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

SUBMISSIONS OF THE FINANCE SECTOR UNION IN RELATION TO THE FIFTH ROUND OF CASE STUDIES

Contents

A Outline of submissions

1. These submissions which are prepared on behalf of the Finance Sector Union of Australia [the Union], deal with the fifth round of case studies concerning superannuation.

2. In *Finch v Telstra Super Pty Ltd*[1] the High Court observed the importance of superannuation:

> For some people, superannuation is their greatest asset apart from their houses; for others it is even more valuable... Employer superannuation is part of the remuneration of employees. Membership of the employee superannuation fund may be compulsory. Superannuation, unsurprisingly, is a matter of trade union interest. The question of superannuation entitlements may form the subject of an industrial dispute within the meaning of s 51(xxxv) of the *Constitution*. Superannuation is not a matter of mere bounty, or potential enjoyment of another's benefaction. It is something for which, in large measure, employees have exchanged value – their work and their contributions. It is "deferred pay"…The legitimate expectations which beneficiaries of superannuation funds have that decisions about benefit will be soundly taken are thus high. So is the general public importance of them being sound.[2]

3. The Union also refers to the startling observations made by Counsel Assisting in his opening address in this round of hearings – that superannuation funds collectively comprise 50% of total Australian household financial assets;[3] that APRA regulated trustees control $1,702,000,000 ($1.7 trillion) in assets[4] and that the regulator, APRA, has not commenced a single civil penalty proceeding in connection under the *Superannuation Industry Supervision Act* for more than 14 years.[5]

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1 (2010) 242 CLR 254
2 at [33]
3 T4159.11
4 T4158.40
5 T4161.14

4. Members of the Finance Sector Union work in both the retail financial sector (including in superannuation funds operated within banks) and in industry funds. They are often the front line between superannuation fund members and their funds. The expectations of them as employees and the culture in which they work are set by some of the same senior executives who were required to attend and give evidence to the Commission. The troubling behaviours of those executives and the organisations they manage are, in the experience of the Union, repeated in the working conditions, and the employment expectations of those employed in the industry.

5. The experience of Union members is that the issues that arise in superannuation are of a kind with those that have been identified in the preceding four rounds of hearings.

6. The Union submits that there is a need for renewal in the regulatory framework in the form of a Financial Services Code. Such a code would, in the submission of the Union, operate in conjunction with the pre-existing regulation of the superannuation sector. One clear and significant gap in the current regulatory framework is an absence of provisions that encourage the regulator to enforce the law; which put in place genuine deterrents, and which punish organisations and senior managers when they act in a manner which breaches the significant trust and responsibility placed in them.

7. The regulators have been too absent, and have approached their role with far too light a touch. There is a conflict in APRA's role as a prudential and conduct regulator. The overreliance on negotiated enforceable undertakings has meant there is negligible risk imposed on institutions for failing to meet their obligations. Remediation is seen as a simple cost of doing business.

8. Finally, and most crucially, there is the dominance of a short term, sales and profit fixated culture that has robbed the Australian financial sector of much of the esteem and trust it previously held. Culture is resistant to regulatory change – new conduct which fails the interests of consumers and the community arises like a game of whack-a-mole - such as, for example, the development of service fees (for no service) when trailing commissions were eliminated; or the introduction of behaviour targets for staff when sales targets were removed, or the move to "general advice" when greater obligations were imposed on the provision of "financial advice".

9. The Union submits that all of these issues were clearly present in the superannuation round of hearings. The culture within retail super funds seeks to find short term profit and revenue in all the actions of the fund – management, administration, advice investment, and product development. So long as the focus is on profit, rather than the best interests of fund members, the kinds of conduct that have been held up to the light during the Royal Commission will continue to occur.

B The conduct of NAB and IOOF

10. The Union notes the submissions of Counsel Assisting as to the significant potential findings in connection with NAB/NULIS and IOOF. As has been the course of the Commission the Union has not been invited to make submissions on those potential findings.

11. While these submissions do not address those potential findings, the Union does seek to raise two issues that flow from the evidence of those case studies:

    (a) firstly, the lack of attention that has been paid to date, on executive remuneration and how those remuneration practices may affect misconduct; and

(b) secondly, in more general terms, the impact of poor management culture on the working experience and conduct of more junior employees.

Executive remuneration

12. The Letters Patent establishing the Royal Commission require the Commission to inquire into:

> (a) whether any conduct by financial services entities (including by directors, officers or employees of, of by anyone acting on behalf of, those entities) might have amounted to misconduct …;
> (b) whether any conduct, practices, behaviour or business activities by financial services entities fall below community standards and. expectations;
> (c) …
> (d) whether any findings in respect of the matters mentioned in paragraphs (a), (b) and (c):
> (i) …
> (ii) result from other practices, including … remuneration practices, of a financial services entity, or in the relevant industry or relevant subsector;

13. To date there has been significant and important inquiry into the role of front line and sales staff remuneration practices. This inquiry has included bonuses for branch staff, bonuses and commissions for sellers and business bankers, commission and ongoing service fees for financial advisers. It has considered the impact of the Sedgwick Report on retail banking and the FOFA reforms on remuneration.

14. The Union believes that contingent and conflicted remuneration is a substantial factor in the development of a corrosive short-term profit and sales culture. The Union strongly supports the inquiry into these issues being undertaken by the Commission.

15. However, that inquiry to date has only covered, in any depth, a small portion of the remuneration practices that operate in financial institutions. The impact of remuneration practices of junior managers, senior managers and executives has been, to date, largely unexplored.

16. So far as the Union is aware no questions were asked in the course of the hearings on superannuation about the remuneration of managers and executives responsible for the apparent misconduct and conduct falling below community standards. No questions were asked about whether the actions within Questor and IOOF led to Mr Kelaher having his bonus reduced. Likewise no questions were asked about how the conduct that occurred within NAB/NULIS affected Mr Hagger's, Ms Smith's or others remuneration, or how the conduct within ANZ affected the remuneration of the executives responsible for the sales of Smartchoice Super through branches.

17. Even more critically, the Union is not aware of any questions or evidence that considered how the remuneration packages offered to the IOOF, NAB, and ANZ executives involved in the misconduct drove or incentivised the misconduct.

18. In each of the instances of misconduct called out above, a central motivating factor appears to be maximising profits to the enterprise. The Union submits that there is a prevalence of highly contingent remuneration arrangements offered to senior executives. A central driver of remuneration is the profitability/shareholder return of the enterprise.

19. As these submissions are made, NAB has announced changes to its executive remuneration structures.[6] The changes are a response to the kinds of issues considered by the Royal Commission. Mr Henry, the chair of NAB claims that the changes are such that:

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6 https://news nab.com.au/news_room_posts/nab-introduces-simpler-executive-remuneration-framework/

> "Where NAB falls short of customer, shareholder and community expectations, the new framework provides the board with the ability to hold leaders accountable," [7]

20. Notwithstanding these changes, NAB will continue its emphasis on contingent remuneration. For most executives, there will be a capacity to earn up to an additional 255% of their fixed remuneration as a variable reward. The CEO will be able to earn up to 300%.[8]

21. As this happens, Mr Hagger has resigned from NAB. It appears that in addition to him not having lost any of his previous variable rewards, he is eligible for a redundancy payment of $750,000.00.[9]

22. NAB's recognition of the role executive remuneration has in driving short term profits over the culture and longer-term interests of the bank is to be applauded. However, the changes being announced are tinkering, and judging by the generous treatment of Mr Hagger, do not reflect genuine change.

23. The Union submits that issues around executive remuneration, including the extent of variable pay, and the extent to which executive remuneration is tied to short term profits and shareholder return, are central to understanding the problems in the sector and should be fully examined by the Royal Commission.

Effect of poor leadership on conduct and expectations of employees

24. The evidence of Mr Kelaher from IOOF was alarming. It appeared to suggest that the Board of IMOL continued to fail "*to understand and comply with the covenants under the SIS Act, and its obligations under trust law*".[10]

25. The Union notes that Mr Kelaher and other similar executives are the management that set the culture and the work environment in which Union members operate.

26. In a number of areas of the financial services sector there are increasing steps towards personal responsibility, including individual registration on employees. The Union supports measures that will increase the professionalisation of the workforce in the sector.

