

## Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

### Colonial First State Investments Limited (CFSIL) and Avanteos Investments Limited (Avanteos)

#### Round 5 Hearing – Superannuation

#### PART B - POLICY AND GENERAL QUESTIONS

##### Introduction

1. These submissions respond, following consideration by the CFSIL and Avanteos boards, to Parts T and S of Counsel Assisting's Closing Submissions for the Round 5 hearing of the Royal Commission. The headings used by Counsel Assisting have been adopted for ease of reference.

##### The retail fund model and its place in Australia's superannuation system

2. Before providing a response to the questions raised by Counsel Assisting's Closing Submissions, CFSIL considers that it may be useful to outline some features of the retail superannuation fund model.
3. An important feature of Australia's superannuation system is the diverse range of available options – both in terms of providers and products - with varying levels of assistance provided to individuals in deciding which option is right for them. This diversity exists within the following segments as described by the Productivity Commission in its draft report entitled *Superannuation: Assessing Efficiency and Competitiveness* (at Box 1.3)<sup>1</sup>:



4. Importantly, the superannuation system can be divided into segments, some of which can overlap. Depending on the segment, members will be introduced into superannuation funds through making, or having contributions made on their behalf, via different means. Some members are defaulted into their superannuation fund and other members choose either the fund to which their employer contributions are directed, or voluntarily invest personal money into superannuation funds of their own choosing.
5. The array of superannuation fund options means that members will have different experiences in their fund, or within different funds including investment performance, retirement options or other benefits such as insurance. This is the result of:
  - (a) the different features and benefits of each fund and product, whether in the MySuper, Choice or Self-Managed Super Fund (SMSF) segment;

<sup>1</sup> Assessing Efficiency and Competitiveness draft report released on 29 May 2018, available at link [https://www.pc.gov.au/data/assets/pdf\\_file/0003/228171/superannuation-assessment-draft.pdf](https://www.pc.gov.au/data/assets/pdf_file/0003/228171/superannuation-assessment-draft.pdf)

- (b) decisions that members make about their investment based on their personal circumstances, appetite for risk and engagement. This includes decisions that intermediaries may assist members with or have made on behalf of members (either at the member's request or as a result of other means, such as legislative or industrial requirements).

*Historical role and position of large institutional funds*

6. The majority of Australians' superannuation is managed by large institutional funds (predominantly retail and industry) operating both within the MySuper segment managing employer default plans, or the Choice segment where funds manage retirement savings on behalf of more engaged members.
7. Differentiation between funds in the institutional fund segment is critical to providing members with the ability to invest their superannuation in a fund that is right for their particular circumstances. It also promotes competition as funds compete to retain members, and attract new members, by differentiating their products and services to optimise retirement outcomes.
8. In meeting the needs of different members within the community, and recognising the demographics of fund membership will vary, it is important to understand how this differentiation manifests itself through superannuation products in the market. Superannuation products do not all take the same form.
9. Within the Choice segment of the market, some funds offer a small range of diversified multi-sector investment options which primarily act as accompaniments to the fund's MySuper product. Members may choose to move some or all of their MySuper balance into one or more of these options during the course of the accumulation phase.
10. Further along the spectrum of products offered within the Choice segment we observe a more complex range of investment options and product features, often catering for advised members who may be older and have more complex needs. These products may take the form of a master trust (e.g. CFSIL FirstChoice Super) or a wrap (e.g. CFSIL Custom Solutions FirstWrap).
11. The Colonial First State FirstChoice Superannuation Trust provides members with a choice of over 150 investment options across superannuation and pension, managed by a wide range of investment managers. These investment options can be both single-sector (e.g. Australian shares) and multi-sector investment options (e.g. 'Growth' or 'Balanced'). There are also seven 'products' (e.g. FirstChoice Wholesale Personal Super) within FirstChoice, representing different fee and tax structures.
12. A superannuation wrap will provide even greater access to a broad range of investments including managed funds, listed shares, term deposits and other assets. Across all labels within the Avanteos Superannuation Trust, there are over 600 different managed funds and access to ASX 200 listed equities. A wrap will generally not include any trustee-constructed investment options and acts as an administration mechanism with trustee oversight. However, both superannuation structures help facilitate the delivery of advice to members through their financial adviser, especially those with more complex needs and/or significant funds to invest.
13. Retail funds are sometimes referred to as "for profit funds". Some retail funds belong to larger listed corporate groups including banks and disclose to members information about their ownership structure and motivation to offer quality products and services. Against this background, profits from product fees may generate surpluses or dividends that may in turn be paid to shareholders. Retail funds generally also follow best practice corporate governance standards through a board composition which consists of a majority of independent directors and an independent chair.
14. Historically, retail funds have relied upon third party intermediaries such as financial advisers to introduce members to the fund. With increasing regulation and costs associated with delivering traditional financial advice and with the rapid emergence of start-up superannuation funds (e.g. Spaceship, Grow Super and Zuper), retail funds have sought to innovate by making

simple superannuation products available to potential members through other means (including directly to potential members through bank branches). CFSIL views this as a natural evolution of the superannuation market, especially outside of the award default segment, where there is continued competition for members by improving services and overall value.

15. In addition to competitive fees and performance, retail funds have created a number of member-beneficial features which have resulted in greater choice and the ability to better meet the retirement needs of members and improve member outcomes. For CFSIL, these include the availability of annuities on platform, superannuation to pension transfer processes which improve the tax efficiency for members moving into retirement phase, and integration with digital banking platforms encouraging members to engage more with their superannuation and reducing the risk of duplicate accounts upon job change.
16. CFSIL believes that a retail fund can deliver optimal results to members, complying with its fiduciary and trust law obligations and the sole purpose test, while still deriving profit. As is discussed further below, "for profit funds" can, and must, have rigorous conflicts management policies and procedures to ensure conflicts are managed appropriately. This obligation is equally apposite for all trustees of superannuation funds, irrespective of the segment in which they operate, as it is a fundamental principle of trust law that a trustee must give priority to beneficiaries. Managing conflicts of interest is an issue that arises for all trustees in the day to day management, administration and investment of superannuation funds. Over time, superannuation funds have become increasingly large and complex and all trustees face challenges in ensuring that they effectively manage conflicts as they arise.
17. Where retail funds have historically operated to a greater extent in the Choice sector, other funds including Industry Superannuation Funds (**ISFs**) have traditionally serviced the default fund market derived from the mandated flow of Superannuation Guarantee contributions directed to them through the industrial award system, based on the particular industry they service through trade union and employer body affiliations.

#### *Characteristics of retail funds*

18. In addition to contributing to the diversity of providers and products, the core benefits that retail funds<sup>2</sup> provide to members relative to other large APRA-regulated funds can be summarised as follows.
19. *First*, retail funds generally provide members with broader investment choice than other institutional funds.<sup>3</sup> As outlined above, members in retail funds and other investments are able to choose from managed funds that cover different markets, industries and investment strategies.
20. A member's financial adviser may recommend them to invest their balance and/or future contributions in a diversified multi-manager, multi-sector Choice option such as the FirstChoice Wholesale Balanced Option or one or more single manager, single sector options such as: Cash, Australian Share, Property or Fixed Interest, in order to construct a diversified portfolio of investments through the superannuation trust. It is also common for a financial adviser to

<sup>2</sup> Retail funds are classified by APRA as 'for profit' (owner aims to retain some profit from running the fund) (APRA, *Annual Superannuation Bulletin Glossary* (28 March 2018) <<https://www.apra.gov.au/sites/default/files/Glossary%2520ASB.pdf>>. Retail funds are usually run by banks and investment companies and generally have a large number of investment options (APRA, *Types of super funds: Retail funds* (18 October 2017) ASIC's MoneySmart <<https://www.moneysmart.gov.au/superannuation-and-retirement/how-super-works/choosing-a-super-fund/types-of-super-funds>>).

<sup>3</sup> There are very few investment restrictions placed on superannuation trustees and, as such, trustees have broad power and discretion over asset allocation and investment manager selection. Investment restrictions include: prohibitions on trustees lending money to (or acquiring assets from) members, or making loans to (or investing in) employer-sponsors beyond 5% of the fund's total assets, and a requirement that all investments be made on arms-length terms. Where a trustee appoints an investment manager, it has to ensure that it receives adequate information about investment and their performance. Trustees of defined benefit funds are required to conduct an actuarial valuation every three years and to comply with resulting recommendations on the adequacy of the fund's resources to meet its liabilities.

consider a member's non-superannuation investments (to the extent relevant) including property investments, when recommending a superannuation investment portfolio.

21. The scope and scale of the business allows CFSIL to offer these products to members. For those who are engaged and active in seeking to optimise their overall financial situation as their personal circumstances and financial needs change over time, including taking into account their dependants, a range of options is important. This helps enable self-determining individuals to create their own optimal solution taking into account their risk profile, liquidity needs, personal circumstances and other assets.<sup>4</sup>
22. The trustee's purpose in offering choice is to make available a broad range of good quality investments for superannuation members to choose to invest in either directly or with the assistance of their financial adviser. This is to be contrasted with the MySuper default option where the trustee is not involved in asset allocation decisions for the member's total portfolio. Choice options are important for those who exercise fund and investment choice. Choice options also become more important for members as they progress in their working life and get closer to retirement. Generally individuals will then become more engaged in ensuring they are appropriately invested and will have enough income in retirement. Choice options are also critical for members in an allocated pension. At this stage, there is no concept of a default pension strategy and hence all options for members in the pension phase are considered to be Choice.
23. *Secondly*, the broader investment choice means that retail funds present the ideal option for the engaged investor who does not have the assets, time and/or inclination to have an SMSF but who values choice and control and wishes to have access to investment options beyond those customarily available in ISFs. While SMSFs play an important role for individuals who want full direction and control over their superannuation savings, members must have significant savings to justify an SMSF and acting as trustee comes with considerable obligations and responsibilities. Retail funds are therefore an important option for those who want some control over their superannuation investments but do not wish to bear the responsibility and time commitments of operating a superannuation fund as trustee. This is especially true for the many Australians who are self-employed, have varying cash flow needs over time and are entirely responsible for their own retirement savings.
24. *Thirdly*, "for profit funds" which operate as part of a vertically integrated financial institution are able to provide benefits of scale. A large scale fund allows access to investments, in some cases exclusively, for members. Scale allows funds to maintain fee competitiveness in and to reinvest in making products more efficient over time. With respect to CFSIL, for example, such investments include investment in: making the retirement program and annuities available via a platform; digital enhancements (including E-setup, which improved user experience for advisers and members); enhancements to member reporting (statements via a Customer Centred Design (CCD) process); systems resilience enhancements and platforming to reduce the cost of change; and the development of new investment offers (alliances and managed accounts).

