ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY SUBMISSIONS BY TWU NOMINEES PTY LTD [TWUSUPER] in RELATION to POLICY ISSUES RAISED by ROUND 5 SUPERANNUATION HEARINGS

The Submissions by Counsel Assisting in Relation to Case Studies Informs Policy Issues

1. TWUSUPER acknowledges the misconduct revealed during the round 5 hearings and supports Counsel Assisting's (hereafter referred to as "CA") submissions and recommended findings, noting that it provided witness statements and documents for the assistance of the Commission. During the round of hearings a number of matters were made clear by CA.

2. These included noting that:
   - Fraudulent conduct was not found in Industry Funds – any misconduct identified was of a relatively minor kind, described as very nuanced in CA's opening [P-1466] and CA was careful to point out that the Commission's review identified fewer examples of such conduct in industry funds;
   - Matters relevant to Regulators raised by CA have not led to misconduct in those funds – their conduct is very different from that of retail funds;
   - The conduct of equal representation directors has not suffered from the same failures as so-called independent directors found where loyalties were divided -this raises issues of the need to consider director's qualifications and experience;
   - Public expectations of Superannuation are under serious threat – it is important to show positive conduct of our part of superannuation industry to restore public confidence taking into account the size and importance of the sector.

3. In the period post the RC hearings comments by observers, including former Prime Minister Keating [whether or not well informed] have added to public concerns and pressure – it is submitted that recommendations for policy responses need to be carefully considered not knee-jerk reactions to serious misconduct or criminality. TWUSUPER expresses its support for and confidence in the Commission in that regard.

Submissions as to Policy Concerns Invited.

4. In their submissions CA highlight the following matters for public discussion and submission. Those policy issues that are of direct relevance to TWUSUPER are:
   - Political and other Advertising
   - Operation and extent of s68A SIS Act re inducing employers' selection of funds

- Selling of superannuation products by banks
- Conflict management and fiduciary duties of boards
- MySuper systemic changes

Submissions by TWUSUPER in Relation to Policy Concerns

5. S68A SIS Act. One proposal is to widen the operation of this section. This would have a significant depressant effect on the ability of Industry funds to compete and should be resisted. It is submitted that the section at present offers sufficient disincentive to misconduct and coupled with the regulations permits the kind of services offered to and provided for employers by Industry Funds.

6. The marketing/selling of Superannuation products by Banks has been a major source of the misconduct identified in the hearings. We make submissions that selling through bank branches is a pernicious practice which should be abolished.

7. In addition to the potential criminal overcharging and refusal to acknowledge the overall operation of ss 62/52 SIS Act by retail funds highlights the need to enforce the existing regulatory scheme.

8. The process of and adequacy of boards of trustees has not demonstrated any defect in industry funds operating under the equal representation model. We submit that the value of the custodian experience of industry funds directors and the value of such management structures, where both Union/worker representatives and employers sit on boards outweighs any perceived advantage of 'independent' directors, or highly qualified professional company executives. We submit that both employee and employer representative directors have a vested interest in the welfare of their member/employee fund members. Powerful evidence is available to the commission to confirm this submission, including high returns on investment, low fees, and payments of superannuation well above the basic SG levels.

9. The issues of conflict management and relationships with unions is a matter that needs to be carefully addressed, but is one where no misconduct or conduct falling below community standards was found by the Commission to have resulted. The presence of a highly experienced and effective independent Chair provides a sound basis for ensuring propriety on such boards. TWUSUPER provides a clear example of the success of the model.

10. Finally we strenuously advance the success at both management and investment of the Industry Funds.

11. Since the hearings, the Keating attack, the press coverage and, for example, the NAB's response to its criminal conduct [by denying an over-

arching duty to members, despite the clear obligation imposed by s62] need to be addressed. The refusal by the bank/ retail funds to acknowledge their failures creates the need for greater and more aggressive control of those funds to protect the superannuation of their members. It may be that the proper conclusion for the Commission to draw is that there is no place for a 'for-profit' model in the provision of superannuation. The conduct of the equal representation model under which TWUSUPER operates has proved to successfully act in member's best interests.

The Submissions of Counsel Assisting in Relation to Policy Concerns

12. These are to be found between pages 199 and 222, pars [752] to [825]. They address culture and governance practices as well as policy and general questions, but there is both a sub-text and an area of consequent or resultant effect that needs to be addressed and which is not clearly expressed in those submissions, in respect of which we make submissions to the Commission by referring to CA's submissions by numbered paragraph and by making comment thereon.

The first and clear example is the reference to failures of culture and governance.

