



ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

INTERIM REPORT

WRITTEN SUBMISSIONS OF THE AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES

1. The Australian Institute of Superannuation Trustees (AIST) makes the following submissions in response to issues arising out of the interim report of the Royal Commission.
2. As an organisation representing the interests of profit-to-member superannuation funds, the primary focus of our responses is on issues related to the provision of superannuation. Whilst superannuation itself is not a topic in the interim report, AIST's comments are applicable to members of superannuation funds.

ABOUT AIST

3. The Australian Institute of Superannuation Trustees is a national profit-to-members organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector superannuation funds.
4. As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.
5. AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

SCOPE OF RESPONSE

6. In responding to the interim report, AIST has chosen to focus on issues identified in the report that directly or indirectly affect superannuation fund members:
 - a. Vertical integration - Should financial product managers be permitted to provide financial advice?
 - b. Grandfathered commissions- Should the grandfathered exceptions to the conflicted remuneration provisions now be changed?
 - c. Disclosure – Are product disclosure requirements sufficient to allow customers to make fully informed choices?
 - d. Regulators – Should negotiation and settlement be the main approach of a regulator?

DETAILED RESPONSE TO ISSUES IDENTIFIED IN THE INTERIM REPORT

7. AIST's detailed responses to issues arising from the interim report are set out in the attached submission.



FURTHER ASSISTANCE

8. AIST is willing to provide further assistance to the Royal Commission in respect of the matters addressed in this response to the interim report.

Ms. Eva Scheerlinck, Chief Executive Officer

AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES

26 October 2018



ATTACHMENT

WRITTEN SUBMISSIONS OF THE AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES

Issue 1: Vertical integration - Should financial product managers be permitted to provide financial advice?

9. Round 2 of the Financial Services Royal Commission public hearings examined multiple case studies of poor-quality advice from advisers working in retail vertically integrated advice practices, as well as case studies of failure to deliver advice services, inadequate systems for remediating affected customers and unacceptable delays in lodging breach reports.
10. The evidence from these case studies is consistent with multiple ASIC reports over many years. These reports include:
 - ASIC Report 594, Review of selected financial services groups' compliance with the breach reporting obligation (2018) – which found that the major retail financial groups took on average 1,726 days to identify an incident that was later determined to be a significant breach as well as lengthy investigations leading to delayed reporting and customer remediation.
 - ASIC Report 562, Financial advice: Vertically integrated institutions and conflicts of interest (2018) – which found that 65% of the advice reviewed was non-compliant, and a further 10% of advice reviewed was both non-compliant, and ASIC had significant concerns about the financial position of these customers.
 - ASIC Report 515, Financial advice: Review of how large institutions oversee their advisers (2017) – which found systemic failures to lodge breach reports about non-compliant conduct by advisers, difficulties identifying high-risk advisers and customers affected by non-compliant advice and weaknesses in licensees' processes for auditing advisers.
 - ASIC Report 499, Financial advice: Fees for no service (2016) – which found systemic failures by advice licensees to discharge their obligations to ensure that ongoing advice services were provided to customers who paid fees to receive these services.
 - ASIC Report 413, Review of retail life insurance advice (2014) – which found that 37% of advice reviewed did not comply with the law.
 - ASIC Report 279, Shadow shopping study of retirement advice (2012) – which found that 39% of the advice reviewed was poor.
11. The evidence before the Financial Services Royal Commission, and ASIC's repeated findings over many years, reflect the fact that the role of vertically integrated financial advice businesses in the retail sector is to cross-sell customers into inhouse products. This role drives poor customer outcomes.
12. This is a systemic problem for superannuation members who receive financial advice from advisers working for vertically integrated advice businesses in the retail sector.



There is a substantial body of evidence that typically, these members are advised to switch from a MySuper product to a choice superannuation product or investment option and typically, this results in the member paying more in fees and costs and receiving lower returns. Most recently, in its May 2018 Draft Report, Superannuation: Assessing Efficiency and Competitiveness, the Productivity Commission found that, on average, the default sector outperforms the choice sector and that retail and choice products have materially higher fees.

