SERIOUS FAILURES IN SUPERANNUATION GOVERNANCE AND CRITICAL OMMISSIONS IN SUPERANNUATION REGULATION

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The superannuation industry has grown considerably and become central to the financial architecture of the Australian economy and the lives of all Australians. A series of significant reports including the Super System Review (2010), Financial System Inquiry (2014), ASIC (2018), Productivity Commission (2018c) have highlighted systemic and structural problems in the industry that remain in urgent need of attention. The deliberations of Round 5 of the Financial Services Royal Commission have fully demonstrated the scale and immediacy of the ongoing systemic misconduct in the Australian financial services sector regarding superannuation, and the weak governance and regulatory structures that have allowed this to happen. Serious omissions and exemptions in superannuation regulation are impacting badly on the interests of superannuation fund members.

The governance failures, omissions and exemptions undermine the purpose and performance of superannuation and require restoring a more robust legislative and regulatory framework. This new framework needs to clarify roles and responsibilities to ensure the system is meeting its objectives efficiently, and that all stakeholders are making transparent decisions in the best interests of members.

The Terms of Reference of the Financial Services Royal Commission propose that “all Australians have the right to be treated honestly and fairly in their dealings with banking, superannuation and financial services providers” and that “these standards should continue to be complimented by strong regulatory and supervisory frameworks.”

The research papers prepared by AIST (Goodwin 2017; AIST 2018) on gaps and exemptions in the regulation of superannuation, together with the evidence considered by the Royal Commission in its Round 5 on superannuation in September 2018, suggest that the regulatory and supervisory frameworks for superannuation are in need of significant repair to rebuild effective governance, ensure the integrity of trustees duties, end systemic conflicts of interest, and eliminate gaps and exemptions which have led to poor outcomes for superannuation fund members.

There is a consistent pattern running through all of the legislative and regulatory gaps, governance failures and conflicts of interest in the superannuation system in the way they have allowed members to be manipulated between different schemes by Choice providers pursuing higher fees for the providers, not members interests' in higher returns.

In the existing legislative and regulatory framework of superannuation in Australia the purpose of superannuation is not articulated with sufficient clarity and conviction, and the performance of superannuation funds is not measured with sufficient rigour and comparability. This is fully demonstrated in the AIST *Gaps and Exemptions in the Regulation of Superannuation – Their Scope, Rationale and Impact* (2017).

This paper reviews the evidence on the implications of the gaps and exemptions documented for the governance and performance outcomes of the Australian superannuation industry and focuses upon the causes of poor member outcomes. The remedy of a new regulatory architecture for the superannuation sector and refocusing of institutions and products upon the long-term interests of beneficiaries is compelling.

Compromised Governance

Australia adopted a trust structure for the governance of superannuation funds (AIST 2017:23). The fiduciary and statutory duties of trustees is to manage the assets of the trust on behalf of, and in the best interests of, the beneficiaries of the trust (*Superannuation Industry (Supervision) Act* 1993 s 52). The Super System Review recommended additional duties to ensure that the trustee is truly accountable to members, and unfettered in its pursuit of the best interests of members (Super System Review (2010: 10-14). The Gillard Government implemented these recommendations as part of the Stronger Super reforms (*Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012).1.* As a result of this Act trustees who offer MySuper products have more focused duties to:

- Promote the financial interests of beneficiaries, in particular returns (after the deduction of fees, costs and taxes).
- Determine annually whether the members are disadvantaged because of lack of scale, in terms of number of members or assets.
- Include details of the trustee's determination of scale in the investment strategy for the product.
- Include the investment return target over 10 years for the assets of the product, and the level of risk appropriate to the investment of those assets, in the investment strategy, and update this information annually.

Yet these duties do not apply to trustees in relation to Choice products and investment options, though they remain subject to the duties to members under trust law. As AIST (2017:24) highlights this may send conflicting signals to Choice trustees regarding their duties.

