round 5 has demonstrated, members in choice products are not necessarily engaged, nor financially literate. Most members who hold choice products do so because they were advised to switch. Choice members are often vulnerable beneficiaries at risk of languishing in poor-performing, high fee products, leading to loss of retirement savings.

Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple accounts of a person, to introduce some form of 'stapling' so that a person's account for receipt of default contributions is linked to the person and travels with the person when she or he changes jobs? Is this a practical method of addressing this type of conduct noting that it is not suggested to be misconduct? (Para 825.23)

The Productivity Commission recently estimated there are 10 million unintended multiple accounts. AIST acknowledges this is a significant problem and it is a function of the existing default system.

However, AIST does not support stapling members to their existing fund when they change jobs as a response to the problem of multiple accounts.

Stapling would effectively dismantle the existing occupational default system. There are good reasons for members to be defaulted into industry or occupation-specific funds. These include:

- Problems with unpaid super are clustered in specific industries, including construction and hospitality. Funds that serve these industries have extensive programs to collect unpaid superannuation on behalf of their members, improving their retirement outcomes.
- Industry-specific life insurance requirements for people employed in construction, mining, electrical and other intrinsically hazardous occupations. Funds that serve these industries have tailored life insurance products that members could not acquire outside of superannuation cost effectively, or in some cases at all.

- The ability of occupation-specific funds to tailor member communications to specific industries and cohorts.
- Retirement strategies and, where appropriate, products, can be tailored to specific demographics. For example, the recommended retirement strategy for a single aged care worker with a low superannuation balance who is eligible for the full Age Pension would differ significantly from the recommended approach for a married white-collar worker eligible for a part Age Pension.

Stapling members to one fund for life would also compound member disengagement, and reduce competition. There is also a risk that members could be stapled to a poor performing fund.

Under the current system, employers are required to give every new employee a choice of fund form. This nudges employees to consider their superannuation fund when they join the workforce and each time they change jobs. These are often milestone events in peoples' lives that may also be associated with changed financial circumstances.

While this is currently a paper form, an ATO initiative to move to online employee commencement processes will further streamline the process and reduce the incidence of multiple accounts.

While recognising that there are low levels of member engagement with super, AIST submits that mandated consideration of superannuation at a time when it is both important for an individual and they are more likely to be receptive to consider super is nonetheless an important existing element in fostering engagement. Current initiatives, as outlined below, will both improve engagement and reduce multiple accounts.

The ATO is moving to require superannuation funds to report account and transaction details to it on a near real-time basis. Most current reporting is on an annual basis. This will eventually mean that the information displayed on the online choice of fund form and on the individual's MyGov account is current. Viewing up-to-date information will also encourage greater engagement.

The Government's Protecting Your Super package of legislation is currently before the Senate. This includes a requirement for funds to transfer all inactive accounts with a balance below $6,000 to the ATO and an obligation on the ATO to reunite these accounts with the member's active account where possible. However, not all members with an inactive, low-balance account also have an active account. Under the legislation before the Senate, in this situation the ATO would transfer the balance of the account to consolidated revenue. Members would receive lower returns on their savings while those savings were housed at the ATO. Members whose savings were transferred to consolidated revenue would lose them entirely.

AIST supports automatic consolidation of multiple accounts, but has proposed that the ATO should be required to directly cross match inactive low-balance accounts with active accounts. This would eliminate multiple accounts while preserving inactive low-balance accounts within the superannuation system.

Are there other system changes that might be appropriately tailored responses to misconduct or misconduct falling below community standards and expectations of superannuation trustees? If so, what are the general parameters for such a system change? (Para 825.24)

Regulatory exemptions and gaps that benefit retail funds at the expense of members

Grandfathered commissions are one example of a broader pattern of regulatory carve outs and exemptions that benefit retail funds, at the expense of their members. This also includes:

- No requirement to produce a Product Disclosure Statement for legacy products.
- Repeated deferral of the requirement to produce a dashboard for choice products.
- No requirement on APRA to collect and publish data on performance or fees for choice products.