13. The Productivity Commission found that being a member of a high-fee product can cost a member \$100,000 at retirement and that belonging to a low-performing fund can cost a member \$600,000 at retirement.
14. Non-compliant advice, failure to deliver advice services, inadequate systems for remediating affected customers and unacceptable delays in lodging breach reports breach numerous existing laws introduced as part of the Future of Financial Advice reforms, which commenced in 2013.
15. While ASIC regularly takes action to ban individual advisers, to date it has rarely taken other forms of action against individual advisers, or acted against licensees. For example, according to evidence heard during Round 2:
 - ASIC can take civil penalty proceedings against individual advisers for misconduct, but has never done so.
 - ASIC has never prosecuted an advice licensee for failing to comply with the requirement to lodge breach reports within 10 days under s 912D of the Corporations Act.
 - ASIC has the power to disclose information about specific financial advisers to their licensee under s 916G of the Corporations Act, but has only used this power once.
 - ASIC can take civil penalty proceedings against advice licensees but has only done so once.
 - ASIC can take action to cancel a licence for a breach of the general licence obligations in s 912A of the Corporations Act, but has only done so in relation to an advice licensee once.
 - ASIC can also take action to suspend a licence for a breach of the general licence obligations, but has only done so in relation to an advice licensee twice.
 - ASIC can take criminal action against licensees, but has only done so once.
16. The Commission's terms of reference require it to examine whether financial services meet community standards and expectations. Most people expect to be able to obtain advice from their product provider, expect that it is in their best interests, and expect the regulator to act against both individual advisers and advice licensees who engage in misconduct. Rather than banning product managers from providing advice, what is needed is for the regulator to use its existing enforcement powers, including powers to take civil penalty action against individual advisers who engage in misconduct, as well as its powers to prosecute licensees for failing to lodge



breach reports, take civil penalty and criminal proceedings against advice licensees and cancel and suspend advice licenses. ASIC needs sufficient resources to support the use of its enforcement powers, and AIST supports a well-resourced regulator.

17. Some profit to member super funds also own vertically integrated advice practices. The primary goal of these practices is to provide advice to existing members of the fund. This includes advice about:

- Making additional contributions, to improve the member's superannuation balance and retirement income.
- Changing investment options, to better reflect the member's risk profile and/or life stage.
- Increasing or decreasing the member's insurance cover, depending on the member's needs and life stage.
- Retirement planning advice.

18. This is an important distinction – advice practices owned by profit to member funds do not exist as a distribution channel to switch new customers into the fund. While vertical integration in the profit to member sector also raises conflicts of interest, the evidence heard during Round 2, and ASIC's work have demonstrated that profit to member superannuation funds do not have problems managing these conflicts when operating advice services. Of the 229 banning orders made against individual financial advisers since 2008, none related to advisers working within the profit to member sector.

Issue 2: Grandfathered commissions- Should the grandfathered exceptions to the conflicted remuneration provisions now be changed?

19. Grandfathering introduced as part of the Future of Financial Advice reforms on the assumption by policy makers that grandfathered arrangements would be temporary and would be phased out over the medium term.

20. Instead, evidence before the Financial Services Royal Commission has demonstrated that, five years after the introduction of the Future of Financial Advice reforms, grandfathered commissions are ubiquitous; and that the retail sector has worked with its vertically integrated advice practices to deliberately implement structures to preserve grandfathered commissions indefinitely.

21. In many instances, this has left consumers stranded in poor performing, expensive legacy products, including superannuation products.

22. Grandfathered commissions incentivise advisers to advise members to remain in their existing superannuation product. In many cases, these members are stranded in poor performing, expensive legacy products. This is not in the best interests of members whose best interests would be served by comparing the long-term net returns, fees and costs of their existing product with other products, including



MySuper products, and switching if they can achieve better long-term net returns and pay lower fees.

23. Since the Financial Services Royal Commission has examined this issue, many stakeholders including ASIC, the Financial Planning Association and the Australian Bankers' Association have conceded there is a need to eliminate grandfathered commissions for financial advice. AIST agrees with this. Grandfathered commissions for financial advice should be banned as soon as possible.

Issue 3: Disclosure – Are product disclosure requirements sufficient to allow customers to make fully informed choices?

24. The pre-sale disclosure regime for superannuation products consists of product disclosure statements and product dashboards.
25. Under s 1016A of the Corporations Act, product providers must generally give a customer a product disclosure statement before the customer applies for the product. However, under s 1012F of the Corporations Act, for certain superannuation products, the product provider can give new members a product disclosure statement up to 3 months after they join the fund.
26. There is no requirement for funds to make product disclosure statements publicly available, and it is difficult for a person who is not an existing member to locate product disclosure statements for many retail choice products. There is no requirement to produce a product disclosure statement for legacy superannuation products, making it difficult for members in these products to compare products and determine whether they would receive better returns and/or pay lower fees if they switched to a contemporary product.
27. While some providers have made significant efforts to make product disclosure statements shorter and easier to understand, many product disclosure statements are long and legalistic. In 2012, the Government introduced a shorter product disclosure statement regime for superannuation products. The objective of the shorter product disclosure statement regime was to make product disclosure shorter and simpler for members and to facilitate comparison between products. The shorter product disclosure statement regime prescribes certain standardised section headings and content for superannuation products. This key information must be disclosed in an 8 A4 page, 16 A5 page or 24 DL page document (primary document).
28. Some material is required, or permitted, to be located separately from the primary document, with a reference to be included in the primary document telling readers where they can find this information: see regs 7.9.11P and 7.9.11X of the Corporations Regulations. This mechanism is called 'incorporation by reference'. The effectiveness of incorporation by reference has not been robustly consumer tested. Anecdotally, it seems incorporation by reference may make it more difficult for many members to find information about superannuation products.