### Measuring success

25. A superannuation fund should be assessed by reference to whether the outcomes it provides members meet their expectations. This includes factors such as the level of investment return but also the risk taken in achieving that return. An examination of investment returns as the sole measure of success is too simplistic. Members will have varying needs and circumstances and many Choice members will consider trade-offs based on their individual preferences, risk tolerances and circumstances. For example, some members will be comfortable accepting higher investment costs or fees to access a particular investment option whilst others will prefer an investment allocation which prioritises capital stability, and therefore lower risk, rather than prioritising the potential for higher returns.

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<sup>4</sup> An outcome of this investment choice is that members are also selecting the corresponding fees. For example, if members select increased allocation to investment options such as overseas equities, private equity or infrastructure, the costs will be higher than the default strategies. However members tend to select these options in the hope or expectation of extra returns over the longer term.

### *Fund performance*

26. Superannuation investment performance is a complex and multi-factorial issue. APRA produces fund level performance data which aggregates the returns of all investment options within the fund into a weighted average. For a retail fund which potentially has hundreds of investment options (only one, or a very small number, of which will be MySuper options), this data point is effectively irrelevant to members. It is not a return that a single member could possibly receive. Both APRA and the Productivity Commission have provided warnings about relying on this data.
27. Unfortunately, performance data is often presented using fund or sectoral level comparisons which are both unhelpful and misleading to members when considering their own superannuation fund investment performance. Further, when more care is taken to attempt more accurate comparisons at product or option level, including the approach used by the Productivity Commission in its draft report, assumptions are often made which fail to acknowledge changes in product features or investment styles over time.<sup>5</sup>
28. The returns on superannuation depend on the assets and investment mix of the fund and how those investments perform over time. Retail funds often have a much higher proportion of older and pension members who are more conservatively invested, which means that, compared to funds with younger members, they will generally have a lower risk appetite which in turn, is likely to translate to lower returns over the long term. This older demographic profile, with a high proportion of pension members making regular withdrawals, requires careful consideration of the liquidity position of the fund. A fund with a younger demographic profile does not need to place the same emphasis on liquidity, and this offers greater investment flexibility and the opportunity to assume a higher risk tolerance overall. While markets are strong, this positioning has the potential to translate into higher relative returns for that time period. Performance comparisons based solely on returns fail to factor in risk and volatility and so do not accurately reflect the true performance of a fund.
29. Further, aggregate retail fund asset allocations are driven by member choice, including by financial adviser recommendations which are determined by a member's needs and objectives, and tolerance for risk. The fund asset allocation is a product of thousands of decisions made by investors and their advisers in constructing their own asset allocation based on their individual needs and circumstances.
30. Given the roles played by the different sectors in the system it can be misleading to attempt to compare performance data between the MySuper, Choice and SMSF segments and between ISFs and retail funds. MySuper options with similar investment allocations can broadly be compared but care needs to be taken to ensure investment definitions and labels are comparable. Choice funds contain a significantly broader range of investment styles and options and will also contain different fee structures, including the existence of grandfathered adviser commissions. Depending on which research firm presents the data, there could be inconsistent treatment of certain fees such as dollar-based member or administration fees (some firms exclude these). All these factors mean simple performance comparisons cannot be made easily.
31. The only true investment performance comparisons that can be made involve comparing investment options with the same or broadly similar asset allocations across the same time period. This is currently not an easy exercise for a member to undertake. CFSIL considers more can be done to:
  - (a) ensure greater transparency, comparability and presentation standards across funds where performance data is concerned, especially in relation to asset allocation and asset class labels across funds; and

<sup>5</sup> Colonial First State submissions dated 13 July 2018 to the Productivity Commission in response to draft report entitled "Superannuation: Assessing Efficiency and Competitiveness" (above at n 1) [https://www.pc.gov.au/\\_data/assets/pdf\\_file/0017/230147/subdr163-superannuation-assessment.pdf](https://www.pc.gov.au/_data/assets/pdf_file/0017/230147/subdr163-superannuation-assessment.pdf).

- (b) help standardise the publication of performance data across the industry, including in the media and by research firms.
32. To ensure the Commission can assess the relative strength of CFSIL's current investment performance, the performance and relative fees of our flagship MySuper and Choice products are discussed below at paragraph 33. CFSIL considers that this is necessary information to clarify the actual experience of a segment of our membership and assist with contextualising individual performance more generally.
33. According to Chant West's Quarterly Survey in June 2018, CFSIL's MySuper product CFS FirstChoice Employer Super (Lifestage 1970-1974) ranked first compared to other lifecycle funds with an investment return of 9.9% over five years<sup>6</sup> (the longest available track record). When compared to other MySuper Growth products over the same period of time, this would place the product in the top quartile.<sup>7</sup> With respect to fees, CFSIL aims to be competitive.<sup>8</sup> Using Chant West's Super Fund Fee Survey from June 2018,<sup>9</sup> for member accounts of balances of \$50,000, the fees charged on FirstChoice Employer Super are within the median of all MySuper funds.

#### The best interests duty of the retail trustee

34. It is a fundamental duty of trustees to exercise their duties and powers in the best interests of members. This is enshrined both as a matter of general trust law and by the trustee covenants contained in the Superannuation Industry (Supervision) Act 1993 (**SIS Act**).
35. These duties do not change based on the nature of the trustee or the sector it services (whether retail or otherwise). However, it is important to recognise that the best interests duty applies to the exercise of duties and powers and requires compliance with the trust deed. It does not apply to the exercise of rights that a trustee may have by virtue of a trust deed. An example of this is where the trust deed confers a right on a trustee to charge product fees (often to a specified cap) to members (for example an administration fee). Typically a trust deed will also provide that the trustee is entitled to be paid a fee and then is free to have the benefit of the fee and apply it as its own. This means that the trustee right to charge a fee in compliance with the trust deed and to retain any profit generated by the fee does not, prima facie, give rise to a best interests issue.
36. Similarly, any right enshrined in the trust deed has the effect of also limiting the scope of "no profit" and "no conflict" fiduciary duties. In this way, the right to fees, and the potential to earn profit from those fees sits comfortably with not only the best interests duty but also the fiduciary nature of the trustee role.
37. This is not to say that trustees are completely unfettered in the quantum of the fee charged. In addition to any restrictions in the trust deed and disclosure to members, other factors such as competitive benchmarking and market comparison provide a natural competitive ceiling to the viability of fees charged. This is particularly relevant to the Choice environment. Added to this, the trustee obligations of impartiality and fairness provide guardrails for how fees are applied across various classes of member within a fund.

<sup>6</sup> Chant West Quarterly Survey June 2018, page 11

<sup>7</sup> Chant West Quarterly Survey June 2018, page 9

<sup>8</sup> Exhibit 5.181, Witness statement of L Elkins in response to Rubric 5-37, dated 30 July 2018, at [25].

<sup>9</sup> Chant West Quarterly Survey June 2018, page 11



## Section T

### Topic 1: Advertising

#### **Question 1: Is political advertising consistent with the intention behind section 62 of the SIS Act? Is any amendment to the SIS Act warranted, and if so, why?**

38. The sole purpose test requires that a regulated superannuation fund be maintained solely for one or more of the core purposes provided for by legislation. In essence, these core purposes together with prescribed ancillary purposes, operate to ensure that superannuation benefits are only provided in a range of retirement or retirement related circumstances. These circumstances include death and disability.
39. The activities of a trustee necessary for the proper administration and operation of the fund will generally fall within the parameters of the sole purpose test. However, APRA stated in 2001:<sup>10</sup>
- “Whether there has been a breach of the sole purpose test is determined in the light of the overall circumstances of the particular superannuation fund. It is not possible to state categorically that a particular service or operational practice would always involve a contravention of the sole purpose test. It is not the type of practice that determines a sole purpose contravention, but rather the purpose for which it is undertaken in particular circumstances.”*
40. APRA further stated that as a guiding principle *“there should always be a reasonable, direct and transparent connection between a particular scheme feature or trustee action, and the core or ancillary purposes. The more tenuous the linkage between a service or activity and the retirement savings objective, the greater will be the difficulty in the fund meeting the sole purpose test.”*<sup>11</sup>
41. In CFSIL's submission, advertising paid for by members, which may seek to exert political influence is likely to fall outside the scope of the sole purpose test. This is for two reasons:
- (a) First, it is unlikely to have a ‘reasonable, direct and transparent connection’ with a core or ancillary purpose. This will be the case if its intention and purpose is to exert political influence in the making of policy and to limit competition by deterring employers and consumers from selecting a fund external to the trustee's own fund; and
  - (b) Second, the purpose for which it is undertaken is unlikely to relate to the fund or its members, or the provision by that fund of retirement or retirement related benefits.
42. Where advertising has a political purpose, it is doubtful that it is appropriate for members' funds to be diverted for this purpose. This expenditure will generally not enhance members' benefits, any ancillary services provided by the fund or the fund itself. Rather, such campaigns may be considered to be improperly diverting members' funds.
43. Various arguments have been advanced about why political advertising is in the best interests of members and satisfies the sole purpose test. It is variously contended that the political advertising is directed toward avoiding legislative change which may disadvantage members due to a risk of employers joining other funds, or that it may serve to attract new members to an industry fund.
44. However, a political advertising campaign usually contains only generalised comment, rather than specific content related to the qualities or characteristics of a particular fund. The member

<sup>10</sup> Superannuation Circular No. III.A.4: The sole purpose test – February 2001, at [40]: <https://www.apra.gov.au/sites/default/files/superannuation-circular-iii-a-4-the-sole-purpose-test.pdf>

<sup>11</sup> Ibid at [42].

is not provided with any information to assess whether they should select a particular fund or would be better placed staying in the fund they are in rather than transferring to another fund. It is unlikely that such campaigns will have the requisite 'reasonable, direct and transparent connection' with a core or ancillary purpose of any particular fund. There is no discernible link between the objectives of the advertising campaign and the interests of the members of a particular fund.

**Question 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?**

**Identifiable detriment**

45. The purpose of political advertising, such as that seen in the 'Fox and Henhouse' advertising campaign and the 'Banks Aren't Super' campaign is to publicly lobby members of Parliament on potential policy issues. Accordingly, CFSIL considers that political advertising is potentially detrimental to members as it:
- (a) seeks to reduce competition and may have the effect of maintaining member interests in underperforming funds;
  - (b) uses members' money for purposes that have no, or very little, benefit to members; and
  - (c) has the effect of undermining the community's trust in the superannuation industry as a whole.
46. CFSIL has explored, in more detail, each of the potentially detrimental effects of political advertising below.