These carve-outs and exemptions make it extremely difficult for choice members to understand what returns they receive or what fees they pay, let alone compare the performance or fees of their superannuation product with other products. This is not in the best interests of members.

The carve-outs and exemptions benefit retail funds, who avoid scrutiny of performance and fees.

This is unacceptable given the importance of superannuation as a social policy for providing Australians with economic security in retirement, and the fact that taxpayers contribute around $30 billion every year to the system in the form of tax concessions.

AIST recommends:

- Requiring every fund to produce a dashboard for every choice product and investment option. The Productivity Commission also recommends this in its Draft Report.
- Requiring APRA to collect and publish data for every choice product and investment option.
- Establishing a simple, centralised online portal for comparing every superannuation product and investment options focusing on long-term net returns. The establishment of such a portal is long-overdue. Despite compulsory super having been around for more than 25 years, there is still no easy way for members to compare super funds on a meaningful basis.

Ensure investment management fees are aligned to the best interests of members and reflects community standards and expectations

There should be a review of the overall structure of fees paid to investment managers. Despite the prevalence of investment management fees being expressed as a percentage of assets under management, there are significant weaknesses in this model that can lead to both over-charging (when markets rise) and under-resourcing (when markets fall).

This was the subject of research commissioned by AIST and undertaken by RiceWarner in 2010[13]. Despite the research being eight years old, this research and its conclusions remain relevant. As we

[13] http://www.aist.asn.au/media/43411/aist_research_report_webv.pdf

concluded at the time: "*Asset-based fee models are not aligned to the interests of either super fund trustees or their members*".[14]

A conclusion of the research was that the superannuation industry needs a fee model that does more than reward fund managers for market beta and managing a growing pool of assets, even when they have not contributed to that growth.

The report recommended that fees for index portfolios should be on a fixed dollar basis rather than as a percentage of assets and that super funds should consider a fixed dollar fee plus a risk-adjusted performance fee model for actively managed funds.

Reform regulation of advice to prevent misconduct

During Rounds 2 and 5 the Commission heard evidence of widespread poor quality, conflicted general and personal advice about superannuation that was not in the best interests of members.

It is clear that the regulatory architecture for financial advice has failed retail fund members.

Alongside this situation, members are retiring with higher retirement savings and the Government is focused on developing a market for new retirement income products.[15]

The Productivity Commission recently concluded that:

> *The most important task remaining is to improve the quality of financial advice to guide members among the various complex products, especially where members may decide to make the mostly irreversible decision to take up a longevity (risk pooled) income product*.[16]

There is real potential for widespread mis-selling of retirement income products by conflicted, for-profit providers and advisers. The regulatory architecture for advice needs to be redesigned so members can get unconflicted, affordable retirement advice.

Superannuation funds can currently give members scaled and intra fund advice that is cross-subsidised by the fund membership. This includes retirement advice. This is a cost-effective way of giving members advice that is in their best interests and should be retained.

However, under the existing law, the adviser cannot examine the impact of different possible retirement strategies or retirement income products on the member's entitlement to the Age Pension. This is at odds with the fact that most members are entitled to a part or full Age Pension. Nor can the adviser consider the circumstances of others in the member's household. This does not reflect the reality that most members have a partner, and couples plan for retirement together.

Law reform is required so members can get retirement advice from their superannuation fund that:

- is in the best interests of the member;

[14] http://www.aist.asn.au/media/42430/aist_2010.09.07_time_for_a_re-think_on_fu, d_manager_fees_super_fund_study.pdf

[1515] Australian Government, Retirement Income Covenant Position Paper, May 2018.

[16] Productivity Commission, Superannuation: Assessing Efficiency and Competitiveness, Draft Report, April 2018.

- examines the impact of different retirement strategies and products on the member's Age Pension entitlements;
- considers the circumstances of the member's household;
- is unconflicted;
- is high quality; and
- is reasonably priced, on a fee for service basis. The high cost of comprehensive financial plan involving a statement of advice is a huge barrier to ordinary Australians getting the advice they need.