29. In 2013 the Government introduced a requirement to produce a product dashboard for every MySuper product. The product dashboard is intended to provide members with five key pieces of information:
- the return target for the MySuper product,
 - previous actual returns,
 - a comparison between the return target and previous returns,
 - the level of investment risk, and
 - a statement of fees and other costs.
30. Unlike product disclosure statements, providers must also make their MySuper product dashboard publicly available.
31. The MySuper product dashboard regime enables members to compare MySuper products. While this is important, most members considering switching funds are members receiving financial advice who are faced with a recommendation to switch from a MySuper product to a choice product offered by a retail fund. These members need to compare their MySuper product with the choice product being recommended to them. To do that, they need a MySuper product dashboard and a choice product dashboard.
32. The product dashboard regime was intended to apply to choice products from 1 July 2015. However, regulations needed to prescribe the content and presentation requirements for dashboards for choice products have never been made. In 2014, the Government proposed changes to the content of choice dashboards and also proposed removing the requirement to make choice dashboards publicly available. However, these proposals were never finalised. ASIC has repeatedly deferred the implementation date for choice dashboards, most recently on 1 June 2017, for a further two years until 1 July 2019.
33. Despite significant efforts by superannuation industry and regulators to improve the financial literacy of members, financial and functional literacy rates in Australia remain persistently low. This reinforces the need for simple product dashboards to assist people to compare superannuation products on the basis of long-term net returns.
34. AIST recommends the implementation of the choice product dashboard regime as soon as possible.
35. The effectiveness of the dashboard regime will depend on the data about long term net returns, fees and costs and risks that is used to produce dashboards being accurate and consistent.
36. There are, however, well documented deficiencies in the adequacy of this data. In July 2018, ASIC released the findings of an expert review of superannuation fees and costs. The review followed several years of consultation on how to improve the accuracy and consistency of fees and costs disclosure. ASIC has committed to further



consultation on superannuation fees and costs disclosure before the end of 2018. The disclosure of fees and costs needs to be standardised for product dashboards to be accurate and comparable.

37. There are also inconsistent approaches to the categorisation of asset allocations and risks across the superannuation industry, which makes it difficult for members to make product comparisons. These problems will also need to be addressed so that the product dashboard regime can enable members to make informed choices between different superannuation products.
38. Technology should also be harnessed to make it easy for members to compare different products. The Government should establish an independent, online superannuation product comparison portal allowing members to compare products. The primary basis for comparison should be long term net returns.
39. Like the product dashboard regime, this requires accurate, consistent underlying data about long term net returns, fees and costs, asset allocation and risk.

Issue 4: Regulators – Should negotiation and settlement be the main approach of a regulator?

40. Evidence from Round 5 demonstrated that ASIC's response to misconduct in the financial advice industry has been to negotiate with licensees to remediate customers, and ban individual advisers from the advice industry.
41. While remediating customers who are financially impacted by misconduct and removing individual advisers from the advice industry are important, a primary focus for the regulator should be to deter individual advisers and advice licensees from engaging in misconduct. If misconduct occurs, the regulator should also focus on ensuring customers are compensated, and wrongdoers are punished.
42. It is clear from the evidence presented during Round 2, particularly in relation to interactions between the retail financial advice industry and ASIC, that negotiation with licensees is not effective in deterring misconduct.
43. Effective deterrence requires regulators to take enforcement action against both individual advisers and licensees who engage in misconduct. Enforcement action is particularly appropriate where an individual or licensee has engaged in deliberate, systemic misconduct resulting in widespread consumer harm.
44. As set out above, ASIC could take enforcement action under numerous laws introduced by the Future of Financial Advice reforms.
45. There is also a role for negotiated outcomes and settlements as part of ASIC's toolkit, for example where misconduct is isolated or unintentional, has not caused significant consumer detriment, and the perpetrator has a strong track-record of compliance.