*Reduction in competition*

47. Fox and Henhouse was created for the purpose of opposing any potential change to open the default market to greater competition, in the absence of any proposed changes being before Parliament. The Productivity Commission's draft report released in May 2018, however, has begun a helpful policy discussion about the future direction of default superannuation fund selection.
48. The Productivity Commission found that there is a high degree of fund concentration in many awards where default superannuation fund listing is concerned (many have just one to four funds listed). Many funds are only in a handful of awards, and there is limited evidence of new entry or exits in recent years.<sup>12</sup> As the Productivity Commission highlighted, the award listings are overwhelmingly represented by industry funds. It concluded:

*the current default system **prevents healthy (or effective) competition between funds**, leads to unnecessary erosion of member balances by encouraging account proliferation and relies too heavily on third party decision makers, thereby ingraining member disengagement. These flaws are regressive in impact. Those least likely to engage with super, and so most likely to rely on the default system, are the young, people with lower education and those on lower incomes.<sup>13</sup>*

<sup>12</sup> Productivity Commission draft report, Superannuation: Assessing Efficiency and Competitiveness (April 2018), above at n 1, at (figure 7.9).

<sup>13</sup> At page 430.



49. The Productivity Commission recommends that a new competitive default selection process be introduced, suggesting the current system acts as an 'unlucky lottery' for many default members, given it effectively rewards certain funds regardless of whether or not they enjoy the benefits of scale or perform well.
50. Like the Productivity Commission, CFSIL believes the introduction of true competitive forces would be a positive influence on the market, delivering better outcomes for consumers.

*Inappropriate use of members' funds*

51. CFSIL understands that one suggested purpose of political advertising is that it provides a benefit to members by increasing the size of the fund. Seeking and achieving scale for a superannuation fund is generally regarded as a positive attribute. However, CFSIL considers that (assuming political advertising is successful in generating an increase in scale that would have a material effect), in this context, the benefits of scale are not proportionate to the purpose or motives of the expenditure of members' funds.
52. CFSIL also considers that the means used to achieve the stated goal is disproportionate to the perceived threat. This is an example of the lack of transparency in respect of utilisation of members' funds (discussed above at paragraph 31) that CFSIL considers existing members of the participating funds may be entitled to be concerned about.

*Erosion of trust in the superannuation industry*

53. CFSIL is concerned by the negative effect that advertisements such as Fox and Henhouse have on general consumer confidence in superannuation and the stability of the system. Given the inherent complexity of the system and the difficulty for many individuals to engage in superannuation, members of all institutional funds should be provided with an appropriate level of positive information in order for them properly to be able to make an informed choice.

## **Topic 2: Section 68A of the SIS Act**

***Question 1: 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?***

54. Section 68A of the SIS Act currently requires not only that the trustee or its associate offers some form of "inducement" to an employer but also that the offer is made "on the condition" that one or more of the employees of that employer will become members of the fund.
55. In CFSIL's view, this prohibition interacts with the broader obligation of a trustee to ensure that members' funds are properly applied. The application of members' monies for the purpose of inducing an employer to select or stay with a particular fund, for example through offering substantial hospitality or entertainment benefits, should be considered by reference to member and community expectations as to how members' funds should be expended. It may be that members and the broader community would not view the application of significant surplus monies to such ends as advertising or entertainment as having a sufficient link to the interests of members as compared to the alternative and more direct application of the monies for the benefit of members such as through a reduction in fees.
56. In CFSIL's view, whether or not corporate hospitality or other forms of inducement are conditional on the employer joining its members to the fund, it is difficult to conceive that targeting of an employer in this way does not have that intended purpose, particularly where it is significant or ongoing. Equally, it is inconceivable that such activity does not have the desired effect of placing pressure on an employer to select that fund.
57. While there may be some issues with the application of section 68A, CFSIL generally considers that section 68A works well in the current context. Accordingly, it does not advocate for any amendment to the provision. Further, conduct covered by the prohibition, or more particularly the expense underlying the conduct, should already be regulated by application of the trustee's existing statutory and general law obligations.
58. As expressed in recent submissions to the Productivity Commission (Superannuation Inquiry)<sup>14</sup> and elsewhere in this submission, CFSIL supports a change to the default fund selection process to remove an employer's obligation to select a default fund for their employees. The Productivity Commission has introduced the concept of the Top 10 "Best in Show" funds which would be independently selected by an expert panel. CFSIL supports the general direction of this recommendation as it encourages competition in the market and genuine member engagement.

***Question 2: 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?***

59. As discussed above, CFSIL believes the provision strikes the right balance as currently drafted.

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<sup>14</sup> Colonial First State submissions dated 13 July 2018 to the Productivity Commission in response to draft report entitled "Superannuation: Assessing Efficiency and Competitiveness" (above at n 1)  
[https://www.pc.gov.au/\\_\\_data/assets/pdf\\_file/0017/230147/subdr163-superannuation-assessment.pdf](https://www.pc.gov.au/__data/assets/pdf_file/0017/230147/subdr163-superannuation-assessment.pdf).

***Question 3: Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?***

60. An employer has a responsibility to its employees to make a considered decision in relation to its default superannuation arrangements. This decision should be based on the characteristics of the fund, not the benefits that may flow to the employer personally via corporate hospitality or other forms of inducement.
61. However, the interpretation and application of such a law may be difficult for trustees (and their associates) as the question of whether particular conduct has the requisite intention or purpose of “inducing the selection of the fund” or “affecting the decision, or being likely to induce or affect that decision”, may be a subjective test as much as one based on objective evidence.

### **Topic 3: Payments from external responsible entities of managed investment schemes**

***Question: 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?***

62. Whether or not it is appropriate for the trustee of a superannuation fund to retain payments from a responsible entity or fund manager depends on the nature and purpose of the payment. Under the Future of Financial Advice (**FOFA**) reforms, any payment from a fund manager relating to a new arrangement is in respect of services provided by the trustee to that fund manager and contributes to the cost of administering the products on the platform. These fees are all calculated on a flat dollar basis.
63. Payments from fund managers to platform operators in relation to arrangements prior to 1 July 2013 are grandfathered and may be calculated by reference to the value of client funds invested in that fund.
64. Fees received from fund managers help ensure that administration fees remain competitive for members. The removal of these fees (including the volume based fees) could result in the trustee needing to charge higher platform administration fees to cover the costs of administering funds on its platform.
65. CFSIL is currently reviewing all such arrangements within its funds and, as with any changes in its practices, will consult with regulators and stakeholders as it conducts that review.

### **Topic 4: Selling of superannuation**

***Question 1: Is it appropriate that superannuation be sold through bank branches? 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?***

#### **Superannuation made available through bank branches**

66. CFSIL considers that it is appropriate for superannuation to be made available to customers through bank branches in circumstances where branch staff are accredited to give general financial advice and do so without providing personal advice to those customers. CFSIL considers that it is useful to clarify the concept of superannuation being "sold" in this context. In CFSIL's view, information about superannuation is provided to customers in bank branches in order for those customers to make a decision about where to invest their super. Accordingly, strictly speaking, it is not "sold" through bank branches and using the terminology "selling" superannuation mischaracterises the way in which these products are made available to consumers.
67. While CFSIL acknowledges the difficulty it faced in making its Essential Super product available to consumers in bank branches, it does not accept that this means that this approach to informing consumers about the availability of certain superannuation products is incapable of achieving good outcomes for consumers.
68. Further, if undertaken appropriately, and in respect of simple product offerings, the approach of making superannuation products available to consumers via bank branches gives consumers the opportunity to engage in decisions relating to their retirement savings and consider whether the product is suitable. For some customers, their superannuation experience may be limited to being defaulted into MySuper products selected by their employer, without regard to the specific needs of individual employees. The engagement via bank branches has a role to play in encouraging customers to consider alternatives.

69. It is relevant to answering both Questions 1 and 2 in Topic 4 to explain the distinction between "personal advice" and "general advice". Under the Corporations Act:
- (a) **personal advice** is financial product advice that is given or directed to a person (including by electronic means) in circumstances where:
- (i) the provider of the advice has considered one or more of the person's objectives, financial situation and needs (otherwise than for the purposes of compliance with the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 or with regulations, or AML/CTF Rules, under that Act); or
  - (ii) a reasonable person might expect the provider to have considered one or more of those matters;<sup>15</sup>
- (b) **general advice** is financial product advice that is not personal advice.<sup>16</sup>
70. The key consideration is whether the "objectives", "financial situation" and "needs" of the consumer have been considered. These terms are accorded their ordinary meaning.<sup>17</sup> There is a general understanding that "each of these items should be "personal" to the client".<sup>18</sup>
71. It is notable that mere awareness of these facts does not necessarily mean that personal advice is being provided. ASIC in RG 244 and RG 175 supports the use of a general advice model even where some of the customer's objectives, financial situation and needs are known. What is relevant is how the information is used.<sup>19</sup>
72. The distinction between general advice and personal advice has been a vexed issue. As Ms Elkins stated in oral evidence *"the definition of general advice versus personal advice is an extremely difficult industry-wide issue."*<sup>20</sup> Ms Elkins also noted that she looks forward to the Federal Court of Australia's decision in *Australian Securities and Investment Commission v Westpac Securities Administration Ltd ACN 000 049 472 & Anor (NSD2204/2016)* which she anticipates will provide *"proper resolution of these definitions for the industry"*.<sup>21</sup> Mr Chun recognised that there are *"potential risks around the general advice distribution model of – of potentially blurring into personal [advice]"*.<sup>22</sup>

#### Outcome in the best interests of members

73. CFSIL considers that, in principle, it is both appropriate and desirable for certain superannuation products to be made available to customers through bank branches using a general advice model and that with the appropriate procedures in place it is reasonable to think that such sales will produce outcomes that are in the interests of consumers.
74. Products, such as MySuper products, are designed to be simple to understand products for members who do not necessarily actively engage with their superannuation. According to the Explanatory Memorandum that introduced the MySuper legislation, MySuper was designed to *"simplify and standardise the default superannuation product available to Australians ... MySuper products will also have common characteristics meaning that they will be able to be compared based on a few key differences — cost, investment performance and the level of insurance coverage... This will enable members, employers and market analysts to make*

<sup>15</sup> Corporations Act 2001 s 766B(3).

<sup>16</sup> Corporations Act 2001 s 766B(4).

<sup>17</sup> RP Austin and Michael Vrisakis, 'Personal Financial Product Advice under the Corporations Act' (2017) 35 *Company and Security Law Journal* 503, 517.

<sup>18</sup> *Ibid.*

<sup>19</sup> Exhibit 5.310.4 [ASIC.0041.0005.0407] CBA document entitled "Response to ASIC Position Paper dated 20 February 2017", dated 17 March 2017, Exhibit TM-4 to the Statement of T Mullaly in response to Rubric 5-61 at 4.1.

<sup>20</sup> Transcript, Linda Elkins, 15 August 2018, 4972-8.