13. These at first sight are related only to the retail funds where those failures were found to exist. However the submissions go beyond retail funds:
    i. *752. The Terms of Reference require the Commissioner to inquire into whether any findings made in respect of conduct…that does not meet community standards and expectations or is otherwise not in the best interests of those members is attributable to:*
    ii. *752.1 the particular culture and governance practices of a financial services entity; or*
    iii. *752.2* ***broader cultural or governance practices in the relevant industry****.*

14. This translates in the submissions to misconduct "*seen across a range of entities*" [753], and founds a submission at [761-762] that legislative intervention might be required to address the issues. This would of course apply to all funds, and at [768] to extend to "*ongoing advice or other service fees dripping out of the consumer's superannuation account"*

15. The questions posed for consideration at [773] are:
    773.1 Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?

16. As CA pointed out in the opening [P-4168] none of the industry funds reviewed were paying grandfathered commission. Commissions have not been paid at all by TWUSUPER. We agree that such commissions are not consistent with the requirements of s62.

773.2 Are there possible detrimental effects on the provision of high quality financial 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.

17. These questions are repeated in the Policy section. They are of general application.

18. Similar observations apply to the issues around managing conflicts, dealt with from [774] on. Whilst at the outset these refer to retail entities, this later is extended to all dual-regulated entities, to shareholders and to a general extension of the ss 62/52 duties by suggesting the introduction of a civil penalty provision –[779]

> *The third general question is: would it be preferable to extend the obligation to act in the best interests of members of a superannuation fund so that:*
> *779.1 contravention of the obligation attracts a civil penalty; and*
> *779.2 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 the members of the superannuation fund?*

19. This is a staggeringly wide proposal which would for the first time in legal history extend liability for breach of duties to shareholders, including the shareholders of 'related bodies corporate'. It is submitted that a proper reading of s62 and s52 together provide an overwhelming duty to act in the best interests of members and already extend to any conduct affecting the interests of members.

20. It is TWUSUPER's position that such an extension is not warranted.

21. Next the CA propose a change to ensure 'effective competition' in the market, at [782]. This seems a proposal which contains significant difficulties of application, as it assumes an ease of switching that is not consistent with experience:

> *It might be expected that if there was effective competition in the market for the supply of superannuation that such competition would make it less likely that RSE Licensees would engage in conduct that would reduce outcomes for members because it would be expected that over the long-term*

> *this would cause members to switch their superannuation to a different trustee. Disengagement of members is one reason why switching may not occur to the extent that might otherwise be expected. Another reason may be that it is difficult for members to obtain access to, and understand, information that enables them to make informed decisions.*

22. This then finds clearer but even more concerning expression at [785]:

> [785] *The Terms of Reference require the Commissioner, amongst other things, to inquire into the adequacy of existing laws and policies of the Commonwealth relating to the provision of superannuation to identify, regulate and address misconduct in the superannuation industry. However, we submit that* ***assessing the extent*** *to which competition within the superannuation system, or within just the default segment, could be* ***improved by significant structural changes*** *is* ***beyond the scope*** *of matters about which this Commission is inquiring. Such an assessment is too complicated and too remote from the misconduct the subject of examination to allow reasonable conclusions to be drawn as to whether laws establishing the* ***infrastructure for the default system*** *are inadequate to identify and address misconduct.*

23. The position then is that structural changes to infrastructure **for the default system** are suggested but left to legislators to respond to without submissions or assistance from those affected by any proposed changes, or from the Commissioner.

24. Notwithstanding, CA go on to suggest three specific matters of change, from [795] on. These changes are:
    iv. [795] the approach to the evaluation of MySuper product;
    v. [800] the adequacy of the existing section 68A of the *SIS Act;* and
    vi. [801] *the policy preference of the Government, and the efficient operation of the entire superannuation system, weighs in favour of consolidation of member accounts rather than duplication across multiple super funds (or within a super fund). One way of addressing that problem might be "stapling" meaning 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 job.*

25. We submit that the first position taken by CA is the preferable one – a recognition that the issue described is outside the remit of the Commission and that no recommendation in relation to those matters should be essayed in the Report of the Commission. However, we respond to the comments of CA in our submissions.

26. This approach led CA to raise for discussion 5 general questions of real importance to TWUSUPER and to industry funds in general, at [802]:

802.1 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?***

27. Industry Super funds returned significantly higher amounts to members. Funds who always maintain focus on the need to return as much to members as possible will not then engage in misconduct. That does not mean however that not engaging in misconduct invariably leads to higher returns. In our submission the link is too tenuous to justify the introduction of a requirement of outcome assessments. As we submit below there are a wide number of variables that impinge on outcomes. The absence of misconduct and the provision of high returns are the end result of good corporate governance and on the member-centric approach adopted by Industry Funds.