At the Financial Services Royal Commission (2018) in Round 5 considering Superannuation, the Senior Counsel Assisting raised the question in his closing speech of whether there are retail structures which raise inherent problems for trustees being able to meet their fiduciary duties (FSRC *Module 5 Closing Submissions* Section 825.17).

A Royal Commission background paper the *Legal Framework Governing Aspects of the Australian Superannuation System* set out the demanding legal position of fund trustees "Superannuation fund trustees operate in a complex legal environment. First and foremost, they are trustees and therefore are subject to all the ordinary principles of the law of trusts, except to the extent these are displaced by legislation…. Their duties as trustee include certain 'core' obligations, such as the duty to keep and render accounts; the duty not to allow a conflict between duty and interest …" (Hanrahan 2018:7). The essential fiduciary duty of trustees is to exercise independent judgement in the best interests of fund members.

The levels of complexity of fund trustees' duties varies according to the structure adopted by the fund. Of the $1,701 billion total of APRA regulated assets (which excludes $712 billion of self-managed super fund assets) the large institutional funds are classified into four types:

> **Retail funds** operate under the trusteeship of a 'for-profit' RSE licensee with a corporate, industry or general membership base.
>
> **Industry funds** operate under the trusteeship of a 'not-for-profit' RSE licensee with either an industry or general membership base.
>
> **Public sector funds** operate under the trusteeship of a 'not-for-profit' RSE licensee with a government membership base.
>
> **Corporate funds** operate under the trusteeship of a 'not-for-profit' RSE licensee with a corporate membership base (Productivity Commission 2016:30).

For not-for-profit industry funds, public sector funds, and corporate funds the position of the trustee to act in the best interests of members is clearly defined. However, in the case of for-profit retail funds the position is not as clear. The for-profit retail superannuation funds were established to generate profits for the corporations that own them, including the large banks. The trustees of the for-profit retail funds are potentially torn between their duties as trustees to the members, and the corporate interests of the parent bank.

In Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd, Garde AJA regarding when a company is the corporate trustee stated the position as:

> "In circumstances where a company is a corporate trustee, a director acting in the best interests of the company as a whole must act in good faith to ensure that the company administers the trust in accordance with the trust deed having regard to the rights and interests of the beneficiaries of the trust. The best interests of the company as a corporate trustee are to act properly in accordance with the trust deed in managing the business of the trust and in dealing with the assets and liabilities of the trust. A director of a corporate trustee must act in good faith to ensure that the company complies with its obligations as a trustee, and properly discharges the duties imposed on it by the trust deed and by trust law generally. It is not in the best interests of the company for it to act in breach of its duties of a trustee, for the company has assumed the responsibilities of that office and must see to it that they are fulfilled" (Hanrahan 2018:33).

However, this resolution in principle is much harder for trustees to maintain in practice. The Commonwealth Government's Stronger Super Reform package in 2011 and 2012 included clearer duties for directors of superannuation trustee boards and other measures to improve the governance and integrity of the superannuation system. Though these measures were expected by Government to 'reduce the average fees paid by members by up to 40 per cent,' this saving did not eventuate (Hanrahan 2018:10).

Despite the many efforts at reform it remains the practice for retain superannuation funds to appoint executives from within the corporate group as trustees of the fund. This leads to immediate and continuous conflicts of interest that trustees must resolve. The Royal Commission in Round 5 revealed many examples of how the for-profit corporate ownership structure caused profound difficulties for bank executives to comply with their essential fiduciary duties to fund members, for example in the widespread and prolonged delay in transferring members to MySuper which would have benefited the members, but not the bottom line of the bank. As employees of the corporation owning the fund executive/trustees are placed in an invidious position of subordination to the shareholder primacy orientation of their corporate managers.

In the FSRC *Module 5 Closing Submissions* asks the following questions:

"Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties." (825:17)

"If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable?" (Section 825:18)

"Would it be preferable to extend the obligation to act in the best interest 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 the members of the superannuation fund?