Deterrence and insight

What can be done to encourage the regulators to act promptly on misconduct or potential misconduct? (Para 825.25)

It is apparent from the various case studies examined by the FSRC during Round 5 that the regulators did not act promptly on misconduct or potential misconduct.

Greater accountability

The effectiveness of regulators would be enhanced by the introduction of measures to make the regulators more accountable. Clear, transparent division of responsibility for every aspect of the regulatory regime, with no gaps, is a fundamental pillar of accountability.

The Federal Treasurer issued a Statement of Expectations for ASIC in 2014. This Statement has not been revised since issue and does not explicitly outline that ASIC is expected to deter misconduct or punish misconduct promptly.

Government should create new Statements of Expectations setting out the mandate of each financial services regulator.

Each Statement should make it clear that the role of the regulator is to proactively investigate instances of misconduct and potential misconduct and undertake enforcement activity promptly to punish and deter such conduct.

The Statement should also make clear that remediation programs cannot be relied upon by regulators as the primary response to misconduct.

The regulators should exercise their enforcement powers rather than relying on negotiated outcomes as a primary response to misconduct. Allowing perpetrators of misconduct to negotiate the consequences of their misconduct does not deliver adequate punishment, specific or general deterrence, may not adequately compensate members and does not meet community standards and expectations.

Each regulator should be required to report publicly on outcomes achieved against each Statement of Expectations.

While self-reporting is valuable, it is not independent. Accountability would also be enhanced by independent oversight of the regulators. The Financial System Inquiry recommended that the

Government create a new Financial Regulator Assessment Board (FRAB) to advise Government annually on how financial services regulators have implemented their mandates.

Government did not implement this recommendation to create the FRAB. Instead, it reconvened the Financial Sector Advisory Council to advise Government on the performance of the financial regulators. Representatives on the Council include Managing Directors and CEOs of major financial institutions, the same institutions that the regulators are to regulate. Representatives include:

- Mr Michael Cameron, Managing Director and Group Chief Executive Officer of Suncorp Group
- Ms Sarah Rennie, Managing Director Equity Capital Markets, Goldman Sachs;
- Mr Brian Hartzer, Managing Director and Chief Executive Officer, Westpac;
- Mr Craig Meller, Chief Executive Officer, AMP.

It is understood the group is currently suspended and that Craig Meller resigned from the group following the FSRC hearings.

There is a clear need for an independent entity to have responsibility for overseeing and reviewing the conduct of the regulators. Options include:

- The Australian National Audit Office (ANAO)
- FRAB
- Office of Best Practice Regulation (OBPR)
- Commonwealth Ombudsman
- Auditor-General

Regulator activity should be informed by data

To be effective, the regulators also need data on the performance and fees and costs of every MySuper and choice superannuation product and investment option. This would enable the regulators to understand which members are vulnerable to being switched into poor-performing, high-fee products that are not in their best interests, and prioritise their regulatory activity to preventing and addressing this. As noted above, APRA does not collect or publish such data for choice products or investment options.

Regulators should be required to:

- collect data on the performance of every MySuper and choice product and investment option; and
- use the data as a tool to identify misconduct and potential misconduct in particular sectors and products.

Use of existing regulatory toolkit

ASIC and APRA have extensive regulatory powers and ability to take enforcement action in response to misconduct.[17]

ASIC can:[18]

- Grant Australian financial services licences to trustees.
- Stop the issue of financial products under defective disclosure documents.
- Investigate suspected breaches of the law.
- Issue infringement notices in relation to alleged breaches of some laws.
- Ban and disqualify individuals for breaches of some laws.
- Seek civil penalties from the courts for breaches of some laws.
- Accept and enforce undertakings.
- Commence prosecutions for breaches of some laws.

