

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

MODULE 5: SUPERANNUATION

SUBMISSION BY AUSTRALIANSUPER PTY LTD

A. Introduction

1. This submission is made by AustralianSuper Pty Ltd (**AustralianSuper**), as trustee and RSE licensee of the AustralianSuper superannuation fund (**Fund**), in relation to Module 5 of the Commission’s hearings which concerned superannuation. This submission responds to the closing submission of Counsel Assisting, as revised on 28 August 2018, concerning the “AustralianSuper case study”.
2. The “AustralianSuper case study” addressed five topics:
 - a. the Fund’s indirect investment in Pacific Hydro;
 - b. the basis of the appointment of directors to the board of AustralianSuper;
 - c. the historic returns earned and costs incurred in respect of the Fund’s cash investment option;
 - d. AustralianSuper’s financial contribution to the establishment of The New Daily on-line news publication; and
 - e. AustralianSuper’s financial contribution to the cost of the “Fox and Henhouse” advertising campaign.
3. AustralianSuper welcomes the submission of Counsel Assisting that the preferable conclusion on the evidence is that the conduct referred to in those topics did not constitute misconduct or conduct falling short of community standards and expectations.¹ AustralianSuper respectfully submits that the submission of Counsel Assisting should be accepted for the reasons given in the closing submissions.
4. This submission primarily responds to the stated policy questions arising out of the Commission’s consideration of the “Fox and Henhouse” advertising campaign. Those questions are:

¹ Paragraph 175 of the closing submission, as clarified by paragraph 3 of the Addendum dated 28 August 2018.

- a. 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?
 - b. 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?
5. This submission amplifies the public policy concern to which the “Fox and Henhouse” advertising campaign was directed before addressing each of the stated questions.
 6. The submission also contains an annexure identifying some minor factual corrections to the closing submission of Counsel Assisting on the “AustralianSuper case study”.

B. Background to the “Fox And Henhouse” Advertising Campaign

7. The “Fox and Henhouse” advertisement was intended to raise public concern about bank lobbying for regulatory changes to the award system and enterprise bargaining system that would remove coverage of superannuation under these instruments. The structure which has been advocated by the banking sector and other elements of the retail wealth management sector in the last few years is to delegate the nomination of default funds to employers only. AustralianSuper, and other industry funds represented by ISA, shared the concern that the change, being strongly advocated by the banking sector, would harm the interests of many superannuation members.²
8. In order to understand the potential implications of such a change to superannuation members, it is necessary to understand the current legal framework governing default superannuation arrangements and how that framework provides protections for superannuation members.
9. As explained by Mr Silk, superannuation emerged as a workplace entitlement in the 1970s and 1980s as a result of employees trading off wage increases for superannuation to provide income during retirement. For that reason, superannuation entitlements were included in industrial agreements, and that has remained the case to today. In the 1990s, employer superannuation contributions became compulsory with the introduction of the superannuation guarantee levy.³

² Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.10; Silk, P-4545 line 45 – P-4546 line 20. See also ISA letter to the Prime Minister dated 17 February 2017 (ASU.0024.0001.0001, being item 35 on Tender List dated 17 August 2018), which preceded the “Fox and Henhouse” advertising campaign and expressed ISA’s concern that the Government’s policy agenda, under intense lobbying by the major banks, was to dismantle the workplace distribution structure of the not for profit sector and legislation to remove the right of employees and employers to agree to default funds in enterprise agreements.

³ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.6.