The weight of the evidence gathered by the Royal Commission clearly demonstrates that structural problems are inhibiting trustees from complying with their fiduciary duties; and that structural change of entities is required by legislation to eliminate these problems. It would be a further reform of profound significance if the obligation to act in the best interest of members was extended, with contravention attracting civil penalties, and included the shareholders of trustees and any related bodies corporate of the trustee with respect to conduct affecting the interests of the members of a superannuation fund.

Evidence was revealed at the Royal Commission that the interests of shareholder returns systemically predominate in for-profit retails funds rather than superannuation fund members best interests. Simply because a practice is deeply embedded in routine financial institutional mechanisms, has historically been accepted, and is conducted on a mass scale, does not make it legal or permissible. These are deeply compromised governance structures requiring urgent reform.

Systemic Conflicts of Interest and Related Party Transactions

The flawed governance of the for-profit retail funds generates systemic conflicts of interest. The conflicts of interest exposed by the Royal Commission in the practices of Australian financial institutions for-profit superannuation funds are large scale, unconscionable, and deeply damaging to the long-term financial health of many of their customers. The ownership structure of retail funds generates pervasive conflicts of interest in the use of related parties. Both APRA and the Royal Commission have discovered that where services are provided from within the same corporate group that superannuation funds pay more for the services. Significantly higher fees are paid to related party administrators.

The Productivity Commission has stated that, "Conflicts of interest are managed differently depending on whether the trustees operate under a not-for-profit or for-profit structure." It

considers that governance arrangements for not-for-profit trustees are concerned with managing conflicts between the trustee and the member, while for-profit trustee arrangements must also manage the interests of shareholders (Productivity Commission (2016:285; Hanrahan 2018:36).

However, many institutional superannuation funds are essentially virtual organisations in which trustees outsource functions to, and acquire products and services from, related-party providers including fund administration, investment management and asset consulting, custodial services, insurance and advice for members. This creates major governance dilemmas for "how responsibility is allocated between trustees and the entities to which they outsource functions related to the operation of the fund" (Hanrahan 2018:37).

The level of related party transactions occurring in major Australian financial institutions as a normal part of doing business is breathtaking. This would not be conceivably tolerated in other industries. The fact that related party transactions have become habitual in finance – an industry ostensibly based on fundamental principles of trust and integrity - is incredible, and a testimony to light regulation, entrenched market power and successive government's looking the other way.

Light Touch Regulation

The neglect of beneficiaries interests endemic in the Australian for-profit superannuation sector has occurred in a context of light touch regulation, that has condoned the structures in which compromised governance is embedded, permitted trustees to neglect beneficiaries interests, and allowed corporate conflicts of interest and related party transactions to fester. When serious misconduct by superannuation trustees is detected by ASIC as in the case of CBA and ANZ examined in Round 5 of the Royal Commission, the enforceable undertakings agreed between ASIC and the CBA and ANZ involved light penalties that did not compensate members for the losses they incurred when switched from high performing and low fee MySuper products to poorly performing, high fee superannuation products owned by the banks.

Successive efforts at systemic reform of the superannuation system have been undermined by the reluctance of the for-profit retail sector to countenance change, and the regulators tolerating the pursuit of corporate interests by the large financial institutions, rather than defending the interests of superannuation fund members. Hence the centre-piece of the Super System Review (2010) reform with MySuper intended as a well-designed simplified product for the majority of members, with scale, transparency and comparability aimed at achieving better member outcomes, was allowed by the regulators to be delayed and

diverted on a large scale by for-profit funds in favour of their own products with poorer returns and little transparency.

MySuper products were able to be offered from 1 July 2013, and default superannuation guarantee payments could only be made into a MySuper product. However trustees had up to 1 July 2017 to transfer existing default members from a Choice product to a MySuper product. AIST continuously lobbied that retail funds were deferring members too slowly. Senior Counsel assisting the FSRC questioned whether such delays were in the best interests of the members.

