

**ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION
AND FINANCIAL SERVICES INDUSTRY**

**SUBMISSIONS OF THE AUSTRALIAN SECURITIES AND INVESTMENTS
COMMISSION**

ROUND 5: SUPERANNUATION

The Australian Securities and Investments Commission (**ASIC**) makes the following submissions in response to certain of the general questions identified by Counsel Assisting in closing submissions.

INTRODUCTION

1. Although Australia's superannuation system has improved the lives of many, Round 5 of the Royal Commission has highlighted that changes are needed, as has the recent draft report of the Productivity Commission.¹
2. The Royal Commission's focus on misconduct in relation to superannuation has demonstrated again that conflicts of interest and incentives are driving conduct that does not deliver good outcomes for consumers.
3. Change is needed to the settings in the system to eliminate or minimise issues such as grandfathered commissions that continue to drive poor behaviour, despite legislative action having been taken against these in 2013. We make this point throughout our submissions.
4. We also note that wider system changes, such as the way in which the default system operates, also contribute to more broadly improving consumer outcomes within our system. While some of those matters are beyond the scope of the Royal Commission, as they go beyond addressing misconduct or community expectation failures, it provides important context.
5. Our superannuation system has evolved and is now at a level of maturity where accountability must be a key focus. Superannuation funds, and other parts of the superannuation system, currently comprise \$2.7 trillion, and with the holding of such significant amounts of other people's money comes great responsibility.
6. There are challenges in ensuring the appropriate level of accountability with the current regulatory settings. The *Superannuation Industry (Supervision) Act 1993 (SIS Act)* provisions require amendment, particularly to increase the powers of the regulators and consequences of misconduct. Some legislative improvements are in train but yet to be adopted. More are needed.
7. As outlined in Topics 9 and 10 ASIC submits that it has acted on misconduct within its jurisdiction and believes that there is scope for it to take on an expanded role as a conduct

¹ Productivity Commission, Superannuation, *Assessing Efficiency and Competitiveness - Draft Report (Productivity Commission draft report)*.

regulator to achieve consumer protection in superannuation, working effectively together with APRA, to improve outcomes for Australians.

TOPIC 1: Advertising

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?

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?²

8. ASIC's views more broadly on marketing and advertising are set out in Regulatory Guide 234 *Advertising Financial Products and Services (including Credit): Good Practice Guidance (RG 234)*. ASIC recognises that advertising can help drive competition and better market outcomes by informing consumers of potentially better products, including products that offer better value for money. Advertising, if it works well, can prompt consumers to constructively consider the appropriateness of their current financial product. This includes advertising by super trustees. However, it should be noted that there is a limit to the utility of advertising when consumers are defaulted into a compulsory product.
9. Further, as RG 234 notes:

Advertisements that do not fairly represent the product or its key features and risks, or the nature and scope of the service, can be misleading and create unrealistic expectations that may lead to poor financial decisions.
10. ASIC regularly takes action against misleading advertising, including in the superannuation area. In April 2018 ASIC issued infringement notices against Spaceship Financial Services Pty Ltd and Tidswell Financial Services Ltd following concerns that the promotional statements in relation to the Spaceship superannuation fund prioritised marketing over accurate disclosure³. ASIC has also been active in targeting misleading online marketing encouraging consumers to switch to self managed superannuation funds.

² Counsel Assisting's submissions (**CA submissions**), [825.1] and [825.2].

³ ASIC media release 18-098MR, *Superannuation trustee and promoter penalised for false and misleading conduct*, dated 10 April 2018.

TOPIC 2: Section 68A of the SIS Act

*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?*⁴

11. Yes, but to ensure better outcomes for consumers it might be appropriate to revise the default system more broadly. This is currently the subject of consideration by the Productivity Commission.
12. For a default system based significantly on employer choice to work well, employers must have the knowledge, capability and motivation to make choices that promote optimal outcomes for consumers. Strengthening the prohibition in s 68A of the *SIS Act* addresses only part of the problem, being the risk that employers are improperly influenced by the provision of inducements by a superannuation trustee.
13. Nonetheless, it is important that the law creates settings that influence employers to choose default funds based on objective criteria, not benefits they receive from fund trustees or their associates. In the superannuation system a majority of members are disengaged and ill informed⁵ and may not have the will, or the expertise, to identify circumstances in which their default member fund is appropriate for them. As the Productivity Commission identified in its draft report, there are differences in the quality of MySuper products so choice of a default fund by an employer is important for long term retirement outcomes for employees.
14. Accordingly, ASIC supports alterations to s 68A and has, for some considerable time, publicly raised the need for law reform to this provision.
15. Section 68A was introduced into the *SIS Act* as part of the reforms which allowed employees to choose the superannuation fund into which mandatory employer contributions would be made. The provision has been described as the “no employer kick back rule”.⁶ It is aimed at preventing an employer from being improperly induced to choose a default fund for employees, rather than basing that decision on performance and other fund characteristics. It is of particular importance that an employer’s choice not be inappropriately influenced in light of the fact that there is no obligation for an employer to ever revisit their choice of default fund.
16. The case study for Host-Plus Pty Ltd (**Hostplus**) evidences that s 68A is ineffective. In that case study, despite significant expenditure from fund assets for the benefit of employers there was no breach of the section. This was because the inducement did not meet one of the requirements of s 68A, namely, it was not “on condition that” one or more of the employees will be or will apply or agree to be members of the fund.

⁴ CA submissions, [825.3].

⁵ Productivity Commission draft report: P211 to 226.

⁶ See Explanatory Memorandum, *Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2005* at [1.24].

*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?*⁷

17. Subsection 68A(1) is of limited scope because it only applies where the inducement is offered “on the condition that” an employee “will” be or apply or agree to be a member. The provision does not prevent trustees or their associates from offering unconditional benefits in an attempt to entice employers to become members of the fund.
18. Subsection 68A(3) is likewise ineffective for similar reasons. It prohibits a trustee of a regulated superannuation fund or their associate from refusing to supply or offer certain supplies of goods or services to a person “for the reason that” one or more employees are not or have not applied or agreed to be members of the fund.
19. A weakness in both prohibitions is that the prohibited condition or reason must relate to particular employees becoming or applying to be members of the fund (i.e. an act of the employee), rather than the simple act of the employer choosing the fund as its default fund for all employees.

A purpose or intention test is too difficult for effective regulation

20. ASIC respectfully disagrees with Counsel Assisting that the prohibition should be based on a “purpose” or “intention” test. Such mental elements are difficult to prove and may continue the problem of the section having no practical application.

The “condition” and “reason that” requirements should be removed

21. ASIC would support a formulation that removes the requirement for the inducement to be on “condition that”, or “the reason that”, particular employees become or apply to become a member.
22. Instead, subsection 68A(1) should be rewritten to prohibit certain supplies, discounts or other benefits that do affect, or are likely to induce or affect, or could reasonably be expected to induce or affect a person’s choice of default fund for employees who have no chosen fund or a person’s choice to change the default fund for employees with no chosen fund.
23. Subsection 68A(2) should be reformed in a similar manner, including by removing the “for the reason that” requirement.
24. The section’s effectiveness may also be increased if employers and, for corporations, their directors and senior executives are obliged not to accept such inducements. Such a reform would place a disincentive on inducements from both the perspective of the inducer and from the perspective of the person sought to be induced.

⁷ CA submissions, [825.4].

The remedies for a breach of s 68A are inadequate

25. In order for s 68A to be effective reform is also needed to the remedies relevant to the section. The only current remedy is that the victim may recover the amount of the loss or damage for a breach of the section from the offender.⁸ It is also possible that ASIC, as the relevant regulator⁹ of s 68A, may cause a civil proceeding to be commenced under s 298 of the *SIS Act* in a person's name to recover damages for a breach of the section.
26. Those remedies are inadequate for two reasons:
- (a) The remedy under this section is dependent on proving loss or damage "because of the contravention". In practice this would be extremely difficult to prove. First, a victim would need to show that he or she had actually suffered loss or damage from being placed into that particular fund and the quantum of that damage. Secondly, a victim would need to prove causation – it would need to be shown that the loss or damage was suffered because of the prohibited inducement.
 - (b) There is no real element of personal or general deterrence to the sanctions. The section is not a civil penalty or criminal provision and does not attract any other type of enforcement mechanism. Consequently, there is no substantive deterrence from trustees or their associates engaging in this type of prohibited behaviour. The result, as demonstrated by the Hostplus case study, is that trustees *do* offer inducements to attempt to have employers choose their fund as a default fund.
27. The provision should be transformed into a civil penalty provision that ASIC can enforce and therefore also a criminal provision if a contravention were to meet the requirements of s 202 of the *SIS Act*. Such a reform would provide some measure of personal and general deterrence to trustees, those involved in the contravention or their associates from contravening the provision.
28. Whilst the remedy for loss or damages should be maintained, further policy consideration may be necessary in respect of *how* such loss should be quantified and whether it is appropriate to include specific rules regarding the appropriate measure of loss or damage.
29. Further, ASIC should be given the power to issue infringement notices with penalties for a breach of s 68A. Such an administrative power would give ASIC an alternative to court action for a breach of s 68A which could be exercised in appropriate circumstances.

Are there matters of principle that would justify such a change? Are there problems that would arise in the application of the law?¹⁰

30. There are matters of principle that would justify a change in the law discussed above.

⁸ *SIS Act*, s 68A(5).

⁹ *SIS Act*, s 6.

¹⁰ CA submissions, [825.5].

Potential problems that may arise in the application of the law

31. Another issue arising from the Hostplus case study was that some industry funds felt the need to build relationships with employers so that they did not lose default fund status with employers to other funds that did not perform as well.¹¹
32. Changes to s 68A would not, however, prevent trustees or their associates from forming business relationships with employers, nor promoting their fund through advertising material that emphasises fund performance. The current regulations, specifically, regulation 13.18A permit exceptions to the prohibition – if fund trustees had concerns with any changes to s 68A, the regulations could be amended to clarify that general promotion or advertising is not covered (although ASIC is of the view that such an amendment is not necessary).

TOPIC 3: Payments from external responsible entities of managed investment schemes

*Is it appropriate for the trustee of a superannuation fund to retain payments from the responsible entity of a managed investment scheme where that payment is derived from the investment of members' money?*¹²

33. No, unless the payments are applied for the benefit of members. A superannuation trustee should make decisions about the investment of members' money based on the interests of the members not influenced by any interest of the trustee itself.
34. The core principle is that a trustee of a superannuation fund is, at heart, a fiduciary in respect of members of that fund. Consequently, the trustee owes a fiduciary duty to those members.
35. A fiduciary duty in the strict sense is proscriptive, forbidding a conflict of interest and duty, and any unauthorised profit from use of position, property or confidential information.¹³ However, to the extent this fiduciary duty in respect of conflicts would prohibit a particular investment, the general law does not apply provided the trustee has complied with the requirements of the *SIS Act*, prudential and operating standards and the governing rules of the fund.¹⁴

¹¹ David Elia (Hostplus): P4868:7-4869:3.

¹² CA submissions, [825.6].

¹³ *Breen v Williams* (1996) 186 CLR 71 (*Breen*) at 82-83 (Brennan CJ), 93-94 (Dawson and Toohey JJ) and 112-113 (Gaudron and McHugh JJ). And see the oft-cited passage of Deane J in *Chan v Zacharia* (1984) 154 CLR 178 (*Chan v Zacharia*) at 198-199 describing the two overlapping proscriptive 'themes': (1) that of precluding the fiduciary from being swayed by personal interest, and (2) that of precluding the fiduciary from actual misuse of his position for personal advantage. Being proscriptive, the fiduciary obligation 'tells the fiduciary what he must not do. It does not tell him what he ought to do': *Attorney-General v Blake* [1998] Ch 439 at 455.

¹⁴ *SIS Act*, s 58B.

36. Once a fiduciary relationship is established the next step is to ascertain the ‘particular obligations’ owed by the fiduciary.¹⁵ It is ‘necessary’ to identify the content of the duty because that is ‘the subject matter over which the fiduciary obligations extend’.¹⁶
37. The content is ‘moulded according to the nature of the relationship and the facts of the case’,¹⁷ and in that regard all of the facts and circumstances must be carefully examined.¹⁸ The actual duty assumed (by reference to the facts) will determine the extent of the fiduciary obligation.¹⁹ The receipt of unauthorised payments from the responsible entity (**RE**) of a managed investment scheme (**MIS**) may be a breach of the trustee’s statutory duties as it would not be possible to prioritise the interests of members, or otherwise manage the conflict appropriately, unless the benefit of the payment is passed on to members.
38. That is, the conflict would be created because it would be in the trustee’s interest to invest in MISs in respect of which the trustee received fees from the RE, whereas investing in those funds may not be the best option for members (for example, if there were alternative higher return products). Although a fiduciary can take profits even where there is a conflict of interest provided they are authorised, it is difficult to see how authorisation could be appropriately given by members to such an arrangement.
39. Consequently, it would not be appropriate for a trustee to retain payments from an RE of an MIS where that payment is derived from the investment of the members’ funds in the MIS.²⁰
40. The only scenario in which the receipt of payments from the RE of a MIS might be appropriate is where the trustee does not retain any of those payments and, instead, refunds them to members or otherwise contributes them to the assets or expenses of the superannuation fund.
41. A secondary issue is whether the current regulatory model is adequate to protect members from such conduct. Many of the fiduciary duties have been transcribed in specific obligations within the *SIS Act*. There is an equivalent “no conflicts” rule in s 52(2)(d) of the *SIS Act*. The covenants in s 52 are deemed to be included in the governing rules of a superannuation fund to the extent not already expressly included. This provision is, generally, under the administration of APRA, but is not currently a civil penalty provision.

¹⁵ *Chan v Zacharia* at 196 (Deane J).

¹⁶ *Breen* at 82-83 (Brennan CJ), citing *Birchnell v Equity Trustees, Executors & Agency Co Ltd* (1929) 42 CLR 384 at 409 (Dixon J).

¹⁷ *Hospital Products Ltd v United States Surgical Corporation* (1984) 156 CLR 41 (***Hospital Products***) at 102 (Mason J). See also *Birchnell* at 408 (Dixon J); *News Ltd v Australian Rugby Football League Ltd* (1996) 64 FCR 410 at 539 (the Court); *Chan v Zacharia* at 195, 196 and 204-205 (Deane J); *John Alexander’s Clubs Pty Ltd v White City Tennis Club Ltd* (2010) 241 CLR 1 at 34-36 (the Court).

¹⁸ *Hospital Products* at 72 (Gibbs CJ).

¹⁹ *Birchnell* at 408 (Dixon J); *Phipps v Boardman* [1967] 2 AC 46 at 127 (Lord Upjohn).

²⁰ Section 58B of the *SIS Act* would need to be considered in this regard because it seeks to negate the effect of the general law against conflicts.

TOPIC 4: Selling of superannuation

*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?*²¹

42. Superannuation is a unique financial product. For the average Australian consumer their investment in superannuation is generally mandatory and integral to their long-term financial well-being. Thus, entry into an unsuitable product may have significant adverse consequences for the consumer many years into the future. Yet, in spite of this, many consumers have limited understanding of superannuation and minimal engagement with their superannuation.
43. The regulatory system offers some protections for these disengaged consumers. Unless consumers choose to acquire an interest in a self-managed superannuation fund, their superannuation investment is subject to prudential regulation. Further, the most disengaged consumers, that is, those who make no choice as to which superannuation product to acquire, are protected to a degree by the MySuper product regulation. These questions need to be considered against this background.
44. The Royal Commission has highlighted that the way superannuation products are distributed and sold can lead to consumer harm. Likewise, ASIC has highlighted and taken action in relation to superannuation sales and distribution models that have caused or may cause consumer harm.
45. Consistent with the evidence presented to the Royal Commission superannuation is significantly distributed or sold through:
 - (a) default arrangements put in place by employers;
 - (b) financial advisers; and
 - (c) related party distribution agreements.
46. ASIC's work has highlighted concerns with respect to all three distribution or sales models:
 - (a) ASIC has been looking at default arrangements through its employers and superannuation project.²² This project is ongoing but has generated concerns regarding employer inducements as well as the role played by payroll providers and corporate superannuation tender consultants. Further, the NAB/NULIS case study illustrates the issues that can arise for members where they enter a fund as part of an employer plan (in that case study the

²¹ CA submissions, [825.7].

²² Peter Kell (ASIC), Exhibit 5.3185.318, at [121(c)].

MKBS product) and are then automatically moved to another product, or another division of that product if they leave that employer (in that case study the MKPS product).²³

- (b) As noted by Peter Kell,²⁴ ASIC has held concerns about the quality of the advice consumers are receiving about superannuation and has carried out significant work in this area.²⁵
 - (c) The arrangements put in place by ANZ and CBA to sell the superannuation products of their related parties in bank branches and Westpac to sell the products over the phone is one example of related party distribution agreements. ASIC had concerns regarding these selling models which prompted it to take action against these three banks.
47. Sales of superannuation in bank branches may create specific consumer risks. Of course, like the sale of any related party financial product, the sale of related party superannuation products in bank branches is inherently conflicted because the bank has an interest in customers joining the fund and lacks any incentive to inform customers that there may be a more competitive fund with better investment returns or lower fees, or a better insurance product or any other relevant advantage, or that their existing superannuation fund is a better alternative.
48. Further, ASIC notes that a consumer's entry to the bank branch creates an opportunity for an unsolicited sale to be made to a consumer who did not intend to purchase a superannuation product. Similarly, a bank can use its relationship with a consumer to seek to sell superannuation in other ways (eg via phone calls). As the bank knows significant amounts of private financial information about its customer, such approaches can be more persuasive than approaches by others. Indeed, the model employed by ANZ and CBA appears to have been a successful one for the superannuation funds involved.²⁶ It was a high priority for CBA to ensure, in its dealings with ASIC, that it could get the CES product "back into the branches".²⁷
49. In light of these issues, ASIC supports initiatives designed to better regulate how superannuation products are distributed and sold in order to protect consumers. In ASIC's view, another approach to tackling this issue would be to focus on improvements to the products on offer as well as the sales processes. In a superannuation system in which all products were of similarly high quality and suitable for most, the amount of harm that may be caused by poor selling practices would be minimised.
50. There are a number of proposals that are in train or actively under consideration that will address some distribution and sale issues:

²³ CA submissions, [9].