<sup>21</sup> Transcript, Linda Elkins, 15 August 2018, 4972-11.

<sup>22</sup> Transcript, Peter Chun, 15 August 2018, 4989-29.

*comparisons across MySuper products based on the actual fees paid and investment returns received by members.*<sup>23</sup>

75. The nature of the products means that they can appropriately be made available to customers in bank branches (by way of provision of general advice only), without the need for the member to pay the cost of obtaining personal financial advice. This is particularly so in light of the improvements to MySuper under the current member outcomes proposals that should give even greater comfort that MySuper can be made available to consumers in this way.
76. CFSIL considers that making MySuper products available via bank branches is valuable for consumers for the following reasons:
- (a) **Accessibility** (of branches and information): Accessibility is particularly important in the context of compulsory superannuation and given the levels of disengagement of sections of the public when it comes to superannuation. Bank branches are accessible locations for customers to obtain information to help them better understand superannuation. CFSIL considers it useful to note that customers, and employers on behalf of customers / members, make choices about superannuation funds on their own without the provision of financial advice. In CFSIL's view, accessible general advice provided to a customer through a branch provides additional information to customers to assist them in forming a view about their superannuation. This is particularly so in circumstances where there will be a likely increase in provision of financial services, including superannuation, by way of digital channels (in relation to which, there is a lack of clarity around how the current legislation translates in this context).
  - (b) **Continuity / Portability:** From a customer centric design perspective, banks are naturally the home for salary credits and customers tend to take their bank account with them as they change jobs. In relation to superannuation, making the MySuper product available in branches increases the likelihood that customers will take their superannuation product from job to job in the same way. This limits the risk that a member will end up with multiple superannuation accounts.
  - (c) **Low cost:** Customers can access information about superannuation without the costs associated with seeking personal advice (in circumstances where personal advice may not be necessary or desired). It is in the public interest for Australians who do not have high earnings or net worth, to have access to free information and advice in the form of general advice. In particular, customers who are likely to benefit from MySuper products being made available in bank branches are younger customers and/or customers who do not have high earnings or net worth. Distribution in branches addresses these customers' needs to access simple, competitively priced superannuation products that suits their financial needs.
77. FOFA was intended to make advice affordable and accessible. Supporting a clear general advice regime for this customer need (simple superannuation products) is consistent with the policy intentions of those reforms.
78. However, CFSIL acknowledges (and has previously acknowledged) that a lack of clarity between what constitutes general and personal advice presents a risk for the bank branch distribution model. Nevertheless, CFSIL consider that with appropriate systems and measures in place, and regular consultation with regulatory bodies, the risk that general advice might be provided can be mitigated to ensure consumers' best interests can be met. In particular the Registrable Superannuation Entity (**RSE**) Licensee must be satisfied that:
- (a) there are proper risk management processes in place;
  - (b) frontline staff are appropriately accredited,<sup>24</sup> are provided with ongoing education and are aware of the limits to their advice; and

<sup>23</sup> *Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2011*, Explanatory Memorandum, p 6.

- (c) appropriate levels of supervision and monitoring of frontline staff are in place to ensure that personal advice is not provided to consumers.

79. Finally, as noted above, CFSIL does not consider that all superannuation products should be made available in bank branches. Where a customer's personal circumstances are required to be taken into account (for example, where a customer expresses an interest in a product that is not a MySuper product, or seeks advice from the branch staff as to the most appropriate product for them), personal advice is necessary to meet the customer's needs and that customer must be referred to a financial adviser for personal advice.

**Question 2: 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? 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?**

80. Clarification to existing laws with respect to the distinction between personal financial advice and general financial advice would assist the industry and decrease the likelihood that bank branch staff provided personal advice in the course of seeking to provide general advice.
81. 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 is general advice or factual information. As described above, general advice is advice or guidance which does not take into account one or more of a person's specific circumstances, needs or objectives. It also may relate to general information about a product.
82. There has been policy discussion in recent years about the need to ensure consumers have greater clarity about when they receive general advice as opposed to personal advice. One means by which to achieve this would be to re-label general advice for greater customer understanding. CFSIL has long supported this change and suggests in depth consumer testing occurs on a range of options for this change of name before this reform is finalised.

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<sup>24</sup> Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018 3 [17]: For example, during the sale of Commonwealth Essential Super, CBA took the stance that staff "be RG146 accredited in superannuation and could only provide general advice to customers".



**Topic 5: Engagement by superannuation funds with Aboriginal and Torres Strait Islander people**

***Question 1: Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members? If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground? If those procedures are not appropriate, what should be changed?***

83. CFSIL has standard identification processes for all superannuation fund members. CFSIL also has specific or modified procedures for Aboriginal and Torres Strait Islander members. All staff members in the contact centre and administration teams are trained on the standard identification requirements for members.
84. CFSIL recognises that for some Aboriginal and Torres Strait Islander members, meeting the standard identification processes can be challenging. The Financial Services Council (**FSC**) is actively engaged in considering this issue and is providing guidance on how superannuation funds can address identification challenges faced by these members while continuing to meet statutory requirements in relation to identification of members. CFSIL is working with the FSC to understand whether, and how, implementation of these processes could be improved to ensure all members are able to be appropriately identified in a manner that minimises fraud risk.

***Question 2: Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?***

85. CFSIL does not capture the ethnicity or heritage of its membership as it does not distinguish between customer backgrounds. There have been occasions where identification received has not been legible and CFSIL has needed to request resubmission of identification from members.
86. Based on current identification or condition of release requirements, CFSIL is generally able to work with all members to identify themselves.
87. However, CFSIL is committed to working with industry and relevant stakeholders to determine whether there is a better approach to capturing and utilising meaningful data to improve outcomes for Aboriginal and Torres Strait Islander members.

***Question 3: Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?***

88. CFSIL considers that, for the best interest of its members, all superannuation funds should offer early release based on financial hardship. This is when members are at their most vulnerable and usually in need of funds quickly.

***Question 4: Should the lower life expectancy of Aboriginal and Torres Strait Islander people be taken into account in the decision-making processes of superannuation funds when considering how to administer or release the funds of Aboriginal and Torres Strait Islander people? If so, how?***

89. CFSIL considers that the lower life expectancy of Aboriginal and Torres Strait Islander people has a significant impact on these members, along with cultural differences and identification challenges. CFSIL does not currently take this into account.
90. It is evident that the rigidity in the administration of legislation relating to release of funds between member cohorts or segments may impact Aboriginal and Torres Strait Islander people to a greater extent than other people. CFSIL supports the FSC's position that further work should be undertaken to determine the best approach to improving superannuation outcomes for Aboriginal and Torres Strait Islander people.
91. In line with financial hardship rules, CFSIL considers that early release of superannuation funds on the basis of severe financial hardship can be considered by the trustee. However, in CFSIL's view, superannuation trustees would be assisted by more prescriptive government policy around the circumstances in which superannuation should be released early in order to ensure consistency of policy regarding release of funds for particular cohorts.
92. CFSIL considers that it is important to note that increasing the discretion in decision making for trustees may negatively impact the consistency of outcomes. In superannuation and other financial services, CFSIL believes individuals value certainty. To the extent that changes to the rules relating to particular cohorts of members are introduced, CFSIL supports increased Government administration of such claims rather than relying on trustee decision-making discretion.

***Question 5: Should the categories of person permitted by legislation to be the subject of a binding nomination be changed to reflect Aboriginal and Torres Strait Islander kinship structures? If so, how should the categories be broadened?***

93. CFSIL considers that it would be useful to address whether categories of person permitted by legislation to be the subject of a binding nomination should be changed to reflect Aboriginal and Torres Strait Islander kinship structures. This change should be made in consultation with Aboriginal and Torres Strait Islander representative groups to ensure no unintended consequences arise from this change.
94. CFSIL notes that an important part of that discussion is a consideration of the practicalities involved with implementing any change to binding nominations, given kinship relationships are often extensive (i.e. who would fall within kinship and relationship status). CFSIL suggests that a potential option would be for members to specifically identify beneficiaries or for their legal representative (who may be better placed) with knowledge of the member's kinship structure to identify beneficiaries on behalf of the member.

## **Topic 6: Discretion to appoint and remove directors**

***Question: Is it appropriate for shareholders of RSE Licensees to retain a broad discretion to appoint and remove directors? Or should there be an obligation imposed on shareholders to exercise such powers in the best interests of the members?***

95. Yes. CFSIL considers it is appropriate for shareholders to retain some discretion to appoint and remove directors. CFSIL also agrees that an appropriate qualification could be to ensure that this power can only be exercised in the best interests of members. Relevant factors to be taken into account may include, for instance, whether the nominee satisfies APRA's 'fit and proper' requirements, whether they offer skills that would be of benefit to the board overall, their previous experience and other matters that would support a merit-based appointment. It is also our view that the existing board should contribute to the decision as to whether a nominee is successfully appointed.
96. In CFSIL's view, the board of a superannuation fund should have a majority of independent directors.

## **Topic 7: Relationship between trustees and financial advisers**

***Question 1: Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?***

### **Grandfathered commissions**

97. An outright ban on conflicted remuneration models was not the preferred option at the time of the FOFA reforms as it was acknowledged that it would result in many market participants leaving the industry, and that those left would need to operate on a fee for service basis, resulting in risks that access and affordability of advice for most consumers would be detrimentally affected.<sup>25</sup>
98. The FOFA reforms are achieving their intended outcome by phasing out, in an orderly way, grandfathered commissions. Taking CFSIL as an example, a significant number of members have moved, over time, from products that incorporated commission arrangements to products with a fee for service model. Within the Colonial First State FirstChoice Superannuation Trust, the number of member accounts in respect of which commissions are payable reduced from approximately 70% as at July 2013 to approximately 18% as at June 2018.<sup>26</sup> More generally, the 2017 investment trends research shows trail commission as a percentage of the adviser book revenue is declining year on year.<sup>27</sup>
99. CFSIL considers the orderly wind down of grandfathered commissions is appropriate and recognises that a legislative approach should now be considered. Market participants including financial advisers and their clients should be provided with sufficient notice and time to transition to other arrangements in an orderly fashion as a result of this change.
100. To help facilitate this transition, CFSIL also supports the introduction of disclosure requirements in relation to grandfathered commissions by RSE licensees, including the

<sup>25</sup> Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012 Revised Explanatory Memorandum at pp 67-68

<sup>26</sup> Exhibit 5.181, Witness statement of L Elkins in response to Rubric 5-37, dated 30 July 2018 at [74]

<sup>27</sup> Investment Trends Planner Business Model Report (2017), page 26.

adoption of the Productivity Commission's recommendation to require regular disclosure of trailing commissions to members.<sup>28</sup>

*The Australian Government should require superannuation funds to clearly inform, on an annual basis, all members who are subject to trailing financial adviser commissions. This information should include the amount of commissions paid and a notice that trailing commissions are now illegal for new members.*

*All funds should publicly disclose the extent of trailing commissions and number of affected members in their annual reports and provide this information to ASIC.*

### Ongoing service fees

101. CFSIL does not support any legislative intervention to remove ongoing service fees.
102. Deduction of ongoing service fees provides benefits to members and operates in members' best interests provided adequate controls are in place to ensure the service is being provided. CFSIL acknowledges that this has not historically been the case, but considers that appropriate arrangements are now in place to ensure that members receive the services they are paying for. Importantly, ASIC has noted most of the systemic failures identified relating to the payment of fees without service occurred before the FOFA reforms, which became mandatory on 1 July 2013. Further, it concluded that *"the changes made under the FOFA reforms—in particular, the requirement that customers opt in to receiving ongoing advice services, and the introduction of fee disclosure statements—contributed to some AFS licensees identifying the fee-for-service failures...[and] these provisions, and the system changes they have required, substantially reduce the likelihood that the type of systemic failures described in [ASIC REP 499] will recur."*<sup>29</sup>
103. Where quality financial advice is provided by professional financial advisers that delivers good retirement outcomes for members, accompanied by transparency of fees and services, the payment mechanism for the advice should not be an issue.
104. CFSIL supports the FOFA-introduced fee disclosure and opt-in requirements which now provide extra transparency and consumer safeguards relating to the provision of personal advice and agreements to pay for these services on an ongoing basis. These requirements are unique to professionals who deliver financial advice and so the regulation of fee for service advice arrangements, when considered within the context of increasing professional and ethical standards, is now of a very high standard.