The Purpose and Performance of Superannuation

The essence of good governance is to define the purpose and objectives of the organisation and to pursue the objectives with efficiency and effectiveness. Defying this logic, in the past there were no explicit duties of trustees to promote the finance interests of beneficiaries, or to apply a scale test for Choice products/investment options.

APRA has issued a member outcomes prudential standard to enhance and replace the scale test that would include Choice products/investment outcomes. However, the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Bill 2017* presently being considered by the Senate, if passed unamended will legislate a members' outcome test, but exclude Choice products/investment options.

Superannuation members in Australia are faced with an industry that is complex, fragmented, opaque and often impenetrable. APRA recognises 120 MySuper products but over 40,000 member investment choices. Yet the choices made by members are fateful. In 2018 SuperRatings found substantial differences between fees for MySuper and Choice products, particularly within retail superannuation funds *even when the underlying asset allocations were almost identical.*

The SuperRatings (2018) shows that the median profit-to-member MySuper has delivered 8.33% per annum to members over 3 years, significantly in excess of the 6.66% per annum delivered by bank and retail-owned super funds, and with substantially lower fees. The extensive evidence from SuperRatings (2018) indicates the Choice sector bank and retail-owned funds charge between 117-182% more than profit-to-member funds and generally underperform them over the both the short and long term.

Recent research by Rice Warner (2018) consultants reveals some startling figures relating to the comparative performance of the MySuper superannuation products and Choice products. Utilising past performance data, the forecast for individual outcomes suggest that individual members who remain in Choice products could be as much as $50,000 worse off compared with those who invest in a MySuper fund for a high income ($100,000 pa) earner, a difference of ten per cent. Collectively Choice members could be as much as $52.5 billion worse off in ten years compared to MySuper members.

Such comparisons indicate that the inevitable consequences for superannuation fund members of the degree of systemic complexity, opaqueness and poor performance in the Choice superannuation sector are:

- The compounding impact of higher fess over the long term significantly reduces retirement incomes for members of Choice products.

- Choice overload leaves members baffled about the selection and performance of their superannuation.

- The Choice sector of the superannuation industry survives without achieving efficiencies of scale or delivering comparable benefits to members (Goodwin 2017; AIST 2018b).

There is mounting evidence of the systemic neglect of members interests in the pursuit of higher fees by Choice providers:

- AIST in submissions to the Financial Services Royal Commission (FSRC) and to the Productivity Commission (AIST 2018a) highlights the lack of comprehensive Choice disclosure or reporting means that it is difficult to gauge member outcomes for Choice products, even with a new member outcomes test. How such higher fees could possibly be in members best interests is queried by AIST.

- ASIC (2018) *REP 562 Financial advice: Vertically Integrated Institutions and Conflicts of Interest*, conducted a survey of the quality of personal advice of the largest banking and financial services institutions in Australia provided by their largest advice licensees authorised to provide personal advice to retail clients (AMP, ANZ, CBA, NAB and Westpac), assessing the quality of personal advice being provided to customers. ASIC discovered 65 per cent of the quality of advice on in-house superannuation platforms was non-compliant, and a further 10 per cent of non-compliant advice raised significant concerns about the financial position of these customers. ASIC concluded:

"In 10% of the sample advice files, we had significant concerns about the impact of the non-compliant advice on the customer's financial situation. We were significantly concerned because, for these customers, switching to the new superannuation platform resulted in inferior insurance arrangements and/or a significant increase in ongoing product fees—without additional benefits being identified that were consistent with the customer's relevant circumstances."

(ASIC offers the following definition: "A customer's relevant circumstances' are the objectives, financial situation and needs of a customer that would reasonably be considered relevant to the subject matter of advice sought by the customer.")

- The Productivity Commission in its draft *Competition in the Australian Financial System* (2018b) report comments on the lack of data which makes it impossible for portfolios to be benchmarked. The Commission states that funds should be required to report to APRA how many members switch from MySuper to higher fee Choice products.