²⁴ Peter Kell (ASIC), Exhibit 5.3185.318, at [133].

²⁵ The vulnerabilities of consumers in terms of superannuation were also highlighted in work we recently did in relation to SMSFs. See ASIC Report 575 *SMSFs: Improving the quality of advice and member experiences*.

²⁶ See CA submissions, [467] with respect to ANZ's distribution of Retail Smart Choice Super product.

²⁷ CA submissions, [376].

- (a) Changes to the default system would minimise poor sales practices directed at employers. The Productivity Commission has recommended that default funds be chosen only once (Draft Recommendation 1) and that this choice be exercised not by employers but by employees from a reduced number of best-performing funds (“assisted employee choice model”) (Draft Recommendation 2). ASIC supports consumers being defaulted once and changes to the current employer choice default arrangements which address the issues identified by the Productivity Commission. We note that concerns have been expressed that funds will seek to cross-sell and up-sell to members once they have succeeded in obtaining them as members of a default fund. These concerns may be addressed by the proposals regarding inherently conflicted structures, dealt with below. The Productivity Commission has also included measures in Draft Recommendation 4 of its draft report to address these concerns.
- (b) It is proposed that superannuation trustees be subject to a design and distribution obligation.²⁸ This reform includes a series of obligations to require product issuers to more carefully consider consumers in the development and distribution of products. For instance, distributors of the product must distribute it consistently with a target market determination. ASIC is to be given powers to enforce these arrangements, including issuing stop orders and there are civil and criminal penalties that apply to contraventions of the new arrangement.
- (c) It is also proposed that ASIC be provided with a new product intervention power.²⁹ This would allow ASIC to intervene temporarily (for a period of up to 18 months) in the distribution of a financial product (excluding MySuper products) where it perceives a risk of significant consumer detriment. Proposed actions that ASIC could take include issuing stop orders in relation to the distribution of products, requiring amendment of the product marketing and disclosure materials and restricting how a product is distributed or banning products. ASIC can also ban aspects of remuneration practices, where there is a direct link between remuneration and distribution of the product. Procedural fairness requirements apply to the use of this power and ASIC will be required to release a public statement about the reasons for any intervention.

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?³⁰

51. In ASIC’s view, further statutory reforms are necessary to tighten the controls around the sale and distribution of superannuation. The current regulation of “personal advice” and “general advice” is not operating effectively to prevent mis-selling under a financial advice model. Often,

²⁸ *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.*

²⁹ *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018.*

³⁰ CA submissions, [825.8].

banks (or other sellers) are not seeking to advise the client, but instead trying to sell a product for the overall financial benefit of the corporate group, and/or with a direct benefit for the bank itself, depending on the exact model utilised.³¹

52. General advice sales are lightly regulated compared to personal advice sales, with minimal consumer protections. However, even under a “general advice” model a bank (or other seller) can make a recommendation or a statement of opinion that is intended to influence a person in making a decision in relation to a superannuation product.³²
53. ASIC’s consumer research indicates that consumers do not necessarily comprehend the limitations of general advice conversations and, in spite of the warning, some are likely to think that their personal circumstances have been taken into account. That was ASIC’s concern with the way in which superannuation products were being sold within ANZ and CBA branches and, in the case of Westpac, via unsolicited phone calls.
54. In ASIC’s view, simply moving the dividing line between general and personal advice is not the answer. Rather, ASIC considers that some types of personal advice could be more lightly regulated (eg strategic financial planning, budgeting advice) whereas general advice about a particular product, such as superannuation, in a sales context should be more heavily regulated. This might take the form of incorporating some but not all consumer protections arising under a personal advice model or including new particular tailored consumer protections.
55. Another reform that could be considered is a restriction on unsolicited sales of superannuation, whether those unsolicited sales be under a personal, general or no-advice model. Unsolicited sales are particularly likely to lead to mis-selling because the consumer is totally unprepared to make a decision. Given that most Australians will already have a prudentially regulated superannuation product and the inherent danger in superannuation switching (through the loss of insurance benefits) and the inherent complexity of the product, ASIC sees merit in considering the banning of unsolicited superannuation sales.
56. ASIC has undertaken consumer research with respect to the sale of life insurance³³ which found that consumers who bought a life insurance policy during an outbound sales call were more likely to have felt pressure to buy and were more likely to have been influenced by the sales person in their decision on the type and level of cover. Analogously, we do not consider that selling complex products like superannuation (or life insurance) on an unsolicited basis is conducive to consumers making informed decisions.

³¹ So much was conceded by Mark Pankhurst: Mark Pankhurst (ANZ): P5055.

³² Definition of “general advice” in s 766B(4) of the *Corporations Act 2001* (*Corporations Act*).

³³ Report 588 *Consumers’ experiences with the sale of direct life insurance* (**REP 588**).

57. Our consumer research also identified that some consumers have difficulty saying ‘no’ when they are interacting face to face in a branch: 34% of consumers who bought insurance in a branch felt pressure to buy.³⁴

TOPIC 5: Engagement by superannuation funds with Aboriginal and Torres Strait Island people

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?*³⁵

58. The evidence presented in Round 5 to the Royal Commission demonstrated that the identification procedures generally used by superannuation funds are not always appropriate for Aboriginal and Torres Strait Islander members. The difficulties include a lack of access to a valid and accurate driver’s licence, passport and birth certificate. Flexibility is required in circumstances where persons either do not have one or more of these documents, or there are inaccuracies. Funds need to be aware that inaccuracies in identification documents can and do arise in the absence of any fraud or wrongdoing which may require funds to demonstrate flexibility to overcome such inaccuracies.
59. The ‘Know Your Customer’ test, under the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth) outlines identification requirements applicable to financial service providers (FSPs). Where an FSP assesses its relationship with an individual customer as of ‘medium or lower’ money laundering or terrorist financing risk, then the FSP may choose to apply a ‘safe harbour’ procedure, which provides flexibility for the FSP in determining what they will require from a customer to verify their identity.
60. Following engagement with the Indigenous Superannuation Working Group (ISWG) and other stakeholders, including ASIC, in 2016 AUSTRAC released updated guidance to the financial services industry about alternative ways industry participants could identify Indigenous customers who are unable to meet the standard 100 point ID test (such as statements by a referee or photographic identification by a services provider). This guidance theoretically means that all Australians should be capable of providing documents proving their identity to the satisfaction of the legislative requirements.
61. While ASIC is aware that some funds, for example QSuper, HESTA and AustralianSuper, have specifically considered the identification challenges experienced by their Indigenous members

³⁴ See paragraph 301 of Report 587, *The sale of direct life insurance*, referencing consumer research reported at page 38 of REP 588.

³⁵ CA submissions, [825.9].

and have taken steps to raise awareness of the alternative identification procedures available under the AUSTRAC Guidance, it is not clear that this has occurred across the industry.

62. During a recent outreach with members of the superannuation industry to the APY Lands direct superannuation assistance was provided to 500 Anangu, and more than half of those who received assistance could not comply with standard identification procedures.
63. It is also ASIC's experience that a significant proportion of Indigenous people in some remote areas are unable to resolve their financial services issues over the telephone without assistance.
64. Apart from anecdotally, there is no data showing the number of people that fail initial identification procedures with FSPs. An obligation to collect and report on this data would assist in identifying FSPs that may have poor procedures in place to assist members that cannot comply with standard identification processes.
65. In ASIC's view it would be beneficial if FSPs, including superannuation funds, adopted escalation procedures where a customer has difficulty passing the initial identity authentication process. Such procedures could include escalation to a staff member with appropriate seniority and understanding of the FSPs' risk policy under the know your customer test to be able to provide tailored assistance. This would benefit not just Indigenous people, but any person having difficulty identifying themselves to a FSP.

Should superannuation funds be required to record whether their members identify as Aboriginal or Torres Strait Islander people?³⁶

66. Aboriginal and Torres Strait Islander people are more likely to experience financial exclusion than the rest of the community. Progress towards reducing levels of financial exclusion for this group has been slow.
67. It is recognised in many fields, including in the delivery of health services and Government programs, that ethnicity related data collection is an important way to detect, measure and improve outcomes for marginalised groups, or populations that might be achieving generally lower outcomes than the broader Australian population. If FSPs were required to keep data on Aboriginal and Torres Strait Islander status, this data could be used to:
 - (a) identify where Indigenous people are experiencing poorer outcomes and identify the reasons for this;
 - (b) design solutions to address the reasons for poorer outcomes;
 - (c) measure the effectiveness of those solutions at improving outcomes; and
 - (d) allow targeted delivery of tailored services and products to Indigenous people.

³⁶ CA submissions, [825.10].

68. Anecdotally, ASIC has heard from some FSPs that whilst they are supportive of reducing financial exclusion of Indigenous people, they do not believe they have any Indigenous members.
69. The ISWG noted the importance of data collection in ensuring that the superannuation sector addresses the challenges faced by their Indigenous members (Discussion paper: Building better superannuation outcomes for Aboriginal and Torres Strait Islander members, dated February 2015).
70. In the QSuper case study, Ms Melcer gave evidence that she did not consider it necessary for funds to ask members whether they identify as Aboriginal or Torres Strait Islander.³⁷ However, QSuper was able to estimate that 5,648 of its members identified as Aboriginal or Torres Strait Islander people. This was done largely on the basis of postcode analysis. While such an analysis may be possible in far north Queensland, in other areas of Australia a postcode may not be a reliable indicator. Given that QSuper undertook the estimate and the postcode analysis in order to inform its approach to these members, there may be value in considering whether funds should seek information as to whether members identify as Aboriginal or Torres Strait Islander.
71. This is not to ignore other vulnerable and disadvantaged groups, but rather to assist in identifying one such group. The policies developed to assist Aboriginal and Torres Strait Islanders to access and interact with their superannuation may be of broader benefit to other disadvantaged groups.

Should those superannuation funds who do not currently permit the early release of superannuation on the basis of severe financial hardship do so?³⁸

72. Early release of superannuation has been a feature of the superannuation law for many years. Early release provisions aim to strike a balance between the overriding policy objective – that superannuation benefits are to be preserved to provide income for retirement - and the recognition that exceptional circumstances may justify the early release of benefits to a member.
73. The specific grounds of early release of superannuation are limited. Those grounds provide a fair balance between providing access to members where exceptional circumstances do arise, whilst ensuring that the majority of superannuation entitlements are preserved to serve their primary purpose.
74. Given that the rules for early access to superannuation are already restrictive, ASIC is of the view that these early access provisions should be standardised and available to members regardless of which superannuation fund to which they belong.

³⁷ Lynette Melcer (QSuper): P4728:10-46.

³⁸ CA submissions, [825.11].

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?³⁹

75. A number of public interest advocacy groups, most notably the Public Interest Advocacy Centre (PIAC), have highlighted that there is scope for the law to recognise the lower life expectancy of Indigenous members by reducing the preservation age applicable to Indigenous members. PIAC has pointed to another area of public policy – the age at which people can access the Age Pension – as an area where the law has recognised variations in the retirement outcomes of different groups of Australians and made allowances accordingly.
76. While it is a valid argument that the discrepancy in life expectancies should be recognised in some way in the administration of the superannuation system, a reduction in the preservation age for Indigenous members may in itself lead to poorer outcomes. This is because the design of the superannuation system, where the total balance of the funds is invested, logically means that (taking into account differing investment returns) the greatest growth of a member's superannuation balance usually occurs in the years directly preceding the member reaching their preservation age. Were the preservation age to be lowered for Indigenous members, this would result in Indigenous members not receiving the benefit of the largest growth phase of a superannuation account. Arguably, a better way of recognising the lower life expectancy of Indigenous members would be to broaden the scope of early access provisions to ensure that it is easier for those members who are in poor health to obtain the benefit of their superannuation funds at that time.
77. The lower life expectancy of Indigenous people might be recognised in other ways. For example, the documentary requirements for early access in relation to terminal illness could be broadened to allow trustees to take the life expectancy of a members' cohort into account as a factor leaning towards making a decision to release super early.

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?⁴⁰

78. Customary adoption is part of Torres Strait Islander culture. Customary Torres Strait Islander adoption makes the child a full member of the adoptive family. However, in the eyes of Australian law, customary adoptions are private arrangements, and although not prohibited, they are not legally recognised unless a formal adoption order is sought in the Supreme Court. In addition to customary adoption, a range of adults are seen to have kinship obligations for the raising of children among Aboriginal and Torres Strait Islander communities – not just the biological mother. This belief often results in long term substitute care of Indigenous children with different relatives in different homes.

³⁹ CA submissions, [825.12].

⁴⁰ CA submissions, [825.13].

79. There is relatively little formality, by European standards, to Indigenous child care arrangements and it is rare for Indigenous persons to seek to regularise the relationship with children by legal means such as adoption or legal guardianship.
80. Where other undocumented relationships exist (for example, de facto relationships), the superannuation administration rules allow for a preponderance of evidence to be used to prove that the relationship meets the requirements of an eligible beneficiary. Similar processes could be put in place to recognise the unique kinship structures within Aboriginal and Torres Strait Islander communities.

TOPIC 6: Discretion to appoint and remove directors

*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?*⁴¹

81. Particular concerns which arose through case studies appear to be:
- (a) appointment of directors from particular shareholder groups who operate based on their affiliation with shareholder organisations, rather than their ability to contribute to the board of directors;
 - (b) lack of particular skills or experience of appointed directors⁴²; and
 - (c) the interests of the shareholder influencing director decision-making.
82. The regulatory framework for superannuation is predicated on directors of superannuation trustees carrying out their role effectively. Directors need to understand and be capable of delivering on the serious obligations rightly imposed on those responsible for managing the compulsory savings of Australians.
83. The regulatory framework already contains provisions designed to ensure that suitable persons are appointed to the board of an RSE licensee. Section 29D(1)(d) of the *SIS Act* requires that, to be granted a RSE licence, the body corporate meets the requirements of the prudential standards relating to fitness and propriety.
84. APRA's Prudential Standard SPS 520: Fit and Proper covers, inter alia, directors of RSE licensees.⁴³ Two of the requirements for determining whether a person is fit and proper to hold a position as a director are whether it would be prudent for an RSE licensee to conclude:⁴⁴

⁴¹ CA submissions, [825.14].

⁴² CA submissions, [694].

⁴³ Prudential Standard SPS 520 at [11].

⁴⁴ Prudential Standard SPS 520 at [18]. Also see APRA's Prudential Practice Guide: SPG 520 – Fit and Proper.

- (a) that the person possesses the competence, character, diligence, experience, honesty, integrity and judgement to perform properly the duties of the responsible person position;
 - (b) that the person possesses the education or technical qualifications, knowledge and skills relevant to the duties and responsibilities of an RSE licensee.
85. Consequently, a shareholder of an RSE licensee, if it does not wish to risk action against the RSE Licensee under the *SIS Act*⁴⁵, should already take a person's qualifications, skills, experience and competence into account when deciding whether to appoint them as a director.
86. Currently the legislation provides for transparency about directors qualifications under Regulation 2.38 of the *Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations)*. There is also a proposed amendment to the *SIS Act* to require corporate RSE licensees to have at least one third independent directors.⁴⁶
87. In addition, there are obligations imposed on directors which mean that, once appointed, particular standards of competence and care are expected of directors regardless of their skills and qualifications⁴⁷ and their duties are owed primarily to the members of the fund, rather than the shareholder⁴⁸. The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* which is currently before the Senate proposes to make a breach of those covenants by a director of a corporate trustee subject to civil and criminal penalties. Law reform to clarify that the s 52A requirements operate as civil penalty provisions is one way in which these obligations could be meaningfully strengthened.
88. To the extent that there are issues with the appointment of directors ASIC would favour strengthening the existing regulatory framework and a greater focus by the regulators on these issues rather than the introduction of a best interests duty imposed on shareholders.

⁴⁵ See APRA's Prudential Practice Guide: SPG 520 – Fit and Proper at [45] –[57].

⁴⁶ *Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017*.

⁴⁷ In particular, directors have an obligation under s 180 of the *Corporations Act* to exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they were a director of a corporation in the corporation's circumstances and occupied the office held by and had the same responsibilities as the director. See also *SIS Act*, s 52A for specific director duty obligations of RSE licensees. In *Shafron v Australian Securities and Investments Commission* (2012) 247 CLR 465 at 476 [18] in a joint judgment a plurality of the Court stated that:

The degree of care and diligence that is required by s 180(1) is fixed as an objective standard identified by reference to two relevant elements – the element identified in para (a): “the corporation’s circumstances”, and the element identified in para (b): the office and the responsibilities within the corporation that the officer in question occupied and had. No doubt, those responsibilities include any responsibility that is imposed on the officer by the applicable corporations legislation. But the responsibilities referred to in s 180(1) are not confined to statutory responsibilities; they include whatever responsibilities the officer concerned had within the corporation, regardless of how or why those responsibilities came to be imposed on that officer.