802.2 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?***

28. Such a filter does not address misconduct. In our submission such an additional filter is more likely to cause problems than to resolve them and does not provide a sound measure for identifying or preventing misconduct.

802.3 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 section 68A of the SIS Act to widen the prohibition?*** *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?* ***Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?***

29. With respect to CA, this does not recognise that the present s 68A expressly permits some services to be provided – *see* s68A(2), and the associated regulations. We make submissions about the scope and operation of the section below for the assistance of the Commission.

802.4 Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation 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 job?* ***Is this a practical method*** *of addressing this type of conduct noting that it is not suggested to be misconduct?*

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

30. These are all matters of general application and importance to the future management of superannuation funds, which if made will apply not only to retail funds, but also to the industry funds who are not infected with the misconduct CA is trying to address. We submit that the Act in its present form, if properly enforced provides adequate control measures to deal with misconduct of the kinds demonstrated in the evidence in Round 5.

31. A second area of general concern for TWUSUPER is reform of a general nature, in relation to deterrence and regulation, concealed as limited to retail funds.

32. These are matters directed at first sight to the retail funds, but which on closer examination extend to all funds: the issues of lack of insight and of deterrence from misconduct:

> *[803] Some conduct of* ***certain retail superannuation trustees*** *suggests that there may be a cultural issue within the entities arising from a lack of insight into why certain conduct is unacceptable. There are two interlinked questions that arise from this:*
>
> *803.1 First, to what extent ought it be concluded that the* ***lack of insight is a reflection of leadership*** *within the organisation?*

33. The lack of insight posed in the question is a matter which is capable of being definitively answered. The cultural issue within the entities which has concerned the Commission has been the need for retail funds to generate profit which is then be remitted to shareholders. This means there is always incentivisation to ensure that profit is maximised which will necessarily impact upon fund members. The lack of insight to which CA refers is the failure of the trustees in the for profit funds that they cannot satisfy the needs of shareholders and the strictures of s 62 in the

SIS Act to always act in the best interests of members. The only viable solution is to remove the incentivisation to engage in misconduct by ensuring profit. A not-for-profit model is one of the only workable ways to remedy the cultural deficiencies present in some organisations. The proof of this submission is to be found in the increased level of performance observed in the not-for-profit sector and the lack of misconduct by those funds.

> *803.2 Secondly, to what extent can it be said that* ***the approach of APRA and ASIC to conduct regulation has adequately deterred the development and hardening of*** *cultures that are not compliant and lack insight.*

34. TWUSUPER declines to make submissions on the matter relating to the regulators, beyond observing that the issue as expressed has consequences that go beyond the recalcitrance of the for-profit funds, as it extends to the nature and extent of regulation for the entire industry:

> *814... the case studies suggest that the approach* ***of neither APRA nor ASIC to regulation of superannuation entities is sufficient to achieve specific or general deterrence****. The evidence suggests that APRA is reluctant to commence court proceeding and to take public enforcement action….*
> *817 …suggests an* ***approach that is not conducive to the development of an industry-wide compliance culture****.*

35. In turn it raises three 'general questions' which need to be addressed:

> *821.1 What can be done to* ***encourage the regulators to act promptly*** *on misconduct or potential misconduct?*
> *821.2 Is* ***the present allocation of regulatory roles appropriate*** *to achieve specific and general deterrence from misconduct?*
> *821.3 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 should the balance between them be restructured or significantly altered?*

36. According to CA two of those questions *require consideration as to* ***who would be best placed*** *to be responsible for conduct regulation* ***in relation to superannuation.*** This is clearly of general application.

37. CA notes in relation to APRA that: *It might be thought APRA's objective of ensuring financial system stability is not readily reconciled with being an effective conduct regulator.*

38. TWUSUPER has enjoyed a positive and beneficial relationship with the Regulator and has acted promptly to comply with its directions and recommendations.

39. Accordingly TWUSUPER has no submissions to make in this regard.

General questions of policy

40. As will be observed there is significant overlap with the foregoing issues in the policy and general questions posed by CA.

41. These are the various subdivisions of CA [825]. TWUSUPER makes submissions in relation to each of these other than those specifically directed to ATSIC issues.

Advertising

825.1 Is ***political advertising consistent with the intention behind section 62****of the SIS Act?*

42. In 2015, APRA informed a hearing of the Senate Economic Legislation Committee that it had considered the meaning of section 62 and its application to the specific activities of trustees which were permitted under the "sole purpose" test. Those activities of trustees included expenditure directly related to the superannuation purposes on a member meeting a condition of release; the provision of services necessary or reasonably incidental superannuation purposes, including legitimate administration expenses; and the investment of fund monies - provided there is a clear connection between the investment and the expected returns for members' superannuation benefits.