- The Productivity Commission in its final report on *Competition in the Australian Financial System* (2018c) presents a series of damning conclusions regarding the levels of competition, conflicts of interest, disclosure, advice, information, and regulation in the financial services industry:

  "The larger financial institutions, particularly but not only in banking, have the ability to exercise market power over their competitors and consumers. – Many of the highly profitable financial institutions have achieved that state with persistently opaque pricing; conflicted advice and remuneration arrangements; layers of public policy and regulatory requirements that support larger incumbents; and a lack of easily accessible information, inducing unaware customers to maintain loyalty to unsuitable products."

  "Poor advice and complex information supports persistent attachment to high margin products that boost institutional profits, with product features that may well be of no benefit. – What often is passed off as competition is more accurately described as persistent marketing and brand activity designed to promote a blizzard of barely differentiated products and 'white labels'."

  "For this situation to persist as it has over a decade, channels for the provision of information and advice (including regulator information flow, adviser effort and broker activity) must be failing."

Lack of Comparability

The basis of consumer choice is adequate information regarding the performance of different products. However, there is considerable evidence the information required to provide effective comparison between different products, and informed choice, is being systemically denied to the majority of superannuation fund members despite any recent reforms.

The Super System Review (2010) insisted “transparency is critical to the efficiency and operation of a market-based saving system. It improves understanding, awareness and engagement at various levels; not always directly at member level.” Yet the Review concluded, “The superannuation system lacks transparency, comparability and accountability in relation to costs, fees and investment returns.”

The Super System Review suggested this lack of transparency was due to a number of factors including the lack of incentives for trustees to be transparent about fees, costs, and investment returns; the outsourcing of many functions leading to inherent complexity and fees and charges being incurred at multiple layers; a cultural barrier to effective disclosure resting on the belief that it is only net investment returns that matter, without clarity on risk exposure; Product Disclosure Statements (PDSs) mechanically reflecting existing complexities, inviting a ‘data dump’ approach to fee disclosure of many pages; a lack of effective enforcement against those who fail to company with disclosure obligations; and finally the language of the debate on data and disclosure is largely captured by those whom it has suited to characterise members as ‘investors’ with the purpose of disclosure simply to enable choice of fund or investment option.

The Super System Review proposed a new set of ‘outcomes reporting standards’ be developed by APRA in consultation with ASIC, the industry and stakeholders to improve transparency and reporting. This was intended to address the measurement, disclosure and comparability issues of the superannuation industry. The Review proposed a new mandate for APRA to monitor and regulate the efficiency and outcomes of super funds. The Review recommended a new ‘product dashboard’ as a guide to super fund performance, to supplement PDS and online disclosures.

The Government has deferred the requirement for choice dashboards in 2014, 2015, 2016, and 2017. The Government plans to amend the laws so funds will only need to produce dashboards for their 10 largest choice options. Having a superannuation fund without a dashboard is like driving a car without a dashboard, there is no immediate information to

guide your progress. This ignores the advice of successive reviews of the Australian financial system.

- The Super System Review, Financial System Inquiry and the Productivity Commission all concluded that the level of fees paid by members is too high.

- SuperRatings (2018) has criticised the poor level of disclosure of fees, noting the long way to achieve comparability of fees across MySuper and Choice products/investment options.

- The Productivity Commission (2018b) draft report suggests that "funds which charge higher fees do not deliver better returns" and that "there are inconsistencies in how fees and costs are reported, despite regulator endeavour… This requires immediate redress by the regulators."

Failure to implement a dashboard regime is inconsistent with the OECD (2011) Principles that providers should give customers standardised disclosure to allow comparison between products, and that customers should be able to compare and switch easily between products and at reasonable cost (AIST 2017:36). Further examples of a systemic lack of comparability of data in the superannuation system include the following:

- According to Rice Warner consultants approximately 30 per cent of personal superannuation assets are held in legacy products. But there is no requirement to produce a shorter PDS for legacy products. The result is that it is more difficult for members in legacy products to compare the performance, fees or costs of the product with a contemporary product, or to understand the exit costs and assess whether they would be better off switching to a contemporary product.