⁴⁸ *SIS Act* ss 52A(2)(d) and 52A(3).

89. Issues of skill and competence have previously been recognised in the Super System Review – Final Report (**the Cooper Review**)⁴⁹ and in the Productivity Commission’s draft report. Mandating how trustees appoint directors to their boards was not the recommended answer.
90. More explicit obligations rather than a novel duty upon shareholders to exercise their powers of appointment and removal of directors in the best interests of members is likely to provide more substantive tools to change behaviour. There may be benefits in increasing transparency around board evaluation practices as proposed by the Productivity Commission⁵⁰ in order to improve market practices.

TOPIC 7: Relationship between trustees and financial advisers

Are legislative interventions to remove grandfathered commissions and ongoing service fees from superannuation accounts appropriate? If so, why? If not, why not?⁵¹

91. ASIC refers to its written submissions in Round 2 regarding financial advice generally and considers those submissions to be equally applicable to financial advice in a superannuation context.

Grandfathering

92. The Government introduced a broad ban on conflicted remuneration, including commissions, in the FOFA legislation *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012* which inserted Division 4 of Part 7.7A into the *Corporations Act*. This was done because of evidence suggesting that the most effective way to improve the quality of financial advice for consumers is to remove conflicts altogether by banning commissions and other conflicted remuneration practices.⁵²
93. Grandfathering was introduced to allow the financial advice industry to adjust their businesses in light of the new requirements. However, the grandfathering provisions have not operated to merely facilitate a short-term transition. Instead, they have allowed commissions to remain a significant proportion of licensee/adviser remuneration and to, therefore, perpetuate misaligned incentives which lead to conduct that is not in the interests of consumers. This is particularly the case in relation to superannuation which is a long-term investment for many consumers; commissions built into superannuation products have the potential to extend for many years.
94. In the superannuation context, grandfathering arrangements incentivise advisers to keep clients in legacy products with a continuing commission structure, even where there may be better products available to meet the client’s needs.⁵³ Further, where a superannuation fund is

⁴⁹ System Review – Final Report (the Cooper Review), P50-51.

⁵⁰ Draft Recommendation 5, Productivity Commission draft report.

⁵¹ CA submissions, [825.15].

⁵² EM to *Corporations Amendment (Further Future of Financial Advice Measures) Act 2012*, [2.6].

⁵³ Peter Kell (ASIC), Exhibit 5.318, at [432].

embedded in a financial institution with an advice business, trustee decisions can be influenced by the desire to retain grandfathered commissions because of the revenue implications for the group.⁵⁴ For example:

- (a) this appears to have been at least one reason why IOOF, when implementing a repricing in 2018, did not automatically re-price all members. The evidence was that approximately 40,000 members had grandfathered commissions and repricing all members automatically would have cost the group \$8 million annually because some of those commissions were payable to advisers within the group;⁵⁵
- (b) the Royal Commission heard evidence indicating that Mercer intentionally did not advertise a repricing to existing members because it wanted to keep them in products with trailing commissions to “protect our existing APD revenue as much as possible”;⁵⁶
- (c) the Commission heard evidence that Suncorp finalised its Product Issue and Distribution Agreement between SPSL, SLSL and Suncorp Financial Services Pty Ltd (**SFS**) in order to entrench commission payments for the distribution of SPSL and SLSL’s products by SFS, including superannuation products, prior to FOFA taking effect.⁵⁷

95. The Commission heard evidence in respect of a number of other superannuation funds where the trustee has made decisions on the basis of assumptions that financial advisers will not advise members to leave products carrying trailing commissions for those advisers.⁵⁸ In general, trustees rely on financial advisers as a key means of selling or distributing their product and are therefore fearful of turning off commissions or ongoing advice fees for advisers because it may result in a downturn in business:

- (a) this was the argument employed by NAB to justify why commissions should continue to be grandfathered after a successor fund transfer was implemented;⁵⁹
- (b) the OPC Board papers with respect to the proposed successor fund transfer to effect the sale of OPC by ANZ to IOOF suggested that grandfathered commissions arrangements would continue because support from the adviser network was critical for the IOOF sale and various risks could arise if grandfathered commission arrangements were disturbed;⁶⁰
- (c) Ms Elkins gave evidence that moving accrued default amounts into a MySuper product early may have affected the relationship between CFSIL and its aligned advisers.⁶¹

⁵⁴ See e.g. Paul Carter (NAB): P4222:17-36 and Linda Maree Elkins (Colonial): P4951 and P4953.

⁵⁵ Mark Oliver (IOOF): P4592.

⁵⁶ Exhibit 5.335, Witness statement of Benjamin Jon Cossart Walsh, 3 August 2018, (1-2) [4], Exhibit BJCW-130 as referred to in CA submissions, [667].

⁵⁷ CA submissions, [285]-[287].

⁵⁸ See e.g. Paul Carter (NAB): P4220:17-21 and Mark Oliver (IOOF): P4599:36 and P4600:8.

⁵⁹ Paul Carter (NAB): P4216:45-42177 and P4219-20; Nicole Smith (NAB): P4391-4; CA submissions, [122]-[124].

⁶⁰ CA submissions, [449].

⁶¹ Linda Maree Elkins (Colonial): P4946:21-26.

96. Further, the Commission heard evidence regarding the introduction of MySuper, and the fact that a number of funds took active steps to assist advisers to move clients to choice products to prevent them moving to MySuper products where commissions would no longer be payable. In some cases, this went hand in hand with a slow timetable for the transition of accrued default amounts (**ADAs**) to MySuper products, apparently in order to preserve the trailing commissions for advisers as long as possible and give them time to persuade clients to move to a choice product so as to preserve trailing commissions. This included:
- (a) Suncorp where accrued default amounts were all transferred to a MySuper product between 9 and 19 June 2017, when the transition period extended from 1 July 2014 to 30 June 2017;⁶²
 - (b) NAB/NULIS;⁶³
 - (c) AMP where PwC was engaged to undertake a detailed analysis of financial planners impacted by the MySuper reforms.⁶⁴
97. These case studies provide further disturbing illustrations of the poor consumer outcomes brought about by the grandfathering of conflicted remuneration.
98. ASIC's view is that the grandfathering of commissions should cease as soon as reasonably practicable and to the maximum extent possible, although consideration may need to be given to a short transition period to allow financial advisers to adjust their businesses.⁶⁵
99. Mr Kell told the Commission that the entire grandfathering provision is not in the interests of consumers and that the grandfathering provision is "an extremely expansive provision" that "enables the continuing payment of commissions that generate conflicts of interest and unnecessary costs widely across the financial system."⁶⁶ ASIC's view is that "it would be highly desirable to have this dealt with at a policy level".⁶⁷
100. Accordingly, ASIC is supportive of the first suggestion of Counsel Assisting to prohibit all commissions payable from superannuation products and end grandfathering, by law reform if possible.
101. ASIC believes it is unlikely that an industry solution will be sufficiently comprehensive, however, notes that constitutional issues have been previously cited as a potential barrier to legislative reform. Should there be no legislative intervention to prevent commissions from superannuation products and to end grandfathering, then ASIC supports the Productivity Commission's recommendation (Draft Recommendation 13) that there be more transparency around the extent of trailing commissions still paid by members for as long as such commissions

⁶² CA submissions, [283]-[284].

⁶³ CA submissions, [126] and [130].

⁶⁴ CA submissions, [564] and [569]-[575].

⁶⁵ Peter Kell (ASIC), Exhibit 5.318, at [432].

⁶⁶ Peter Kell (ASIC): P5258:39.

⁶⁷ Peter Kell (ASIC): P5258:45.

remain payable/permissible. In ASIC's view, consumers should be clearly informed of the extent of trailing commissions being paid, and that a switch of product would cease their exposure to trailing commissions.

Ongoing service fees

102. The second suggestion made by Counsel Assisting is to prohibit ongoing service fees (including advice fees and plan service fees) from being deducted by trustees from superannuation accounts. This would mean that financial advisers could only be paid from a member's superannuation account for one-off advice to a member in relation to superannuation. A consumer could still enter into an arrangement to make ongoing payments from the consumer's bank account to a financial adviser if the consumer wished to pay for and commit to paying for ongoing advice.⁶⁸
103. The fee for no service issue provides a powerful illustration of why the proposal to prevent the deduction of fees for financial advice by trustees from superannuation accounts is sound.⁶⁹
104. In October 2016 ASIC released its initial Fee for No Service Report.⁷⁰ The report discusses the systemic failure by advice licensees to ensure that ongoing advice services were provided to customers who paid fees to receive these services and the failure of advisers to provide such services. It also discusses the systemic failure of product issuers to stop charging ongoing advice fees to customers who did not have a financial adviser.
105. The Royal Commission heard further evidence with respect to this conduct in a superannuation context in Round 5. For example, in the NAB/NULIS case study the Commission heard evidence regarding the charging of fees for no service by NULIS (Australia) Nominees Pty Ltd (and its predecessor MLC Nominees Pty Ltd) in respect of members of super funds of which those entities are or were the trustee. Counsel Assisting has made submissions regarding the available findings of misconduct in that regard.⁷¹
106. The evidence was that NAB's RSE Licensees conducted the SWiFT project in early 2012 in order to abolish commissions for financial advice and move to a fee-based structure. NAB prided itself on moving ahead of the industry in this regard. However, when it later turned out that no services were being provided in return for some of the fees, NAB presented arguments to ASIC that it should not be required to refund such fees, because if it had retained a commission-based structure then no service would have been required in order to retain the commission.⁷²

⁶⁸ CA submissions, [763]-[764].

⁶⁹ A similar suggestion was made by ASIC in respect of ongoing service fees in its Round 2 submissions dated 7 May 2018, [5]-[6].

⁷⁰ ASIC Report 499 *Financial Advice: Fees for no service*. There have been a number of updates to the report since that date.

⁷¹ At [137]-[147].

⁷² Exhibit 5.76, 13 April 2018, Letter from NAB to ASIC as referred to in CA submissions at [90].

107. Some of the issues arise because the trustees themselves benefit from the deduction of fees for financial advice:
- (a) NULIS followed a practice of retaining some fees purportedly deducted for financial advice;⁷³
 - (b) ANZ acknowledged that from 2003 to 2015, OPC continued to deduct Adviser Service Fees from the accounts of 2,640 members of the OPMF after those accounts ceased to be allocated to an adviser, and that the incorrect deductions were not remitted to any adviser;⁷⁴
 - (c) this was the case for BT Funds Management Limited with respect to fees charged to members of superannuation funds for advice despite those persons ceasing to be advised by financial advisers.⁷⁵
108. Further issues arise where related parties derive benefits from the fees deducted by the trustees for financial advice:
- (a) For NULIS 40% of the revenue of MLC Direct (the administrator of the relevant superannuation funds) was represented by plan service fees and advice service fees that had been incorrectly debited from the accounts of superannuation fund members for financial advice where, in fact, the member had no financial adviser (indeed no financial advisers were housed within MLC Direct).⁷⁶ In addition, NAB has other advice licensees in its group in receipt of fees from the trustee of the superannuation fund, including NAB Financial Planning.⁷⁷
 - (b) Similarly, it was also the case for BT Funds Management Limited and its administrator ACML with respect to some of the fees charged to members of superannuation funds for advice where those persons were no longer advised by financial advisers.⁷⁸
109. As stated above, trustees are reliant on financial advisers to bring in business and retain business. Therefore, they are reluctant to turn off ongoing advice fees for advisers because it may result in a downturn in business, in the same way that turning off commissions may impact on their ability to retain members.
110. For example, Sunsuper Pty Ltd has implemented a retail advice and distribution strategy since 2015 to increase member numbers and funds under management by improving relationships with financial advisers. This was introduced in part because of a perceived challenge to the vertical integration model of retail superannuation funds.⁷⁹ The strategy is to allow financial advisers

⁷³ CA submissions, [79] and [96].

⁷⁴ CA submissions, [472].

⁷⁵ CA submissions, [655].

⁷⁶ CA submissions, [26].

⁷⁷ CA submissions, [110] and [136].

⁷⁸ CA submissions, [655].

⁷⁹ CA submissions, [683].

fees to be paid directly from members' superannuation accounts. This strategy has had the desired result.⁸⁰

111. The case studies illustrate that trustees of superannuation funds are often not fully aware of, nor fully in control of, the extent to which fees are deducted from member accounts for financial advice.⁸¹ The case studies also show that trustees have not had adequate processes in place to determine whether advice is in fact being provided to members where fees are being deducted.⁸²
112. Accordingly, the evidence suggests that payments of ongoing financial advice fees from superannuation accounts are not operating in the best interests of members of superannuation funds.
113. In its written submissions in Round 2, ASIC stated that it was concerned that many clients who are currently paying for ongoing advice services may not be receiving benefit from that advice commensurate with its cost to them. This concern is more acute where that ongoing advice service fee is deducted from a superannuation account. It necessarily follows from the sole purpose test in s 62 of the *SIS Act* that the only kind of financial advice for which such deductions can properly be made is advice relation to superannuation. Clients should not require ongoing advice on a yearly basis in relation to superannuation, particularly in accumulation phase.
114. In light of these concerns ASIC considers that further consideration should be given to what arrangements, if any, are appropriate if advisers are to receive payments from superannuation accounts. In its written submissions in Round 2, ASIC expressed the view that fees for advice should be invoiced to the customer and the payment specifically authorised, as and when the service is provided, rather than being deducted automatically from a client's investment funds. ASIC makes this observation, even in light of the opt-in requirement for new clients in s 962K, *Corporations Act* which was designed to prevent passive fees.

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.⁸³

115. Further research and cost benefit analysis would need to be undertaken to understand the effects of any reforms.

⁸⁰ CA submissions [685].

⁸¹ With respect to NULIS: Nicole Smith (NAB): P4426-7 P4500:1-4; With respect to AMP: CA submissions, [517].

⁸² With respect to NAB/NULIS: Nicole Smith (NAB): P4483:39-4484:15 and P4487; CA submissions, [143]; with respect to CFSIL: CA submissions, [352]; with respect to AMP: Rachel Sansom (AMP): P5145.

⁸³ CA submissions, [825.16].

116. The reforms that are proposed will remove commissions – which are not related to the provision of advice – and on-going service fees, which have been shown in many cases to be a flawed vehicle for providing advice. Neither supports the provision of high quality advice. Removing these fees and commission is important for the reasons set out above. To the extent that their removal does increase the cost of advice, and as a result decreases access, there are alternate ways to manage these consequences which will provide better services to consumers. Paragraph [59] of ASIC’s Round 2 submission outline that better-targeted measures should be considered for addressing this potential harm, including facilitating more basic advice offerings, simplifying financial products, and restricting access to more complex products.
117. ASIC notes that in the superannuation context intra-fund advice enables limited cross-subsidised basic superannuation advice to be provided and that MySuper product regulation is intended to ensure that disengaged consumers who do not seek advice are suitably protected. Both these mechanisms help ensure that the interests of consumers are protected in the absence of the consumer seeking personal advice. Another alternative would be to provide support for accessible advice at particular times in consumer’s life where advice is of particular importance, such as approaching retirement.
118. Moreover, in the context of superannuation, the reforms recently proposed in the Productivity Commission’s draft report on the efficiency and competitiveness of the superannuation system will help mitigate any potential for harm. The Productivity Commission’s draft recommendations that members be defaulted only once, with better selection of default funds and closer supervision of MySuper funds, will ensure better outcomes for members who do not receive advice.

TOPIC 8: Managing conflicts

*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?*⁸⁴

119. Fundamentally any situation which involves someone having control and oversight of the investment of other people’s money for reward creates a potential for conflict issues. Superannuation trustees are entrusted with other people’s money in circumstances where superannuation is compulsory and members are generally disengaged. This heightens the risk of conflicts. In ASIC’s view, there should be high expectations about a trustee’s ability to recognise conflicts, to avoid those that cannot be managed and to effectively manage those conflicts that remain.

⁸⁴ CA submissions, [825.17].

120. It follows that there should be high expectations of the board of the superannuation trustee, which bears ultimate responsibility for ensuring that conflicts are appropriately managed and that the trustee acts in accordance with its fiduciary duties.
121. The conflicts that were the focus of the Round 5 case studies primarily concern for profit superannuation funds operating within a corporate group (that is, vertically integrated structures). But it should not be assumed that these are the only kinds of conflicts affecting superannuation trustees or directors of superannuation trustees. For instance, in the case of an employer sponsored fund conflicts may arise between the interests of members and of the employer where the employer is a shareholder in the trustee or appoints directors to the trustee board. Or a profit for member fund may be an important shareholder in an investment management business.
122. The *SIS Act* also expressly contemplates the existence of arrangements with service providers and investments that may give rise to a conflict of interest. Most relevantly, s58B provides that the general law relating to conflicts of interest does not apply to the extent that it would prohibit a trustee from paying, acquiring a service from or investing in or through another entity, provided the trustee complies with other *SIS Act* requirements, prudential and operating standards and the governing rules of the fund. Section 58B was inserted at the same time as s 58A. Section 58A essentially frees the trustee from any ‘tied’ arrangements in their governing rules which required the trustee to use a specified person or entity for services or investments. The combined effect of these provisions is that the governing rules of a fund cannot restrict the fund’s service providers or investments to a particular entity, but the trustee can use or invest in or through an entity where that may give rise to a conflict where this is in the best interests of members and otherwise consistent with the trustee’s other statutory duties.