### Convenience for members

105. In order to deduct the ongoing fees from a members' account, an agreement between the member and the RSE Licensee is entered into to facilitate the deduction.
106. The deduction of fees for retirement related advice from a member's superannuation account is both flexible and convenient for members, including from a cash flow perspective. CFSIL believes this allows more members to afford advice that may otherwise be out of reach. It is not uncommon for a member's superannuation account to be used for the deduction of other expenses (including via a limited condition of release) for example the release of funds to meet an excess superannuation contributions tax liability. Here, the Government permits a member to choose to fund a liability either through a personal source or through their superannuation account. CFSIL sees no reason why the cost of advice on the account, paid to the member's personal financial adviser, should be any different.

<sup>28</sup> Productivity Commission draft report "Superannuation: Assessing Efficiency and Competitiveness" at page 62.

<sup>29</sup> ASIC Report 499 Financial Advice: Fees for no service, released 27 October 2016, p 6: <https://download.asic.gov.au/media/4054607/rep499-published-27-october-2016.pdf>.

107. CFSIL also considers that the method of payment, given the member contracts and authorises the payment personally, is more transparent and understandable to members compared to other methods of payment such as for intra-fund advice.
108. CFSIL is concerned that reducing a member's options in relation to facilitating payment of their fee for service contracts is both unnecessary and likely to reduce access to advice.

*Management of fee for no service risk*

109. When a member enters into an arrangement and agrees for their adviser to charge an adviser service fee via a product, there are effectively three contractual arrangements in play. These are the arrangements between:
- (a) the adviser and the member (the ongoing service agreement) and the associated obligations relating to Fee Disclosure Statements;
  - (b) the RSE Licensee and the adviser (to allow the adviser access to and ability to charge via the product); and
  - (c) the member and the RSE Licensee (to direct the RSE Licensee to pay the fee to the adviser).
110. These contracts are separate. This arrangement is consistent with the sole purpose test.
111. The RSE Licensee can deduct the ongoing service fee to pay the adviser only where the member has authorised the RSE Licensee to pay the stipulated amount on an ongoing basis from the member's account and subject to the terms of the relevant trust deed.
112. The contract for services and delivery of those services is one that exists between the member and the adviser. Whilst the financial adviser has the principal obligation to ensure that they have a lawful entitlement to the fee, the trustee of a superannuation fund also has an obligation to ensure that the deduction of those monies from a member's account is appropriate.
113. However, with a number of Australian advice licensees acknowledging that at times they have failed to meet expectations by not providing ongoing services as promised, CFSIL recognises the importance of controls directed to ensuring that members receive these services. CFSIL believes trustees can improve the supervisory role they play in confirming that the services have been provided for the fees deducted from the fund.
114. While removing the option to deduct ongoing service fees from members' accounts would manage the risk of fees being charged where no service has been provided, CFSIL considers that taking that step is not in the members' interests as it will deprive members of the benefits outlined above. Instead, CFSIL suggests the fee for no service risk should be managed by both the RSE Licensee and by the ASF licensee in a way that reflects those parties' contractual and other obligations to members.
115. Some of the current and proposed policies and procedures in relation to fees deducted from CFSIL funds are detailed here:
- (a) In regards to ongoing service fees and other explicitly agreed fees, the RSE Licensee has primary responsibility to ensure that the fee is specifically authorised and reasonable. CFSIL has processes in place to ensure fees are authorised. In regards to fees being reasonable, CFSIL has adviser fee guidelines and monitoring in place. This monitoring occurs on a monthly basis and any fees in excess of a prescribed percentage are investigated.
  - (b) CFSIL's terms of per annum trade represent an agreement with licensees that expressly requires advisers to ensure they are meeting their obligations, including requiring them to notify CFSIL where a client does not agree to the services

provided under the fee disclosure statement. CFSIL is in the process of introducing a more formal process for advice licensees attesting to their obligations (and those of their advisers) and to provide assurance to CFSIL on an ongoing basis, including confirming that appropriate services are being provided to members.

- (c) CFSIL is continuously enhancing adviser monitoring processes including monitoring of customer call data, complaints reporting and other sources to investigate any cases where CFSIL becomes aware that advisers are not actively servicing members. In these cases, CFSIL ceases to deduct ongoing service fees.

**Question 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. 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?**

116. Research undertaken by the FSC and KPMG Econtech<sup>30</sup> has calculated the value of advice in economic terms. This research demonstrates that, for example, a 30-year-old who has a financial adviser will be \$91,000 better off in retirement due to the impact of financial advice on savings behaviour. A 45-year-old will be \$80,000 better off, whilst a 60-year-old will be \$29,000 better off.
117. The average cost of providing advice to a new client is \$2,500.<sup>31</sup> This contrasts starkly with the \$780 that consumers are willing to pay, on average, for initial advice.<sup>32</sup> The demand for financial advice among Australians is growing strongly. In 2017, approximately 9.4 million Australians had unmet advice needs, yet the number of Australians who have seen an adviser has declined over the past ten years. Factors that inhibit Australians from seeking advice include insufficient wealth and the high cost of advice.<sup>33</sup>
118. The cost of living in Australia continues to be high by international standards and in this environment consumers will prioritise meeting immediate or short term expenses and financial obligations over longer term financial needs. It follows that consumers are less focused on planning for their long term financial security through financial advice than if conditions were different. To the extent advisers face further barriers to providing professional, quality financial advice to consumers such as the changes proposed in Question 1, there are natural consequences which policy makers would need to consider.
119. Members would be less likely to obtain regular financial advice. Given the general levels of disengagement of superannuation members, and the costs of obtaining one-off advice, members are less likely to proactively opt-in to obtain financial advice to review their circumstances as regularly as they would under an ongoing service arrangement where services and fees are documented in an upfront agreement.
120. Removing the option of deduction of ongoing service fees would make advice less affordable and risk advice not being sought by members due to the behavioural bias of valuing current consumption over purchasing advice for their future consumption benefit.

<sup>30</sup> KPMG/Econtech, Value Proposition of Financial Advisory Networks – Update and Extension, 18 January 2011 [https://www.ifc.ca/wp-content/uploads/2013/09/KPMGReport\\_ValuePropOfFinAdvisoryNetworks.pdf/4566](https://www.ifc.ca/wp-content/uploads/2013/09/KPMGReport_ValuePropOfFinAdvisoryNetworks.pdf/4566).

<sup>31</sup> Investment Trends, Planner Business Model Report, 2017.

<sup>32</sup> ASIC Submission to Productivity Commission Inquiry into Competition in the Australian Financial System”, 2017 para 398.

<sup>33</sup> ASIC’s Corporate Plan 2018-22, August 2018: <https://download.asic.gov.au/media/4855947/asic-corporate-plan-2018-22-focus-2018-19-published-31-august-2018.pdf>.

121. CFSIL considers further consequences would follow which could be detrimental to member outcomes:
- (a) with members much less likely to be advised on maximising savings and managing cash flows in retirement, they would rely to a greater extent on the age pension in retirement;
  - (b) from a policy perspective, there may be a need to consider embedded, product-driven forms of financial advice which may give rise to sub-optimal member outcomes and inconsistent regulatory policy outcomes; and
  - (c) members would retire with less and have a lesser quality of life in retirement.
122. With respect to paragraph 121(a), CFSIL believes Australians should have the opportunity to achieve the ability to be self-sufficient in retirement. Ensuring quality, professional financial advice is as affordable and accessible as possible is key to supporting this outcome.
123. With respect to paragraph 121(b), CFSIL believes there are limits on the utility of product-driven forms of advice, especially if this became the predominant form of advice delivery in the market. One existing form of product-driven advice is intra-fund advice. Intra-fund advice, which was introduced to permit members to have greater access to advice, can offer some lessons. This form of advice has limited value (compared to quality personal financial advice) given the permitted advice is very limited in scope and can only be provided to existing members.
124. Given the issues discussed above, CFSIL continues to believe there is value in quality, professional personal advice to consumers seeking to maximise their retirement outcomes and CFSIL supports the continued professionalisation of the financial advice industry.



## **Topic 8: Managing Conflicts**

***Question 1: 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?***

125. An RSE Licensee and Related Entity (**RE**) must be cognisant of the risks and requirements identified by ASIC and APRA in their dealings with the industry regarding trustees with a "dual regulated entity" status (**DREs**). However, CFSIL does not consider that such a structure raises an inherent problem or prevents a superannuation trustee from being able to comply with its fiduciary duties.
126. CFSIL's view is that it is possible for a trustee that is a DRE to:
- (a) effectively manage any risk of conflicts with its duties as a superannuation trustee; and
  - (b) obtain operational efficiencies and other benefits from having "end-to-end" control and oversight of the investments of the superannuation fund.
127. Subject to consistently applied investment selection and due diligence processes, a trustee (having regard to the interests of superannuation fund members and relevant investment strategy factors prescribed by the SIS Act) may appoint investment managers or alternatively, select externally managed investment options, for the fund. Where a mandate structure is employed, investment parameters (including the investment strategy for the relevant fund) are agreed in the investment management agreement (**IMA**) and are generally subject to monitoring by the trustee in accordance with industry standard terms.
128. Similarly, structures which involve relationships between the trustee and the investment provider (e.g. through a life insurance investment policy) or alternatively, the trustee and an advice licensee, do involve the potential for conflict. Again, appropriate processes and controls can be put in place to manage these potential issues.
129. Conflicts management policies should ensure that the interests of impacted investor groups (e.g. as between superannuation fund members, managed investment scheme unitholders and policy owners) are identified and appropriately managed. Key to this is an understanding of the capacity in which relevant decisions are made, as well as the ability to separate advisory and management teams for each group of investors, if required.
130. In the course of the Round 5 hearings, issues identified as arising in the context of a DRE structure appeared to involve a series of important compounding factors or errors, including (potentially) a failure to have in place adequate risk management systems and appropriate processes for clarifying the relevant decision-making capacities. In these cases, it would appear that the core issue may not have been a conflict between the duties of the RSE Licensee and those of the RE, but rather a conflict between the trustee duties generally and the interests of the corporate entity or the shareholders.