- In the same vein, the as yet unimplemented dashboard regime for choice products and investment options will not apply to legacy products. Rice Warner have found fees and costs for legacy products are on average more than double those for contemporary products. (The UK Independent Project Board found that $26 billion in legacy pension schemes had investment manager fees above 1%, with nearly $1 billion exposed to fees over 300 basis points per annum). Without a dashboard members who hold legacy superannuation products will find it difficult to compare their returns, fees, or costs with contemporary products (Goodwin 2017; AIST 2018b).

- Portfolio Holdings Disclosure (as with dashboards) were deferred by the Government four times in 2014, 2015, 2016 and 2017. This prevents members seeing the individual holdings for their super investments.

Lack of Data

As the Super System Review (2010) insisted access to relevant data in the superannuation industry is vital to improve the understanding of members, to promote competition and drive innovation in the industry, and to allow trustees and others to engage in benchmarking of fund performance with other funds, locally and nationally. APRA requires comprehensive data to allow effective prudential supervision of superannuation funds to ensure funds are operated soundly by trustees in accordance with risk management, investment strategies and other fund policies. Financial advisers need to make informed, evidence-based recommendations to their clients. Analysis of comprehensive data enables APRA to intervene early to mitigate losses due to mismanagement. Finally, Government and policy advisers require reliable industry-wide data to assess the soundness of policy settings, and to ensure there is value for money for the tens of billions of dollars a year investment the government makes in the industry through tax concessions.

This critical need for comprehensive and accurate data on the performance of the superannuation industry is being systemically denied in government sanctioned omissions across large parts of the sector. APRA does not collect or publish statistics on Choice products or investment options equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.

- APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for Choice dashboards.

- AIST has advocated that sufficient data should be collected to enable APRA at system and fund level, and ASIC at product level to benchmark whether good value is being delivered to the members. The lack of this data means the regulators cannot readily analyse whether for example related party transactions have impacted on system/fund/product performance (Goodwin 2017; AIST 2018b).

- At the Financial Services Royal Commission, the Senior Counsel Assisting in his round 5 closing submission queried what would encourage regulators to act promptly on misconduct. AIST believe one solution is the proper collection and analysis of data would help identify misconduct, aided by a level playing field regarding disclosure.

- In an ASIC commissioned review of Regulatory Guide 97 on fee and cost structure disclosure, McShane (2018) stated that system analysis is an important objective of disclosure. AIST regards this as a critical objective.

- Senior Counsel Assisting at the Royal Commission in his round 5 closing submission that APRA or a new body should apply an outcomes filter to MySuper, which poses the question how are Choice products being assessed?

- According to Rainmaker over 70 per cent of retail superannuation assets in Australia are held via platforms. APRA does not collect or publish statistics on platforms equivalent, or on legacy products, equivalent to the comprehensive statistics collection available from MySuper reporting. APRA deferred collecting data for Choice products/investment options during the development of the requirements for Choice dashboards. Lack of data hampers the analysis of the relative performance of superannuation held via a platform by APRA, employers, advisers, Government and trustees that members rely on.

Lack of Best Interests Test

- There is no requirement to ensure switching super funds is in the best interests of the member when giving general advice or under no-advice business models. ASIC has accepted enforceable undertakings from the CBA and ANZ regarding distribution of super products through their branches. Industry Super Australia has found an increase in cross-selling retail superannuation using general advice and no-advice business models. Through this process members are switched from MySuper products to an inferior Choice Product/Investment option, when it is not in the best interests of the member (Goodwin 2017; AIST 2018b).