27. However, there need to be measures to ensure that individual workers are not held responsible for systemic failures, or misconduct directed by management. Similarly, the Union submits that the Commission may wish to recommend better whistle-blower and other protections to support employees who call out instances of misconduct and the like.

C Advertising

C-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?

Key points

- Political advertising should not be seen as distinct from other forms of political engagement.

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7 Australian Financial Review, *NAB revamps executive pay, slices CEO Andrew Thorburn's pay, 19 September 2018 (https://www.afr.com/business/banking-and-finance/financial-services/nab-revamps-executive-pay-slices-ceo-andrew-thorburns-pay-20180919-h15ks3)*

8 https://news nab.com.au/news_room_posts/nab-introduces-simpler-executive-remuneration-framework/

9 https://www.smh.com.au/business/banking-and-finance/andrew-hagger-leaves-nab-in-executive-shake-up-20180917-p5046z html

10 Closing submissions of Counsel Assisting, [227]

- ❖ Political decisions may affect the viability and value of different funds or kinds of funds, and in so doing impact the capacity to provide for members on their retirement. Political engagement that seeks to further the interests of members of the fund in connection with the fund should meet the sole purpose and best interest tests.
- ❖ The current obligations placed on trustees are the appropriate way to regulate political engagement by funds.
- ❖ The Fox and Henhouse advertisement is an example of political engagement that is appropriate in the circumstances.

28. The Union believes that political advertising may be consistent with the intention behind s.62 of the *SIS Act*.

29. The Union does not believe that it is useful, or appropriate to seek to section out any type or kind of political or community engagement, by reference to the activity rather than its purpose. Political advertising is simply a different form of political engagement which may (depending on the circumstances) be more or less appropriate than other forms of political engagement such as lobbying, the commissioning of research, the conduct of education campaigns. The decision as to how to best engage in the political process is a matter for the trustees.

30. The decision as to *how* to engage in a political process is, of course, a secondary question that an RSE licensee should address. The primary question is whether, on any particular issue, it is appropriate for the RSE licensee to be engaging in the political process at all.

31. The Union submits that it is plainly true that there will be circumstances where it is not only desirable for RSE licensee to engage in a political process, but that a failure to engage would be contrary to the interests of the members of the fund.

32. Superannuation as a system is a product of public policy, enacted into law by specific legislative provisions. Changes to those provisions will impact on the sole purpose of the funds – their capacity of the fund to provide for its members on the member's retirement. A hypothetical example of a government proposal that sought to prescribe or limit investment options for funds would clearly affect the interests of members and warrant contemplation by the RSE licensee as to whether it should seek to affect the policy.

33. The Fox and Henhouse advertisement examined by the Commission provides a good example. The decision by the board of Australian Super that a contemplated change in policy would, if enacted, have adversely impacted the retirement benefits of members of Australian Super was rational and appropriate. It follows as a matter of logic that the decision to engage politically on the issue was justifiable, and that the method of engagement, so long as it remained in the best interests of the members, was appropriate.

C-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?

Key points

- ❖ The Union believes that the sole purpose and best interests tests are appropriate controls on decisions to engage in advertising.

34. The Union repeats its submissions at C-1 above. As noted above the Union submits that the Fox and Henhouse advertisement was appropriate. More broadly, there is a benefit to consumers from legally compliant advertising as it raises awareness of superannuation.

35. More generally, the Union notes that advertising in connection with superannuation, be it conducted by an RSE licensee or other entity, will also be subject to the prohibitions in the Australian Consumer Law against misleading or deceptive conduct.

D Section 68A of the SIS Act

D-3 Is it appropriate, as a response to conduct of superannuation trustees that seeks to induce employers to select funds, or affect their decisions as to default funds, to make alterations to section 68A of the *SIS Act* to widen the prohibition?

Key points

- Section 68A should be extended to make clear that it includes selection of a default fund
- Attracting and retaining members to superannuation funds is a necessary goal of a fund.
- Regulation should seek to drive incentives to make decisions on default funds based on the interests of employees, not employers.
- The Union supports an obligation on employers to act in the interests of employees when shifting from a listed default fund.

36. This question arises from the evidence of Mr Elia of Hostplus concerning corporate hospitality expenditure by Hostplus. The more general question relates to what conduct of trustees (or the associate of a trustee) should be permissible in terms of recruiting new members, or maintaining members.

37. Submissions of Counsel Assisting identify the obligation imposed by s.68A of the *Superannuation Industry (Supervision) Act* 1993 [SIS Act], which provides:

> (1) A trustee of a regulated superannuation fund, or an associate of a trustee of a regulated superannuation fund, must not:
> (a) supply, or offer to supply, goods or services to a person; or
> (b) supply, or offer to supply, goods or services to a person at a particular price; or
> (c) give or allow, or offer to give or allow, a discount, allowance, rebate or credit in relation to the supply, or the proposed supply, of goods or services to a person;
> on the condition that one or more of the employees of the person will be, or will apply or agree to be, members of the fund.

38. Associates of trustees are defined by reference to the definition in the *Corporations Act.*[11] Relevantly, for current purposes, they include financial institutions that retail superannuation funds operate within.

39. The Union acknowledges the observations of Mr Elia as to the need to attract and retain members in order to maintain fund liquidity, service member withdrawals, and obtain the best possible returns for members. However, this need must be balance by a restraining provision of the kind contained in s.68A.

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[11] *SIS* Act, s.12

40. The Union notes that the current terms of s.68A refer to employees being, or applying to be members of a fund, as distinct from an employer's selection of a fund as a default fund. ASIC's guidance on the provision[12] does not identify any distinction, noting that:

> employers may be offered inducements to select a particular default super fund for their employees. Inducements may cover a range of things including corporate hospitality and tickets to sporting events, or discounts on products or services. Many of these inducements are prohibited under s68A of the *Superannuation Industry (Supervision) Act 1993*.

41. However, particularly in the context of new businesses without current employees, there may be a material distinction. The Union submits that the Commission consider recommending that the terms of s.68A be clarified so as to confirm that s.68A is invoked by the employer's selection of a default fund for employees.

42. The purpose of s.68A is to avoid the selection of superannuation funds by an employer on the basis of the employer's interest, rather than the fund member's interest. The Union submits that rather than extending the operation of s.68A, consideration should be given to introducing an obligation to be imposed on employers in the selection of default funds.

43. The Union notes three distinct areas in which Union members have relevant experience.

Bundling of financial services

44. This first area is in the practice of the "default fund" being sold to an employer as part of a package of banking products.

45. From the Union's experience it was (and remains) relatively common for financial institutions to seek to provide a comprehensive suite of financial services to business customers. This process may involve offering additional services to current customers (often known as 'deepening' the relationship), or alternatively seeking to bundle financial services to new customers.

46. Such financial services generally include credit cards, overdrafts, payment facilities such as EFTPOS machines, operating bank accounts as well as default superannuation products.

47. As may be expected by a business bundling various products, fee discounts and other incentives may be offered. The Union understands such discounts and incentives often include free or subsidised financial advice for the business, discounts on interest rates or fees for business accounts, reduced insurance premiums, technology products (such as EFTPOS machines) and tickets to sporting events and hospitality.

48. The bundling of superannuation products with other financial services should be avoided. Bundling of this kind incentivises the selection of a default fund on the basis of the employer's, rather than the fund member's best interest. The Union is concerned that sector workers who are directed to seek to sell superannuation products in bundles are breaching s.68A, and may, in turn imperil their employment.

Experience of workers in financial services

49. The Union notes finance sector workers' experience of default funds. Workers within the sector are unique in that, because many of their employers are associates[13] of retail super funds, their employers have an incentive to ensure that the default fund will generate profits with the employer's enterprise.

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12 16-038MR ASIC guidance to employers about super, https://asic.gov.au/about-asic/media-centre/find-a-media-release/2016-releases/16-038mr-asic-guidance-to-employers-about-super/

13 Using the meaning of the term associate contained in the *Corporations Act*

50. The default fund nominated by the enterprise agreement for each of the big four banks is a fund operated by an associated entity of the employer:

    (a) Clause 20 of the Commonwealth Bank of Australia Enterprise Agreement 2014 nominates "Commonwealth Bank Group Super";

    (b) Clause 3.11 of the ANZ enterprise Agreement provides that "*the default fund for superannuation contributions for employees employed under this Agreement will be a compliant MySuper product of ANZ Staff Superannuation (Australia) Pty Limited*.";

    (c) Clause 20.5 of the NAB Enterprise Agreement provides *"If an employee does not choose a superannuation fund, the default fund to which his or her superannuation contributions will be made by NAB is the MLC Super Fund (or successor) which is MySuper compliant*."; and

    (d) Clause 8.4 of the Westpac Group Enterprise Agreement nominated "BT Super for Life".