10. Today, superannuation is both a compulsory product and a relatively complex product. As a consequence, it can produce a low level of active engagement by employees. While choice of fund is generally available to a wide range of employees, the low level of engagement by employees creates the risk of poor choices, or insufficient attention to excessive fees or poor financial returns.⁴
11. As explained by Mr Silk, a person may become a member of the Fund in one of three ways.⁵ The first way is where:
- a. choice of fund applies under the superannuation guarantee laws; and
 - b. the employer selects the Fund as the default fund in accordance with those rules; and
 - c. either the employee does not exercise choice of fund and does not notify his or her employer of any other fund to receive superannuation contributions (ie as a “chosen” fund), or the employee is satisfied with the default arrangements.
12. The second way is where:
- a. choice of fund applies under the superannuation guarantee laws; and
 - b. the employer selects another regulated superannuation fund as a default fund in accordance with those rules; but
 - c. the employee chooses the Fund as his or her “chosen” superannuation fund and directs his or her employer to pay superannuation contributions to the Fund as the “chosen” fund.
13. The third way is where:
- a. choice of fund does not apply under the superannuation guarantee laws and the employee’s employment is governed by an enterprise agreement or similar industrial instrument that nominates the Fund as a potential default fund (usually among a short list of funds); and
 - b. if applicable, the employer nominates the Fund as the default fund to receive superannuation contributions; or
 - c. if applicable, the employee notifies his or her employer to remit contributions to the Fund (from that list).
14. Currently, about 70% of the Fund’s members became members through a process of employer nomination.⁶ In other words, AustralianSuper attracts (and has historically attracted) a large

⁴ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.7.

⁵ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, paras 1.1 to 1.4.

⁶ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 1.4.

majority of new members through being named as the “default fund” for superannuation guarantee contribution purposes; largely as a result of relevant terms in modern awards and enterprise agreements. As a substantial proportion of the Fund’s members become members through employer nomination under awards or enterprise agreements, AustralianSuper also promotes the Fund to employers and unions as the preferred default fund. In doing so, AustralianSuper must compete against a wide range of industry and retail superannuation funds that also seek to promote themselves to employers and unions.⁷

15. Mr Silk expressed the opinion that the current regulatory structure for default superannuation funds has been an effective means to protect members against identifiable market failures (due to the low engagement which many members have with their superannuation, with the result that they do not actively choose a fund to belong to). The current default fund mechanisms ensure that default funds are selected by both employers and employee representatives, and not just employers. This improves the likelihood that the selection will be made with only the best interests of members in mind, resulting in the best performing funds being nominated.⁸
16. Mr Silk also expressed the view that the current regulatory structure for default superannuation funds reduces administration costs. Marketing and advertising are reduced because the nomination of default funds is effected through negotiations between unions and employers. While AustralianSuper incurs expenditure through marketing to those bodies, that marketing is relatively low cost. Distribution costs are also reduced because a large number of employees become members through employer nomination of the fund, which greatly reduces distribution expenditure.⁹
17. The manner in which default superannuation funds are chosen is an important public policy question, with very real consequences for superannuation members. The current default fund framework is the subject of consideration in the recent Draft Report of the Productivity Commission concerning superannuation.¹⁰ According to calculations undertaken by the Productivity Commission, a typical full-time worker in the median fund in the bottom quartile (in terms of investment performance) over their lifetime would retire with a superannuation balance 53% (or \$635,000) lower than if they were in the median top-quartile fund.¹¹ As Mr Silk observed in his testimony to the Commission, the selection of a default fund is critically

⁷ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 3.4.

⁸ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.8.

⁹ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.9.

¹⁰ Productivity Commission, Draft Report, *Superannuation: Assessing Efficiency and Competitiveness*, April 2018.

¹¹ Productivity Commission, Draft Report, p10.

important to the retirement outcome of individuals¹² and is literally life-changing for a lot of people.¹³ The data presented in the Draft Report shows that industry (not-for-profit) funds have materially outperformed retail funds on average.¹⁴

18. As observed in the Productivity Commission Draft Report, default arrangements are a necessity in a compulsory super system to protect members who do not make their own investment decisions.¹⁵ The Productivity Commission expressed some reservations about whether the current system was delivering optimal outcomes for superannuation members, commenting that member outcomes from the current system were too variable and the current policy settings were failing to ensure that members are placed in the very best funds.¹⁶ The Productivity Commission noted that employers are not always well placed to make decisions on behalf of their workers and commented:

“Any system in which employers play such a central role in choosing default funds will always be hostage to constraints on employer’s time, expertise and even goodwill to find the best super product for their workers. ... And there will always be a risk that some funds will offer benefits to influence employers’ choices – a problem that is both hard to observe and regulate.”¹⁷

