

**Royal Commission into Misconduct in The Banking,
Superannuation and Financial Services Industry**

INTERIM REPORT

**SUBMISSIONS BY TWU NOMINEES PTY LTD atf TWU
SUPERANNUATION [TWUSUPER]**

1. These Submissions in relation to the Interim Report are advanced to assist the Commissioner in relation to the specific questions raised by CA as to conflict of interest and duty, as to causes and as to possible solutions to the problems that have been identified. While TWUSUPER, as an RSE Licensee was not directly involved in the first 4 tranches of hearing or the case studies that were explored, the issues that were there identified are of general application, have both direct and indirect impact on the superannuation models that operate in Australia and on the welfare of the retirement outcomes of all Australians. The submissions are made from the perspective of TWUSUPER's provision of financial services, in the limited context of superannuation and as the holder of a group insurance policy. To that end, and for the assistance of the Commission we largely repeat the submissions advanced in the Round 5 Superannuation Segment as having direct relevance to the questions posed by CA at issues 8.2 and 8.3

Issue 8.2 Causes

What were the causes of the conduct identified and criticised in this report?

- *Conflict of interest and duty?*
- *Remuneration structures?*

- *Culture and governance?*
 - *Regulatory response?*
2. The conflict of interest and duty identified and the subject of detailed examination and critical analysis in the Interim Report involved elements of all of the four subheadings offered for consideration by CA. The fundamental conflict, as has been pointed out by the Commissioner lies in the tension between the duty to maximise return or profit to shareholders and the duty to act honestly imposed by the Corporations Acts, and associated legislation. That these are irreconcilable is nowhere more clear than in the area of superannuation.
 3. In the submission of TWUSUPER the other issues, of remuneration structures and of culture and governance failures may be seen to be symptoms or signs of the underlying conflict identified above. General responses of compliance and enforcement provide a costly but necessary method of minimising breaches of legal and ethical duties. We repeat the submissions earlier made as explanatory of this submission.
The paramount consideration of advancing members interests as a superannuation trustee is easily comprehended in circumstances where the trustee/duty-holder has only one stakeholder group to which they owe a duty. The potential for conflict does not arise when the trustee is not involved in a separate and distinct venture of providing other services to a superannuation fund.
 4. As to whether the 'conflicts are ever manageable' the short answer is that the only way the conflict could be effectively managed is to ensure that the commercial venture which operates as a MIS or insurer is operated so as not to return a profit. In saying this the conflict is clearly removed but the obligation to shareholders to generate and maximise profit is taken out of the equation. That is not so much managing the conflict as cancelling a set

of obligations to one side of the member/shareholder scales to remove the conflict altogether.

5. As an analogy, if the superannuation trustee holds fixed assets such as real estate on behalf of members then the trustee is undertaking an investment role directly utilising member's funds. Provided that the superannuation trustee is operating in a profit-for-member manner and all profits are being returned to members (other than operating costs, administrative costs and other incidentals directly related to the management and operation of the superannuation fund) then the potential for member's funds to be utilised to boost the profit of the entity's commercial undertaking will not arise.
6. It is the search for profit for the entity who is the superannuation trustee which gives rise to the potential for a conflict to arise. This is all the more so when a percentage of the profit generated on member's funds is remitted to the entity by way of commission or inappropriate remuneration. This situation will almost always have inherent dual-obligations for the persons operating the entity. On the one hand the trustee, such as TWUSUPER, has the obligations present in the SIS Act to act in the best interests of members. At the same time however, the entity is answerable to shareholders who own the vehicle who acts as the trustee of member's funds. It would not be permissible for the Board of such an entity to not generate a profit for shareholders because all profit is to be remitted to members of the superannuation fund. It is these two fundamental duties which will always give rise to a tension between members on the one hand and shareholders on the other.
7. The issue dealt with above does not arise in the TWUSUPER context. TWUSUPER operates solely for the benefit of its members and all profits are returned to members. True it is that the fund and trustee will invest in for-profit ventures such as property trusts and MISs. The

investments are however at arm's length and should the investment begin to underperform (or perform in a manner which the Board does not consider is in the interests of members) the trustee is wholly able to withdraw member's funds and invest elsewhere. Taking such a step as an Industry Fund does not then conflict with the rights of shareholders because the trustee is under no obligation to return any profit to shareholders.

8. The example of a dual-regulated entity which operates an insurance arm as well as being a trustee raises the same concerns already dealt with in this submission. Operating a for-profit commercial venture which is answerable to shareholders will lead to a level of conflict due to the need on the one hand to maximise returns to members of the fund and on the other to maximise returns to shareholders. In such a case it is impossible to maximise returns on both sides of the ledger. Again, the supply of insurance through superannuation will obviously lead to the insurance provider making some level of profit (presumably) as a result of the provision of the service. When the superannuation fund obtains the insurance from a third party non-related party then the insurance costs will be known, can be negotiated and fixed and the member can then elect whether to hold insurance or not. The decision making by the trustee can therefore occur with only one duty and obligation in mind: the duty and obligation to members.
9. It is clear from the evidence which was adduced during the Round 5 case studies that Industry Super funds, who did not face such a conflict, were able to return to their members amounts far in excess of the returns generated by for profit commercial ventures. Furthermore, the need to try and balance members interests against those of shareholders must mean that the primary obligation of returning to members the maximum amount acting as their custodian is never achieved. To put it very simply: when the servant has two masters neither master can demand absolute

loyalty and expect to receive it. When a trustee has to operate for both members and shareholders the result will always be that one party does not receive the whole benefit of the trustee's actions.

10. Insurance in related party entity is of concern if the sale is undertaken for the generation of profit to the related party.
11. Provision of superannuation through an advice business is not of concern provided that both s.52 and s62 of the SIS Act strictures are followed.
12. In their request for submissions in relation to superannuation CA raised the question - *if certain structures do raise inherent problems, is **structural change of entities, mandated by legislation** or otherwise, something that is desirable?*
13. Inherent within the question posed is the notion that the types of conflicts identified can be effectively managed (presumably through legislation).
14. It is important to remember that superannuation was not designed as a product through which financial entities could make profit. The basic premise of superannuation was and is that the fund is operated as a custodian of people's money to ensure that their retirement savings are maximised. That is a difficult task to undertake when also seeking to generate profit from the same pool of money for shareholders.
15. It follows that the only available legislative change which may be effective would be to prohibit entities acting as a superannuation trustee where they also have obligations to generate profits for shareholders or shareholders of related entities.

Issue 8.3 Responses

How should

- *APRA*
- *ASIC*

respond to conduct and compliance risk?

16. TWUSUPER is an entity that is required at present to report to each of APRA and ASIC in relation to matters of governance and compliance in several respects.

17. These arise because it is a corporation and RSE licensee with responsibilities under both Corporations legislation and the SIS Act, the latter administered by APRA. The experience of TWUSUPER has been that as a body concerned to ensure compliance and to effectively minimise exposure to risk thus providing the best service to its members, TWUSUPER has enjoyed a positive and supportive relationship with both regulators. TWUSUPER has regular meetings with APRA as well as detailed correspondence. On occasion we have had to deal with ASIC but as our record establishes, have not experienced any problems with ASIC as regulator. In the circumstances TWUSUPER cannot offer any suggestions to the Commission as to these matters.