43. TWUSUPER submits that where a fund, or a congeries of funds, decides to advocate on policy issues, if the associated advertising is characterised as an expenditure or investment made in good faith and the trustee advances cogent reasons for believing that this will result in an improved retirement income outcome for the members, that conduct would be not breach, nor be inconsistent with the sole purpose test, even where the cost of the advertising was funded with members monies. The proper construction of the sole purpose test in s 62 of the SIS Act permits in our submission, that use of monies for a proper purpose associated with the

purpose for which a superannuation fund is run. In this context, the word "purpose" should be taken to refer to "the end in view' and where the protection of member funds and interests are concerned that end must include policy matters likely to adversely affect the fund[s].

44. To this end TWUSUPER agrees with the submission of AustralianSuper that public advocacy conducted through "political advertising" is entirely consistent with the sole purpose test in s 62 of the SIS Act, provided that the advocacy is aptly directed to the maintenance or improvement of retirement benefits. As was submitted by AustralianSuper:

There is no reason to construe section 62 of the SIS Act as prohibiting absolutely policy (or political) communications undertaken by superannuation trustees, and any such absolute prohibition would be likely to infringe the constitutional freedom referred to… It is consistent with the sole purpose of providing retirement benefits for a trustee to engage in policy (or political) communications which are properly directed to maintaining and improving the retirement benefits received by the trustee's beneficiaries. As the High Court concluded in a broadly analogous context, public advocacy which is suitably directed to influencing government policy on the best methods for the relief of poverty through the provision of foreign aid is not disqualified from being characterised as charitable merely because the activity takes the form of political communications.

Is any ***amendment to the SIS Act warranted****, and if so, why?*

45. TWUSUPER submits no amendment to the SIS Act is warranted, no breach of the present act having been identified and both policy and public interest justifying the course that was taken by ISA and its constituent members in the protection of the national Superannuation scheme.

825.2 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?*

46. These two questions are the obverse and reverse of the same issue: that of public benefit. TWUSUPER agrees that this is an appropriate enquiry where member funds, however derived have been applied. The answer we submit is clear: there is identifiable consumer benefit, but no observable detriment flowing from the "Fox and Henhouse" advertisement and from other advertising undertaken by TWUSUPER as part of ISA.

47. Current default arrangements for superannuation products protect the financial interests of superannuation members who become members through default arrangements. These are designed to ensure that the

selection of default funds involved those with interests aligned to the prospective members: both employers and employee representatives, often Union officials whose remit is the advancement of their members and is not limited to employers. The evidence that came to light during the round 5 hearings of the Commission revealed the need for such a model as well as its success both financially and in terms of probity.

48. The Fox and Henhouse advertisement was designed to advocate against any change to the default arrangements to enable employers to select the default fund for their workers absent such additional representation . The conduct of the retail funds, disclosed in evidence, gave life to the warning issued by the Productivity Commission, that an alteration to the present system would "always be hostage to constraints on employer's time, expertise and even goodwill to find the best super product for their workers. ... And there will always be a risk that some funds will offer benefits to influence employers' choices". It is to the benefit of consumers to avoid such a situation.

49. The advertisement was successful in preventing such a change up to the time of the hearings of the Royal Commission. What has been revealed during those hearings is, as we have already submitted, justifies the position taken by the Funds in expending members monies on protective political or policy advocacy.

50. No discernible detriment has been occasioned to members or to the public interest by that action.

51. No amendment to the SIS Act is warranted.

Section 68A of the SIS Act

825.3 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 section 68A of the SIS Act to ***widen the prohibition****?*

52. In the submission of TWUSUPER, the following need to be considered before any legislative reform or extension of the present provision is recommended:

    i. *What is the scope of the present section*
    ii. *What vice was exposed in the hearings*
    iii. *What if any response is required*
    iv. *What principle[s] is/are engaged*
    v. *What inducements, benefits or services may legitimately be provided*
    vi. *Is competitive conduct to be proscribed*
        § *If so how would that benefit members?*

§ *What protections can be provided to trustees?*

vii. *How could the section be amended to provide the appropriate level of control*

53. S 68A SIS Act provides, subject to sub [2s] a conditional proscription of conduct by a trustee:

vii. A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not:
supply, or offer to supply, goods or services to a person; or
supply, or offer to supply, goods or services to a person at a particular price; or
give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person;

viii. *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. (emphasis added)*
(2) However, subsection (1) does not apply in relation to a supply of a kind prescribed in the regulations for the purposes of this subsection.