APRA can:

- Seek injunctions
- Suspend or remove trustees
- Disqualify responsible officers
- Appoint acting trustees
- Issue infringement notices
- Investigate trustees
- Issue directions
- Approve RSE licensees
- Impose licence conditions on RSE licensees, vary or revoke licenses, and cancel licences
- Refuse a MySuper authorisation
- Create prudential standards on prudential matters
- Accept and enforce undertakings
- Initiate proceedings for breaches of some laws

[17] https://download.asic.gov.au/media/4837214/regulation-of-superannuation-entities-by-apra-and-asic.pdf ; https://download.asic.gov.au/media/1339118/INFO_151_ASIC_approach_to_enforcement_20130916.pdf ; https://asic.gov.au/about-asic/asic-investigations-and-enforcement/asic-s-compulsory-information-gathering-powers/

[18] This list is not exhaustive https://asic.gov.au/about-asic/what-we-do/our-role/

It is not possible to assess whether these powers are sufficient, because neither regulator has extensively tested its existing regulatory toolkit.

Even though APRA already has extensive powers enabling it to identify misconduct and undertake enforcement activity AIST supports proposals to expand its powers through the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* which is currently before the Parliament.

Accrued default amounts: A case study

Problems with the level of protection of default super fund members have been long and widely recognised and were a key theme of the Super System Review (the Cooper Review) in 2010. All industry participants and regulators were well aware of these problems.

Notwithstanding this, it is not clear that regulators tested their existing powers in relation to members with accrued default amounts after the establishment of the MySuper regime.

The Cooper Review proposed the creation of MySuper products as the only defaults for Superannuation Guarantee payments. It was clear that until the transition to MySuper members in other default funds would remain not adequately protected.

Following extensive industry consultation, the Government legislated for the transition of 'accrued default amounts' to into MySuper products to be completed by 1 July 2017.

AIST supported a two-year transition period and opposed the four-year transition period from the outset. In our submission on the draft legislation, we said the period was "far too long" and that it was "disingenuous and wrong, and inconsistent with the draft APRA Prudential Standard on MySuper Transition"[19] for the transition period to be expended to 1 July 2017.

This has consistently remained our position, and has been communicated to Government, Treasury, APRA and the media over the past seven years.

The APRA Prudential Standard on MySuper Transition (SPS 410) required trustees to transfer ADAs to a "…MySuper product [that] promotes the financial interests of the member."

The associated Prudential Practice Guide (SPG 410) states:

> *Notwithstanding that the legislation allows for an RSE licensee to move accrued default amounts at any time up until 30 June 2017, APRA expects that the attribution to a MySuper product would be made much earlier than 1 July 2017 when it is in the best interests of members. APRA would expect the RSE licensee's transition plan to reflect this approach*.[20]

SPG 410 also required trustees to put in place measures to assess the effectiveness of their transition plans.

[19] P.15 http://www.aist.asn.au/media/137868/2012.05.16_sub_ed_mysuper%20tranche.pdf
[20] P.6 https://www.apra.gov.au/sites/default/files/spg-410-february-2013.pdf

It is not clear that APRA used their powers under the SIS Act and regulations and prudential standards to monitor, assess and enforce appropriate fulfillment of trustee duties in relation to transition to MySuper.

To the best of our knowledge, APRA did not:

- release details of transition plans;
- produce updated reports (beyond the quarterly reporting on the total value of ADAs) on the progress of ADA transitions; or
- take any enforcement action against funds for deliberately delaying the transfer of ADAs.

Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct? (para 825.26)

There is a need for a separate, stand-alone review of the roles of regulators, including how roles are allocated. The review should consider whether responsibility for taking action by RSE Licensees for breaches of the sole purpose test and obligations to act in the best interests of members should be transferred from APRA to ASIC.

Given that what we are fundamentally concerned with is conduct that in subtle but ongoing ways negatively affects the retirement outcomes of consumers, are either of the regulators best placed to carry the responsibility to protect consumers or should the balance between them be restructured or significantly altered? (Para 825.27)

See response to question 825.25.