19. The regulatory change to the default system which has been advocated by the banking sector in the last few years is to delegate the nomination of default funds to employers. In the view of AustralianSuper and other industry fund members of ISA, consistent with the views expressed by the Productivity Commission in its Draft Report, such a change would create the risk of poor outcomes for superannuation members. Employers may not have the expertise or goodwill to select the best fund for their employees or, worse, may be vulnerable to extraneous influences such as the employer’s wider commercial relationship with its bank. The change advocated by the banks creates the possibility that employers would be offered lower fees on various financial services supplied by their bank if they chose the bank’s superannuation fund as their default fund.

¹² Silk, P-4542 line 42.

¹³ Silk, P-4538 line 30.

¹⁴ Productivity Commission, Draft Report, p9.

¹⁵ Productivity Commission, Draft Report, p26.

¹⁶ Productivity Commission, Draft Report, p26.

¹⁷ Productivity Commission, Draft Report, p27.

20. The concern held by AustralianSuper and the ISA is well supported by evidence. An ISA Briefing Note dated February 2015¹⁸, and accompanying survey results¹⁹, record the conclusions of various enquiries and research about the potential risks to superannuation members arising from banks cross-selling (or bundling) superannuation services with traditional lending services. The survey was updated in 2016, with consistent results.²⁰
21. The removal of the selection of default funds out of the industrial relations framework removes the involvement of unions as employee representatives which is an important safeguard to the interests of members. The end result would be that existing and future members of industry funds, including AustralianSuper, are exposed to the risk of being defaulted into poorer performing bank-owned funds. Such a change would also increase distribution costs for industry super funds, and thereby increase costs for industry fund members. As explained by Mr Silk, a change away from the current default fund mechanisms to a framework that would enable cross-selling of financial products and conflicts of interest:

*"... present a situation where the very great likelihood, indeed, the express design objective of such a change, would be to see millions of Australians that would otherwise be in higher performing industry funds in poorer performing retail funds."*²¹

C. First Question: Section 62 of the SIS Act

22. The closing submission of Counsel Assisting posits the questions whether political advertising is consistent with the intention behind section 62 of the SIS Act and whether any amendment to the SIS Act is warranted. For the reasons explained below, AustralianSuper submits that political advertising (in the sense of advertising which advocates a particular regulatory policy position) is consistent with the intention behind section 62 of the SIS Act and no amendment to the SIS Act is warranted to address the issue of political advertising.

C.1 Relevant requirements of the SIS Act

23. Section 62(1) of the SIS Act provides that the trustee of a regulated superannuation fund "must ensure that the fund is run solely" (a) for one or more specified "core purposes" or (b) for one or more specified core purposes and for one or more "ancillary purposes". Broadly, the core purposes, which are specified in section 62(1)(a), include the provision of benefits for each member of the fund on or after the member's death, retirement, or attainment of an age not

¹⁸ ASU.0023.0001.0009 (Item 32 on Tender List dated 17 August 2018).

¹⁹ ASU.0023.0001.0029 (Item 34 on Tender List dated 17 August 2018).

²⁰ ASU.0023.0001.0016 (Item 33 on Tender List dated 17 August 2018).

²¹ Silk, P-4546 lines 17-20; P-4552 lines 11-28.

less than 65. The ancillary purposes are specified in section 62(1)(b). Section 62 has inbuilt flexibility in that "the Regulator" can approve additional ancillary purposes, under section 62(1)(b)(v).

24. As a matter of context, it can be observed that the sole purpose test pre-dated the SIS Act and was directed to the tax deductibility of employer contributions to superannuation.²²
25. There has been limited judicial guidance on the application of the sole purpose test under the SIS Act. The sole purpose test is administered by APRA²³ and, for that reason, AustralianSuper has close regard to APRA's policy statements concerning the sole purpose test.
26. In 2006, APRA made a submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the Structure and Operation of the Superannuation Industry in which APRA commented on trustee advertising or marketing campaigns intended to obtain or maintain economies of scale, in the following terms:²⁴

"A trustee has a fiduciary and statutory obligation to act in the best interests of current members and any expenditure by the trustee of fund monies should be consistent with this obligation.

