

COMMONWEALTH OF AUSTRALIA

Royal Commissions Act 1902 (Cth)

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

**WRITTEN SUBMISSIONS OF SCS SUPER PTY LIMITED
FOR CSF CASE STUDY IN ROUND 5 HEARINGS**

INTRODUCTION

- 1 At the fifth round of public hearings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the **Royal Commission**) Catholic Super (**CSF**) was a case study.
- 2 SCS Super Pty Limited ABN 74 064 715 607 (**SCS**) is an RSE Licensee and trustee of the Australian Catholic Superannuation and Retirement Fund (**ACSR Fund**). SCS is not a related party of CSF and was not identified as a case study that was the subject of the fifth round of public hearings.
- 3 SCS nevertheless had a direct and substantial interest in the hearing of the CSF case study and was granted leave to appear at the fifth round of public hearings. Its interest arose out of the following matters:
 - (a) SCS provided statements by David Hartley and Greg Cantor and produced documents, which were admitted into evidence by the Royal Commission¹;
 - (b) Mr Hartley's statement addressed dealings between SCS and CSF in respect of a proposed merger, relevant to topics identified for the round 5 hearings;
 - (c) SCS apprehended that a direct or substantial interest in the CSF case study would arise if evidence (either oral or written) was given or submissions were to be made relating to dealings between CSF and SCS, which might lead to SCS becoming a subject of inquiry or prejudicial allegations.
- 4 The Closing submissions by Counsel Assisting the Royal Commission made on 24 August 2018 (identified here, for convenience, as the **Closing Submissions**) address the merger negotiations between CSF and SCS at paragraphs 406-415 and 436.
- 5 SCS wishes to respond to five matters raised by the Closing Submissions, namely matters relating to:
 - (a) the principles applied by SCS in evaluating the merger proposal;

¹ Exhibits 5.248 and 5.249 respectively.

- (b) the statement regarding findings open to the Commissioner;
- (c) CSF's assertions about its financial performance;
- (d) the issue of Mr Casey's independence; and
- (e) SCS's concerns regarding the CSF Bank.

THE PRINCIPLES APPLIED BY SCS IN EVALUATING THE MERGER PROPOSAL

- 6 The Closing Submissions identify only one aspect of the thinking of SCS when it came to consider and evaluate the proposal to merge with CSF. Paragraphs 411, 413 and 414 of the Closing Submissions, when read together, may create the impression that the only matter of concern for SCS was to have appointments to the merged entity at board and executive level determined by an independent process.
- 7 SCS submits that, to give an accurate account of SCS's approach to the proposed merger, paragraph 411 should be expanded to reflect the range of reasonable considerations in fact taken into account by SCS, according to the evidence before the Royal Commission.
- 8 The Statement of Mr Cantor sets out the strategic objectives of SCS, and the statement of Mr Hartley identifies the range of considerations that SCS took into account in evaluating the proposal to merge with CSF.
- 9 According to Mr Cantor (at [23]), one of the strategic objectives of SCS is to maintain the ACSR Fund at a size that is sustainable and provides sufficient scale to meet the needs of members. To that end, the Board of SCS reviews the sustainability and scale of the ACSR Fund on an annual basis.
- 10 SCS accepts that one of the ways to meet that objective is to look for potential merger partners, in addition to other activities focussed on member retention and growth with contributing employers (Mr Cantor at [24]).
- 11 SCS accepts that any consideration of potential mergers must be directed to meeting the best interests of its members.