54. As to sub (2), regulation 13.18A prescribes certain goods and services, set out hereunder.

55. By sub (5), breach by the trustee will give rise to a civil action for damages for loss or damage occasioned by any breach. It must be acknowledged that such loss or damage is difficult to imagine, even more problematic to quantify.

56. Thus, the conduct at present proscribed by the section appears subject to a toothless penalty. Moreover the prohibition is a limited proscription, prohibiting only the conduct that is conditioned upon employee[s] applying or agreeing to be members of the fund at its widest.

57. However, a number of industry and other funds provide assistance or benefits to employers by the provision of 'clearing house' services to employers in relation to payment of contributions where employees are or become members of the funds. These are not offered as direct benefits to employers but are to simplify payment and receipt of those contributions. They should be regarded as unexceptionable.

58. It is open however to construe the service provided at no cost to the employer as a benefit and also as an inducement where the service is

disclosed at the time of offer of membership of the superannuation fund. Where the trustee is one of a number of possible default funds substantial savings and efficiencies in the cost of collection and handling may be achieved to the advantage of both the fund and the employer.

59. Consequently there is a resultant advantage to the members of the fund and any action to restrict or prohibit that kind of inducement is both inappropriate and counterproductive.

60. These services are at present protected, or appear to be protected, by the operation of Regulation 13.18A:

> (1) For subsections 68A(2) and (4) of the Act, the following kinds of goods and services are prescribed:
> …
> (c) an advice or administration service that relates to the payment of superannuation contributions to a regulated superannuation fund, that is supplied by a trustee, or an associate of a trustee, of the fund to:
> a person; or
> (ii) the employees of the person;
> (d) the supply or offer to supply goods or services to a person by a trustee, or an associate of a trustee, of a regulated superannuation fund, only if:
> the supply or offer is available to the employees of the person who are members of the fund; and
> a. (ii) the terms of the supply or offer to each employee are not less than the terms supplied or offered to the person.

61. We advise the Commission that the service contemplated by regulation is the only kind of service provided by TWUSUPER to employers as an 'inducement' to choose its fund as their default fund. In the case of TWUSUPER, the service so provided is by way of a clearinghouse. Any amendment or alteration to s68A which had the effect of prohibiting such an arrangement would have a doubly damaging impact on members, increasing both the employer's costs of paying in to the fund and the funds cost of managing receivables. There are significant benefits of the arrangement for both parties and the provision of the service while clearly an inducement to selection of TWUSUPER is offered to all employers whose workers use the fund, not selectively. It does not offend the present section, even absent the regulation, as it is not offered conditionally, but made available where employees are members of the fund.

62. There is also a significant risk if the operation of the section was to be enlarged without due care that promotional events – such as attendance

by the Fund at employer and Union conferences, industry showcases and similar promotional events which offer an opportunity to advance the fund and show advantages of membership to both employers and likely members might be prohibited or compromised. The commission has recognised that growth and economies of scale have positive advantages for funds. Any legislative provision which impedes these objectives is likely to be counter-productive.

63. It appears from the evidence adduced during the hearings that the conduct sought to be prevented is of the negative kind corrupt conduct to bribe or to offer inappropriate inducements to prospective employers, such as expensive gifts, sporting marketing and the like. This is a desirable outcome, but needs to be carefully approached.

64. In our submission the present section fails to achieve that outcome. No actions appear to have been taken under subsection (5), and as is submitted, proof of loss or damage would be very difficult. Any prohibition would need to be carefully drafted to avoid the negative outcome of prohibiting the provision of legitimate services to employers and so disadvantaging all parties.

825.4 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****?*

65. This of course assumes that the commission will recommend a prohibition. In our submission no change to the extent of the prohibition is likely to be effective which does not also have the negative effects referred to above. A consideration of the proposed new section carries with it serious difficulties of construction, however it is to be expressed. On a proper reading a blanket prohibition would preclude providing that which is now expressly permitted and would operate to the detriment of members as described above. A purposive provision [based on proof of intent to induce] is doubly problematic- it punishes all conduct intended to encourage investment in a particular fund and so is unfair and anti-competitive, and it requires a second line of proof – that of effect.

66. The wider provision catches all services provided to employers regardless of intent or value and contains an objective test 'likely to induce or affect'.

67. Neither proposed amendment or widening of the prohibition is likely to achieve the desired end which we understand to be that of preventing a trustee making illegitimate payments to 'bribe' employers to commit employees to a fund.