51. Similarly, employees engaged by industry funds and their related and associated entities are generally subject to enterprise agreements which nominate that industry fund as the default fund.

52. The Banking, Finance and Insurance Modern Award lists a number of default funds. Historically, Australian Super, into which the Finance Sector Industry Fund merged has been the primary industry fund. Generally, the returns of each of the retail funds listed above has been lower than Australian Super.

Unfinished Fair Work Commission processes and the BOOT

53. The Union submits that the Commission should recommend the imposition of an obligation on employers that they act in the best interests of their employees in the selection of a default fund other than one nominated by a Modern Award.

54. The Union submits that employer concerns about having obligations imposed upon them outside their areas of expertise are resolved by the listing of a series of acceptable default funds within Modern Awards.

55. Notwithstanding the provisions of the *Fair Work Act,*[14] the Fair Work Commission has not completed its superannuation review or the process of including two or more default funds in all modern awards.[15] The Union also notes the Productivity Commission Inquiry into default superannuation funds. The Union submits that the process for naming default funds in all Modern Awards should be completed. So as to ensure that no workers are left out, a list of default funds for non-award employees should be set.

56. Where there is an intention through an enterprise agreement, or, potentially, some other process, to move from one of the listed default funds to a non-listed default fund, an obligation to consider the interests of their employees should be imposed.

57. Such an obligation would in turn incentivise funds, when seeking to recruit and maintain default fund relationships with employers, to focus not on ancillary benefits (such as corporate hospitality) to the employer, but on comparative and competitive benefit of one compliant superannuation fund as against another.

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14 *Fair Work Act,* section 149D

15 For an explanation of the reasons for the Commissions failure to comply with the legislation see the Fair work Commission submission to the Productivity Commission dated 19 December 2016 https://www.pc.gov.au/__data/assets/pdf_file/0017/211625/sub051-superannuation-alternative-default-models.pdf

58. For workers in the finance sector, whose employers may seek to ensure they are members of a retail fund operated by the employer, there will be a strong and important incentive to ensure that the staff fund is as good as or better than any default funds included in the Modern Award.

59. Enterprise agreements are subject to a "better off overall" test[16] when compared to the comparable award. The test is often referred to as the BOOT, or BOOT test. A mechanism for ensuring the obligation to consider the interests of the employees is to impose a requirement in the context of superannuation that the employees must be "better off overall" compared to their listed default fund.

60. Alternatively, the Union refers to the process for Successor Fund Transfers under the SIS Act. The process requires RSE licensees who seek to transfer members between funds without their consent to meet certain requirements in ensuring that the transfer is in the best interests of the fund members.

D-4 How wide should the prohibition be – should it extend to prohibiting providing benefits to employers for the purpose or with the intention of inducing the selection of the fund as the default fund for employees, or affecting the decision, or being likely to induce or affect?

Key points

- Prohibition should be extended to make clear that it includes the selection of a default fund.
- Consideration should be given to the introduction of an obligation on employers to act in the interest of employees in determining default funds.

61. The Union refers to its answer to Question D-3 above.

62. Subject to the comments above, the Union does not believe that the prohibition currently in s.68A of the SIS Act needs to be extended. The Union believes that provision, in concert with the sole purpose test, act as appropriate regulation on the conduct of the trustee and its associates.

63. The Union submits that while actively seeking to recruit and maintain employer/default funds relationships may often be in the interest of fund members, the law should create incentives for such activity to focus on selling the relative merits of the default funds, rather than simply developing deeper relationships with employers. To this end, the Union again submits that the Commission should recommend the introduction of an obligation on employers to act in the best interest of their employees in the selection of default funds.

D-5 Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?

64. The Union repeats its submissions at D-3 and D-4 above,

E Payments from external responsible entities of managed investment schemes

E-6 Is it appropriate for the trustee of a superannuation funds to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money?

[16] *Fair Work Act*; sections 186(4) and 193

65. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

F Selling of superannuation

F-7 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?

Key points

- Concern that ANZ (and others) may have directed employees to breach Corporations Act.
- Concept of "selling" superannuation misconceived. Superannuation should be the subject of advice by appropriately trained and qualified staff.
- The fundamental issue is a cultural one. Focus on A-Z reviews, and behaviours targets are a consequence of Sedgwick reforms that replaced direct sales targets with targets around activities that are associated with sales.
- Removal of vertical integration is not the answer as banks may just negotiate contracts with external parties with the same inherent conflicts
- Focus should be on increased professionalisation of staff.

66. The Union's experience is that the kind of conduct revealed by this case study remains commonplace and is not limited to ANZ.

Background observations

67. The Union notes two developments that led to the specific issues relevant to the ANZ case study:

The General / Personal advice divide

68. The distinction between general and personal advice assumed increasing importance following the FOFA changes.

69. As is discussed below, the distinction between the forms of advice can be a fine one.

70. The provision of personal financial advice requires significant work and time by skilled individuals. Under FOFA, the capacity to earn commissions from financial products sold as a result of personal financial advice is very limited. Conversely, general advice can be provided routinely by all manner of bank staff. The capacity to charge fees and the like from the provision of such advice is less regulated.

71. A consequence of the less onerous work requirements, and greater capacity for profit, is the creation of an incentive for financial product advice to be provided in a manner that can be characterized as general advice, rather than personal advice where possible.

72. In the Union's experience banks have tended to do this by increased reliance on automated processes (such as websites), and more significantly customer facing branch and call centre staff. Such staff tend to be lower paid, with less training and resources, and more vulnerable to unreasonable demands and expectations of management.

Action targets and "Behaviours" rather than sales targets

73. The second 'complimentary' trend is away from hard sales targets, and the introduction of so-called "balanced scorecards". As part of this trend a number of the financial institutions have introduced targets for various "Actions", as well as rating staff by reference to "Behaviours" (which are also known as "values" in some banks). Examples of these Behaviours are things like "Integrity", Respect", "Collaboration", and "Excellence".

74. The Actions that are the subject to targets can refer to sales targets, customer exchanges, or other forms of conduct that may be a proxy for sales. The A-Z Reviews conducted by the ANZ are a good example of an Action of this kind. The Union notes that other financial institutions also maintain processes that are essentially the same as the A-Z Review. CBA refer to these processes as "Financial Health Checks", NAB refers to them as "Mind Maps", WBC refers to them as "Customer Needs Profiles".

75. Staff are issued targets in respect of the number of such reviews they are required to fulfil each week. A failure to meet a target may lead to performance management, and the staff member's employment being imperilled.

76. Banks may use the "Behaviours" metric as a way to ensure that there is sufficient translation of Actions into sales. The expectation on employees is not simply to complete the Action, but to complete it in a manner that meets the sales expectations of the bank. A staff member who complies with their Actions target, but fails to convert a sufficient number to actual sales may be assessed as failing in relation to relevant Behaviours.

77. As with targets, staff that fail Behaviours may be subject to performance management and their employment imperilled.

78. This recharacterization of targets has an additional benefit for banks in the context of general and personal advice. Sales proxy behaviour, such as provision of information about a superannuation fund can be the subject of a KPI, where a target for sales of a superannuation fund would more clearly expose the bank to allegations that it had infringed the personal / general advice divide.

The experience of staff

79. The experience of staff is that behaviour requirements like the A-Z review are simply disguised sales targets. It follows that their experience is that they are at risk of adverse assessment if they do not achieve enough results, generally in the form of reviews completed and sales flowing from those reviews.

80. Union members report having limited training on the legal obligations of banks around the provision of advice, including around the distinction between general and personal advice.

81. The staff experience of customer engagement in all banks is that they are required to mine the information provided by customers for the purpose of identifying sales opportunities. The A-Z Review process requires a discussion of the customer's financial circumstances and is a typical example of an enforced procedure the purpose of which is to generate product sales.

82. The second step of the A-Z case study (noting again that in the Union's experience ANZ is not an outlier in this conduct) is to exploit the information gathered in the A-Z review for the purpose of seeking to sell a product.