Lack of Disclosure on Costs

- Regulatory Guide 97 platforms new fees and costs disclosure requirements do not apply to superannuation held via a platform. McShane's (2018) Review recommends changes to ensure members understand the aggregation of platform costs (product costs and distribution costs). AIST has recommended that a review of platforms be undertaken in Australia, as in the UK, to determine whether platforms are delivering value. According to the UK Financial Conduct Authority platforms add 20-90 basis points to costs. While the compounding effect of higher costs over the long term reduces retirement incomes for members, ASIC states it would be misleading to compare the fees and costs of platforms and non-platform super funds (Goodwin 2017; AIST 2018b).

Conflicted Remuneration

- Conflicted remuneration is banned from most of the financial services industry, but there is an exemption for advice about retail life insurance. In 2017 ASIC set commission caps and clawback amounts. In 2014 ASIC found more than one third of advice about retail life insurance reviewed did not comply with the law, and 96% of non-compliance advice was given by advisers paid with upfront commissions.

- Due to exemptions from regulation conflicted remuneration features in other aspects of the superannuation system which ASIC has condoned including product issuers using consent forms to obtain client consent; rebutting the presumption that volume based payment is conflicted remuneration; asset based fees which are ongoing as a percentage of fees under advice; balanced scorecards which incentivise staff to switch customers into bank owned superannuation funds (AIST 2017:33).

- Grandfathered commissions are permitted under FoFA. AIST has advocated these commissions should be banned. ASIC submitted to the FSRC that grandfathered commission should be banned as they may encourage advisers to keep clients in legacy products rather than moving them to better performing products. Senior Counsel Assisting FSRC in his closing submission in Round Five asked whether grandfathered commissions and/or fees should be banned. With grandfathered commissions consumers are at significant risk of being recommended to stay in a product which is not in their best interests.

Product Design and Distribution

- If the *Improving Accountability and Member Outcomes in Superannuation (2017)* Bill is passed product manufacturers and distributors will be exempted. AIST has submitted that the complete chain of product manufacturers and distributors should be included to ensure ownership of accountability. The focus on individual products is meaningless given the systemic carveouts from the legislative framework and the lack of data to assess system/fund value. The proposal would require entities issuing PDSs to undertake a target market assessment and would provide ASIC with product intervention powers to remove unsuitable products, including Choice products but not legacy products (Goodwin 2017; AIST 2018b).

Exit Fees

- The Government's proposals on Protecting Your Super package would cap fees for low account balances and ban exit fees. However the proposals do not include sell

spreads in the calculation of exit fees, (buy/sell spreads being generally applied in the retail fund sector) enabling gaming to increase fees ((Goodwin 2017; AIST 2018b).

Conclusions

As the AIST (2017:56) concludes there are evident weaknesses in regulation and governance in the superannuation sector exposed in the many current and proposed exemptions, gaps and inconsistencies that apply to Choice products and investment options, platforms, legacy products, new products and self-managed super funds. This panoply of self-interested exemption exhibited by the for-profit superannuation sector has arisen over time, incrementally and without any ostensible rationale other than to benefit the providers.

This does not reconcile with the OECD *G20 High Level Principles on Financial Consumer Protection*, particularly the principles relating to equitable and fair treatment of consumers, disclosure and transparency, responsible business conduct, competition and the role of oversight bodies; the legislated objectives of APRA, ASIC or Chapter 7 of the *Corporations Act 2001*. Nor does it reconcile "with the proposed legislative objective of superannuation which does not distinguish between members depending on what kind of fund, product or investment option their superannuation is invested in" (AIST 2017:56). In summary these exemptions reduce the protection for superannuation fund members, reduce competition and compromise the capacity of regulators to supervise the system.

The Australian superannuation system requires the development of a new regulatory architecture and new institutional structure capable of focusing on the best interests of super members. For this to be achieved a new business model is required that eliminates conflicts of interest between members and shareholders. Comprehensive data must be accessible on all products and investments including data on long term returns. The system purpose and objectives of superannuation should be firmly anchored in pursuing the optimal long term returns for the retirement of beneficiaries.

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