## Superannuation fund governance

### *Trust model*

131. The trust model for APRA-regulated funds is an inherent governance control because the role of the trustee is fiduciary by nature, and it additionally imposes an obligation on trustees to act in members' best interests. At its essence, there is an underlying obligation of loyalty requiring the trustee, subject to the trust deed, to act in, and prioritise the interests of, the members. This means that where a trustee is exercising its duties or powers, other interests (for example, related party, employer, union, or shareholder) are only relevant to trustee decision-making where those interests are concurrently in the interests of beneficiaries. Otherwise, where a conflict exists, the interests of the members must be prioritised ahead of all other interests.

### *Board governance*

132. Independence of board members is also an important feature of trustee boards in ensuring that conflicts of interest are identified and appropriately managed. Where functions are carried out by separate legal entities, separate boards would likely be involved in making decisions for each party. However, where there are common directors across the boards for each entity (for example, multiple trustee boards), it is important to ensure that formal mechanisms exist to manage conflicts, ensure entity role clarity and prioritise the interests of superannuation fund members.

### *General management of conflicts*

133. CFSIL acknowledges that in a vertically integrated model, conflicts can and will arise and that even where those conflicts are managed effectively there may remain a perceived conflict in respect of related party transactions.
134. CFSIL has a strong focus on identifying, assessing and managing conflicts. This focus allows each entity to confidentially deal with related parties, while retaining appropriate separation of functions and interests. Within the Wealth Management business this means that the business is structured so that different business functions are provided by different corporate entities, or separate teams (including advisers) as appropriate.
135. CFSIL recognises that further enhancements to those conflict management processes could provide greater transparency. One such measure could include ensuring that where benchmarking is undertaken, the basis of comparison is clearly set out. Benchmarking should also be the subject of ongoing review and consideration, including where appropriate, independent review.
136. CFSIL believes that a "best practice" conflicts management approach adopted by a trustee would contain the following core elements:

<b>Conflicts Management Framework and Policy</b>	<ul style="list-style-type: none"> <li>Policy on identifying, assessing and managing conflicts which is reinforced and operationalised through mandatory training and compliance review.</li> </ul>
<b>Conflicts Management Registers</b>	<ul style="list-style-type: none"> <li>Maintaining a conflicts management register (as well as the registers required under the Superannuation Prudential Standards, such as the registers of relevant duties and relevant interests). The purpose of this type of register is to identify conflicts and outline how these conflicts can be managed going forward.</li> </ul>
<b>Board awareness</b>	<ul style="list-style-type: none"> <li>Board and management awareness and understanding of potential conflicts of interest and duty are critical. It should be part of the normal operating rhythm of a board to identify, assess and manage or avoid conflicts, and for the board to communicate its expectations</li> </ul>

	<p>to management regarding these issues. This can be achieved by processes put in place to facilitate this culture and approach, such as:</p> <ul style="list-style-type: none"> <li>• a standing agenda item is in place for the disclosure of any conflicts;</li> <li>• the requirement for board papers to address any conflicts relating to a proposal (specifically identifying, assessing and the managing conflicts);</li> <li>• the development of guidelines and education sessions held for the business to enhance conflicts understanding and application of conflicts principles;</li> <li>• formal conflict management protocols utilised for specific significant conflicts (for example, relating to transactions, transfer or SFTs being considered) at the board and management level.</li> </ul>
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### **Structures, identified risks and conflict management - Related party transactions**

137. As noted above, a trustee has statutory and general law obligations to give priority to the interests of members over those of any other person and to act in the best interests of members. If the trustee is acting properly and in accordance with its duties (and assuming that there are appropriate risk management arrangements in place), then the appointment of a related party provider, for example an insurance provider, should not prevent the trustee from being able to satisfy its duties.
138. A superannuation trustee has an obligation to ensure that it has appropriate policies and procedures in place and is operating effectively to control any circumstances that may put it in a position of conflict with the interests of its members. Such measures include recognising and managing any conflict that may arise by negotiating the terms and conditions of the insurance policies at arms-length.
139. Critical to determining if a policy has been negotiated on arms-length terms is that the terms are commercial in nature and, where possible, independently supported (e.g. through benchmarking by external consultants). The arms-length nature of the arrangement must also continue through the life of the relationship, including the approach to monitoring the insurer, dealing with breaches of agreements or service standards and reviewing declined claims.
140. Fundamentally, business structures must also support the approach to the management of conflicts. Added to this is the heightened governance and professional approach arising from the appointment of majority independent boards for superannuation trustees (as discussed above). In a typical vertically integrated structure which includes both a superannuation trustee and a life insurer, it is usual for business, management and board structures to be maintained separately and according to distinct sets of business objectives and strategies.
141. CFSIL considers that related party dealings where conducted on an arms-length basis, entered into honestly, with due care, skill and diligence, for a proper purpose and in the best interests of members, should not cause concern or impinge upon the trustee's ability to comply with its fiduciary obligations.

**Question 2: If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable? Can it be said with confidence that conflicts that arise from structures are so unmanageable as to warrant legislative intervention? Should there be a strong preference away from any form of legislative intervention in particular corporate structures? Are there alternative interventions that might better address the problems?**

142. CFSIL does not consider structural change mandated by legislation or otherwise is desirable or necessary and in CFSIL's view, existing legislative obligations in relation to the management of conflicts (for example, section 912A(1)(aa) in the Corporations Act and the APRA obligations imposed on RSE Licensees in relation to management of conflicts of interest) are sufficient, if implemented appropriately.
143. However, CFSIL acknowledges that in a vertically integrated model, conflicts can and will arise and that even where those conflicts are managed effectively there may remain a perceived conflict in respect of related party transactions and arrangements. Accordingly, CFSIL recognises that there are further enhancements to those processes which could provide greater transparency and assurance that related party transactions are on arms-length terms and are in the best interests of members. Those enhancements could include, for example, requiring trustees to undertake:
- (a) robust benchmarking of related party transactions and arrangements, including clear and transparent comparison criteria;
  - (b) independent reviews of benchmarking as part of internal and external audit processes.

**Question 3: 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?**

144. While CFSIL appreciates the intention to protect member interests by widening the scope and application of the best interests duty, the above suggestion would (in CFSIL's view) create a lack of clarity and a degree of complexity for parties associated with the trustee in understanding how to comply with the duty.
145. For that reason, CFSIL does not consider that it would be preferable to extend the obligation to act in the best interests of members in the way described in Question 3. As set out above, CFSIL considers that the current fiduciary obligations placed on the trustee are adequate.

**Question 4: Are there unforeseen consequences of such a legislative intervention that would make it undesirable to strengthen the SIS Act in this way?**

146. Yes. It is possible that a range of unforeseen consequences or undue complexity would arise as a result of applying a best interests duty where one does not currently exist based on the nature of the relevant relationship. For example, a service provider to a trustee is already subject to a range of contractual and prudential requirements that are commensurate and appropriate to the nature of that role. To impose a fiduciary-type responsibility in the absence of other key indicators would be to elevate the levels of compliance risk and potential liability in

a manner that may expose fund members to a greater degree of business continuity risk, higher costs and/or a need for wider indemnification from the fund.

## **Topic 9: System changes**

***Question 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?***

### **Current framework and proposed reforms**

147. With the introduction of MySuper, retail default products were required to undertake significant change and transformation in order to comply with the new rules. As outlined in Section S and in other parts of this submission, for retail funds compliance with MySuper and other regulatory reforms was complex, requiring significant resources and critical decision-making about a large program of legislative change in a short space of time. MySuper has now effectively 're-baselined' the regulatory standards for all default products on the market. Conflicted remuneration can no longer exist in default superannuation and trustees must offer a single default investment strategy (or lifestage product) to such members. Default members can now take comfort in the safety and relative consistency of experience they should receive as MySuper members as a result of this standardisation, irrespective of which type of superannuation fund offers their product. However, it is clear the default system could be further improved.
148. CFSIL supports increased transparency and competition to improve superannuation member outcomes. A market environment which permits competition for members between for-profit entities and not-for-profit entities promotes efficiency, innovation and better retirement outcomes for individuals. CFSIL believes it would not be in the interests of the community or the broader economy to prohibit a segment of the market from competing for the right to offer services to members. CFSIL continues to support reforms to strengthen regulation, conduct and default allocation across the superannuation sector.
149. To that end, CFSIL believes the combination of the reforms proposed below will adjust the default system sufficiently to provide members with a strong framework which encourages healthy competition for members and introduces even stronger consumer protections. Whilst these reforms will reach beyond MySuper products impacting the broader system, CFSIL views these measures as the next phase of necessary default superannuation reforms.

### **Continuing to improve the default system**

150. As highlighted in the Productivity Commission's report the design of the existing default superannuation system discourages competition and results in many members being placed into underperforming and subscale funds. Some funds have benefited from the proliferation of small and multiple accounts (a characteristic of the current system) as a result of the revenue from dollar based fees attached to those accounts. Members in these funds are disadvantaged by the current system as multiple sets of fees and insurance premiums unnecessarily reduce their total benefit. The below section of the submissions expands on CFSIL's views about current reforms CFSIL supports and which will operate to improve member outcomes for default superannuation members.
151. The Government has proposed a number of measures to review and reform various aspects of superannuation policy, including:
- (a) *The "Protecting Your Super" package of legislative reforms* – this package of reforms legislates changes announced in the 2018-19 Federal Budget to prevent low-balance and inactive accounts from erosion from fees and insurance premiums, and reduce the proliferation of multiple accounts. The reforms include capping fees for members with balances below \$6,000, the cancellation of insurance cover for specific cohorts of members (and preventing default insurance to be granted to



these cohorts), and consolidation of low-balance and inactive accounts into active accounts via the ATO.