In making an assessment about the benefits of a campaign for membership or the most cost-effective way to provide information to members, APRA also notes that a trustee should be able to demonstrate that the expenditure has been considered in the context of the specific circumstances of the fund and its current members. If advertising or marketing is being considered in order to obtain or maintain economies of scale, the trustee should be able to demonstrate a good understanding of the behaviour of the fund costs which it considers would be influenced by economies of scale. Often the main costs incurred by superannuation trustees are for outsourced administration and investment services and these costs may already reflect scale economies on the part of the service provider."

27. In 2015, in Answers to Questions on Notice before the Senate Economic Legislation Committee, APRA stated:

"In the course of supervising trustees, APRA has considered the meaning of section 62 and how it applies to the specific activities that trustees carry out. APRA has publicly stated that the following activities may be permissible without breaching the "sole purpose" test:

- (i) *Expenditure - the purpose of which is directly related to the superannuation purposes on a member meeting a condition of release. A trustee must be able to demonstrate how the*

²² See for example *Walstern Pty Ltd v. Federal Commissioner of Taxation* (2003) 138 FCR 1 at [65].

²³ SIS Act, section 6(1)(a)(iv).

²⁴ APRA, *Superannuation Submission to the Parliamentary Joint Committee on Corporations and Financial Services' Inquiry into the Structure and Operation of the Superannuation Industry*, September 2006, page 11.

expenditure will result in the acquisition of superannuation benefits by the members of the fund who have paid the expense;

- (ii) Provision of services - which are necessary and reasonably incidental to the superannuation purposes, including legitimate administration expenses; and*
- (iii) Investment of fund monies - provided that the relevant investment meets all the relevant requirements of the SIS Act, and there is a clear connection between the investment and the expected returns for members' superannuation benefits.*

If an individual fund was to advocate on certain policy issues, and the cost of such advocacy was funded with members' monies, the issue of whether or not such an activity was in breach of the sole purpose test would require an assessment of the activity and its connection with the superannuation purposes. If the activity is characterised as an expenditure or investment made in good faith and the trustee puts forth cogent reasons for believing that this will result in an improved retirement income outcome for the members (or the protection of that retirement income), then the trustee's conduct would be unlikely to be in breach of the sole purpose test (even if others might disagree with the trustee's reasoning)."²⁵

28. AustralianSuper considers that the foregoing observations by APRA are consistent with the proper construction of the sole purpose test in s 62 of the SIS Act. The section is directed to the purpose for which a superannuation fund is run. In this context, it has been held that the word "purpose" refers to "the end in view".²⁶

29. The core purpose is the provision of benefits for each member of the fund on or after the member's death, retirement or attainment of an age not less than 65. The section is not directed to the means by which that purpose is achieved. The running of a fund requires a large array of activities to be undertaken, including attracting memberships, processing memberships, receipt of contributions, the investment of contributions and all necessary communications with members and administration of the fund and individual investments. All such activities have the sole purpose of the provision of retirement benefits to members, but many of the activities cannot themselves be described as the provision of retirement benefits. The activities are all means to that end.

C.2 Political Advertising

30. The topic of political advertising was specifically adverted to by APRA in its 2015 response to the Senate Economic Legislation Committee, quoted above. As stated by APRA, with respect

²⁵ APRA, Answers to Questions on Notice, Senate Economic Legislation Committee, 9 June 2015.

²⁶ *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation* [2018] FCAFC 122 at [176] per Moshinsky J, with whom Besanko J agreed.

correctly, the question whether policy (or political) advocacy is in breach of the sole purpose test requires an assessment of the particular activity and its connection with the superannuation purposes.