ASIC work to date on conflicts of interest relevant to superannuation

123. ASIC has issued two relevant reports following a review by it of conflicts in financial services. The first of these is ASIC Report 474: *Culture, conduct and conflicts of interest in vertically integrated businesses in the funds-management industry* (released March 2016). In this report ASIC stated at paragraph [30]:

There are competitive advantages associated with operating a vertically integrated business in the funds-management industry, including readily available product distribution channels, revenue cross-subsidisation, supply chain management and economies of scale. Nonetheless, we have identified that the vertically integrated business model gives rise to inherent conflicts of interest, and consequently there may be a divergence in many areas of the financial services organisation between the interests of:

- (a) each business division;*
- (b) the same entity acting in different capacities;*
- (c) employees and directors acting in different roles or for different entities within the same corporate group;*
- (d) the entity and the interests of customers and investors; and*

(e) employees and directors and the interests of customers and investors.

124. In January of this year ASIC issued Report 562: *Financial advice: Vertically integrated institutions and conflicts of interest*.⁸⁵ This work raised concerns regarding the disproportionate investment of clients of such institutions in in-house products and the quality of personal advice being provided, particularly where advisers had recommended an in-house superannuation platform to new customers.
125. As outlined in paragraphs [135] – [137] of ASIC’s submission to the Round 2 Hearings, ASIC’s work in relation to conflicts of interest in various parts of the financial services sector is ongoing.
126. While ASIC has examined conflicts affecting superannuation trustees in past work including in surveillance and enforcement work outside of specific projects, ASIC has not undertaken a comprehensive assessment focused on RSE licensees. ASIC notes that superannuation trustees that hold AFS licensees must have appropriate conflict arrangements in place in relation to the provision of the financial services⁸⁶. The *SIS Act* and the prudential standard on conflicts,⁸⁷ set out requirements by which conflicts of superannuation trustees are specifically regulated.
127. The work undertaken by ASIC is consistent with the findings of the Royal Commission through its case studies that conflicts can play a very significant role in influencing consumer outcomes and driving misconduct. It is clear that there are entities that have failed to manage such conflicts and, of greater concern, have failed to recognise the existence or extent of the conflict.
128. ASIC notes that some of the steps that might be used to manage conflicts arising in the case of other businesses operated through a company are not available. The approval of shareholders or members of a trust is not a practical possibility in this instance as the key duties are owed to a large body of members who are poorly informed and likely to be disengaged. Accordingly, the statements below are not general statements of principle about company or trustee operations but made having regard to the particular circumstances of a superannuation trustee.

Dual regulated entities

129. The IOOF case study illustrated the difficulties where the trustee of a superannuation fund is also the responsible entity of a managed investment fund (**DRE**) and the trustee of the superannuation fund then invests in the managed investment fund.
130. The evidence included three instances where an RE had failed in its duty, however, members of the superannuation fund were compensated for losses from reserves of the superannuation fund itself (i.e. from money held for their benefit anyway).⁸⁸ A further issue that emerged was that Mr Mark Oliver, since 29 February 2016 General Manager Distribution of IIML, appeared to be

⁸⁵ The work conducted leading to this report is summarised in Peter Kell (ASIC), Exhibit 5.318, at [67]-[72].

⁸⁶ See s 912A(aa) of the Corporations Act.

⁸⁷ Prudential Standard SPS 521 *Conflicts of interest*.

⁸⁸ One in relation to the over-distribution from the CMT to unit-holders, the other two described in CA submissions, [225].

unaware that the responsible entities of various managed investment schemes were paying commissions to IOOF Holdings (calculated as a percentage of the funds invested with the relevant external fund manager under agreements that predated 1 July 2013).

131. The challenges in addressing conflicts for a DRE are considerable. The Board of the DRE company must serve both the interests of the members of the superannuation fund and the members of the managed investment scheme. The business operations intersect. A superannuation trustee has to decide where to make investments, which will include investments in managed investment schemes. A responsible entity is seeking to acquire investment into its scheme.

Other conflicts

132. Many of the conflicts issues were illustrated by the NAB/NULIS case study in particular. Nicole Smith acknowledged the conflict of interest inherent in arranging for a superannuation trustee to be embedded within a conglomerate organisation,⁸⁹ and made the general statement that “the more control the trustee has over where and how money gets spent and profit gets made, the better the trustee is able to manage conflicts.”⁹⁰
133. These included problematic behaviour arising in connection with investment by a superannuation trustee in a related life insurer or other products of related parties, integration of a financial advice business within the same corporate group, use of a related party as an administrator for the superannuation trustee and other outsourcing arrangements.
134. For instance, Nicole Smith gave evidence that the successor fund transfer undertaken by NAB/NULIS in 2016 was in the best interests of members because it entailed a separation of the superannuation fund from the life insurer.⁹¹ One reason this was said to be in members’ best interests was that it “removed a layer of intermediation”⁹² and freed the superannuation fund from the liquidity requirements applicable to the life insurer which presented an obstacle to it investing in more off-market infrastructure assets.⁹³ Further, it meant that the trustee could then make a decision as to how much of the investment fee was taken as profit, rather than that being controlled by the life company.⁹⁴ Project SWiFT undertaken by NAB in 2012 was intended to provide fee transparency rather than commissions that were in some cases imposed unilaterally by MLC under the life policy.⁹⁵

⁸⁹ Nicole Smith (NAB): P4412:20-25.

⁹⁰ Nicole Smith (NAB): P4421:44-46.

⁹¹ Nicole Smith (NAB): P4398.

⁹² Nicole Smith (NAB): P4389.

⁹³ Nicole Smith (NAB): P4414.

⁹⁴ Nicole Smith (NAB): P4421.

⁹⁵ Nicole Smith (NAB): P4320:8-11.

*If certain structures do raise inherent problems, is structural change of entities, mandated by legislation or otherwise, something that is desirable?*⁹⁶

135. ASIC believes that legislative intervention is warranted to address the inherent conflict issues raised by DREs. That is, consideration should be given to prohibiting DRE structures.
136. In relation to broader legislative intervention, ASIC supports a more comprehensive review to see if particular structures are sustainable and the costs and benefits of these structures. One issue that might be usefully explored through such a review is whether there should be a reversal of ‘onus of proof’ in relation to related party arrangements. That is, such arrangements are assumed to be contrary to the best interests of members unless the contrary is proved. In some respects whether conflicts will be successfully managed within a corporate group depends on the business case for the structure: is it predicated on conflicts not being appropriately managed (for instance, exploiting within corporate group distribution channels that generate a significant level of product sales based on failure to fulfil other duties, such as best interests duty in advice)? Managing conflicts successfully requires an investment of resources that brings with it a level of expense that may or may not outweigh other benefits of acting within a vertically integrated model. This is an issue that could be usefully explored through a review.
137. At this stage despite the significant problems arising from conflicts in relation to superannuation outcomes it cannot be concluded that blunt legislative intervention to prohibit or require changes to structures is desirable. However, certain other legislative interventions (considered below) to better promote the proper management of conflicts could be worthwhile.
138. It may be that other policy proposals under consideration by the Commission would, if implemented, drive better management of conflicts of interest in superannuation. For example, removal of grandfathered conflicted remuneration may minimise the incidence of certain conflicts of interests. In addition, more public regulatory outcomes in superannuation, including in relation to *SIS Act* obligations in respect of conflicts, may also drive better practices. Given the important role of the board of directors, it is also important that there are appropriate consequences for directors that fail to fulfil their duties in respect of conflicts. In this respect, ASIC notes that the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017* proposes civil and criminal penalties for trustee directors who fail to execute their duties.
139. In addition to these proposals, there may also be a role for greater transparency around decisions and structures that give rise to inherent conflicts of interests. This could be achieved through expansion of the existing transparency requirements in section 29QB of the *SIS Act* to require greater disclosure of, for example, the reasons why the trustee has chosen to engage certain service providers and the results of formal reviews of outsourcing arrangements. Transparency does not resolve conflicts but it imposes a level of discipline and scrutiny that can be helpful.
140. The Productivity Commission has also made draft recommendations regarding outsourcing and specifically as part of draft recommendation 20 regarding APRA, the recommendation is to

⁹⁶ CA submissions, [825.18].

“require all APRA-regulated superannuation funds to conduct formal due diligence of their outsourcing arrangements at least every three years, to ensure the arrangements provide value for money. Each fund should provide a copy of the assessment to APRA (including the fees paid and the comparator fees).”

141. Nonetheless it is ASIC’s view, given the evidence that has been heard by the Royal Commission regarding conflicted structures and the inability of RSEs to manage these in the best interests of members, that more stringent measures are required than those already in train and those recommended by the Productivity Commission.

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?***⁹⁷

142. ASIC is of the view that the sanctions for contravention of the best interests covenants under s 52(2)(c) and s 52A(2)(c) of the *SIS Act* should be strengthened by making them civil penalty provisions (which would also mean that they could attract criminal sanction if the contravention met the requirements of s 202 of the *SIS Act*).⁹⁸

143. ASIC is of the view that public enforcement against misconduct is critical for general deterrence. Enforcement action brings the prospect of both direct penalties and reputational damage to entities and individuals.⁹⁹

144. ASIC sees some challenges with extending the best interests duty to shareholders or related parties of the superannuation trustee. The risk is that the accountability of the superannuation trustee and its directors is diluted. Challenges may also arise to the extent that these other parties have conflicting duties.

145. ASIC has addressed the second part of the question in the paragraphs that follow.

Are there unforeseen consequences of such a legislative intervention that would make it undesirable to strengthen the SIS Act in this way?¹⁰⁰

146. There is one *foreseeable* problem that might arise from an extension of the best interests covenant. ASIC does not support the extension of the best interests obligation (and the civil

⁹⁷ CA submissions, [825.19].

⁹⁸ See generally, Peter Kell (ASIC), Exhibit 5.318, at [234]-[236].

⁹⁹ Peter Kell (ASIC), Exhibit 5.318, at [156].

¹⁰⁰ CA submissions, [825.20].

penalty for breach) to shareholders of trustees and any related bodies corporate (within the meaning of the *Corporations Act*) based on this potential problem.

147. The best interests covenant is very broad and looks to the best financial interests of beneficiaries. One may consider, when assessing if the covenant is breached, what the beneficiaries would have done in the circumstances to protect their own position and to promote their own advantages. It is a positive duty to do what a person can in the best interests of the beneficiaries, not just one of avoiding negative impacts.
148. The difficulty with the proposed reform is that it ignores shareholder primacy theory. That is, the view that the directors and a corporation should be acting in the best interests of shareholders. D Gordon Smith describes the theory in the following manner:

The structure of corporate law ensures that corporations generally operate in the interests of shareholders. Shareholders exercise control over corporations by electing directors, approving fundamental transactions, and bringing derivative suits on behalf of the corporation. Employees, creditors, suppliers, customers and others may possess contractual claims against a corporation, but shareholders claim the corporation's heart. This shareholder-centric focus of corporate law is often referred to as shareholder primacy.¹⁰¹

149. Acting in the best interests of shareholders generally means the maximisation of profit for shareholders. This has been described in the United States as follows:¹⁰²

A business corporation is organized and carried on primarily for the profit of stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.

150. Consequently, requiring shareholders or related entities of a superannuation trustee to act in the best interests of the members of a superannuation fund would give rise to a fundamental conflict between the duty to maximise profits for shareholders and a duty to act in the best interests of members.
151. If shareholders or related bodies corporate were acting to maximise profits then they would act in a manner which maximised revenue. If, for example, the relevant companies were providing services to a fund then they would act in a manner that maximised the fee payable by the fund for those services. If a best interests obligation were imposed upon them in respect of fund members then, being an obligation to act in the members' best financial interests and considered in the context of how members would promote their own interests, they would be required to reduce any such fee to the maximum extent possible. Taking that obligation to its extreme, if a related party were truly acting in the members' best interests then they would either charge them

¹⁰¹ D. Gordon Smith, *The Shareholder Primacy Norm* (1998) 23 Iowa Journal of Corporation Law 277.

¹⁰² *Dodge v Ford Motor Company* 170 NW 668 (Michigan Supreme Court).

no fee for service or charge it at cost (i.e. without a profit element). That gives rise to an irreconcilable inconsistency between the competing duties.

152. That fundamental conflict can be further highlighted by the duties of the directors of such related bodies corporate. A director has obligations, amongst others, to exercise their powers and discharge their duties in good faith in the best interests of the corporation and to not improperly cause their position to gain an advantage for themselves or someone else or cause detriment to the corporation.¹⁰³ Requiring directors to act in the best interests of members of superannuation funds potentially causes a conflict between different sets of duties placed on a director.
153. That is precisely the type of conflict that was recognised by Parliament when it introduced s 52A(3) of the *SIS Act*. The precursor to that subsection's introduction was the Super System Review (the Cooper Review). In the final report from that review, the Panel recognised the governance problems that could arise from different duties being placed on directors of trustees of superannuation funds under different regulatory regimes and legislation:¹⁰⁴

Lack of coordination between the SIS Act, the Corporations Act and the regulatory regimes creates a range of governance problems. For example, the present system creates ambiguity and confusion for some trustee-directors as to whom their duty of loyalty is primarily owed: to the members of the fund or to the for-profit trustee company (and hence its owners and associated parties). Ordinarily, directors would owe their duties directly to the company, which would owe duties as a trustee to the members.

154. The Panel was of the view that directors of a trustee of a superannuation fund should be subject to duties recorded in a single place, namely, the *SIS Act*.¹⁰⁵

..... The Panel believes that there ought to be unambiguous clarity about the duties owed by the trustee-directors, as well as the standard of competence that they should possess and exercise. These should be distinguished from those related to the trustee. Rules of a similar nature, such as those governing the standards of conduct and competency of trustee-directors, should be found in the one place wherever possible. Trustee-directors should not have to collate rules from multiple sources in order to understand their core duties.

...The Panel believes that there is value in creating a distinct new office under statute, that of 'trustee-director'. The duties, powers and standards required of that office should be recorded clearly and cogently in one place, preferably the SIS Act.

155. To that effect, the Panel recommended that *all* the statutory duties of a director, including those in the *Corporations Act*, be set out in the *SIS Act*:

Recommendation 2.1

The SIS Act should be amended to create a distinct new office of 'trustee-director' with all statutory duties (including those which would otherwise be in the Corporations Act) to be fully set out in the SIS Act, along with re-focused duties for trustees.

¹⁰³ *Corporations Act*, ss 181 and 182.

¹⁰⁴ Super System Review: Final Report, P46.

¹⁰⁵ Super System Review: Final Report, P46.

156. Section 52A was introduced in 2012 to include those covenants in the *SIS Act*. Importantly, the legislative background to the section suggests that the rationale was to place the duties of directors of a corporate trustee of an RSE licensee in one place, in the *SIS Act*, to be governed by the relevant regulator. APRA is the relevant regulator which has predominant oversight of those duties. The rationale was not for ASIC to be enforcing *Corporations Act* duties of directors of a superannuation trustee in respect of superannuation matters that fell within the *SIS Act*. The legislature intended that task to be primarily APRA's role under the *SIS Act*. That is, of course, how APRA acts in practice by, for example, releasing and policing a standard, Prudential Standard, SPS 521: Conflicts of Interest, on one of the covenants relating to conflicts of interests.
157. Section 52A(3) recognises the potential conflict between directors' duties under the *Corporations Act* and those under s 52A and gives primacy to the *SIS Act* duties. The Explanatory Memorandum to the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012* explains the issue as follows:¹⁰⁶
- As is the case for trustees under new subsection 52(4), the duty of a director of a corporate trustee of an RSE to give priority to their duties to (and the interests of) beneficiaries overrides any conflicting duty an executive officer or employee of the corporate trustee has under Part 2D.1 of the Corporations Act or under [Division 3 of Part 2-2 of the Public Governance, Performance and Accountability Act 2013.]*
158. According primacy to the duties under the *SIS Act*, including to act in the best interests of members, makes sense when a director is performing a special role as part of the directing mind and will of a trustee of a superannuation fund. In that scenario, the trustee has fiduciary duties towards the members.
159. A similar fundamental conflict would arise if a director of a shareholder of a trustee or a director of a related body corporate had a duty placed upon them to act in the best interests of superannuation fund members. It is difficult to see how the conflict could be appropriately dealt with by giving duties to members primacy over duties to shareholders and the corporation. Corporate shareholders or related bodies corporate would not be in that same special position of a trustee of a superannuation fund with commensurate fiduciary duties owed to members. Neither they, nor their directors, should be placed in a position where their fundamental duty would conflict with a further duty to members of a superannuation fund imposed by statute. Structural change would be a better mechanism to avoid the risks of vertical integration. Section 58B perhaps creates some difficulties in this regard and its operation would need to be considered as part of any broader structural reform.¹⁰⁷

TOPIC 9: System changes

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

¹⁰⁶ Explanatory Memorandum, *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012* at [1.128]. And see Peter Kell (ASIC), Exhibit 5.318, at [259]-[265].

¹⁰⁷ Peter Kell (ASIC), Exhibit 5.318, at [255]-[258].