- (b) *The Productivity Commission's review of efficiency and competition in the superannuation system* - this review is in its third, and final, stage. As part of the review, the Commission has been asked to make recommendations to improve outcomes for members and system stability. The Commission has also been tasked with identifying, and making recommendations to reduce, barriers to the efficiency and competitiveness of the superannuation system. The scope of the review includes an assessment and evaluation of the accumulation, transition and retirement phases of superannuation as well as the default, Choice (including self-managed) and corporate fund member segments;
- (c) *Member outcomes reforms* - APRA has proposed a number of changes to the superannuation prudential framework to place greater focus on the delivery of sound outcomes to superannuation fund members. The changes proposed by APRA include the consideration of member outcomes in RSE strategic and business planning, proposals relating to fund expense management and reserving, and the introduction of an annual outcomes assessment which will require trustees to consider the impact of its investments, insurance benefits, scale, product features and fund expenditure on the outcomes provided to members; and
- (d) *Governance reforms (independent directors on trustee boards)* - This reform will require that superannuation licensees will be required to have at least one third independent directors and for the Chair of the board to be an independent directors. This reform is consistent with the recommendations of both the 2010 Cooper review and the 2014 Financial Services Inquiry and better aligns superannuation governance to that of ASX listed companies.

(together, the **Reforms**).

- 152. These extensive and comprehensive Reforms would have a significant impact on the superannuation industry, and CFSIL believes, would improve (amongst other things), outcomes for members in default funds. CFSIL considers that the Reforms are sufficient to address any concerns that the Commission has in respect of evidence arising out of the Round 5 hearing and accordingly, does not consider it necessary for the Commission to recommend additional changes to the default system.
- 153. For example, and as discussed in more detail below, this includes the introduction of a concept of a limited number of approved "Best in Show" default funds independently and expertly selected based on certain criteria. While this reform does not specifically and directly 'address and discourage misconduct', a reform such as this will improve member outcomes by introducing a quality filter into the default selection process, increasing competitive pressure relative to the status quo. It will also encourage member engagement.<sup>34</sup>
- 154. Currently, members are placed into funds based on the decisions of employers or industrial parties. As the Productivity Commission has alluded to, under current arrangements consumers continue to run the risk of being placed into underperforming and subscale funds. Removing third party decision makers and encouraging engagement will improve member outcomes.
- 155. While the criteria for the selection process has not been finalised, CFSIL agrees with the Productivity Commission's suggestion that a range of metrics would need to be considered including fees, net return, governance arrangements, compliance with the insurance code and administration efficiency.

<sup>34</sup> Productivity Commission draft report, Superannuation: Assessing Efficiency and Competitiveness, above n 1, at p 446.



156. The Productivity Commission also supports the passage of the MySuper outcomes test requirements as an additional filter for MySuper products, and it is important to ensure APRA can remove underperforming subscale funds from the market. As discussed below in response to Question 2, CFSIL supports these changes.

**Question 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?**

157. As noted above, CFSIL supports the introduction of an annual MySuper outcomes assessment as per current proposals before Parliament and under consideration by APRA as part of its consultation to enhance the prudential standards for superannuation. Specifically, Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 which is currently before the Senate, proposes amendments to replace the existing 'scale test' with a new outcomes test for trustees of APRA funds with MySuper products. If enacted, this will require trustees to assess whether their MySuper product is optimising outcomes to members by effectively promoting the financial interests of their beneficiaries.<sup>35</sup> This will be an important tool for use by APRA in regulating the sector, especially under the new default structure as proposed by the Productivity Commission.
158. These reforms are designed to increase general trustee standards, transparency and greater accountability in relation to trustee decision making and improved superannuation fund data. Increased trustee standards and accountability, if accompanied by greater representation on trustee boards by independent directors, will have a positive impact on member outcomes. Implementation of the outcomes test will need to include guidance from APRA as to how to appropriately develop the processes to deliver outcomes, including for example how to appropriately benchmark products against relevant and well-defined peer categories. This is critically important given the role of the trustees is not to deliver or guarantee specific outcomes but rather to ensure processes are in place so that appropriate outcomes can be achieved.

**Question 3: 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?**

159. The Productivity Commission review and the Protecting Your Super (PYS) package, discussed above at paragraph 151(a), specifically addresses the concept of "stapling".
160. In particular, the PYS package, goes some way to fixing this problem, but the root cause still needs to be addressed. PYS proposes changes to strengthen the ATO-led consolidation regime by requiring the transfer of all inactive accounts where the balances are below \$6,000 to the ATO. The ATO will be given powers to reunite ATO-held accounts with the member's account where possible.
161. In isolation, and in the context of existing default rules, this reform helps to address the proliferation of low balance accounts. It could be improved, however, by taking the transfer

<sup>35</sup> Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017, Explanatory Memorandum p.15.

one step further and immediately reuniting the inactive account with a member's active account (instead of remitting/holding the funds with the ATO). The full package of SuperStream reforms, implemented over the course of the last five years by superannuation funds, now permit this reunification to occur.

162. However, the Productivity Commission's recommendations outline an even more comprehensive solution. As the Productivity Commission has demonstrated in its draft report released in April 2018, the proliferation of unintended multiple accounts across the superannuation system can, and is, unnecessarily eroding member benefits and should be addressed. According to the Productivity Commission, unintended multiple accounts cost members \$2.6 billion per year in excess insurance premiums and administration fees.
163. The Productivity Commission's recommendation 1: *Defaulting only once for new workforce entrants*, is a positive solution. This addresses the root cause of the problem and will help to solve the proliferation of multiple accounts, including many inactive small accounts.
164. The Productivity Commission proposes that a centralised online service should: allow members to register online their choice to open, close or consolidate accounts as they submit their Tax File Number when starting a new job; facilitate the 'carry over' of existing member accounts when members change jobs; and, collect information about member choices (including whether they are electing to open a default account) for the Government. This service would be achieved by enhancing the Single Touch Payroll (**STP**) and MyGov systems.
165. CFSIL has been working with the ATO on the design for STP and considers that this solution will provide better outcomes for employees. CFSIL considers that providing technology solutions for members is essential to ensuring positive outcomes for members. CFSIL currently integrates some members' superannuation accounts into Netbank (CBA's internet banking website). This is a natural extension for employees to interact with their superannuation. The solution proposed by the Productivity Commission will also provide benefits to employers as it will reduce the administrative effort in capturing choice of fund details from employees. This information would automatically flow from the ATO's MyGov system into an employer's payroll system.
166. As previously mentioned, the Productivity Commission also makes recommendation 2: *the Top 10 'Best in Show' shortlist for new members*. As the draft report states "*The best in show shortlist is about putting members first- regardless of their employer or industry of employment*".<sup>36</sup> The report also, in CFSIL's view, correctly identifies that the current workplace relations system acts as a barrier to competition in the default market:
- "While embedding the choice of default super products in the workplace relations system may have made sense in the past, the existence of different lists of funds in different awards is fuelling the creation of unintended accounts (by having different funds for different industries), and poses barriers to new funds entering the default market (chapter 7). Moreover, enterprise and workplace agreements that restrict an estimated 1 million individuals from exercising their own choice of fund serve no purpose in a modern super system, and should be prohibited by legislation (chapter 12)".<sup>37</sup>*
167. However, without the creation of a more competitive default fund market as per recommendation 2 (and CFSIL strongly supports the direction and intent of this reform and notes the final form has not been confirmed), recommendation 1 entrenches the barriers to a competitive market. Accordingly, CFSIL supports the introduction of both recommendation 1 and 2 as a package which will address issues relating to multiple accounts.

<sup>36</sup> Productivity Commission draft report, Superannuation: Assessing Efficiency and Competitiveness, above n 1, p 462.

<sup>37</sup> Productivity Commission draft report, Superannuation: Assessing Efficiency and Competitiveness, above n 1, p 458.

**Question 4: 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?**

168. In CFSIL's response to Topic 10 below, CFSIL has emphasised its support for a range of reforms recently proposed by the Government which increase the powers and resources of the regulators as well as suggested improvements to their engagement models. CFSIL also supports the introduction of a product design and distribution obligation for financial services product issuers.
169. CFSIL has also offered long-standing support for the introduction of an enhanced legacy product transfer regime (product rationalisation). Recent changes to APRA guidance have been of assistance in helping to reduce the barriers to the transfer of the members of one superannuation fund to another fund through the Successor Fund Transfer mechanism. CFSIL would also support any consideration to remove other barriers to such transfers including extending capital gains tax relief or making the exemption permanent.
170. CFSIL has outlined its support above for a number of structural initiatives currently proposed or under consideration which generally address issues relating to MySuper products.
171. In addition, CFSIL believes good member outcomes flow from the diversity of experience, skills and opinion that independent directors bring to superannuation trustee boards, and supports the Government's current proposal to require at least one third independent directors on boards. CFSIL also notes Helen Rowell, APRA Deputy Chairman, has previously observed enhanced member outcomes are correlated with independent directors on superannuation fund boards.
172. CFSIL also believes there should be greater transparency and consistency relating to superannuation fund data, including the regulations relating to fees and costs (e.g. RG 97 reforms) and reporting performance data and consistent labelling by research houses, media and other stakeholders including when used in advertising. This is extremely important in relation to MySuper products, where like for like comparisons will become increasingly important to members and where the assistance of financial advice in interpreting performance and fee data is less prevalent.

*Implementation of regulatory reforms*

173. Superannuation related reforms are complex in nature. The reforms introduced which have impacted the superannuation industry over the course of the last 5 to 6 years have been significant in their size and scale. CFSIL has supported these important reforms. However, implementing multiple regulatory changes within a compressed timeframe becomes challenging for businesses to complete successfully. CFSIL considers that policymakers should give greater consideration to the regulatory reform timetable when introducing significant tranches of reform, in order to ensure that superannuation funds are provided with sufficient time to accurately interpret and comprehensively implement the reforms for the benefit of members.
174. This was emphasised as part of the Financial System Inquiry under Recommendation 31 — Compliance costs and policy processes: *“Increase the time available for industry to implement complex regulatory change. Conduct post-implementation reviews of major regulatory changes more frequently.”*

## **Topic 10: Deterrence and Insight**

### **Question 1: What can be done to encourage the regulators to act promptly on misconduct or potential misconduct?**

175. To assist with regulator awareness, strong breach reporting obligations and clearly defined role expectations for regulators, including around information sharing between regulators, is paramount.
176. There are a number of reforms currently being shaped via the ASIC Enforcement Taskforce Review to enhance ASIC's role (including enforcement and oversight), and the Government has largely committed to the taskforce recommendations or will wait until after the Royal Commission report to determine if further changes are needed.
177. In addition, in its draft report *Superannuation: Assessing Efficiency and Competitiveness*, the Productivity Commission found<sup>38</sup> the proposed MySuper outcomes test<sup>39</sup> should better enable APRA to de-authorise poorly performing products and better promote fund consolidation. Giving APRA more power to deal with ownership changes of superannuation funds would also help in this regard. CFSIL agrees with the Productivity Commission on this point. APRA's guidance and updated Prudential Standards on these matters will be important to ensure trustees have certainty in understanding how such tests will be administered.