825.5 Are there ***matters of principle that would justify*** *such a change?*

68. In the submission of TWUSUPER the answer to this question of CA is NO. No issue of principle is engaged – the suggested legislative change is no more than a pragmatic response to the misconduct discovered by the commission.

*Are there **problems that would arise** in the application of the law?*

69. Yes. In addition to the problems of construction outlined above, in a competitive market, establishing proof of intent in the trustee and then establishing that such inducement as was given either 'induced' the employer, or 'affected' the employer's decision to select the fund adds another layer of difficulty to ever successfully proving a breach of the proposed section.

70. It is our submission that positive outcome is likely to be achieved by the proposal of CA that would outweigh the concomitant disadvantages.

Payments from external responsible entities of managed investment schemes

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

71. The answer to this question surely lies in the operation of s62 and of s52 of the SIS Act. Accepting the sole purpose test at its widest two things need to be recognised, viz; that investments by trustees must be for the sole purpose as that term is defined by s62 and that income derived, including payments of whatever kind, must be used in the same way.

72. This does not however mean that all funds received must be banked to member accounts or applied to member funds. The trustee of the fund has a number of duties – operating costs, compliance costs, accounting and legal costs must all be provided. The only sources of income available to the trustee are from member contributions or returns on investment. Other payments, of the kind contemplated by this question are surely subject to the same consideration. They are all subject to both external and internal audit. If properly accounted for no issue arises. If the funds are misused, as has been the case with some retail finds, we submit that there should be appropriate action to secure the interests of members. This is yet another example of the reason that the retail fund model of superannuation suffers from insuperable conflicts of interest between the duties to shareholders of the trustee to return a profit and the duty to members imposed by the joint operation of s62 and s 52.

Selling of superannuation

825.7 Is it appropriate that superannuation be ***sold through bank branches****?*

73. Modern superannuation policy in Australia was designed to advance safe retirement outcomes for the workforce and at the same time relieve Government of part of the burden of providing for an ageing population. The basic premise of superannuation was and is that the fund is operated as custodians and stewards of people's money to ensure that their retirement savings are maximised. That is an impossible task to undertake when also seeking to generate maximum profit for shareholders from the same pool of money. It is important to remember that superannuation was not designed as a product through which financial entities could make profit. In the submission of TWUSUPER this is not an appropriate superannuation model. 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.

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 consumers?*

74. No. the evidence before the Commission established that unlikelihood.

825.8 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?

75. If the submission above is accepted the answer to the second part of the question is NO. TWUSUPER submits that 'for profit' funds ought not to be involve in superannuation, as there is an insuperable conflict of interest between maximising returns to members and providing profit to investors. Some legislative reform may be needed to effect this change.

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?

76. By reason of the duty to return a profit to shareholders and the conflict of interest to which we have referred, it is reasonable to conclude that such advice is likely to be to the banks advantage rather than to that of the prospective member, despite the clear requirements of S52.

Discretion to appoint and remove directors

*825.14 Is it appropriate for shareholders of RSE Licensees to retain a **broad discretion to appoint and remove directors**?*

77. TWUSUPER does not make any submissions in relation to this issue.

*Or should there be an **obligation imposed** on shareholders to exercise such powers in the best interests of the members?*

78. TWUSUPER does not make any submissions in relation to this issue.

Relationship between trustees and financial advisers

*825.15Are **legislative interventions to remove grandfathered commissions** and ongoing service fees from superannuation accounts appropriate?*

79. Commissions are an unnecessary waste of members' funds. Commissions lead to advice being given which is not necessarily in the interests of members but rather in the interests of the person to receive the Commission. The absence of commissions in the Industry Fund space is demonstrative of the returns to members being maximised by funds and members not having to pay unnecessary commissions to advisors.

*825.16 Are there **possible detrimental effects** on the provision of high quality financial advice by such changes?*

80. No. The quality of financial advice revealed in the evidence does not suggest any detriment to members of funds should it not be available.

> *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.*

81. This does not arise.

Managing conflicts

*825.17 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 issued 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****?*

82. Dual-regulated entity for the purpose of these submissions is taken to mean an entity which is both a superannuation trustee and also a provider of financial services through managed investment schemes (MIS) (see [177] of CA's submissions).

83. 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 the owe a duty. The potential for conflict does not arise when the trustee is not involved in a separate and distinct venture of providing financial services by way of a managed investment scheme. That is not to say that every time a managed investment scheme is operated that there will be inherent conflicts which arise if the entity is also a superannuation trustee. For example, the superannuation trustee was operating a managed investment scheme whereby all profit generated was returned to members of the superannuation fund then the potential for a conflict to arise is markedly reduced. It is when the MIS is operated by the entity as a for profit venture that the potential for the entity to face a conflict of interest arises.