*MySuper products or is the link too tenuous to justify recommending any system changes to the default system?*¹⁰⁸

160. There are already a number of proposed reforms afoot with respect to MySuper. The Government has presented the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017*, which was introduced into the Senate in September 2017, but it has not yet been called to a vote. The Bill relevantly provides for the following reforms (among others mentioned above):

- (a) requiring trustees to make and publish an enhanced MySuper outcomes assessment, whereby trustees must annually determine whether their MySuper product is meeting the best interests of their members, and must annually compare their MySuper product against others in the market based on fees, returns, risk and other metrics;
- (b) enhancing APRA's ability to refuse or cancel MySuper authorisations, to improve the quality of MySuper products.

161. The Productivity Commission report at page 465 states that these reforms are a clear step in the right direction and should be legislated. The report goes on to recommend as follows:

To complement and bolster the outcomes test, funds should be required to obtain independent verification — to an audit-level standard — of their outcomes test assessment, comparison against other products in the market, and determination of whether members' financial interests are being promoted, at least every three years.

In addition, funds should be required to report to APRA annually on how many of their MySuper members switched to a higher-fee choice product within the same fund each year. This would give APRA greater visibility over upselling and cross-selling practices by funds. Further, funds should be required to immediately adopt the insurance code of conduct to obtain (or retain) MySuper authorisation, with the code to be strengthened and made enforceable within the next few years (section 13.4).

And funds that fail to meet these elevated standards — or persistently underperform (for five or more years) an investment benchmark tailored to their asset allocation by a material margin (as determined by APRA) — should have their MySuper authorisation revoked.

162. ASIC is strongly in favour of additional, and stronger, criteria for MySuper authorisations. In light of the broad nature of the core best interest duty to efficiently promote good system outcomes supplementing this with requirements for a regular consideration of member interests and industry-wide expectations around the interests of members is desirable.

163. ASIC believes that improvements in MySuper outcomes have the capacity to assist in addressing and discouraging misconduct on the part of superannuation trustees. First, this will promote better behaviour in respect of a large number of members (the Productivity Commission identifies that the number of MySuper accounts exceeds the number of Choice product accounts).¹⁰⁹ Second, to the extent that the standard of MySuper products is indisputably high,

¹⁰⁸ CA submissions, [825.21].

¹⁰⁹ See Productivity Commission draft report figure 1.6, page 76.

pressure is placed on superannuation trustees in relation to their behaviour in formulating and offering alternatives. The introduction of a design and distribution obligation in relation to Choice products, as proposed, should promote more discipline around this aspect of trustee behaviour.

164. APRA's member outcomes work¹¹⁰ proposes a prudential standard to require a regular documented assessment of member outcomes across all products. ASIC supports that proposal by APRA and notes that a more direct way of encouraging improvements in the superannuation system is a focus on outcomes assessment for both MySuper and Choice products.

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?¹¹¹

165. As stated above, this is already in train and, further, such reforms are recommended by the Productivity Commission. As stated in ASIC's submission to the Productivity Commission, this should include specific requirements relating to insurance. ASIC supports the introduction of outcome assessments.

166. As discussed below, ASIC believes that APRA should continue to have responsibility for the regulation of the superannuation system framework so that 'gatekeeping' decisions which of their nature have long term consequences should lie with APRA. This suggests that APRA is the most appropriate regulator to apply the test, supplemented with independent assurance if APRA believes this desirable. ASIC would expect that APRA would consult with ASIC both in terms of setting the criteria for the test and, if there are particular issues within ASIC's expertise or interest, in applying the test in respect of particular MySuper products.

Is it appropriate, as a response to the conduct of superannuation trustees that might inhibit the consolidation of multiple superannuation accounts of a person, to introduce some form of "stapling" so that a person's account for receipt of default contributions is linked to the person and travels with the person when she or he changes job? Is this a practical method of addressing this type of conduct noting that it is not suggested to be misconduct?¹¹²

167. ASIC considers it is appropriate, as recommended by the Productivity Commission, 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.¹¹³ In ASIC's view this would significantly reduce the incidence of consumers unintentionally having multiple accounts (and some of those accounts then necessarily becoming inactive) and the depletion of retirement savings by multiple insurance policies. Care would need to be taken to determine at which point

¹¹⁰ APRA Discussion Paper Strengthening Superannuation Member Outcomes released December 2017.

¹¹¹ CA submissions, [825.22].

¹¹² CA submissions, [825.23].

¹¹³ See ASIC's submission to the Productivity Commission of 7 August 2018, P6.

the stapling should occur as there may be unintended consequences arising from the fact that the first job for most is a transitory, casual position in particular industries.

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?¹¹⁴

168. As a general point ASIC notes that system changes can be powerful by eliminating misconduct or conduct falling below community expectations as a result of addressing the drivers of such conduct or narrowing the scope of circumstances in which such conduct may occur. The right system changes can be more efficient than incremental changes to legislative obligations. Further, while enforcement action by regulators is important for consumer outcomes, the right system changes can ensure more consistent cross-sectoral benefits for consumers than individual enforcement actions.

Insurance in superannuation

169. ASIC has conducted a significant body of work with respect to insurance in superannuation (and intends to do further work), and the Productivity Commission report also contains a number of recommendations with respect to insurance in superannuation.

170. ASIC strongly supports the need for significant industry change in respect of insurance in superannuation. ASIC agrees with the Productivity Commission that actions are needed to address issues such as:

- (a) inappropriate balance erosion by insurance premiums;
- (b) multiple and confusing coverage and definitions;
- (c) inappropriate defaults;
- (d) lack of consumer awareness about insurance coverage;
- (e) inadequate consumer communication and information at the point that cover changes or ceases;
- (f) poor claims handling and complaints handling.

171. A particular issue regarding insurance and superannuation was revealed during the Round 5 hearings with respect to the tax deduction available to funds in respect of insurance policies taken out on behalf of members and the fact that, in the case studies examined, funds did not pass on the advantage of such deductions to members.¹¹⁵

¹¹⁴ CA submissions, [825.24].

¹¹⁵ With respect to Suncorp, instead an "Additional Services Agreement" was entered into in an attempt to justify retention of the entire benefit of the tax deductions in circumstances where the administrator could not identify with certainty what the services cost and whether they were in fact already provided under other agreements. With respect

172. Proposed reforms identified by the Productivity Commission's draft recommendations 14 and 15 and announced by the Government as part of the 'Protecting Your Super' package address some of these issues. Other issues are addressed in the Insurance in Superannuation Voluntary Code of Practice but ASIC notes that, at present, there are significant weaknesses in the current Code that limit its potential effectiveness.
173. There is likely to be more scope for system changes in relation to insurance in superannuation if the Code and the proposed enhanced outcome assessments proposed under legislation and by APRA are not sufficiently effective in improving consumer outcomes.

Financial reporting

174. Currently superannuation trustees do not need to lodge financial reports for the fund with ASIC, nor does ASIC have a role in ensuring that financial reports comply with the accounting standards or that audits are conducted appropriately in accordance with auditing requirements. Although APRA has responsibilities under the *SIS Act* concerning financial reports of funds, improvements in trustee behaviour would be promoted if the level of rigour and transparency around fund accounts were consistent with those for other public investment vehicles operated within Australia. APRA, as well as ASIC, supports legislative reform to produce this result.

Systemic transparency

175. ASIC notes that many systemic transparency reforms first identified in the Cooper Review are yet to be implemented, although initiatives are underway. These include portfolio holdings disclosure, choice dashboards, and ensuring consistency of public data with data provided to APRA.¹¹⁶ APRA is actively working on improving the quality of the data provided to APRA and made publicly available under the *Financial Sector (Collection of Data) Act 2001*.

Dispute resolution reforms

176. Related to systemic transparency are upcoming changes to internal dispute resolution requirements. Recent amendments in the *Treasury Laws Amendment (Putting Consumers First – Establishment of the Australian Financial Complaints Authority) Act 2018*, establishing AFCA, will significantly change trustees' internal dispute resolution (**IDR**) obligations.
177. In early 2019 ASIC will be consulting on new IDR requirements and changes to Regulatory Guide 165 *Licensing: Internal and external dispute resolution*. This will include reviewing the definition

to Hostplus, it has estimated that if new legislation is passed requiring members who have balances of less than \$6,000 or who are under the age of 25 or who have not received a contribution in 13 months to opt-in to insurance, then premiums of \$96.8 million will not be payable and Hostplus will lose a tax benefit of \$14.5 million per year. This although an independent report commissioned by Hostplus suggested that particular cohorts of (particularly young) members are over-insured.

¹¹⁶ In some instances these reforms have been delayed as a consequence of an ASIC instrument (eg ASIC Corporations (Amendment) Instrument 2017/569 which defers both choice dashboards and portfolio holdings disclosure requirements). However, this is a product of Government plans to reconsider the policy or technical formulation of these provisions rather than ASIC forming the view that the reforms should not be implemented.

of complaint, consulting on reducing the timeframe for dealing with superannuation and other complaints, and stronger obligations imposed on trustees to provide written reasons for decisions. These requirements will apply to all superannuation trustees regardless of whether the trustee has an AFS licence.¹¹⁷

178. The requirement for IDR data to be reported to ASIC provides a level of industry wide transparency about trustee conduct that is likely to drive better outcomes for consumers, particularly given the possibility of disclosure of superannuation trustee level data.
179. In addition, the AFCA regime for external dispute resolution as applied to superannuation disputes will also contribute to system improvements as the obligations and powers of AFCA to notify matters to ASIC, APRA and the ATO is much broader than as currently apply in respect of the SCT.

Improvements in performance

180. One of the issues identified by the Productivity Commission in its draft report is persistent underperformance. Regardless of whether this may amount to misconduct in a particular instance or more simply failure to meet community expectations there are advantages to considering system changes that minimise the impact of ongoing underperformance. Dealing with an issue of this kind through individual regulatory actions can be problematic (see the discussion below in relation to Topic 10).
181. The Productivity Commission's suggestion of a best in show list is a proposal designed to address some risks of persistent underperformance. ASIC supports system change to address this risk but notes that a best in show proposal is not the only way in which system risk of this kind may be addressed.

Product Comparability

182. Although competition is not entirely effective in providing market discipline that minimises misconduct or a failure to meet community expectations, to the extent that consumer choice remains part of Australia's superannuation system reforms that promote product comparability are important. These play a role in trustees tailoring their offerings in a way that meets the needs of consumers and provides real value for consumers.
183. As stated in ASIC's submission in response to the draft report of the Productivity Commission, ASIC supports the appropriate development of comparison tools and system changes that are compatible with comparisons being made. Key considerations include real evidence-based design to ensure that the needs of consumers are met and steps to ensure the integrity of included data.

¹¹⁷ See *SIS Act*, s 101(1).

Role of others

184. For the sake of completeness, ASIC notes that other persons within the superannuation system have an important influence on trustee behaviour and using a system wide approach to the conduct of others may influence trustee behaviour as well. Through case studies in Round 2 and Round 5 the role of others in contributing to the behaviour of trustees that might amount to misconduct or fall below community standards was highlighted. For instance, if all the financial advisers with clients in Mercer's Allocated Pensions Division, actively sought to encourage the client to move into the cheaper product then a different approach may have been adopted by Mercer. The questions posed by the Commission in relation to grandfathered commissions reflect in part this issue.

TOPIC 10: Deterrence and insight***What can be done to encourage the regulators to act promptly on misconduct or potential misconduct?***¹¹⁸

185. ASIC joins issue with the premise underpinning this question which, on its face, appears to be that ASIC has not acted promptly on a consistent basis to address misconduct or potential misconduct. With respect to specific matters raised by the case studies and referred to in Section S of the CA submissions, ASIC addresses these in Appendix B.

ASIC's increased focus on superannuation and other means to increase promptness

186. ASIC accepts that there is always a need to respond promptly to misconduct, and notes that there are almost always lessons to be learned in retrospect regarding improvements that can be made. Like other regulatory agencies, ASIC is very aware of the time taken with its regulatory actions and regularly gives consideration as to how faster outcomes might be obtained. Nonetheless, the breadth, nature and complexity of the types of matters being regulated, along with the regulatory tools available, means that many outcomes necessarily take time.

187. ASIC's record of prompt regulatory and enforcement action does, however, compare favourably with its international peers (see **Annexure A**).

188. As the hearings of the Royal Commission have amply demonstrated, ASIC in its regulatory role has and is facing widespread and systemic misconduct across a broad range of sectors within banking and financial services. Across the sector, demand side competitive pressure has generally been inadequate to discourage such misconduct and competition regulation has not been a disciplining force. The Productivity Commission has found competition in the financial system to be significantly compromised:

But the larger financial institutions, particularly but not only in banking, have the ability to exercise market power over their competitors and consumers.

¹¹⁸ CA submissions, [825.25].

Many of the highly profitable financial institutions have achieved that state with persistently opaque pricing; conflicted advice and remuneration arrangements; layers of public policy and regulatory requirements that support larger incumbents; and a lack of easily accessible information, inducing unaware customers to maintain loyalty to unsuitable products.

Poor advice and complex information supports persistent attachment to high margin products that boost institutional profits, with product features that may well be of no benefit.

What often is passed off as competition is more accurately described as persistent marketing and brand activity designed to promote a blizzard of barely differentiated products and 'white labels'.¹¹⁹

189. As both the Financial System Inquiry and the draft report of the Productivity Commission, conclude, in superannuation this general weakness of competitive forces is exacerbated by its compulsory nature, consequent consumer disengagement and complexity.
190. This has, overall, resulted in widespread non-compliant conduct. To take one example, ASIC's review of how large institutions managed conflicts of interest in relation to financial advice found that 75% of advice files reviewed did not demonstrate that the advice complied with the best interests duty in relation to advice to switch superannuation accounts¹²⁰. ASIC's regular shadow shopping of financial advice between 1999 and the present, and many other sector reviews, has revealed widespread and systemic levels of non compliance and poor outcomes for consumers¹²¹. While enforcement is an important part of the response to these issues, overall it is not a situation that can be efficiently addressed solely through individual enforcement actions against a limited number of entities.
191. All regulators face challenging, real time choices about what matters to investigate and how many matters to investigate, and this is certainly apparent in financial services. It has more potential actions available to it than it can possibly take in practice and within its enforcement

¹¹⁹ Productivity Commission Inquiry Report "Competition in the Australian Financial System" No 89, 29 June 2018, P2.

¹²⁰ ASIC Report 562, Vertically Integrated Financial Institutions and Conflicts of Interest, [21], P8.

¹²¹ (2003) ASIC Report No 18 "Survey on the quality of Financial Advice", in which 27% of financial plans were judged to be poor or very poor and a further 14% borderline, and where the judges considered much of the advice to be "commission driven product selling, not impartial advice"; (2006) ASIC Report 69, "Shadow shopping on superannuation advice" where 16% of the advice was judged to be clearly not reasonable given the client's needs (as required to be addressed under the law) and a further 3% probably not reasonable, one third of advice to switch funds lacked credible reasons and risked leaving the consumer worse off, with unreasonable advice 3 to 6 times more likely where the advisor received conflicted remuneration; and (2011) ASIC Report 279 "Shadow shopping study of retirement advice" (2011) where 39% of advice was of poor quality and only 2 examples of good advice were seen. Non shadow shopping based reviews on financial advice, based on a random sample of files being reviewed include (2003) ASIC Report 17, "Compliance with advice and disclosure obligations: Report on primary production schemes" which found that there was a correlation between primary production scheme promoters paying high commissions to advisers and those advisers providing inappropriate financial advice when they recommended those products to clients; (2005) ASIC Report 50 "Superannuation switching surveillance" which found most advisers recommending a switch had made limited or no investigation of the fund that they advised the client to switch from and a strong tendency to for advisors to recommend their licensees fund; (2018) ASIC Report 562 "Financial Advice, Vertically Integrated Institutions and Conflicts of Interest" (2018) which found 75% of advice files reviewed non-compliant; and (2018) ASIC Report 575, "SMSF's Improving the quality of advice and member experiences" which found 91% of advice files reviewed in relation of SMSF advice didn't demonstrate compliance with the best interests duty.

activity has to choose between acting on a wider front and potentially taking more time with matters or taking action on a narrower range of issues leaving other issues unaddressed. Sometimes this involves difficult choices between enforcement through the courts or actions through EUs focused on faster remediation of customers and managed reform within institutions. It also has to make choices about how best to achieve regulatory improvements and the balance between entity focused enforcement action and work across industry sectors that fixes market wide failures through reviews, exposure of problems, persuasion and advocacy for reform.