83. The Union submits that a de-linking statement, no matter how artfully scripted, cannot overcome the fundamental premise of the exercise – the bank, through the staff member is proposing a superannuation product to the customer arising from a process of consideration of the customer's specific financial circumstances.

84. Staff are expected to achieve sales for the bank. Their language and communications to the customer will reflect this expectation. It would require extraordinary skills of language precision for staff communications to not, on occasions, cross the line to personal rather than general financial product advice.

The question of whether ANZ is directing staff to breach Corporations Act

85. The Union is concerned that the conduct exposed by the ANZ case study suggested that the Bank was aware, for a number of years, that the conduct of staff in connection with distribution of the Smart Choice Super Retail product may be unlawful, and yet continued to direct staff to perform that work.

86. That case study involved the following relevant facts (paraphrased from the closing submissions of Counsel Assisting): [17]

(a) Between 2012 mid 2018, One Path engaged ANZ to distribute its Smart Choice Super Retail product through ANZ bank branches.

(b) The distribution process involved ANZ staff engaging with ANZ customers who attended the bank branch for any purpose - "for a solution of some sort".

(c) Bank employees were required to seek to conduct an "A-Z Review". These reviews were processes "in which a branch staff member asks a customer questions about the customer's financial situation and has a discussion about the customer's goals and needs".

(d) "At the conclusion of the A-Z Review, the banker would inform the customer that the review was complete and read out a "de-linking statement" from a script. That script did not refer to general advice, but asked whether the customer wanted "some general information on ANZ Smart Choice Super", and stated that the staff member "would not be able to use or reference any of the information you've already provided". If the customer indicated that they wanted further information, the branch staff member (in many circumstances) would provide the customer with a number of documents, including the PDS and a brochure, and would read out a "general advice disclosure" from the brochure. Then, if the customer instructed them to do so, the branch staff member would assist the customer to open a Retail Smart Choice Super account." [18]

(e) ANZ was aware of numerous potential issues[19] in this method of operating including:

(i) a risk that customers could "switch their superannuation without understanding the potential consequences and end up with a less suitable product than their existing funds".

(ii) a risk that the customer may understand the promotion of the Smart Choice product as involving a belief by the bank employee that the product was suitable for them.

(iii) a risk that the "de-linking statement" did not, as a matter of law, shift the conduct from personal to general advice.

17 [459] – [467]
18 at [461]
19 at [462]

(iv) that if the conduct was personal advice, and not financial advice, the bank employee was breaching Corporations Act as few of the obligations imposed on the provision of personal advice were achieved.

87. The obligations imposed on the provision of personal advice are significant. They are set out in s.961B of the *Corporations Act* and require the employee (described in the section as the provided) to act in the best interests of the customer. The section provides:

> **961B Provider must act in the best interests of the client**
> (1) The provider must act in the best interests of the client in relation to the advice.
> (2) The provider satisfies the duty in subsection (1), if the provider proves that the provider has done each of the following:
> (a) identified the objectives, financial situation and needs of the client that were disclosed to the provider by the client through instructions;
> (b) identified:
> (i) the subject matter of the advice that has been sought by the client (whether explicitly or implicitly); and
> (ii) the objectives, financial situation and needs of the client that would reasonably be considered as relevant to advice sought on that subject matter (the ***client's relevant circumstances***);
> (c) where it was reasonably apparent that information relating to the client's relevant circumstances was incomplete or inaccurate, made reasonable inquiries to obtain complete and accurate information;
> (d) assessed whether the provider has the expertise required to provide the client advice on the subject matter sought and, if not, declined to provide the advice;
> (e) if, in considering the subject matter of the advice sought, it would be reasonable to consider recommending a financial product:
> (i) conducted a reasonable investigation into the financial products that might achieve those of the objectives and meet those of the needs of the client that would reasonably be considered as relevant to advice on that subject matter; and
> (ii) assessed the information gathered in the investigation;
> (f) based all judgements in advising the client on the client's relevant circumstances;
> (g) taken any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.
> Note: The matters that must be proved under subsection (2) relate to the subject matter of the advice sought by the client and the circumstances of the client relevant to that subject matter (the client's relevant circumstances). That subject matter and the client's relevant circumstances may be broad or narrow, and so the subsection anticipates that a client may seek scaled advice and that the inquiries made by the provider will be tailored to the advice sought.

88. As is noted above, the distinction between personal and general financial product advice is a fine one.

89. Financial product advice is "*a recommendation or a statement of opinion, or a report of either of those things, that is, or could reasonably be regarded as being, intended to influence a person or persons in making a decision about a particular financial product or class of financial products, or an interest in a particular financial product or class of financial products*".[20]

[20] Section 766B

90. Such advice is personal financial product advice if "*the provider of the advice has considered one or more of the person's objectives, financial situation and needs …*; ***or a reasonable person might expect the provider to have considered one or more of those matters***." (our emphasis)[21].

91. The provision has been held to have a wide meaning. In *ASIC v. Park Trent Properties Group Pty Ltd (No.3)* [2015] NSWSC 1527, Sackville AJA said in relation to s.766B:

> The authorities have accepted that the statutory language should be given a broad interpretation. Specifically, they support the proposition that a person may provide information or present material in a way that implicitly makes a recommendation or states an opinion in relation to a financial product.

92. The evidence before the Commission revealed that ANZ branch staff, throughout the relevant period, were required to undertake the A-Z Reviews and, when prompted by a script, inform customers of the availability of superannuation products. Crucially, (and notwithstanding the expressed de-linking statement) the conversation around the superannuation product was a consequence of the initial conversation in the A-Z Review in which the staff had discussed the personal circumstances of the customer.

93. As ANZ recognized, there is a real and appreciable possibility that staff were providing personal financial product advice and in so doing breaching the Corporations Act.

94. Staff who failed to comply with the A-Z Review requirements, or failed to do so sufficiently often, were marked as not having met their KPIs and their employment was imperilled.

95. There is a distinct possibility that if the advice being provided by ANZ staff was financial advice those staff were being directed by their employers to breach the Corporations Act. At a minimum, the evidence reveals that ANZ was aware from at least 2014 when the FOFA amendments were enacted that there was an appreciable risk that it was directing its employees to act unlawfully on a daily basis.

96. The Union believes that had there been a finding that an employee had acted in breach of the Corporations Act, it is likely that ANZ would have summarily terminated the employment of the employee on the grounds of serious misconduct, and would have (as signatories to the ABA Code Background Check) published a decision to other banks that the individual had been terminated for misconduct in breach of consumer protection laws. Such an outcome would have been plainly unfair.

Vertical integration

97. The Union notes that issues around vertical integration have been subject to significant consideration by the Commission. A substantial element of this case study is that the superannuation product being promoted by the branch staff was a product operated by an ANZ group company.

98. The Union submits that the Commission should not place undue weight on this fact. The problematic behaviour was the effective quasi-endorsement (without consideration of the circumstances of customers) of a superannuation product, rather than the bank's ownership of the product. The same problem could have arisen in the event of a contract between ANZ and an external entity, had ANZ agreed to its branch staff promoting a superannuation product in general terms.

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21 *Corporations Act*, s.766B

99. Indeed, it has been the Union's experience that as each of the large banks withdraw, to greater and lesser degrees from the financial advice space, the problematic behaviours associated with vertical integration are being replicated by contractual relationships between entities.

Professionalisation of staff

100. The Union rejects the suggestion that superannuation products should not be sold/advised from within bank branches.

101. There are experienced and qualified staff in many bank branches who provide high quality personal financial product advice that complies with FOFA obligations. Indeed, for many retail customers their local bank branch remains the place where they are most likely to turn in order to obtain financial advice.

102. Rather than seeking to further erode the role of bank branches, the Union submits that banks should recognize that their branch networks provide an extraordinary point of difference between them and non-bank financial services. In this context, rather than closing branches and reducing the skills of those employed within them the Union believes that banks should invest and train more staff, to a higher standard.

103. Had ANZ branches each had employees who were trained and resourced to provide personal advice, the issues that arose in this case study would never have occurred.

F-8 Are there statutory reforms that are required to address this problem (if it is a problem) or are the existing laws with respect to personal financial advice and general financial advice sufficient? 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?

