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21 September 2018

Royal Commission into Misconduct in the Banking
Superannuation and Financial Services Industry
By email: FSRCenquiries@royalcommission.gov.au

To whom it may concern

Response to The Royal Commission's submission on policy issues raised in round five

About Rice Warner

Rice Warner was established in 1987 to support superannuation funds and businesses operating in the financial services industry. It is an Australian business, owned and controlled by its key executives.

Over the last three decades, it has built a strong reputation for insightful commentary. Its independence means clients can be sure the firm always acts in their best interest and provides unbiased advice. Clients include most large superannuation funds as well as many other participants in the industry (service suppliers to funds, regulators and industry bodies).

Through its research and public policy activities, Rice Warner has built an unrivalled reputation for delivering a unique perspective across the superannuation, wealth management and life insurance industries. Some of our consulting work was presented as evidence during the superannuation hearings.

Our submission

We have limited our submission to questions from the following categories:

- Advertising - we are supportive of limiting the advertising that superannuation funds conduct to be specific to the fund in question rather than simply lobbying for a group or sector of the market.
- Managing conflicts – we are not supportive of a blanket ban of vertical integration in superannuation businesses or banning commercial business from managing superannuation funds. We note there can be many benefits of vertical integration and the practice is not limited to one market sector. We would prefer the Royal Commission pursue policy options that strengthen governance and management of conflicts.
- System changes – we are not averse to some changes to the system but note that some changes may not be specific to addressing the policy issue of misconduct. Where system changes are considered we would advise that consideration be given equally to both MySuper and Choice segments of the market. System changes should also be carefully considered to avoid unintended consequences.

We thank the Royal Commission for the opportunity to contribute to the policy debate and are happy to provide further information and data, or to answer questions on request.

Yours sincerely

[redacted]

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Response to policy and general questions

Advertising

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?

We are of the view that advertising that promotes segments of the superannuation industry has the potential to cause brand damage for the entire industry. Further, as many members would be unaware of the segment in which their fund lies, this information would not necessarily be helpful for consumers.

This type of advertising may discourage consumers from engaging with their superannuation to their own detriment. Some consumers will believe that all superannuation is bad. As such, we believe there may be benefits to consumers of restrictions to superannuation fund advertising to focus on individual funds rather than segments.

Further to this, analysis by the Productivity Commission in its draft report on superannuation efficiency and competitiveness shows that whilst there may be identifiable trends in performance when segmenting funds by their sector (retail vs. profit-to-member) this does not equate to all funds in one sector outperforming all those in another. It is unfair that some funds may be attributed as under/over-performing based on the sector they are from rather than their actual underlying performance.

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?

The Royal Commission's round five hearings have caused some industry commentators to call for an outright ban on vertical integration of advice businesses with superannuation or for the complete ban of for-profit funds from the industry all together[1].

We believe such calls are misguided and miss the root cause of the problem which is a failure to adequately ***manage conflicts***.

We note that many industries experience high levels of vertical integration and superannuation is no different. Further, vertical integration is not a feature that is unique to one segment of the superannuation market. Along with large vertically integrated providers such as the banks, there are profit-to-member funds which own their own service providers, often as an investment on behalf of the members. For example, First State Super owns the advice business StatePlus, QSuper owns its own insurer QInsure and QInvest, its financial advice business. IFM is owned by a number of superannuation funds (as a private equity investment), and funds like AustralianSuper are increasingly moving much of their investment activities in-house.

[1] See for example:
https://www.afr.com/personal-finance/superannuation-and-smsfs/paul-keating-says-all-super-funds-should-be-non-profit-20180903-h14vrj

Vertical integration of these types of services can make sense and deliver members additional benefits, especially where the fund gains control of the member experience, drives down costs, or acquires unique capabilities that they can leverage to the members' benefit.

Further to this, we note that all superannuation funds (RSEs) are run on a 'not for profit' basis. For profit providers may make some money out of the trustee business, however, for most 'retail' funds, profits are made from the outsourcing to related party service providers. Again, this is not a problem in and of itself as the fund may be able to influence the strategy and services provided by the related party to better help members. What is needed are strong governance required to benchmark the competitiveness of services and regulation by APRA to ensure that these contracts are to a market standard. If a service is delivered competitively and efficiently, does it matter if a profit is made by a third-party provider, whether related to the fund or not?

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

Structural change of entities is likely to have a few unintended consequences and does not address the root cause of the problem which can be solved by managing conflicts and good governance.

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

- ***i. contravention of the obligation attracts a civil penalty; and***
- ***ii. the obligation (and the civil penalty for breach) extends to shareholders of trustees and any related bodies corporate (within the meaning of the Corporations Act) of the trustee in respect of any conduct that will affect the interests of the members of the superannuation fund?***

Civil penalties are one way to increase the pressure of trustees to act in the best interests of members. Extending these penalties to the shareholders of trustees may have the unintended consequence of forcing some shareholders to consider whether they should continue in this role. Particularly employer associations for profit-to-member funds.

Our preferred policy solution would be to strengthen APRA's oversight of outsourcing agreements with particular attention to related party providers and introduce legislation to reduce conflicts in the provision of advice.

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?

Rice Warner is of the position that misconduct is not unique to MySuper members. Indeed, many of the instances of misconduct examined by the Commission impacted predominantly Choice members. As such, any recommendations to improve member outcomes by addressing / discouraging misconduct should seek to apply these changes to both the MySuper and Choice environments. See our comments on this topic from August 2017 in our blog: https://www.ricewarner.com/the-shift-from-disengaged-to-ill-informed-members/.

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

Rice Warner is generally supportive of the government's intention to strengthen the scale test and replace it with the member's outcomes test to be applied by APRA. This is a sensible approach, and it may well expedite the removal of inefficient funds, but it is unclear how it will specifically address issues of misconduct.

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

Multiple accounts in the superannuation system have been a symptom of policy design. Addressing this issue by introducing some form of stapling as recommended by the Productivity Commission is a sensible policy initiative. However, the policy should have regard to potential unintended consequences. For example, members might:

- Miss out on being defaulted into a new fund with generous insurance benefits with automatic acceptance (not subject to underwriting).
- Not receive benefits specific to their new employer (e.g. employer plan discounts on fees, tailored insurance, employer paid fees / premiums).