31. AustralianSuper submits that public advocacy conducted through “political advertising” is entirely consistent with the sole purpose test in s 62 of the SIS Act, provided that the advocacy is aptly directed to the maintenance or improvement of retirement benefits.
32. As recognised by the High Court of Australia, the Commonwealth Constitution mandates a system of representative and responsible government with a universal adult franchise. Communication between electors and legislators and the officers of the executive, and between the electors themselves, on matters of government and politics is an indispensable incident of that constitutional system.²⁷ The Constitutional provisions which prescribe the system of representative government necessarily imply a limitation on legislative and executive power to deny the electors and their representatives information concerning the conduct of the executive branch of government throughout the life of a federal Parliament.²⁸ As such, any burden which the law places upon communications respecting matters of government and politics must be reasonably appropriate and adapted to serve a legitimate end in a manner which is compatible with the maintenance of that system of government.²⁹
33. There is no reason to construe section 62 of the SIS Act as prohibiting absolutely policy (or political) communications undertaken by superannuation trustees, and any such absolute prohibition would be likely to infringe the constitutional freedom referred to in the preceding paragraph. It is consistent with the sole purpose of providing retirement benefits for a trustee to engage in policy (or political) communications which are properly directed to maintaining and improving the retirement benefits received by the trustee’s beneficiaries. As the High Court concluded in a broadly analogous context, public advocacy which is suitably directed to influencing government policy on the best methods for the relief of poverty through the provision of foreign aid is not disqualified from being characterised as charitable merely because the activity takes the form of political communications.³⁰

²⁷ *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520 at 557-9; *Roach v Electoral Commissioner* (2007) 233 CLR 162 at [7] – [8] and [44] – [49]; *Aid/Watch Inc v Commissioner of Taxation* (2010) 241 CLR 539 at [44].

²⁸ *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520 at 561.

²⁹ *Lange v Australian Broadcasting Corporation* (1997) 189 CLR 520 at 561; *Aid/Watch Inc v Commissioner of Taxation* (2010) 241 CLR 539 at [44].

³⁰ *Aid/Watch Inc v Commissioner of Taxation* (2010) 241 CLR 539 at [46] and [47].

D. Second Question: Consumer Benefits and Detriments

34. The closing submission of Counsel Assisting posits the questions whether there is identifiable detriment to consumers from advertising by super funds or particular advertising (such as “Fox and Henhouse”) and whether there is identifiable benefit to consumers from advertising by super funds or particular advertising? For the reasons explained below, AustralianSuper submits that there is identifiable consumer benefit from the “Fox and Henhouse” advertisement and from other advertising undertaken by AustralianSuper and ISA. Necessarily, all advertising must be assessed on its individual merits.

D.1 Fox and Henhouse Advertisement

35. The policy objective of the Fox and Henhouse advertisement is described in section B above. For the reasons explained above, AustralianSuper submits that there is identifiable consumer benefit from the advertisement.

36. The current default arrangements for superannuation protect the financial interests of superannuation members who do not actively choose their own superannuation fund and become members through default arrangements. The current default arrangements ensure that the selection of default funds is made with the involvement of both employer and employee representatives, and not just employers.

37. The Fox and Henhouse advertisement was designed to advocate against a change to the default arrangements whereby employers would be free to choose the applicable default fund for their workers. As recently observed by the Productivity Commission, such a system would “always be hostage to constraints on employer’s time, expertise and even goodwill to find the best super product for their workers. ... And there will always be a risk that some funds will offer benefits to influence employers’ choices”³¹. It is to the benefit of consumers to avoid such a situation. The advertisement has been successful in preventing such a change to date.³²

D.2 AustralianSuper Advertising

38. As explained by Mr Silk, most of AustralianSuper’s marketing expenditure is directed to the objective of retaining existing members and gaining new members. This produces a financial benefit to all members by protecting and enhancing the Fund’s economies of scale. In Mr Silk’s experience, the scale of the AustralianSuper Fund has enabled it to generate a number of economies, particularly:

³¹ Productivity Commission, Draft Report, p27.

³² Silk, P-4554 line 42.