192. Three things would assist in this situation:
- (a) policy/regulatory settings that facilitate better consumer outcomes;
 - (b) resources that allow regulators to more effectively drive better market conduct and meet community expectations; and
 - (c) stronger powers and penalties for the regulators, including in sector specific legislation.
193. The first is the establishment of broad regulatory settings that reduce the drivers of and incentives for misconduct, push towards better consumer outcomes and help compensate for the lack of effective competition. Central to this across financial services are settings that reduce or remove conflicts of interest and on this issue, the regulatory settings have not served the community well.
194. From its outset the financial services regime has been permissive in relation to a wide range of conflicts of interest, such as payment of intermediaries and advisors by commission. This was based on a belief that disclosure of the conflicts would be sufficient to protect consumers against any negative impacts that might arise. This quickly proved unfounded. However it was not until the commencement of the FOFA regime (which became mandatory from 1 July 2013) that the settings on conflicts started to change. The previous permissive settings drove industry ownership, organisational and payment structures, industry culture and industry conduct. Those structural elements are now only starting to be unwound.
195. As noted above in relation to topic 8, further steps should be taken to reduce conflicts of interest. Specifically within superannuation, regulatory settings that improve default allocation of funds, and reduced multiple account holding, for example those proposed by the Productivity Commission, would also help reduce the scale of poor consumer outcomes. This would mean that regulatory time could be directed more towards enforcement action in relation to particular instances of misconduct with less time spent seeking to address broader sectoral or structural problems that would be more efficiently and consistently dealt with through policy changes.
196. Secondly, a step change in the level of resources provided to ASIC would enable it to take action, including additional court based action on the wide range of fronts necessary to drive the necessary change in industry. As noted by the Treasury in its policy submission to the Royal

Commission¹²², “ASIC’s annual appropriations (in real terms) and staffing levels are broadly the same as they were a decade ago”¹²³, whereas “Over the past twenty years the remit of ASIC has expanded considerably”.¹²⁴ A significant part of that expansion has occurred in the last 10 years including: in 2010 responsibility for all of consumer credit and finance broking; taking over market supervision of domestic licensed equity, derivatives and futures markets (including the ASX); and responsibility for the national financial literacy strategy. At the same time, the scale of activity in each sector of ASIC’s mandate has grown¹²⁵ and the work of ASIC has exposed an ever-expanding range and scale of conduct problems across financial services which require attention. This led an International Monetary Fund panel assessing Australia’s financial system in 2012 to observe that:

*However, ASIC is hampered in its ability to fully carry out proactive supervision because of the lack of budgetary resources. A significant amount of ASIC’s funding is non-core funding earmarked for specific projects, and the share of non-core funding has been increasing in the last few years. To supervise a large number of financial services licensees, ASIC uses desk-top, rather than on-site, reviews for initial risk-based assessments, reflecting in part its resource constraints. In determining the target and intensity of its supervisory actions, ASIC relies heavily on its initial risk-based assessments, self-reporting of breaches of regulatory requirements and third party notifications.*¹²⁶

197. On 7 August 2018, the Government announced additional funding for ASIC with, over two years, an additional \$9.4m earmarked for supervision of the superannuation sector, and an additional \$26.2m to accelerate and increase the intensity of ASIC’s enforcement activities more generally. This will enable ASIC to devote more resources to enforcement in relation to superannuation as well as other areas of its mandate.
198. However, if the community expectation is that ASIC’s default position should be to pursue all or even most matters through the courts, the increase in the level of resources needed is much more significant and would necessitate a substantial increase to ASIC’s core funding sustained over time, rather than increments of short term project based funding.
199. The Murray Financial System Inquiry found that funding for regulators should have a high degree of stability and certainty and total funding should be proportionate to the task. It recommended more stable funding for regulators through the adoption of a three-year funding model based on periodic funding reviews¹²⁷. Government did not adopt that recommendation. It is worth noting in this context that in 2014 the ASIC Capability Review found that only 15% of

¹²² Financial Services Royal Commission, Background paper 24, *Submission on key policy issues*, Treasury, 13 July 2018.

¹²³ *Ibid*, [117], P29.

¹²⁴ *Ibid*, [86], P22.

¹²⁵ For example, in the 10 years from June 2001 to June 2017 total superannuation industry assets increased by 113.5% from 1.2 trillion to 2.5 trillion dollars, *APRA Annual Superannuation Bulletin, June 2017* (released March 2018 at P5).

¹²⁶ International Monetary Fund *Australia Financial Stability Assessment*, October 2012, [41], P25 <https://www.imf.org/external/pubs/ft/scr/2012/cr12308.pdf>.

¹²⁷ Financial System Inquiry, Final Report, November 2014 at pages 246-7.

external stakeholders, and only 11% of ASIC senior executive leaders and Commissioners, considered ASIC was adequately funded to do its job¹²⁸.

200. Thirdly, there are reforms that could facilitate ASIC's promptness in dealing with potential misconduct and the strength of the actions it would take both in relation to its more general powers and in relation to the frontline superannuation legislation (i.e. the *SIS Act*).
201. In relation to ASIC's broader powers, many of these are the subject of the reform proposals in the ASIC Enforcement Review¹²⁹, which have been in principle accepted by the Government and include:
- (a) Reform of the breach reporting requirements under s 912D to make them less subjective and more effective in requiring entities to disclose significant breaches in a timely manner.
 - (b) The wholesale increase in the level of penalties recommended by the Enforcement Review, with the addition of penalties based on a multiple of the benefit obtained, and availability of disgorgement as an additional remedy.
 - (c) The introduction of penalties for breach of AFS licensee obligations, including the obligation to act fairly, honestly and efficiently in the provision of financial services.
 - (d) Introduction of a power to direct financial services entities to take actions to prevent or address risk to consumers, which would facilitate ASIC concurrently taking steps to ensure prompt remediation of customers (through the directions power) and action through the courts to punish and deter the misconduct involved.
 - (e) The power to ban people from management in appropriate circumstances.
 - (f) Reform to enable ASIC to utilise materials seized by ASIC under search warrant in civil and administrative proceedings, in addition to their use in criminal proceedings.
202. Further, the introduction of the proposed Product Intervention Power and Design and Distribution Obligations¹³⁰ would also assist ASIC to act promptly where conduct by industry, even if technically lawful causes or risks causing significant detriment to consumers.
203. In relation to ASIC's ability to take prompt action under the superannuation legislation, consideration could be given to reforms that would strengthen ASIC's role to take strategic conduct action in the superannuation sector (this is discussed further below).
204. Aside from changes to policy setting and regulator funding and powers, another reform that would assist encourage regulators to act promptly is more effective consumer advocacy and

¹²⁸ Commonwealth of Australia, *Fit for the future: A capability review of the Australian Securities and Investments Commission*, page 8.

¹²⁹ Itself a recommendation of the Financial System Inquiry, Final Report, November 2014.

¹³⁰ Both recommended by the Financial System Inquiry, Final Report, November 2014, Recommendations 21 and 22, accepted by Government with legislation recently introduced into Parliament *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill*.

representation. Such advocacy exists in areas such as consumer credit, with long established case-work and advocacy organisations that help identify priority areas for regulatory action.

205. The establishment and funding of a properly resourced and independent consumer advice and advocacy centre focused on superannuation would also assist regulatory action in a number of ways, including through:
- (a) identifying and demanding action on misconduct and conduct below community standards;
 - (b) assisting in the assessment of what issues are most significant and worthy of regulatory attention from a consumer perspective;
 - (c) urging regulators to take action and raising public alarm where they do not act or act too slowly; and
 - (d) providing a balancing consumer voice in policy and other debates.
206. A strong case for the establishment of such a body has been made to various Governments in the past. Given that superannuation has now been compulsory in Australia for more than 25 years, funding for an organisation to represent superannuation members should be a priority.
207. Earlier this year, as a result of community benefit payments arising from the enforceable undertakings obtained from ANZ and CBA, ASIC was able to provide initial funding for the Superannuation Consumers' Centre¹³¹ (\$2.5 million in funding¹³²). This is a welcome development that ASIC was able to achieve through those EUs, but further funding must be provided for this Centre to be properly resourced and sustainable.
208. Finally, it may be observed that for a regulator, acting promptly is a wider concept than court proceedings. Counsel Assisting's submissions may suggest a view that specific and general deterrence can only be achieved if any misconduct is sanctioned by court action, particularly with larger companies.¹³³ ASIC's approach to regulation is based on the strategic regulatory approach and the enforcement pyramid as explained in ASIC's evidence¹³⁴ and its Round 2 submissions at [107]-[125].
209. ASIC has an expansive record of litigation in the broader superannuation sector in areas where it is the frontline regulator, for example, in respect of financial advisers.¹³⁵ ASIC's evidence has set out the extensive investigations and other actions that ASIC has taken which touch, in some way, on the superannuation sector.¹³⁶ However, under the twin peaks model, ASIC has only a

¹³¹ Peter Kell (ASIC), Exhibit 5.318, at [33].

¹³² Tim Mullaly (ASIC), Exhibit 5.310, at [69]-[72].

¹³³ CA submissions, [813]-[814], [819].

¹³⁴ Peter Kell (ASIC), Exhibit 5.318, at [4]-[13].

¹³⁵ Peter Kell (ASIC): P5262:1-16.

¹³⁶ Peter Kell (ASIC), Exhibit 5.318, at [47]-[150], [230].

limited jurisdiction under the *SIS Act* which is predominantly administered by APRA and the ATO, as explained in the evidence of Mr Kell.¹³⁷

Is the present allocation of regulatory roles appropriate to achieve specific and general deterrence from misconduct?¹³⁸

210. ASIC supports the twin peaks framework for financial services regulation in Australia, involving APRA as prudential regulator and ASIC as conduct regulator. However, the allocation of conduct regulation responsibilities in respect of superannuation does not align with the way ‘twin peaks’ works in other sectors, notably banking and insurance, in that greater responsibility for conduct regulation under the *SIS Act* lies with the prudential regulator. ASIC is of the view that an adjustment of ASIC’s role to provide ASIC with greater powers in respect of conduct regulation would be appropriate, while making sure not to diminish the ability of APRA to fulfil its role.
211. ASIC has outlined its views on the Productivity Commission’s findings about the regulatory overlap between ASIC and APRA in superannuation in its evidence.¹³⁹ APRA is presently the frontline regulator that deals with conduct under the *SIS Act*, with ASIC given a secondary role predominantly focused on disclosure issues.
212. ASIC considers that it could assume an expanded role in the regulation of conduct in the superannuation sector. The broader regulatory environment has evolved significantly, as has the superannuation industry, since the regulatory roles in superannuation were settled after the Wallis report. ASIC supports consideration of how to better align powers and accountabilities under the *SIS Act* with the expectations for enforcement of matters relating to conduct and consumer protection in other regulated financial industries. Any consideration of this nature should also include consideration of whether parts of the *SIS Act* might require updating, rather than seeing the exercise one of merely identifying the regulator for existing provisions.
213. If ASIC were to assume an expanded conduct role this could involve some allocation to ASIC of the primary regulatory responsibility for particular provisions directly impacting consumers.
214. There could also, to some extent, be shared regulatory responsibilities for requirements relevant to both prudential and conduct matters. It would be important to clarify as part of any such reformulation who is the primary regulator expected to act in relation to specific instances of misconduct where shared responsibilities exist.
215. ASIC notes that it may be reasonable to accept a degree of overlap in relation to certain *SIS Act* provisions (eg best interests duty, provisions relating to conflicts of interest) across the two regulators. Both ASIC and APRA have common areas of interest in respect of individual superannuation trustees and broader industry issues. This arises from ASIC’s consumer-focused

¹³⁷ Peter Kell (ASIC), Exhibit 5.318, at [215]-[229], [235]-[238].

¹³⁸ CA submissions, [825.26].

¹³⁹ Peter Kell (ASIC), Exhibit 5.318, at [179]-[197]; see also ASIC’s submissions in response to the Productivity Commission’s draft report.

conduct mandate and APRA's prudential focus on trustee governance and overall member outcomes. As long as the objectives and purposes of regulation for the two agencies is set out adequately, such overlap should be manageable. In fact, it could help avoid difficult 'boundary' issues arising and also minimise the possibility of gaps in responsibilities between the two regulators.

216. APRA and ASIC can work together to minimise overlap and avoid gaps, and aim instead to leverage off their respective skills and perspectives to ensure better member outcomes. In a particular instance, APRA or ASIC may be the more appropriate regulator to take the lead to achieve behavioural change.
217. ASIC recognises that further developing its cooperative efforts and communication with APRA would help address any issues with overlap. Any increase in ASIC's conduct role would of course necessitate closer collaboration between APRA and ASIC. ASIC expects to continue to share with APRA forward work plans, areas of focus and agree areas for coordinated investigation or other action but this would become even more important if any changes were made.
218. ASIC does not support any change in roles that would prevent APRA from properly carrying out its prudential functions.¹⁴⁰ APRA's prudential focus is important in setting the framework for superannuation trustee operations, for testing the governance, risk management and operational capability of superannuation trustees and determining which trustees and funds are part of the system. But there is more scope for ASIC to take responsibility for conduct regulation focused on consumer protection. A division of responsibility ensures that one regulator can focus on compliance with standards of conduct and the other can focus on ensuring trustees are positioned to deliver quality outcomes for members over the long term.
219. ASIC takes a strategic, compliance based approach to regulation, including in respect of its limited allocation of responsibilities under the *SIS Act*. ASIC's approach uses the deterrent value of such action to achieve behavioural change. That is, of course, quite different to a prudential approach to regulation, which generally seeks to achieve outcomes through means other than public enforcement action.
220. Although it is not currently the frontline conduct regulator for superannuation under the *SIS Act*, ASIC does have significant superannuation sector experience. ASIC is also fundamentally a conduct regulator. It understands the importance of public enforcement and other deterrent actions, including court-based action and other enforcement action as detailed in the enforcement pyramid where appropriate.¹⁴¹ ASIC has the capabilities and experience to make a greater contribution to conduct regulation in superannuation.
221. As a conduct regulator with extensive enforcement experience, ASIC uses a range of enforcement tools to regulate behaviour. If warranted by its strategic approach, ASIC will seek

¹⁴⁰ Peter Kell (ASIC), Exhibit 5.318, at [193]-[194].

¹⁴¹ Peter Kell (ASIC), Exhibit 5.318, at [198]-[203].

harsher sanctions through court action. In the last financial year ASIC conducted about 30 civil cases and obtained around 25 enforceable undertakings.¹⁴² Providing ASIC with an enhanced conduct role under the *SIS Act* would be a natural expansion of its current powers and experience. ASIC has in place the necessary infrastructure, processes and experience to undertake an enhanced role in conduct regulation under the *SIS Act*.

Expanded powers and strengthening of sanctions

222. Were ASIC to be given an expanded role under the *SIS Act*, it would need a corresponding set of broad powers. These have been explained in ASIC's evidence.¹⁴³ It would be inadequate for ASIC to assume a greater role for conduct regulation in superannuation using existing powers under tangential legislation that is not aimed specifically at superannuation. ASIC must have appropriate powers under the primary legislation, the *SIS Act*, in order to effectively be more involved in conduct regulation in superannuation.
223. The above is merely a brief indication of the jurisdiction that ASIC would need to be an effective conduct regulator under the *SIS Act*. If such a reform did become part of Government policy, then further detailed consideration would need to be given to the precise provisions that ASIC should have responsibility for. MySuper would be another area for which responsibility may need to be appropriately allocated.
224. Any review of the current *SIS Act* should also consider whether other provisions in that Act should be accorded civil penalty provision status (eg ss 99F, 103, 105 and 152, *SIS Act*). ASIC should, of course, be able to take civil and criminal action (and issue infringement notices) for any civil penalty provisions over which it is given general administration.
225. Further, one of the issues arising from the Royal Commission has been the involvement of associated entities in potential misconduct by superannuation trustees. Any review of the *SIS Act* should give consideration to whether changes are needed to the accessorial liability provision. Section 194 of the *SIS Act* deems a person involved in a contravention to have contravened the provision themselves. The equivalent accessorial liability provisions under the *Corporations Act* are also based on involvement and being "involved" is defined in s 79 of the *Corporations Act*. "Involved" in a contravention is defined in s 10 of the *SIS Act* by reference to the "meaning given in section 17". Unfortunately, s 17 was repealed in 2001 due to the understanding that Part 2.4 of the *Criminal Code* would deal with those matters.¹⁴⁴ That leaves an unsatisfactory outcome because there is no definition of "involvement" for civil matters under the *SIS Act* as the *Criminal Code* does not apply to civil matters.

¹⁴² Peter Kell (ASIC): P5250:35-36.

¹⁴³ Peter Kell (ASIC), Exhibit 5.318, at [208]-[212] and [215]-[229].

¹⁴⁴ Explanatory Memorandum, *Treasury Legislation Amendment (Application of Criminal Code) Bill 2000* at Item 171.

226. Finally, current penalties under the *SIS Act* are inadequate and should be reinforced. It may also be appropriate to consider adding disgorgement remedies under the *SIS Act* (removal of benefits illegally obtained or losses avoided) in civil penalty proceedings brought under that Act.
227. ASIC supports the increase of penalties in a consistent manner with those recommended by the ASIC Enforcement Review for the *Corporations Act*:

Criminal

- (a) for strict liability offences, an increase in the fines;
- (b) for ordinary offences, an increase in the maximum term of imprisonment from the current term of 5 years to 10 years;
- (c) for ordinary offences, maximum fine amounts to be standards issued by reference to a formula based on the length of the available prison term. That is, term of imprisonment in months multiplied by 10 would give the maximum fine for individuals and multiplied by a further 10 would give the maximum fine for corporations;

Civil

- (d) for individuals, a maximum penalty of the greater of 5,000 penalty units or three times the value of the benefits obtained or losses avoided;
 - (e) for corporations, a maximum penalty of the greater of 50,000 penalty units or three times the value of the benefits obtained or losses avoided or 10% of annual turnover in the 12 months preceding the contravening conduct (but not more than 1 million penalty units).
228. Comment has been made as to ASIC's use of more 'generic' conduct powers to regulate the superannuation sector. ASIC has conduct tools under other laws that it administers, such as the *ASIC Act* or *Corporations Act*, and takes regulatory action in relation to superannuation matters using these provisions. However, to ensure more effective regulation it is desirable for a regulator to have appropriate powers under the 'front line' legislation, as this legislation contains more detailed provisions that are specifically designed to address the particular behaviours, requirements and risks that arise in that sector. This is particularly true for superannuation, where its complexity and compulsory nature has required extensive and detailed sectoral laws. While more general powers such as those found in the *Corporations Act* and the *ASIC Act* can be used to address gaps or add to the powers available in 'front line' legislation, they are not an adequate substitute for those needed to regulate complex markets such as superannuation.
229. Of course, simply strengthening roles and reallocating responsibilities will not necessarily deal with all of the types of harm that have been illustrated during the Royal Commission – regulators can only deal with misconduct if the law limits that conduct. Some issues may be better dealt with through system changes (eg dealing with grandfathered commissions). MySuper has been one example of an attempt to do just that with at least some success.