84. 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 not-for-profit 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.

85. 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 on profit in the MIS. This situation will almost always have inherent dual-obligations for the persons operating the entity. On the one hand the trustee 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.

86. The issue dealt with above does not arise in the Industry Superannuation Fund context. Industry Superannuation 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.

87. The example of a dual-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 always lead to a level of conflict due to the need to one the one hand 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.

88. 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.

89. It is clear from the evidence which was adduced during Round 5 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.

90. Insurance in related party entity is of concern if the sale is undertaken for the generation of profit to the related party. Sale of insurance through superannuation an important service provided it is of benefit and necessity to the member.

91. Provision of superannuation through an advice business is not of concern provided that both s.52 and s62 SIS Act strictures are followed.

825.18 If certain structures do raise inherent problems, is ***structural change of entities, mandated by legislation*** *or otherwise, something that is desirable?*

92. Inherent within the question posed at 825.18 is the notion that the types of conflicts identified in 825.17 can be effectively managed (presumably through legislation).

93. 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.

94. Therefore 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.

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

> *contravention of the obligation* ***attracts a civil penalty****; and 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 the members of the superannuation fund?*

95. The present legislative operation of the 'best interests of members test' is not a provision which should be the subject of civil penalty provisions for the following reason: the term best interests of members is not readily

able to be defined in an objective sense. The best interests of members requires (at times) an evaluation of a series of competing considerations which may mean there is no bright line to determine what actions would serve the best interests of members. By way of example: A trustee is given advice that there is a 25% risk of market failure similar to the market failure which brought about the GFC. The fund is currently returning around 12% per annum to members. The trustee has a choice to make: it can either be risk averse and call in investments and move them to low yield products which are inherently safer (government bonds and the like) or it can continue with the current balanced type investment option it is carrying to ensure its members continue receiving their 12% per annum. If there is no market failure but the trustee has diminished returns based on a 1 in 4 risk the question arises: 'was that action in the best interest of members'? On the flip side, the 1 in 4 chance eventuates and the fund size decreases by 20%. Which of those decisions could be seen to clearly have been in the best interests of members? It could only be with hindsight that the answer is certain. But that is not the way financial markets operate in circumstances where there is always a risk/reward evaluation to be made on investment decisions. Whilst the example given is fairly rudimentary it highlights the subjective nature of the belief the trustee holds when making decisions on behalf of members and demonstrates that the need to act in the best interests of members is a matter which at times has no clear and correct answer.

96. The second matter to be considered is whether, if civil penalties were to be introduced, those penalties should extend (presumably by way of a deeming provision) to capture shareholders in the event the trustee breached its obligations. Whilst deeming provisions are common in relation to directors there is very little historical enactment of provisions which capture shareholders of a corporation being liable for the breach of the corporation. Unless provided for in the Constitution it is usually the case that shareholders have very little opportunity to influence the day-to-day conduct of a corporation. Furthermore, the addition of shareholders facing civil penalty provisions would lead to a conflict between the discharge of director's duties and the rights and obligations of shareholders. Whilst shareholders maintain ownership of the corporation they are two separate legal entities. A shareholder who holds 0.1% of a corporation would have no right to insist that certain decisions be made at a board level to ensure compliance with the SIS Act or the best interests of members requirement.

*825.20 Are there **unforeseen consequences of such a legislative intervention** that would make it undesirable to strengthen the SIS Act in this way?*

97. In addition to the matters raised above it is difficult to determine what unforeseen consequences there might be without the benefit of a draft amending bill to consider.

System changes

825.21 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?

98. The evidence taken as part of Round 5 was clear and it was compelling: Industry Super funds returned significantly higher amounts to members and no misconduct was identified which would suggest that Industry Funds had engaged in misconduct. That does not mean that there is a strong link between the two matters. It likely follows that funds who always maintain focus on the need to return as much to members as possible will not then engage in misconduct. That does not mean however that not engaging in misconduct invariably leads to higher returns. The absence of misconduct and the provision of high returns are the end result of good corporate governance and on the member-centric approach adopted by Industry Funds.

99. Whilst the equal representation model in Industry Super funds has at times been challenged the proof of the pudding is as always in the eating. Industry Funds have Boards of Directors comprised of persons who as their daily undertaking ensure that the rights of workers are protected. For example, Union secretaries act as custodians of workers' rights. It has long been the case that a unionised workforce will have higher rates of pay than those who do not. This is in large part due to the advocacy on the worker's behalf by those in the Union elected to represent the workers. In this way union officials are custodians of worker's rights. Similarly employer representatives who are engaged in their relevant industry usually have a vested interest in ensuring workers' rights are protected on a day-to-day basis. This is done through a range of measures from work health and safety measures to flexible working arrangements to anti-discrimination measures. It is those union and employer representatives who often then sit on Boards of Industry funds. They have as their primary objective when sitting on such Boards the best interests of the fund's members. This is principle which readily translates to such Board members usual daily roles.