- a. a reduction in the administration costs per member;
- b. a reduction in investment costs generated through, amongst other things, increased buying power with external investment managers and an enhanced capability to bring investment management functions inhouse; and
- c. increased investment returns, including through enhanced opportunities to invest in large, longer term, assets.³³

39. AustralianSuper submits that each of the foregoing are identifiable benefits to consumers.

D.3 ISA Advertising

40. As also explained by Mr Silk, AustralianSuper also participates in marketing activities with other industry funds, conducted by ISA, which is a not for profit organisation representing the interests of industry super funds. Some of the marketing activities undertaken by ISA on behalf of industry super funds are well known. They commenced in the late 1990's featuring Bernie Fraser. More recent marketing includes the "compare the pair" series of advertisements. AustralianSuper contributes to the costs of those marketing activities.³⁴

41. Mr Silk gave evidence that the objective of such marketing is to retain existing members and gain new members and thereby generate economies of scale that financially benefit all members. The advertising also enables members to make informed choices about the performance of competing funds and to be aware that over many years industry super funds have consistently delivered materially better returns in comparison to retail super funds.³⁵

42. AustralianSuper submits that each of the foregoing are identifiable benefits to consumers.

DATED: 31 August 2018

³³ Exhibit 5.88, Witness Statement of Ian Scott Silk dated 30 July 2018, para 34.1.

³⁴ Exhibit 5.88, Witness Statement of Ian Scott Silk dated 30 July 2018, para 34.4.

³⁵ Exhibit 5.89, Witness Statement of Ian Scott Silk dated 31 July 2018, para 15.4.

ANNEXURE

Minor Factual Corrections to the Closing Submission

1. This annexure identifies two minor factual corrections to the closing submission of Counsel Assisting in respect of the “AustralianSuper case study”.

Board Governance

2. At paragraph 163, the closing submission suggests that clause 8.5 of AustralianSuper’s Constitution prescribes a maximum tenure for directors of 12 years. That is not correct.³⁶
3. Clause 8.5 of the Constitution provides that a director’s term of appointment is 3 years, but a director may be re-appointed after the expiry of the 3 year term.³⁷ That provision was introduced on 12 December 2007 and applies to directors appointed after that date.
4. The provision for a default maximum tenure of 12 years (i.e. four 3-year terms) was introduced in June 2017 through the Board Renewal Policy.³⁸ As this default maximum tenure policy is founded on the 3 year term limit in the Constitution, it also is only applicable to directors appointed after 12 December 2007. The Board has recently proposed to AustralianSuper’s shareholders that these requirements should apply to directors appointed before 12 December 2007 (there are four such directors).³⁹

Industry Super Australia Pty Ltd

5. At paragraph 166, the closing submission contains the following sentence:

ISA is a wholly-owned subsidiary of Industry Super Holdings Pty Ltd (**ISH**) which provides amongst other things, collective marketing and research services and engages in policy activities on behalf of industry funds.
6. The sentence might be misunderstood to mean that ISH provides collective marketing and research services and engages in policy activities on behalf of industry funds, whereas it is ISA that undertakes those activities.⁴⁰ ISH owns a number of entities that provide benefits and services to industry funds or members of industry funds including ISA, Industry Fund Services Pty Ltd and Industry Funds Management Holdings Pty Ltd.⁴¹

³⁶ There was initially some confusion about this issue at the time Mr Silk gave evidence. See transcript P-4522 line 42 – P-4523 line 35.

³⁷ A copy of AustralianSuper’s Constitution is Annexure ISS-1.1 to the Witness Statement of Ian Scott Silk dated 30 July 2018 (Exhibit 5.88).

³⁸ Exhibit 5.88, Witness Statement of Ian Scott Silk dated 30 July 2018, para 8.7.

³⁹ Silk, P-4524 at lines 27 to 30.

⁴⁰ Exhibit 5.90, Witness Statement of Paul Johan Schroder dated 1 August 2018, para 7.2.

⁴¹ Exhibit 5.90, Witness Statement of Paul Johan Schroder dated 1 August 2018, para 9.4.