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?¹⁴⁵

230. As noted above, ASIC believes that the most effective regulatory structure for financial services is a combined or ‘twin peaks’ model. We have also set out above proposals for a reconsideration of the responsibilities of ASIC under such a model. ASIC believes that outcomes for consumers would be enhanced if ASIC were to be given a more extensive conduct role in superannuation. But retention of APRA as an effective prudential regulator is also important. Such reform would, to some extent, be a recalibration of the twin peaks regulatory model in relation to superannuation, directed to increasing ASIC’s role in enforcing proper conduct by REs but not lessening the prudential role of APRA.
231. ASIC has a track record across different parts of the financial services industry in publicly identifying and remedying systemic and ongoing misconduct, much of which is not immediately evident to the affected consumers. Examples range from the charging of fees for no service in financial advice, through to mis-selling of add-on insurance in car dealerships, or the defaulting of superannuation fund members into insurance products under the more expensive ‘smoker’ category. In doing so, ASIC has obtained many hundreds of millions of dollars in remediation, changed the way that entire industries operate and the products they sell, and achieved a range of enforcement outcomes. ASIC will continue to undertake such activity in superannuation, especially given the additional powers that have been foreshadowed and recent additional funding.
232. It is also important in this context to emphasise that as well as the regulators, ‘the responsibility to protect consumers’ lies in the first instance with trustees under the regulatory system for superannuation. Trustees of superannuation funds are tasked with acting in the best interests of their members and avoiding conflicts pursuant to the trustee covenants in the *SIS Act*. The current regulatory system assumes that trustees should act in accordance with those obligations. However, as shown during the course of several case studies in this Royal Commission, some trustees have not been acting in the best interests of members contrary to the assumption upon which the superannuation system has been designed.
233. In this regard, system design influences the scope of conduct that may negatively impact on consumers. Therefore, and as argued above, appropriate systems changes will also help drive good consumer outcomes. For instance, there may be much more of this conduct where authorisation to engage in regulated conduct is easy to obtain and hard to lose than in a system where authorisation is hard to obtain but easy to lose. In part, the Productivity Commission’s “best in show” proposal is a recognition that competition and efforts of the regulators alone will not be effective in addressing all of the risk associated with such conduct.

¹⁴⁵ CA submissions, [825.27].

ASIC does not support the creation of a new superannuation regulator

234. One alternative that might be considered is a new separate superannuation regulator. The Insurance and Superannuation Commission regulated superannuation up until 1 July 1998. The Financial System Inquiry (resulting in the Wallis Report in 1997) considered the combination of economy-wide and institutionally-based regulatory arrangements to be inconsistent with the emerging structure of the financial markets, resulting in inefficiencies and regulatory gaps which were not conducive to effective competition in the financial sector.
235. The Wallis report also stated that the Australian financial system was experiencing ongoing change in response to changing customer needs, new technology and other economic policy reforms. It was argued that financial regulatory reform would allow the financial sector to better respond to these pressures. Among those customer needs was a recognition that the Australian population was (and continues to be) an ageing population, which increases the focus on the importance of assets to fund consumption in retirement.
236. Acting on the Inquiry's recommendations, the government replaced the institutions-based framework with an objectives-based model of regulation. This new model had APRA, ASIC and the RBA as single, separate regulators for each of the three broad areas of government intervention in the financial system.
237. Initially, ASIC and APRA regulated superannuation through the relevant parts of the *SIS Act*. However, the Wallis report was further developed by the Corporate Law Economic Reform Program Paper No 6 in December 1997, ultimately resulting in financial services reforms in 2002. These reforms introduced a single licensing regime and consistent disclosure requirements for all financial products, including superannuation.
238. ASIC does not support the creation of a new specialised superannuation regulator for the following reasons (although, as discussed earlier in these submissions, it may be necessary to reallocate the responsibilities of the regulators under the current twin peaks model governing superannuation):
- (a) The twin peaks model has generally worked well for Australia and we should not depart from it unless there is very good reason to do so. It is acknowledged that there is a need for a greater focus on conduct regulation within super. Generally it would be better to allocate that responsibility and the powers necessary to meet it to an existing body with superannuation experience rather than to create a new entity.
 - (b) The creation of a third regulator would exacerbate boundary issues and overlap issues between the responsibilities of regulators and open up greater possibility of inconsistent or conflicting approaches. Consistent with the recommendations of the Wallis Inquiry, regulatory agencies should be allocated functions in a way which minimises overlaps, duplication and conflicts. Both from the perspective of industry structures, including the large conglomerates, and the perspective of consumer experience and use of financial services, superannuation is part of a broader continuum that can not easily be 'hived off' into a discrete and separate space. For example, financial advisors advise clients on their

overall financial plans including superannuation and non-superannuation aspects. Life insurance is inextricably linked to superannuation. Superannuation funds may invest in other financial services investment products.

- (c) A single regulator for superannuation which had both prudential and conduct responsibilities would face the difficulty of maintaining the culture, skills and type of relationship with industry necessary for its prudential work, along with the culture, skills and type of relationship with industry necessary for conduct regulation and enforcement. Historically the combination of the two roles has been a challenge for regulators in Australia and elsewhere, and more often than not conduct regulation has received less focus. As noted by the Turner Review in the UK there is a risk that there may be an inadequate specialist focus on either role or that the consideration of one of the roles will crowd out the other.

PW Collinson

P Bender

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Counsel for ASIC

21 September 2018

Annexure A

SEC and ASIC

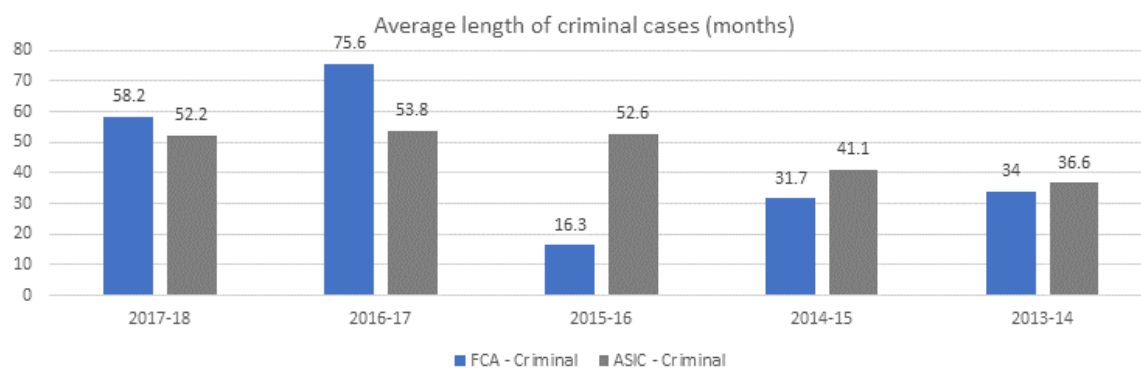
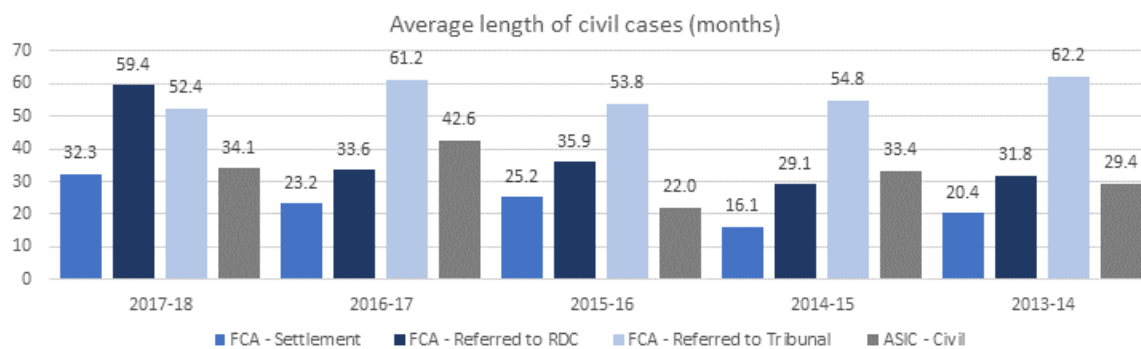


Notes:

ASIC data relates to civil actions only.

SEC data drawn from [FY 2017 ANNUAL PERFORMANCE REPORT AND FY 2019 ANNUAL PERFORMANCE PLAN](#).

FCA and ASIC



Notes:

ASIC data does not include summary prosecutions

Average months calculated from date formal investigation was commenced to date of closure.

FCA data drawn from: [Enforcement annual performance report 2017/18](#)

Annexure B: response to section S factual matters

1. In this Appendix, ASIC responds to some specific contentions set out in section S of Counsel Assisting's closing submissions in respect of the ANZ/CBA and NAB/NULIS matters.

The ANZ and CBA matters

2. ASIC's concerns in the ANZ and CBA cases were whether bank branch staff were giving personal financial advice.¹⁴⁶

ASIC did take prompt action to investigate the ANZ / CBA matters

3. ASIC became aware of the ANZ / CBA issue in May 2014 and commenced surveillance activities in June 2014.¹⁴⁷ This then became part of ASIC's Wealth Management Project in about September 2014¹⁴⁸ (including similar issues about provision of personal financial advice in respect of Westpac).
4. The relevant ASIC team was investigating a whole range of conduct at that time, including fees for no service, conduct by advisers and poor advice.¹⁴⁹ This context is important because resourcing levels, of course, affect the speed at which investigations can be conducted and completed. The sheer scale of the fees for no service issue is discussed further below – those series of investigations consumed and still do consume vast amounts of resources.
5. Mr Mullaly conceded that ASIC needs to do things more quickly,¹⁵⁰ but prompt action is not to be equated with just bringing court proceedings. It is abundantly clear that ASIC commenced surveillance activities as soon as it became aware of this particular issue. One does not simply commence court proceedings as soon as a complaint has been made.
6. These were complex matters, both factually and legally. Sufficient evidence is, of course, required to articulate one's pleadings and to determine whether the onus of proof can be discharged *prior* to commencing court proceedings. That, of necessity, involves the investigation and gathering of evidence.

¹⁴⁶ Tim Mullaly (ASIC): P5224: 6-33.

¹⁴⁷ Tim Mullaly (ASIC): P5225: 20-23.

¹⁴⁸ Tim Mullaly (ASIC): P5226: 1-11.

¹⁴⁹ Tim Mullaly (ASIC): P5227: 30-47.

¹⁵⁰ Tim Mullaly (ASIC): P5235: 12-13.

Interlocutory proceedings would not have been successful

7. Premature court proceedings would not have been successful. An application to the Court for an interlocutory injunction, on ASIC's legal advice, would have been futile as the balance of convenience would have favoured the banks.¹⁵¹

Enforceable undertakings were an appropriate regulatory response

8. Counsel Assisting submits that ASIC's approach to ANZ / CBA in relation to the personal financial advice issue is not conducive to the development of a compliance culture.¹⁵² Specifically, Counsel Assisting suggests that Mr Mullaly failed to recognise that ASIC should have brought court actions against all three banks (ANZ / CBA / Westpac), not just against Westpac where there had been potential contraventions.¹⁵³
9. Mr Mullaly noted however that not every case of misconduct is appropriate to take to court – if that occurred, the courts would be swamped for years with legal proceedings and there would be no timely resolution.¹⁵⁴ In Mr Mullaly's words, "if [ASIC] took the proposition that each small difference, or difference where the principle is the same but a different attempt to get to that same end, that we needed to test every single one of them through the courts, we would be clogging up the courts for ever and a day".¹⁵⁵ That view of the matter is not merely common sense, it accords with the regulatory theory of a risk-based approach to regulation.¹⁵⁶

To be sure, various regulatory regimes have been conscious of the need to target resources and moderate the level of effort required by regulated sites to the level of risk posed. Risk-based regulation is the name given to this particular strategy. Here, regulators assess the impact and likelihood of noncompliance across their regulatees to decide where their resources are best employed.

10. The differentiation between general and personal advice involves some fine distinctions and has not previously been tested in the courts.¹⁵⁷ The Westpac case was the chosen vehicle to test these issues.¹⁵⁸ Where an appropriate enforcement outcome can be achieved other than through court action, it is not appropriate, under the enforcement pyramid model, to prosecute *all* cases of misconduct – nor would be it appropriate to undertake three test cases from a risk perspective.
11. It may be added that, in the course of considering its strategy and regulatory objectives, ASIC obtained and acted upon written opinions from very experienced senior counsel.¹⁵⁹ That advice

¹⁵¹ Tim Mullaly (ASIC): P5235: 38-43.

¹⁵² CA submissions, [817].

¹⁵³ CA submissions, [818].

¹⁵⁴ Tim Mullaly (ASIC): P5229: 33-39.

¹⁵⁵ Tim Mullaly (ASIC): P5229: 36-39.

¹⁵⁶ F. Haines, P189, chapter 11: Regulation and risk. *Regulatory Theory: Foundations and Application*, Published by ANU Press, 2017.

¹⁵⁷ Tim Mullaly (ASIC): P5228: 36-46.

¹⁵⁸ Tim Mullaly (ASIC): P5229: 11-39.

¹⁵⁹ Tim Mullaly (ASIC), Exhibit 5.310, at [20].

was to the effect that there was some significant risk¹⁶⁰ and this aspect was not explored any further in Mr Mullaly's cross-examination. At a level of broad generality, the mere prospect that a court may not agree with the regulator is not a reason to avoid court,¹⁶¹ but ASIC carefully considers counsel opinions before proceeding with court action. Adverse costs orders can be a significant impost on the public purse and consequently reduce future enforcement capability and capacity and, whilst not a reason to avoid court, that risk does mean that opinions from counsel have to be taken very seriously.

Enforceable undertakings can have a deterrent effect

12. Court-based enforcement action is an important tool in achieving deterrence, but ASIC has outlined in its evidence a range of other measures that can also achieve deterrence outcomes.¹⁶² CBA's behaviour and offer in the personal financial advice matter indicates that it was fearful of the impact an enforceable undertaking would have.¹⁶³ ASIC would not consider an enforceable undertaking where it was not prepared to take the next step of proceedings if negotiations broke down.¹⁶⁴
13. Enforceable undertakings are a powerful tool to convey public condemnation as they are publicised by ASIC. Adverse publicity has been recognised in regulatory theory as having a deterrent effect:¹⁶⁵

..... In this instance, publicity was the top-level sanction, which is not the same as being able to fine or revoke a licence, but nevertheless is an action with considerable capacity to change behaviour in those agencies for whom the risk of adverse publicity was a significant deterrent....

14. It is established that firms may be more concerned about reputational damage derived from negative publicity, than court-ordered penalties, and such reputational sanctions may often have a greater effect on future profits by alienating consumers.¹⁶⁶
15. It ought not be forgotten here that the legislature has *mandated* enforceable undertakings as an available enforcement tool under both the *Australian Securities and Investments Commission*

¹⁶⁰ Tim Mullaly (ASIC): P5228: 46.

¹⁶¹ Tim Mullaly (ASIC): P5229: 11.

¹⁶² Peter Kell (ASIC), Exhibit 5.318, at [154]-[165]. And see also *The General Deterrence Effects of Enforceable Undertakings on Financial Services and Credit Providers*, Final Report, M.Nehme, J.Anderson, O.Dixon, D.Kingsford-Smith, Centre for Law Markets and Regulation, University of NSW.

¹⁶³ Tim Mullaly (ASIC), Exhibit 5.310, at TM 23.

¹⁶⁴ Peter Kell (ASIC): P5250:35-43.

¹⁶⁵ C. Scott, P271, chapter 16: The Regulatory state and beyond. *Regulatory Theory: Foundations and Application*, Published by ANU Press, 2017.

¹⁶⁶ Hardy, T. and Howe, J., *Creating Ripples, Making Waves: Assessing the General Deterrence Effects of Enforcement Activities of the Fair Work Ombudsman*. 39 Sydney L. Rev. 471 (2017) at 475-476.

*Act 2001 (ASIC Act)*¹⁶⁷ and the *SIS Act*¹⁶⁸. Indeed, the legislature itself viewed enforceable undertakings as an efficient enforcement tool:¹⁶⁹

8.37 New section 262A mirrors similar provisions in section 87B of the Trade Practices Act 1974 and section 93AA of the Australian Securities and Investments Commission Act 1989, and is designed to provide the Regulator with a flexible and efficient enforcement tool.

16. Likewise, in relation to the ACCC, the responsible Minister made the following comments about the enforceable undertaking mechanism when s 87B was introduced into the *Trade Practices Act 1974* (Cth) mechanism:¹⁷⁰

It has proved efficient in some cases for the Commission to avoid prolonged litigation by accepting undertakings from businesses to cease particular conduct or to take action which will lessen the otherwise undesirable effects of their conduct. This approach has been used in appropriate cases for several years and has avoided considerable cost to both the Commission and the businesses concerned. At the same time the outcomes have been demonstrably advantageous to affected third parties and consumers generally.