### **Breach Reporting**

178. The ASIC Enforcement Review Taskforce reviewed the self-reporting regime for financial services and credit licensees (breach reporting framework). Along with ASIC's surveillance project on breach reporting, the Taskforce's recommendations present an opportunity to address concerns regarding potential under reporting or delayed reporting of significant breaches. The review is also an opportunity to clarify self-reporting obligations and improve and standardise breach reporting practices across the financial services industry.
179. The Australian Banking Association (**ABA**) believes that any reforms to the breach reporting framework should:
- (a) ensure accountability and transparency of financial services and credit licensees;
  - (b) promote consumer protection;
  - (c) enable identification of emerging issues and risks; and
  - (d) support ASIC to meet its law enforcement objectives.
180. The design of the reforms should take account of the findings and outcomes of ASIC's breach reporting surveillance project, which is looking at current industry breach reporting practices. In June 2016, ASIC commenced the breach reporting surveillance project, the key objective of which is to review the adequacy and effectiveness of the breach reporting framework and the extent that culture is a driver for compliance with these obligations. The project includes surveillance of the practices of 12 banking groups (four major and eight large to small banks) and their licensees.

<sup>38</sup> Productivity Commission draft report, *Superannuation: Assessing Efficiency and Competitiveness*, above n 1, Draft Finding 10.1, p 55.

<sup>39</sup> Contained in the Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017.

181. ASIC has commented in the past that there is a clear community expectation that financial services firms need to take responsibility and play a role in lifting industry standards, and part of this comes from timely identification of problems within the industry.<sup>40</sup>

#### **Clearly defined roles and responsibilities and information sharing across regulators**

182. The Treasurer issued Statements of Expectations (**SOEs**) to the Chairmen of Financial Sector Regulators in 2007 following a review of how statutory authorities were governed. The 120 SOEs are high-level but provide clarity from the Government's perspective as to the purpose, direction and objectives of each regulator. These are similar in concept to a Board of Directors' risk appetite statement, which establishes boundaries for the acceptable types and levels of risk which an entity may accept.
183. While respectful of the independence of each regulator, SOEs also broadly paint a picture of the end-state regulatory environment to which the Government aspires.
184. The growing maturity of expressions of risk appetite, as a key mechanism of ADI (Asset-Level Data Initiative) governance, has useful application to the public sector. CFSIL recommends that the Treasurer's SOEs should serve a similar purpose for regulators. The Treasury should review and update the SOEs to establish principles or boundaries around which regulation is formed.
185. CFSIL supports the role of the Council of Financial Regulators (**COFR**) to balance these objectives to ensure Australia's economic prosperity and the financial wellbeing of members.
186. COFR is a forum of the main financial sector regulators that aims to facilitate cooperation between the RBA, APRA, ASIC and the Treasury. While supportive of the purpose of COFR, CFSIL is concerned that a number of other regulators or agencies are not members. For example, the Office of the Australian Information Commissioner, ATO, AUSTRAC and ACCC are all currently overseeing significant regulatory changes impacting the industry and their roles interact and overlap with the main regulators.
187. CFSIL recommends that the membership of COFR extend to include all financial sector regulators and agencies. The RBA, as Chair, should establish a process for COFR to promote the efficiency of financial sector supervision and minimise overlaps in activity.
188. In practice COFR's membership is comprised of senior management from each agency. To enhance engagement and collaborative efforts between agencies, COFR needs to be appropriately resourced and structures need to be established to facilitate inter-agency contact at all management levels.

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<sup>40</sup> Speech by P Kell, Deputy Chairman, ASIC, to Risk Management Association Australia CRO Forum: Why breach reporting is important, dated 16 September 2014: <https://download.asic.gov.au/media/1901747/speech-to-rma-cro-forum-published-16-september-2014.pdf>.

**Question 2: Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct?**

**Question 3: Given that what we are fundamentally concerned with is conduct that is subtle but ongoing in ways that negatively affect 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?**

189. The following response is provided in respect of Questions 2 and 3, on the basis that both of these questions are addressing whether the current regulatory roles and responsibilities of APRA and ASIC are appropriate to protect consumers.

#### **Regulatory Settings**

190. CFSIL supports the current regulatory framework and believes that it is robust, comprehensive and appropriately balanced to promote competition, preserve financial system stability and protect members. Indeed, in November 2017, the international ratings agency S&P Global Ratings said that the existing laws and regulations governing Australia's banks are amongst the strongest in the world.<sup>41</sup>
191. Any regulation designed to stimulate competition should give consideration to "through the cycle" implications, in particular the potential risks to customer protection, market integrity and/or financial system stability in the event of an economic downturn or period of economic volatility.
192. CFSIL also takes this opportunity to reiterate the importance of maintaining financial system stability as the primary aim of policy, whilst also ensuring members are protected and competition is promoted for the benefit of members.
193. CFSIL supports the clear division of accountability between the RBA, APRA and ASIC to ensure system stability, prudential supervision, customer protection and competition respectively.

#### **Clarity of roles**

194. CFSIL supports the use of SOEs to establish principles or boundaries around which regulation is formed. CFSIL notes that the then Minister for Revenue and Financial Services announced that the Government has settled on the new SOE for ASIC (19 March 2018). CFSIL considers a regulator's SOE should ensure that future regulation be guided by "through the cycle" implications. CFSIL also supports Statements of Intent to be published by regulators as a matter of good practice.
195. CFSIL supports in principle the need for regulators to provide in their annual reports the actions they are taking in line with Statements of Intent. However, CFSIL also recognises that there might be some specific decisions or actions taken by regulators that might need to remain confidential for an extended period of time. CFSIL believes that regulators are in a better position to comment on such circumstances.
196. CFSIL recommends that regulator SOEs are updated and Statements of Intent are published by regulators. CFSIL supports in principle the need for regulators to be more mindful of competition outcomes.

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<sup>41</sup> J Eyers, Australian Financial Review, "Australian banks the best regulated in the world: S&P", 29 September 2017: <https://www.afr.com/business/banking-and-finance/financial-services/australian-banks-the-best-regulated-in-the-world-sp-20171129-gzv8b0>.

**Minimising overlap between regulators in superannuation**

197. The superannuation industry is highly regulated. Apart from ASIC and APRA, the ATO also regulates some of the activities of larger superannuation funds and is the primary regulator of SMSFs.
198. There are a number of other regulators currently relevant to financial services and wealth management, as well as a range of external dispute resolution systems and other relevant bodies which often have quasi-regulatory status given the impact of the decisions they make.
199. CFSIL supports the twin peaks model but has observed growing overlap and inconsistency between regulators in the superannuation context, in particular when considering the functions of ASIC and APRA.
200. There are two commonly discussed options for improving regulation of superannuation and removing overlap and inconsistencies between regulators. One option is to establish a single regulator of superannuation. The other option is better co-ordination and clarification of the roles of the existing regulators. CFSIL supports the latter option given the overall success of the current structure.
201. CFSIL recommends a review of both ASIC's and APRA's roles in relation to superannuation. The review should assess whether their functions remain consistent with the intentions of the twin peaks model. CFSIL also recommends that ASIC and APRA continue to improve engagement and knowledge sharing via COFR. Transparency of the output of this engagement (e.g. through the release of minutes or updates) will ensure accountability and assist the industry to understand the regulators' approach.



## **Section S: Culture and Governance Practices – Deterrence and Insight**

***Question: 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: First, to what extent ought it be concluded that the lack of insight is a reflection of leadership within the organisation? 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?***

202. Culture and tone is key to the leadership of any organisation. This was examined by APRA as part of its Prudential Inquiry into CBA. Governance arrangements and the way decisions are made and communicated was found to be an important component of how the organisation is led. These governance arrangements can be complex given the size and scale of an organisation. The report of APRA's Prudential Inquiry into CBA is seen as the blueprint for governance, culture, tone at the top and risk management. The Report provides organisations, including superannuation trustees, the opportunity to self-reflect and assess how they compare to these governance standards and what businesses need to consider in managing complex business and decisions making. CFSIL, as part of the CBA Group, is implementing those recommendations of the Report relevant to it in its business context.
203. Throughout the course of this submission CFSIL has described the position and role of retail funds within the superannuation sector as a whole. CFSIL continues to see an important and growing place for quality retail funds in the market, especially to the extent that consumer-led competition for quality funds within the marketplace grows and barriers to supply are removed. Indeed, with baseline product requirements confirmed in regulations in recent years (e.g. MySuper), the nature of public offer funds continues to converge and a focus on ensuring a regulatory level playing field is increasingly important to ensure members can access the best products.
204. Decision making and governance within institutional retail superannuation funds has continued to evolve over time, including as a result of the mandated influence of independent directors (through Financial Services Council Standard No. 20<sup>42</sup>). Understandably, the demographics and history of retail funds such as those managed by CFSIL influence the approach to decision-making taken by trustees. To this end it is worth noting the majority of CFSIL superannuation members are in the pre-retiree and pension stage, having been introduced to the fund via the assistance and recommendation of a financial adviser.
205. Below CFSIL offers some further context relating to decision-making, governance and the approach of regulators through the example of the implementation of regulatory reform.
206. Through MySuper, the Stronger Super and FOFA reforms, CFSIL believes the industry has implemented a large and complex program of regulatory reform. CFSIL supported the need to undertake these reforms to ensure improved retirement outcomes for consumers. However, the adoption of reforms of this scale was complex and challenging, requiring trustees to make decisions which considered a range of multi-faceted influences and stakeholder considerations.
207. Throughout this process, strong, open and robust relationships with regulators was critical. With such a large volume of legislative change on foot and to be implemented in a short period of time, interpretative guidance and insights regarding expectations relating to implementation

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<sup>42</sup> FSC Standard No. 20 *Superannuation Governance Policy* March 2013:  
<https://www.fsc.org.au/resources/standards/20s-superannuation-governance-final-fsc-standard-no-20-issued-26-march-2013.pdf>

from the regulators was essential. CFSIL found its strong relationship with the regulators was very helpful throughout this process. This was important both during the process of preparing the implementation response relating to the reforms and in managing self-reported issues where that implementation was subsequently found to be deficient and where efficient rectification was required to ensure members were appropriately informed and remediated.

208. As mentioned in paragraph 199, the role of APRA and ASIC has started to overlap. However we note that APRA, in its role as the prudential regulator, considers the role of culture and leadership as part of the fabric of the compliance arrangements of an organisation. This was clearly examined as part of the Financial Services Inquiry.

**21 September 2018**