Key points

- Culture within financial institutions that pushes the boundaries of lawful behaviour in the pursuit of sales in the central problem
- Statutory reform to the FOFA provisions of the Corporations Act are required
- Importance of education and training of bank staff so that they understand the legal framework they operate in, and are best placed to assist customers

104. The Union repeats its submissions in respect of question F-8 above.

Culture is central

105. At its core, the conduct of ANZ in this case study is reflective of the common approach within Australian banks which is to see the limits of selling behaviour as being set only by the regulation, rather than any ethical or cultural factor.

106. On the most generous analysis, ANZ's approach was to push the boundaries of the general/personal advice line. Their conduct showed no indication that there was a cultural inhibitor in play.

107. Financial systems are too complex for the regulator to solve or prevent all problems. While banks, regulators and the government fail to address the overwhelming reality that there is a short term profit and sales culture that is dominant throughout the sector that is doing damage to consumers, and creating risks to the economy, no amount of marginal improvement in regulation will solve the problem.

108. The Union submits that the primary challenge for the Royal Commission, and the Government in dealing with the systemic misconduct identified by the Commission, is to focus on a fundamental cultural overhaul of the sector.

Change to regulation

109. In terms of the issues raised by the case study the Union submits that part of the incentive towards the provision of general advice, as opposed to personal advice can be removed by ceasing to permit commissions to flow from general advice. While the commissions issues did not appear to play a significant role in the specific case study, it does form part of the more general incentive towards general as opposed to personal advice which should be addressed.

110. The Union further submits reform to the statute so as to limit the use of warnings and delimiting statements that seek to render advice general advice, when it would otherwise be personal advice. The importance of such warnings, which may be carefully scripted, is inappropriate to a conversation between a customer-facing employee and bank customer in which the detail and precision may be lost to occasional error by employees in the course of their day to day working lives. Similarly, customers may relate to such warnings as they do small print in standard form contracts, with insufficient attention to the detail.

Increased training and education

111. The Union's experience is that staff are not sufficiently trained on matters such as the distinction between general and personal advice. In circumstances where the relevant regulation is complex, and there is a risk that the employee may, though inadvertence or over enthusiasm breach obligations imposed on them personally under the Act, employers should ensure that there are high levels of training and education provided.

G Engagement by superannuation funds with Aboriginal & Torres Strait Islander people

G-9 Are the identification procedures used by superannuation funds appropriate for their Aboriginal and Torres Strait Islander members?

(i) If those procedures are appropriate, are those identification procedures sufficiently understood and implemented by staff on the ground?

(ii) If those procedures are not appropriate, what should be changed?

Key points

- Current identification procedures are inappropriate for the particular circumstances of some Aboriginal and Torres Strait Islander people.
- The Union supports better education of front-line staff engaged to deal with Aboriginal and Torres Strait Islander people so as to minimise identification and other engagement issues.
- The Union supports changes to the law and fund rules that have a disproportionate and adverse impact on Aboriginal and Torres Strait Islander people.

112. The Union refers to its submission at [165] to [168] made in relation to identification procedures for Aboriginal and Torres Strait Islander people in the fourth round of Royal Commission Case Studies.

113. Identification issues for Aboriginal and Torres Strait Islander people begin at birth. Older generations' births were not always recorded in some official capacity thus making birth certificates impossible to obtain.

114. Some records are also inaccurate and do not contain the proper spelling of names, changing of names, and incorrect recording of birth dates leading to problems in establishing identities to the satisfaction of non-Indigenous entities.

115. Names in many Aboriginal societies are also considered cultural property, often of particular groups, and restrictions on the sharing and use of these names are actively managed in everyday life. A common example is that after the death of a person, their name will not be spoken and those with the same or similar name will use an alternative name for some period.

116. The Union notes AUSTRAC's guidance for industry, that improves outcomes for Indigenous customers by setting out the flexibility available for alternative forms of identification – including references from Elders, medical personnel, community leaders or other forms of photo ID, such as the Larrakia Nation card.

117. The Union submits that it is important that workers be provided sufficient training and resources to address these issues including by implementing AUSTRAC's guidance.

118. The Union further submits that trends toward greater reliance on centralisation and call centres, and off shoring of advice and similar functions, have exacerbated these issues

G-10 Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?

119. The Union notes the evidence of Ms Melcer,[22] and that she disagreed with evidence of Mr Boyle and Mrs Edwards from earlier rounds of the Commission.

120. The Union believes there is merit in requiring some form of identification program for Aboriginal and Torres Strait Islander people that explicitly addresses their unique identification issues.

121. Such a program could play an important role in enabling Aboriginal and Torres Strait Islander people to engage with their superannuation in a much improved way.

G-11 Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?

Key points

- ❖ Issue extends beyond Aboriginal and Torres Strait Islander people
- ❖ Current system where some funds permit early release and other funds do not is inappropriate.
- ❖ All funds should permit early release on the basis of a common test to a common cap (both is terms of a percentage and dollar value)

122. While this question is located within a group concerning Aboriginal and Torres Straight Islanders, it has general application.

123. Consistent with the evidence before the Commission, there is a divergence of practice as to whether superannuation funds permit the early release on the basis of financial hardship.[23]

22 T4728.10
23 T4724.19

Indeed, even within those funds that do permit early release, there are differences in their practices, including as to the amounts that may be released (some impose percentage caps on top of the $10,000 statutory cap), and the practical operation of the criteria for release.

124. The Union understands that the primary reason provided by funds for not permitting early release is practical difficulty and administrative costs.

125. The Union believes that this disparity is inappropriate and that funds should all permit the early release of superannuation on the basis of severe financial hardship.

126. Union members who work in customer-facing roles report significant difficulty in dealing with often distressed and distraught individuals who are members of funds that do not permit early release.

127. Further, the Union is concerned that employees may be placed in situations that would imperil their employment. Anecdotally, the Union is aware that some front-line staff advise fund members on which funds do permit early release, and on mechanisms for rolling over funds so as to place themselves in a position of being able to obtain emergency access to funds where required.

128. The Union also noters the instances of unlawful schemes where vulnerable individuals are encouraged to roll their superannuation into an SMSF and then unlawfully access the funds. Better, more transparent capacity to access limited funds in cases of severe financial hardship will reduce the instances of such conduct which is clearly contrary to the public interest.

129. For these reasons the Union believes that a clear and consistent approach to the provisions governing the early release of superannuation is warranted. Such an approach should prescribe the conditions that need to be met in order to access funds, the amounts that may be accessed, and frequency of access.

G-12 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?

130. The Union does not believe it is able to assist the Commission on this issue.

G-13 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?

131. The Union notes the evidence of Ms Melcer[24]and supports the extension of categories of people permitted to be subject to binding nominations. The categories should be expanded to ensure that the legislation does not operate to prevent individuals within kinship structures, or other structures where cultural and moral obligations of dependence arise from being nominated.

H Discretion to appoint and remove directors

H-14 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? [See para 695]

[24] T4726.11

Key points

- ❖ Shareholders should retain a broad discretion as to the appointment and removal of directors.
- ❖ Focus should be on ensuring that directors are trained, understand their obligations to members, and are free of influence from shareholders.
- ❖ Evidence before the Commission does not support the contention that financial experts are necessarily best placed to be directors. The recent performance of industry versus retail funds suggests that the appointment of directors from a variety of backgrounds and training is beneficial.
- ❖ Directors of RSE licensees have a significant capacity to impact culture and operations of the RSE.

132. Given the importance, and size of the investments overseen by superannuation funds, there is a clear public policy incentive to ensure that shareholders appoint the "right" people as directors of RSE Licensees.

133. The significance of the appointment process sits alongside a number of other significant and similar propositions – it is important that shareholders do not seek to influence the decisions of the directors; it is important that shareholders appoint an appropriately diverse group of people to a board so as to ensure that the board is not an echo-chamber, but rather obtains the benefit of decisions that emanate from debate and discussion.

134. The Union particularly identifies risks that arise within retail funds where shareholders of RSE Licensees are profit-seeking enterprises that look to the RSE as a source of income. Directors who owe their appointment (and potential re-appointment) to a shareholder may be more likely to permit the shareholder to have inappropriate levels of control over the actions of the fund (as was seen in the NULIS and IOOF case studies).