100. An example can be seen in various enterprise agreements in place for workers who are employed through Toll Holdings. Those workers receive 15% superannuation pursuant to their enterprise agreement. This measure was negotiated with the technical assistance of TWUSUPER

which was able to supply projections relating to the member outcomes which resulted from the superannuation guarantee being set at 15% rather than 9%. Both the employer and the Union representatives recognised that such a measure promoted long term loyalty to Toll Holdings. It is not in any employer's interest to have a high turnover of staff. Therefore as a retention strategy worker received higher superannuation contributions. This is an example of the type of custodianship which occurs in relation to Industry super funds and the persons who sit on the Boards of those funds. That is precisely why superannuation was found to be an industrial/employment related matter by the High Court in 1986. Superannuation is intimately connected with workers and their conditions. Through ensuring worker's superannuation is properly cared for Industry funds act in a manner closely connected with the organisations which sought to establish them over 30 years: for the betterment of working men and women in Australia, not as a vehicle to delivery healthy profits to shareholders. That is the reason that industry funds consistently outperform commercial entities: they have the worker at the centre of their model, not shareholders.

825.22 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?

a. If so, what are the general parameters for such a system change and who is appropriate to apply the test?

101. It is not appropriate to apply a filter to MySuper authorisations in an attempt to eliminate or at least reduce the propensity for misconduct. The use of outcome assessments in combination with 'filtering' does not provide an incentive to comply but rather focusses attention on the outcomes which are applied as part of the assessment systems. The use of rankings or external benchmarks whilst helpful in public decision making regarding funds does not by itself lead to compliance with the law.

102. Misconduct or conduct falling below community expectations is reduced by fostering a culture of compliance and good governance at all levels within an organisation. To form a system which leads to quantitative analysis of a funds compliance and performance is a conceptually difficult matter in circumstances where compliance is not necessarily a matter to be measured by rankings and numbers.

103. Ensuring that a Board is possessed of knowledge about a fund's compliance and performance is essential in maintaining public confidence in the governance of a fund. TWUSUPER provides performance analysis by metrics which are reported to each Board meeting. Continuing education of the Board in compliance and corporate governance leads to a reduction in the risk of non-compliance with the existing legislative regime. It is important to recognise that such measures, over time, foster

cultures of compliance which drastically reduces the incidence of misconduct and conduct falling below community expectations.

104. Finally, so far as outcome assessments are concerned APRA already holds power to require outcome assessments.

825.23 Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation 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 job?*

b. Is this is a practical method of addressing this type of conduct noting that it is not suggested to be misconduct?

105. It is difficult to understand how 'stapling' would act as a disincentive for funds to engage in misconduct or conduct falling below community expectations.

106. The ability of individuals to be aligned with industry-centric funds provides outcomes for members which are in their best interests. The current data indicates that workers will change careers several times in their working lives. On top of the change of career workers will change jobs with some frequency. Whilst TWUSUPER acknowledges the importance of consolidation of funds and avoidance of unnecessary duplication which incurs fees there remains a strong need for workers to be aligned with a fund which recognises some of the unique characteristics of certain industries.

107. The Commission may consider whether a worker's superannuation should be transferred from one default fund to another should the relevant industrial agreement covering a particular industry prescribe a default fund different to the worker's current fund.

825.24 Are there ***other system changes*** *that might be appropriately tailored responses to misconduct or conduct falling below community standards and expectations of superannuation trustees?*

c. If so, what are the ***general parameters*** *for such a system change?*

108. As has been submitted previously misconduct or conduct falling below community expectations is likely to arise where superannuation trustees are exposed to the inherent and insuperable conflict between the necessity to generate profit for shareholders and the requirements of s 62 and 52 of the SIS Act. It is not possible to satisfy both duties concurrently.

109. The only system change which could conceivably be effective in ensuring members interests are always paramount is to remove the other source of conflict by legislative instrument prohibiting for profit superannuation funds.

Deterrence and insight

825.25 What can be done to encourage the regulators to ***act promptly*** *on misconduct or potential misconduct?*
TWUSUPER declines to make submissions on this matter.

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

110. TWUSUPER declines to make submissions on this matter.

825.27 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 should the* ***balance between them be restructured*** *or significantly altered?*

111. TWUSUPER declines to make submissions on this matter.