Recognising the importance and desirability of affording the Commission a flexible approach to the resolution of trade practices matters, the Government has decided to provide legislative recognition of this practice. This will promote a greater public awareness of the range of options available in the administration and enforcement of the Act. By providing for the enforceability of undertakings, the scheme will remove the need to rely on means outside the Act to enforce undertakings that people have given, should this prove necessary. (emphasis added)

17. The courts have also recognised the function of undertakings as a legitimate alternative enforcement tool to litigation.¹⁷¹
18. Counsel Assisting criticises enforceable undertakings for not requiring persons to remediate customers for loss they have suffered. Remediation frequently forms part of the outcomes from ASIC's enforcement activities, as in the fees for no services matters.¹⁷² Remediation, of course, also depends on it being possible to identify loss and efficiently quantify that loss.

¹⁶⁷ S 93AA and s 93A, ASIC Act.

¹⁶⁸ S 262A, *SIS Act*.

¹⁶⁹ Explanatory Memorandum, *Financial Sector Legislation Amendment Bill (No. 1) 2000* at [8.37] (in the context of the introduction of s 262A, *SIS Act* which deals with enforceable undertakings under the *SIS Act*). And see, as other examples of the legislature's intent for regulators to use enforceable undertakings as an alternative to litigation, Explanatory Memorandum, *National Consumer Credit Protection Bill 2009* at [6.377] and Explanatory Memorandum, *Corporations Amendment (Financial Market Supervision) Bill 2010* at [2.21].

¹⁷⁰ Commonwealth, *Parliamentary Debates*, House of Representatives, 3 November 1992, 2407 (Mr Michael Duffy).

¹⁷¹ See, for example, *ACCC v Signature Security Group Pty Ltd* [2003] FCA 3 at [41]; *TPC v Cue Design Pty Ltd and Cue and Co Pty Ltd* [1996] FCA 1343 at [21]; *Murdaca v Australian Securities and Investments Commission* (2009) 178 FCR 119 at [101].

¹⁷² Peter Kell (ASIC), Exhibit 5.318, at [160].

Enforceable undertakings achieved a more timely resolution of the matter than court proceedings

19. It is probable that ASIC was able to achieve the outcome it wanted with ANZ through an enforceable undertaking more quickly than if it had gone to court.¹⁷³ The experience with the Westpac matter in court demonstrates starkly that matters take time to travel through the court system.¹⁷⁴ If ASIC had gone to court on ANZ it would still be waiting for a judgment into next year¹⁷⁵ and in the meantime ANZ may not have abandoned the conduct about which ASIC had concerns – it was far better for consumers to have the matter resolved more quickly and for general deterrence to be achieved for others in the industry.¹⁷⁶
20. In CBA's case, CBA advised that the conduct ceased in October 2017.¹⁷⁷ ANZ's enforceable undertaking allowed 45 days from the date it was accepted to stop the conduct. This was a short period of time to recognise the practical reality of the time needed to change systems and processes and the potential risk of technical, inadvertent breaches of the undertaking while processes and systems were being changed.

Enforceable undertakings achieved an appropriate regulatory outcome

21. ASIC not only procured enforceable undertakings that the conduct would cease, but also that the banks would not engage in similar conduct, community benefit payments and a monitoring process to ensure compliance with the law.¹⁷⁸ This is a positive outcome for consumers.
22. The community benefit payment has allowed funding of the Superannuation Consumers' Centre. That Centre addresses the lack of a dedicated consumer body to advocate for consumer members and for improvements of the operation of the superannuation system.¹⁷⁹ It will provide significant benefits for consumer protection in the future.
23. An enforceable undertaking also allowed ASIC to be prescriptive about what needed to be changed and to require independent oversight to monitor the changes.¹⁸⁰ A court may be less likely to make monitoring orders which might require future intervention by the court and it is uncertain that a court would be so prescriptive in what was prohibited. A court case may sanction the precise conduct covered by the case, but the risk would be that the banks would do the bare minimum to fall outside the confines of the judgment but may still engage in conduct which could potentially contravene the law.
24. It is not accurate to suggest that ASIC could have obtained significant civil penalties in this case (when compared with the banks' market capitalisation and gross revenue). The maximum

¹⁷³ Tim Mullaly (ASIC): P5234: 42-47.

¹⁷⁴ Tim Mullaly (ASIC): P5235: 14-18.

¹⁷⁵ Tim Mullaly (ASIC): P5244.10-5245.32.

¹⁷⁶ Tim Mullaly (ASIC): P5245: 41.

¹⁷⁷ Tim Mullaly (ASIC), Exhibit 5.310, at [61].

¹⁷⁸ Tim Mullaly (ASIC): P5240: 38-47.

¹⁷⁹ Peter Kell (ASIC), Exhibit 5.318, at [33].

¹⁸⁰ Tim Mullaly (ASIC), Exhibit 5.310, at [16].

penalty per contravention of, for example, s 961K of the *Corporations Act* is \$1m. In order to establish significant penalties for contraventions, ASIC would have had to plead hundreds of customer examples that would potentially have taken some years to investigate, let alone prosecute to completion in a court. Penalties that could be imposed are not necessarily equivalent to profits. This can be contrasted with, for example, the ACCC's power under s 76 of the *Competition and Consumer Act 2010* which does permit penalties to be imposed by reference to the value of the benefit obtained from the contravening act or omission.

25. Counsel Assisting referred to profits disgorgement.¹⁸¹ However, in the ANZ/CBA case, the *Corporations Act* does not provide a mechanism to enable the forfeiture of gains, or disgorgement of profits from an AFS licensee for breaches of s 912A(1)(a), s 912A(1)(c), s 946A, s 961K and s 961L of the *Corporations Act*.¹⁸² Further, a specific problem in this case was that the banks only conceded that in some instances personal advice may have been provided (i.e. some customers did not receive personal advice or advice that did not comply with the *Corporations Act*) and some customers may have been better off. Remediation was not appropriate because ASIC was unable, after analysis, to form a definitive view as to whether customers had suffered a loss and some customers actually appeared to be paying lower fees with ANZ in other products that they had been rolled out of.¹⁸³

ASIC's approach to the CBA media release proposal and ANZ draft pleadings does not demonstrate a lack of regulatory authority

26. Counsel Assisting suggests that ASIC lacks regulatory authority in the eyes of the regulated population by reference to the following matters in respect of the personal advice issues with CBA and ANZ:¹⁸⁴
- (a) CBA offered up a media release as a means of resolving the issue;
 - (b) ASIC drafted a document in support of an originating process and indicated to ANZ that it would commence proceedings and then did not do so when ANZ came to the negotiating table (which resulted in an enforceable undertaking).
27. ASIC did not consider that CBA's offer of issuing a media release was satisfactory and rejected that offer.¹⁸⁵ ASIC also rejected CBA's proposal to postpone the matter until after the Westpac case was concluded.¹⁸⁶ Licensees, like any party in a regulatory or commercial matter, are entitled to put offers in a negotiation. Simply because a party puts an offer does not mean that ASIC will accept it, nor does a party putting an offer suggest any lack of regulatory authority.

¹⁸¹ CA submissions, [819].

¹⁸² ASIC has received advice from Senior Counsel that s 1101B of the *Corporations Act* does not provide a disgorgement power.

¹⁸³ Tim Mullaly (ASIC), Exhibit 5.310, at [73]-[77].

¹⁸⁴ CA submissions, [820].

¹⁸⁵ Tim Mullaly (ASIC): P5230: 38-41.

¹⁸⁶ Tim Mullaly (ASIC): P5241: 42-45.

The fact it was rejected by ASIC and CBA ceased the conduct in October 2017 and still agreed to an enforceable undertaking acceptable to ASIC suggests otherwise. ASIC, of course, has obligations as a Model Litigant and that includes exploring settlement possibilities as follows:¹⁸⁷

...endeavouring to avoid, prevent and limit the scope of legal proceedings wherever possible, including by giving consideration in all cases to alternative dispute resolution before initiating legal proceedings and by participating in alternative dispute resolution processes where appropriate.

28. In respect of ANZ, ASIC moved with reasonable promptness from a process of engagement with ANZ through position papers to the point of threatening court proceedings. On 17 February 2017 ANZ provided its response to ASIC's position paper¹⁸⁸ but in the absence of a suggested resolution mechanism, ASIC's Enforcement Committee resolved on 10 April 2017 to commence court proceedings against ANZ alleging contraventions of ss 912A, 946A, 961B and 961K of the *Corporations Act*.¹⁸⁹ On 10 May 2017 ASIC notified ANZ of its intention to issue proceedings and provided a draft Concise Statement to ANZ. ANZ immediately adjusted its position in response to this enforcement pressure.
29. ASIC's indication of its intention to file its court proceeding if it could not otherwise obtain a satisfactory outcome from ANZ was not a false threat.¹⁹⁰ ASIC would have filed the proceeding and gone to court if ANZ did not settle on terms ASIC considered appropriate.¹⁹¹ The injured tone adopted in ANZ's correspondence¹⁹² appeared to reflect a stance that ASIC had acted unfairly in threatening legal proceedings within 24 hours when the parties had exchanged position papers with a view to resolving ASIC's concerns without the need for protracted litigation. ASIC then agreed to postpone the issue of proceedings to allow genuine settlement discussions to take place as soon as possible.¹⁹³ Contextually, there is nothing in this exchange to suggest that ANZ viewed ASIC's conduct as conveying a lack of authority, nor has any ANZ internal document, or any other evidence, been produced suggesting that ANZ held that opinion.
30. Regulatory theory suggests that regulators should move up and down the levels within the regulatory pyramid¹⁹⁴ to deal with non-compliance. Where regulated entities comply, the regulator ought consider moving back down the pyramid.¹⁹⁵

In game theoretic terms, the theory of responsive regulation suggested that regulators should start at the base of the pyramid with education and advice and escalate where there

¹⁸⁷ Clause 2(d), Appendix B, Legal Services Directions 2017. And see also clauses 5.1 and 5.2 of Appendix B.

¹⁸⁸ Tim Mullaly (ASIC), Exhibit 5.310, TM 3.

¹⁸⁹ Tim Mullaly (ASIC), Exhibit 5.310, [29].

¹⁹⁰ Tim Mullaly (ASIC): P5231: 27-30.

¹⁹¹ Tim Mullaly (ASIC): P5232: 40-46 and P5233: 8-10.

¹⁹² Tim Mullaly (ASIC), Exhibit 5.310, TM 8.

¹⁹³ Tim Mullaly (ASIC), Exhibit 5.310, TM 10.

¹⁹⁴ ASIC's approach to regulation is based on the strategic regulatory approach and the enforcement pyramid as explained in ASIC's evidence (Peter Kell (ASIC), Exhibit 5.318, at [4]-[13]) and its Round 2 submissions at [107]-[125].

¹⁹⁵ C. Scott, pg 270-271, chapter 16: The Regulatory state and beyond. *Regulatory Theory: Foundations and Application*, Published by ANU Press, 2017.

was noncompliance, but should be contingently forgiving and move back down the pyramid where regulatees fell into line (Ayes and Braithwaite 1992: 62–3).

Such practices were advocated on the basis that the perception of fairness and responsiveness would build commitment among regulatees, while at the same time ensuring that regulators escalated sanctions where necessary.

31. This is precisely what Mr Mullaly and his team have done in dealing with ANZ. They escalated their response up the enforcement pyramid by preparing to launch proceedings and when the regulated entity, ANZ, indicated a willingness to fall in line, ASIC moved back down the pyramid to achieve the result it desired. This is both an acceptable and expected example of good enforcement practice and not an example of regulatory abrogation.

Summary

32. In summary, ASIC submits that its actions regarding the ANZ and CBA matters were appropriate. It commenced investigations swiftly once a problem had been identified. ASIC received and accepted legal advice against prematurely commencing interlocutory court proceedings. ASIC made sure its investigations had gathered sufficient evidence before it came to that point. Its actions resulted in the cessation of the offending conduct and a court action against Westpac to test the legal boundaries of personal financial advice. The court enforceable undertakings obtained not only stopped the conduct, but prevented similar conduct occurring in the future and secured community benefit payments that will assist consumer protection in the superannuation sector.

The NAB / NULIS matters

33. Counsel Assisting's submissions raise various issues in relation to the fees for no service matter involving NAB/NULIS. ASIC now responds to those issues.

The fees for no service issue is complex and extensive in scope

34. The fees for no service issues were first raised with NAB in about mid 2015.¹⁹⁶ This was, however, part of a much larger project relating to all of the major entities (31 licensees) around this issue. There are 27 investigations as part of the project, collecting more than two and a half million documents and resulting in hundreds of millions of dollars of remediation.¹⁹⁷
35. The statistics are set out in the table below. These statistics are current as at 17 September 2018, with further investigations and outcomes expected.

Breach reports	Total:	78
	No. from AMP, ANZ, CBA, NAB:	73

¹⁹⁶ Peter Kell (ASIC): P5254:8-9.

¹⁹⁷ Peter Kell (ASIC): P5254: 8-24.

Remediation	Total:	\$259.6 million
	Paid or offered by AMP, ANZ, CBA, NAB, Westpac:	\$222.3 million
	Total estimated compensation:	\$364.3 million
	Total estimated compensation and provisions: (approx. \$500 million)	\$850 million
Investigations	Total commenced, incl. scoped for investigation:	27
	Active ongoing investigations:	14
	Concluded without further action	4
Licensees	Investigated or being investigated:	31
Outcomes	Enforceable undertakings:	2 (ANZ, CBA)
	Adviser bannings:	2
	Licence conditions:	1
	Civil penalty proceedings:	1
ASIC Notices issued	Total issued:	194
	Documents provided to ASIC:	2.5 million

36. Any suggestion that ASIC has not been prompt in responding to this misconduct is not correct. ASIC has been thoroughly investigating the conduct and dealing with one of the main issues, remediating customers, as a first priority. The enormous scale of the tasks of investigating the conduct (with about 2.5 million documents provided to ASIC) and putting remediation programs in place is self-evident.
37. ASIC promptly began investigating the matter. Its promptness in doing so should not be confused with bringing immediate action in court. Only following proper investigation can ASIC bring proceedings in court with the best prospects of securing a successful outcome. ASIC commenced civil proceedings in the Federal Court on 6 September 2018.

ASIC's focus was on remediation, review and evidence gathering

38. Remediation of clients within a reasonable time was made possible by making that a priority while other investigations were still ongoing. In addition to remediation, the financial institutions the subject of the investigations were required to conduct further reviews to

determine if there were any more issues that needed to be rectified – ASIC had no legal power to compel those reviews. It is difficult to see how that remediation would have been achieved if civil proceedings had been commenced even before investigations were concluded sufficient to marshal the necessary evidence to draft pleadings and discharge the onus of proof.

Remediation for customers was achieved and civil penalty proceedings have been commenced

39. In respect of the NAB fees for services issue, there appears to be a suggestion by Counsel Assisting that there should have been remediation and disgorgement of profits and civil penalties should be imposed. ASIC has now commenced civil penalty proceedings in the Federal Court.¹⁹⁸
40. The remediation includes the fees that should not have been paid plus earnings on those fees.¹⁹⁹ It was suggested during cross-examination of Mr Kell that profits have not been repaid by the banks because the rate of earning on that money by the bank *might* be more than the rate of interest for which customers were remediated.²⁰⁰ ASIC indicated that it would need to give further thought to this issue.²⁰¹
41. Additional profit, if any, could not be easily determined. Gross fee revenue obtained was remediated. Profit is a function of revenue and the costs incurred to earn that revenue. That does not just mean direct costs, it also includes indirect costs (eg overheads). The difficulty of cost allocation is an issue in all organisations, particularly, in finding an appropriate methodology to allocate indirect costs to products or services. Once an appropriate allocation of costs was made, it is difficult to see how any *additional* profit over and above the remediated fees and time value of money compensation would have been likely. Although Counsel Assisting rightly makes the point that the rate of return remediated to customers might be different to the rate of return earned on the fees by the banks, it would be extremely difficult to identify such a difference. Would one attempt to trace the funds through to the specific use that they were put and determine the rate of return earned on that specific utilisation? Should the rate of return be equated to the banks' weighted average cost of capital? Or should the risk free rate of return simply be used, or some other measure of return? Such methods would appear to be inappropriate because they may not be a reflection of the true returns (if any) earned.

Summary

42. In summary, ASIC's actions in respect of the NAB matter, and the fees for service issue across the industry have been appropriate. The investigations and remediation process have taken time because of the sheer scale of the undertaking and the resources needed to gather sufficient evidence, and the important need to follow due and proper process (including the Model Litigant rules). Evidence in respect of the NULIS / MLC investigation has now been gathered and civil penalty proceedings have been commenced. Other key investigations are continuing, with

¹⁹⁸ ASIC media release 18-259MR dated 6 September 2018.

¹⁹⁹ Peter Kell (ASIC): P5254:26-30 and P5255: 23-24.

²⁰⁰ Peter Kell (ASIC): P5255:26-28.

²⁰¹ Peter Kell (ASIC): P5255:28.

further actions and outcomes expected. Customers either have, or are in the process of being, remediated as a first priority.

Concluding Observations

43. In these hearings, for understandable reasons, the Commission has utilised the technique of individual case studies, ASIC's dealings with ANZ and CBA being one of them, to illustrate features of the financial industry under examination. However, this methodology creates a risk in reasoning in a reliable way from the particular to the general. ASIC respectfully submits that a cautious approach should be applied in seeking to draw, from the above case studies, the broad propositions about ASIC's regulatory approach found in section S, paragraphs [814], [815], [817] and [820] being examples.