135. There was no suggestion that the directors appointed to the NULIS or IOOF superannuation funds were not appropriate appointments. However, the evidence before the Commission around the conduct of the trustees (and directors) of those entities was indicative of a relationship that was far too close, and where the shareholder continued to have too much influence and control over the actions and decisions of the RSE licensee.

136. While there may be scope for the imposition of a statutory duty in the appointment process, the Union submits that such a duty would be a final safeguard, and that the focus of attention should be paid to ensuring shareholders recognize the importance of separation of shareholder and fund interests, and directors are educated and empowered to ensure that they carry out their statutory and fiduciary obligations without the risk of suffering shareholder disapproval.

I Relationship between trustees and financial advisers

I-15 Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not? [See para 773]

Key points

- ❖ Grandfathering of commissions was inappropriate and led to poor outcomes. It should be eliminated.

- ❖ Elimination of commissions should not be a back-door method of reducing remuneration to advisers.
- ❖ A robust, profitable financial advice industry in which there is a mix of advisers located in banks, large financial services companies, superannuation funds and smaller, independent advisory services in desirable. Piece-meal and reactive changes that lead to withdrawal from the industry by some segments in not in the consumer interest.

137. The Union submits that grandfathered commissions are not appropriate, while ongoing service fees, when appropriately constructed and charged, are appropriate.

138. The Union has been consistently supportive of the FOFA reforms and opposed the decision to grandfather commission arrangements and to exclude general advice from the prohibition on commission payments.

139. The Union believes that a robust and ethical financial services sector should avoid all forms of conflicted remuneration.

140. Accordingly, the Union supports the elimination of grandfathered commissions.

141. The Union does not support the elimination of ongoing service fees. We understand such fees to be for the provision of ongoing advice services, as opposed to no service, or the customer having the right to request services.

142. Such service fees, where paid on the basis of an agreement and in consideration of work performed should be encouraged as the type of fee arrangement that is most appropriate. While not universally true, there are a number of superannuation holders who would benefit from maintaining advice relationships in connection with their superannuation.

143. Notwithstanding the Union's strong support for the elimination of commissions, such a process should not be used as a backdoor method to reduce adviser remuneration. The Union is aware of instances where proposals to eliminate commissions would reduce annual remuneration of advisers by 60% and more. It is manifestly unreasonable to place the burden of these changes significantly on the back of individual workers who have had expectations of income, and have commensurate financial commitments.

144. The Union submits that while broad points of principle (such as the elimination of commissions, and fees for no service) may be readily identified, the fundamental and structural change affecting the financial advice sector – both in connection with superannuation and more generally, needs to be undertaken in a considered manner.

145. The Union points to a number of changes already implemented which had laudable goals but due to piecemeal or reactive alterations, were directly associated with behaviours that were contrary to the community interest. By way of example:

- the grandfathering of commissions has led to an incentive to advise clients not to change investments;
- the elimination of commissions led to a plague of fees for no service issues;
- the exclusion of general advice from the commissions exclusion incentivised the provision of poor quality general information as opposed to considered, customer focused advice.

146. The possibility of greater reform in the industry appears already to have contributed to the large institutions selling financial advice subsidiaries. Further, there are concerns that the

compliance and training costs flagged by FASEA will force smaller operators, particularly part time workers, out of the industry.

I-16 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.

Key points

- ❖ Changes that seek to improve provision of financial advice have already had detrimental and unforeseen effects
- ❖ A cautious approach to future change needs to be taken.

147. The Union refers to and repeats its answers to questions I-14 and I-15 above.

148. A cautious approach to change in the structure of the financial advice industry is required. The changes that have already occurred, and that may arise as a result of FASEA (and potentially recommendations from the Royal Commission) have had the simultaneous effect of reducing revenue sources while increasing training and compliance costs. These drivers are reducing the size of the financial advice industry.

149. Given the poor state of financial literacy in the community, and increased reliance on superannuation and other savings in retirement, there is a public policy imperative to improve the amount of, and accessibility to, financial advice services.

150. As noted above, the changes that have already been announced have led to each of the banks divesting, in whole or part, their wealth and financial advice businesses. This may affect the diversity of financial advice options, and competition within the industry. Effective unilateral reduction in remuneration of advisers also needs to be avoided. The industry needs as diverse a base as possible, including from within the retail banks with their wide branch networks as points of access.

151. The challenge of having consumers pay a direct cost of a service where the cost has previously been obscured, is one facing many industries. The Union supports the development of strategies to assist advisers through this transition period.

J Managing conflicts

J-17 Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties. For example, where a trustee is a dual-regulated entity, that would seem to raise an inherent conflict of interest, or the potential of a conflict of interest. Are there other structures such as investment of funds in insurance policies issued by related party insurers or the integration of a superannuation trustee into an advice business that also raise inherent problems? Is it possible to say that these conflicts are ever manageable?

Key points

- Retail funds have inherent problems of conflict between the best interests of members and provision of profit to shareholder.
- This inherent problem can be managed.
- Focus needed on culture that promotes the primacy of the best interest of members of the fund over the short-term profit interest of retail funds shareholders.

152. The Union submits that superannuation trustees that are subsidiaries of, or associated entities of banks and/or other financial services entities that operate on a for profit model face inherent problems due to conflicts between meeting their best interest obligations to fund members on the one hand, and obligations (be they legal, structural or cultural) to the parent entity on the other hand.

153. Notwithstanding the above, the Union submits that such conflicts are manageable.

154. However, this is an area in which there has been insufficient regulator interest, and in which poor institutional culture has had significant effects.

155. The Union notes that the nature of superannuation investments makes it particularly vulnerable to exploitation. Superannuation investments for most workers involve relatively large amounts of money (approximately 10% of their income) coupled with the need to make investment decisions beyond the capacity of their financial literacy. The administration and investment decisions are generally taken with no or limited active oversight or concern from the ultimate beneficiary of the funds.

156. The Union is not opposed to improved regulation that would better serve the interests of fund members, and may clarify obligations in the event of conflict. However, changes to regulation are secondary to required changes to cultural practice and expectations.

157. The Union refers to the NULIS case study considered in detail by the Commission in this round.

158. This case study involved the National Australia Bank and various of its associated entities. NAB operated a number of superannuation funds. Following a restructure, the RSE licensee and trustee of each fund was NULIS Nominees (Australia) Limited, a wholly owned subsidiary of NAB;[25] the fund contracted National Wealth Management Services Limited to perform management and administration functions of the fund. National Wealth was also a subsidiary of NAB. When issues arose over the conduct of NULIS (and National Wealth) they appear to have been primarily dealt with by engagement between Mr Hagger of NAB and ASIC.

159. The confusion over relative roles and obligations is profound. In such circumstances, the rise of unresolved conflicts becomes unescapable.

160. The retail model of superannuation funds operates on the basis that financial institutions will take multiple bites of each cherry. There will be an expectation of a dividend from the trustee company, direct income from the management company, profit from the provision of financial advice and profit from the sale of financial services. Although not examined by the Commission, the model may also involve the provision of legal and regulatory advice services, marketing services, etc, each for internal payment from the fund.

[25] T4182.45

161. The fact that NULIS engaged, so far as was revealed in evidence to the Commissions, NAB related entities for each and all of these services and functions demonstrates more than just an institutional bias. It is difficult to believe that NULIS performed a competitive tender process; or genuinely considered contracting such services from entities outside of NAB. The pattern of behaviour is such as would give rise to a presumption that decisions were not being made by NULIS in the best interest of members.

162. In the Union's experience, the conduct of NULIS is consistent with that of other RSE licensees operating within the retail financial services sector.

163. Rather than arising from regulatory issues, the Union identifies the problem as a product of poor cultural practices. The underlying legal obligation imposed on the trustees is not confusing, or subtle. Section 52(2)(d) of the SIS Act clearly identifies their priorities:

> (1) If the governing rules of a registrable superannuation entity do not contain covenants to the effect of the covenants set out in this section, those governing rules are taken to contain covenants to that effect.
>
> **General covenants**
>
> (2) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:
>
> …
>
> (d) where there is a conflict between the duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee:
>
> (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
>
> (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
>
> (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
>
> (iv) to comply with the prudential standards in relation to conflicts;

164. Trustees have an obligation, before providing a dividend to their shareholders, to act in the best interest of the fund members. Likewise, the obligation of trustees in making decisions around investment and administration is to, first and foremost, act in the best interest of members.

165. This cultural problem is indicative of the RSE licensees that are too culturally and structurally enmeshed in their operations of the financial institution that owns them.

166. Further, this cultural problem is not unique to RSE licensees but it is the same cultural problem that bedevils the financial services industry – a triumph of profit oriented behaviour over conduct that serves the best interests of consumers.

167. The Union submits that the manner in which these conflicts should be managed is, as with other conflicts, for them to be identified, eliminated where possible and expressly addressed where they cannot be excluded. In the context of superannuation entities, such conflict must be dealt with by RSE licensees ensuring independence from their shareholder and that their decisions are in the best interest of the members of the fund.

168. Further, the Union believes that there is a need for an appropriate regulator to take a significantly more aggressive approach to the enforcement of the obligations imposed on RSE licensees.

J-18 If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable?

Key points

- Structural change to entities is not required.
- Focus needed on fundamental changes to culture within retail financial institutions to instil a service, customer and community interest model in place of a short-term profit and sales model.
- There is also a need for a proactive, aggressive, regulator to ensure that RSEs act in the best interests of members at all times.

169. The Union repeats its answer to J-17 above.

170. The Union does not submit that there is a need to impose a structural change of entities. The appropriate response is to, as part of a whole of sector approach, identify mechanisms that will overhaul cultural practices and profit expectations. Indeed, structural change will often be the cheap option with illusory effects. Previous experience suggests that integrated relationships are simply replaced with contractual relationships, with negligible change to behaviours.

171. The Union also submits that such a response demands more aggressive and concerted conduct by an appropriate regulator, along with a greater capacity for adversely impacted consumers to seek remedies for losses suffered by poor conduct of RSEs.

J-19 Would it be preferable to extend the obligation to act in the best interests of members of a superannuation fund so that:

(i) contravention of the obligation attracts a civil penalty; and

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

Key points

- Broad ranging obligations to act in the best interests of members, and consumers of financial services should be imposed on banks, RSE licensees and others with power to determine the decisions.
- Available penalties should be wide ranging and include, in appropriate circumstances, civil penalties payable to the regulator, disgorgement provisions and criminal sanction.

172. The Union notes the operation of the best interest duty as a covenant implied, if not otherwise present, into the terms of superannuation trust deed by operation of s.52(2)(c) of the SIS Act. Whether an extension of the obligation so as to mean that breach would attract a civil penalty that would fundamentally alter the character of the term is not a matter Union has insight into and accordingly the Union does not believe it can assist the Commission on this issue.

173. The Union does however note the broader introduction of best interests of consumers tests into various elements of the provision of financial services: see s 601FC of the *Corporations Act 2001* (Cth) in relation to managed investment schemes, and more significantly in the FOFA reforms at s 961B(1).

174. The Union, generally, supports imposing obligations on financial services entities (including RSE Licensees), and those with power to make decisions affecting the conduct of such entities to act in the best interest of consumers. The Union further supports aggressive regulation, including the imposition of more significant penalties. Such penalties would generally include not only civil penalties, but also, as appropriate provisions for disgorgement and criminal sanction in the cases of serious, wilful failures to meet community expectation and standards. These issues are discussed in more detail at paragraphs 180 to 211below.

J-20 Are there unforeseen consequences of such a legislative intervention that would make it undesirable to strengthen the *SIS Act* in this way?

175. The Union refers to its answer to J-19 above.

K System changes

K-21 Is one way of addressing and discouraging misconduct on the part of superannuation trustees to seek to encourage improvements to outcomes for members whose contributions are made to MySuper products or is the link too tenuous to justify recommending any system changes to the default system?

176. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

K-22 Is it appropriate, as a response to misconduct of superannuation trustees, to apply an additional filter to MySuper authorisations so as to require outcome assessments? If so, what are the general parameters for such a system change and who is appropriate to apply the test?

177. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

K-23 Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation accounts of a person, to introduce some form of "stapling" so that a person's account for receipt of default contributions is linked to the person and travels with the person when she or he changes job? Is this being a practical method of addressing this type of conduct noting that it is not suggested to be misconduct?

178. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

K-24 Are there other system changes that might be appropriately tailored responses to misconduct or conduct falling below community standards and expectations of superannuation trustees? If so, what are the general parameters for such a system change?

179. The Union has limited insight on this matter and does not believe it can assist the Commission on this issue.

L Deterrence and insight

L-25 What can be done to encourage the regulators to act promptly on misconduct or potential misconduct?

Key points

- APRA's role as prudential regulator creates a conflict with oversight of conduct issues.
- Regulator needs to sufficiently resourced.
- Less emphasis should be placed on enforceable undertakings.
- Regulation should be changed so as to provide wide ranging options for enforcement including bigger civil penalties, disgorgement and criminal sanction.
- Penalties should be payable to regulator.
- Enforcement of cultural separation between regulator and financial institutions to prevent "capture", or perceptions of capture, that undermine confidence in the regulator.

180. The Union identifies the following steps that can be taken to encourage regulators to act promptly on misconduct or potential misconduct:

(a) Clearly articulate which regulator has responsibility for misconduct;

(b) Take steps to enforce cultural separation between the regulator and the banks to avoid actual or perceived capture, and ensure that the community has confidence in their actions;

(c) Enshrine in legislation the primacy of enforcement proceedings as a regulatory tool, as opposed to enforceable undertakings;

(d) Ensure that the regulator is adequately resourced and funded;

(e) Make penalties and fines payable as a result of regulation payable to the regulator to be used in breach and enforcement proceedings;

(f) Introduce a wider range of breaches and penalties, including criminal sanction for serious conduct by executives that is wilful or deliberate, capacity for the courts to order disgorgement.

181. From the Union's perspective a high quality active regulator is a fundamental requirement to the restoration of trust in the sector, and the improvement of culture within financial institutions.

Clearly articulate which regulator has responsibility for misconduct

182. The Union refers to its submissions in relation to question L-26, below. There is clearly confusion between ASIC and APRA as to who is responsible for what in connection with regulation of conduct in superannuation.

183. Such confusion should be eliminated. For reasons set out below, the Union submits that APRA is not the appropriate entity to have oversight of conduct issues in superannuation.

Improving culture within the regulator

184. The criticisms of ASIC arising from the Royal Commission hearings – that it is slow, gun-shy and unwilling to challenge the banks, too eager to engage in negotiated resolutions – are essentially the same criticisms that have been made by commentators, inquiries and experts for more than 20 years.

185. The Union submits that the Commission would recommend the need for a cultural overhaul of ASIC.

186. Such a review should examine the extent to which there is a "revolving doors" process for employees of banks, the professional services firms that they regularly engage, and the regulator. The anecdotal experience is that most engaged by ASIC have previously worked in, or for the institutions they now work to regulate. Such a relationship of proximity exacerbates the perception that ASIC enforcement efforts have been captured by the banks.

The primacy of enforcement proceedings

187. The evidence of both ASIC and APRA displayed a concern about the cost, and length of time enforcement proceedings may take.

188. While the cost of litigation can be substantial, and expenditure of public funds should be done prudently, it is not acceptable that the statutory regulator of a sector which contains the national retirement savings is reluctant to enforce the law because they are worried about the cost of doing so.

189. Further, the current approach leaves much of the heavy lifting in litigation to consumers and other private litigants. Generally, those individuals are much less well placed than the regulator to commence and maintain proceedings. Poorly run litigation runs the risk of setting poor precedent.

190. Litigation and enforcement proceedings has a significant and important function, that may be achieved even if the action itself fails. Proceedings:

(a) permit courts to examine the language of statutes, and provide greater certainty and clarity as to the content of legal obligations;

(b) demonstrate to the community that financial institutions will be held to account for their actions;

(c) Set appropriate benchmarks against which fines or other elements of agreed settlements may be determined; and

(d) Create reputational risk for financial institutions.

191. Given the infrequency of proceedings actually completed, the concern around timeliness is misplaced. Further, more frequent proceedings which permit the development of processes, and legal principle will mean that future litigation will be able to be conducted more quickly. A reason for the time taken in current proceedings is that there are so many issues that are untested by Courts.

192. The focus on only conducting litigation that is certain to succeed is not appropriate for a regulator. Proceedings where an institution or individual are able to defend their conduct plays an important role in developing the law, and maintaining public confidence in financial institutions.

Ensure that the regulator is adequately resourced

193. A feature of explanations for the poor performance indicated by both ASIC and APRA was inadequate resourcing.

194. The Union notes recent decisions by Government to allocate less funding to ASIC. It is critical that regulators receive the funding required to meet their objectives and community expectations.

195. Further, as discussed below penalties should be payable to ASIC, unless otherwise ordered by a court.

Make penalties and fines payable as a result of breaches of regulation payable to the regulator to be used in breach and enforcement proceedings.

196. The Union submits that the Commission should recommend that fines and penalties recovered by ASIC be, subject to contrary order of a court, paid to ASIC for use in its enforcement activities.

197. Such a model would provide scope for ASIC to address limitations in funding, and given the size of penalties that should be issued, level the playing field substantially.

Introduce a wider range of breaches and penalties

198. The Union submits that the Commission should consider recommending a widening and strengthening of penalties and sanctions including by:

(a) Imposition of criminal sanction for unlawful misconduct by senior executives that is serious and deliberate;

(b) Imposition of penalties that act as a genuine deterrent, not simply a cost of doing business; and

(c) Extension of the capacity to order disgorgement.

199. Penalties for corporate misfeasance are generally lower in Australia than in other jurisdictions.[26] The is no sound rationale for this.

L-26 Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct?

Key points

- Present allocation of regulatory roles is not appropriate.
- There needs to be a separation of prudential and conduct regulators.
- Consideration should be given to the establishment of a new financial services regulator which would have oversight of conduct issues within RSEs and well as other activities of financial institutions.

200. The Union submits that:

(a) APRA should no longer have a role as a conduct regulator in connection with superannuation;

(b) Consideration should be given to whether ASIC should be responsible for all conduct regulation in connection with superannuation, or whether a new financial services regulator which would have responsibility for conduct matters in the sector including superannuation.

[26] OECD, Pecuniary Penalties for Competition Law Infringements in Australia 2018, http://www.oecd.org/daf/competition/pecuniary-penalties-competition-law-infringements-australia-2018 htm

201. The Union further submits that deterrence is achieved by a conduct regulator:

(a) having a proactive and aggressive prosecution policy;

(b) being adequately resourced to implement such a policy;

(c) being supported by regulation that is clear, and capable of straight word application; and

(d) being supported by penalties that punish institutions and senior executives that are responsible for misconduct.

APRA

202. Under the current law APRA has significant obligations to act as a conduct regulator in connection with superannuation.

203. On the evidence of its witness, Ms Rowell, APRA appears reluctant to embrace these obligations, but instead sees itself as a prudential, not conduct regulator, with a focus on the overall stability of funds and the sector. From the evidence:

Counsel Assisting:	*I'm sorry, I said other conduct regulators. I think in fact you very specifically make the point in your statement that you are not a conduct regulator, you are a prudential regulator?*
Ms Rowell, APRA	*Yes*
Counsel Assisting:	*And you distinguish between those two types of regulators?*
Ms Rowell, APRA	*To a degree. I mean, I think – there is an element of conduct regulation in all regulators because ultimately what is delivered in a prudential sense come back to the behaviours and practices of the individuals that are running the entities. But prudential regulators typically do have concerns about protecting the value of the assets and the – yes, and particularly when you're talking about pension trusts or superannuation trusts, that is a – a general concern of prudential regulators in undertaking their roles*

204. The evidence also revealed:

(a) Significant confusion and uncertainty between APRA and ASIC over which regulator had responsibility for certain acts or investigations;

(b) That, given the almost non-existent record of prosecutions, it was evident that APRA does not believe that actual prosecution of conduct issues is a useful tool to be deployed by it as regulator; and

(c) That APRA appeared concerned about the effects on system and fund stability when making decisions on prosecutions.

205. The Union submits that the Commission may wish to recommend that the legislation be amended so that APRA be permitted to focus solely on prudential regulation, and no longer have a role as a conduct regulator.

ASIC

206. The Union submits that a single regulator should be responsible for oversight of conduct in the financial services sector.

207. ASIC has not satisfactorily performed this role to date. The culture revealed by Mr Mullaly's evidence was alarming:[27]

Counsel Assisting:	*Now, so that I understand, at this stage ASIC has said in writing to ANZ we're going to commence a proceeding on 15 May 2017?*
Mr Mullaly, ASIC	*Yes*
Counsel Assisting:	*It hasn't been qualified or conditional in any way, the statement that was made to ANZ?*
Mr Mullaly, ASIC	*Not that I'm aware of, no.*
Counsel Assisting:	*You're saying what ASIC was actually looking for was for ANZ to say, "We're prepared to give an enforceable undertaking"?*
Mr Mullaly, ASIC	*We're looking for a response from ANZ, and I think it shows that when the group general counsel starts engaging in the process, we've got their attention.*
Counsel Assisting:	*You've got their attention. Is that honestly what you regard as a successful application of the regulatory process?*
Mr Mullaly, ASIC	*I'm not sure what you mean.*
Counsel Assisting:	*Having told them that you were going to commence on 15 May 2017, you then didn't commence on 15 May 2017?*
Mr Mullaly, ASIC	*No, we haven't commenced at all against ANZ*
Counsel Assisting:	*And why did you not commence on 15 May, as you had said you would?*
Mr Mullaly, ASIC	*Because we had been contacted by ANZ who indicated they wanted to engage in the process of resolving the matter, and – at the – at the very – I mean, the focus of this was to stop the conduct. We wanted the conduct to stop. And that's what happened. We were able to achieve that. We were able to achieve it in a very timely way without having to go to court*
Counsel Assisting:	*On 18 May 2017 there was a meeting between ASIC and ANZ?*
Mr Mullaly, ASIC	*That's correct.*
Counsel Assisting:	*I'm sorry, can I just go back – did you just say in a timely way?*
Mr Mullaly, ASIC	*That's correct.*
Counsel Assisting:	*You had a proceeding drafted in May of 2017?*
Mr Mullaly, ASIC	*That's correct.*
Counsel Assisting:	*You entered into an enforceable undertaking with ANZ at the end of July 2018?*
Mr Mullaly, ASIC	*That's correct.*
Counsel Assisting:	*You had begun investigating this in June of 2014?*
Mr Mullaly, ASIC	*That's correct*

208. The evidence revealed ASIC as weak and lacking in confidence. In the financial services sector - when it consistently interacts with a limited number of entities, the willingness to not

[27] T5234.24

carry out a threat, and being satisfied by having 'got the attention' of the general counsel is extraordinary.

209. This cultural failure of ASIC is not new. The Union refers to the *2014 Report of the Senate Standing Committee on Economics* which found:[28]

> ASIC's enforcement role is one of its most important functions. ASIC needs to be respected and feared. It needs to send a clear and unmistakeable message, backed-up and continually reinforced by actions, that ASIC has the necessary enforcement tools and resources and is ready to use them to uphold accepted standards of conduct and the integrity of the markets.
>
> …
>
> … the credibility of the regulator is important for encouraging a culture of compliance. That ASIC is consistently described as being slow to act or as a watchdog with no teeth is troubling.

210. The matter underlying this issue - the sale of superannuation by front line branch staff - was significant. From the Union's perspective it concerned ongoing and widespread directions by the Bank, as an employer, that their employees engage in conduct in which the staff members may be breaching the *Corporations Act*. From the perspective of the community, it involved a persistent risk of consumers moving to less appropriate superannuation funds, with significant adverse effects in their retirement income.

211. The Union submits that any future conduct regulator, be it ASIC or not, cannot operate on basis of this kind of culture.

L-27 Given that what we are fundamentally concerned with is conduct that in subtle but ongoing ways negatively affects the retirement outcomes of consumers, are either of the regulators best placed to carry the responsibility to protect consumers should the balance between them be restructured or significantly altered?

Key points

- ❖ APRA, as prudential regulator should not have responsibility for conduct issues
- ❖ Consideration should be given to the establishment of new conduct regulator
- ❖ Whether it is ASIC, or a new entity, the regulator must be adequately resourced, must be underpinned by legislation that supports rigorous oversight, and must ensure that there is sufficient cultural separation between it and the financial institutions.

212. The Union repeats its submissions in response to L-25 and L-26 above.

213. There should be a restructure such that APRA no longer have a role as conduct regulator. A single regulator, whether it be ASIC or some other entity, should be adequately funded and supported by a broader range of potential penalties.

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