- 12 Section M of the Statement of Mr Hartley and tabs M3 and M4 of exhibit DH-1 reflect the true position of SCS regarding governance considerations in respect of the merger, and show:
- (a) the preparedness of the CEO of SCS to forgo his position (SCS.0012.0013.0219);
 - (b) that SCS sought to achieve a merger of equals with 6 directors from each fund and an independent chair;
 - (c) nevertheless SCS accepted that CSF's CEO could continue subject to presenting to the ACSR Fund directors or otherwise for there to be a spill with a market search undertaken to identify a new CEO of the merged fund (SCS.0012.0013.0386 at 387 and 0389)(SCS.0012.0013.0468) (SCS.0012.0013.0507).
- 13 At paragraphs 182 to 191 of his Statement, Mr Hartley has set out the approach SCS took to its consideration of a potential merger with CSF.
- 14 Consistently with Mr Hartley's Statement, SCS submits that, subject to the overriding consideration of members' best interests, the following are key governance criteria by which mergers (as opposed to takeovers) should be assessed:
- (a) with funds of similar size and standing, a merger should be based on "merger of equals" principles: this means bringing together the best elements of each fund to form a new entity that is better than each of the original funds for the greater good of the combined membership;
 - (b) the choice of which fund should be the successor fund should be decided by financial and business reasons (such as tax implications, outsourcing contracts, the likely utility of the existing infrastructure for the merged fund and staffing arrangements);
 - (c) the appointment of the Chief Executive Officer and the Chair of the merged fund should be achieved through an objective and transparent process;
 - (d) governance arrangements of the merged fund should generally provide for:
 - (i) an equal number of directors coming from each fund;

- (ii) if the Chief Executive Officer of one fund is to continue as Chief Executive Officer of the merged fund, then the chair of the merged fund should not come from that same fund;
- (iii) the management roles of the newly created fund should be filled by candidates based on merit; and
- (iv) the board of the newly created fund should make decisions relating to the future of the fund based on the best interests of its members.

15 Tab M3 of Exhibit DH-1 evidences that SCS retained its focus, appropriately, on those matters.

16 By way of example, a communication that is representative of SCS's position is a letter dated 6 April 2017 from the SCS Chair to the CSF Chair (Exhibit #5.242 CSF.0001.0003.0314). Mr Haysey (of CSF) was taken to that correspondence and Counsel Assisting put it to Mr Haysey that:

"That seems like a reasonable position, Mr Haysey, that was being put?" (T P-5004.12)

17 Mr Haysey did not unequivocally accept that proposition put by Counsel Assisting.

18 Mr Hartley's Statement and the exhibits to it show that, while the approach of SCS to the proposed merger was consistent throughout the negotiations, it was also flexible, in response to changes of position by CSF. Some aspects of CSF's changes of position, emerging from the evidence, are not fully explained in the Closing Submissions.

19 Thus, Mr Haysey denied (TP-5002) that CSF initially insisted that it continue to hold the CEO and Chair position in any merged fund (cf Hartley, Tab M3 of DH-1, SCS.0012.0013.0219). However, there is no doubt that the position of CSF changed in respect of board configuration. See for example:

- (a) Lines 40 to 46 of P-5002 of the Royal Commission's Day 47 transcript discussing CSF letter to the SCS Chair dated 27 March 2017 (Exhibit #5.241 – CSF.0001.0003.0361) that:

"The board of CSF provided its consent to the following arrangements –

...ACSRF chair would be invited to chair the board of the merged entity.”

- 20 Lines 5 to 45 of P-5005 of the Royal Commission’s Day 47 transcript discuss a letter from CSF to SCS dated 9 May 2018 (Exhibit #5.243 – CSF.0001.0003.0349), in which CSF says:

“The CSF board has concluded new leadership is required to take the merged entity forward.

We believe a new independent chair is essential.

The chair should be someone who is not currently on the board of either fund who has a commitment to ensuring the long-term success of this substantial Catholic enterprise and who has the support of the Archbishops of Sydney, Melbourne and Brisbane.”

- 21 When asked by Counsel Assisting whether “*that was a change in CSF’s position at the time*” and that CSF “*wanted there to be an independent chair rather than a chair coming from the Sydney fund*”, Mr Haysey confirmed by replying “Yes” to both questions (TP-5005.41-45).
- 22 The evidence given by Mr Haysey (on behalf of CSF) concerning their proposal that Mr Danny Casey be appointed as the chair of the merged fund, after insisting that the chair be an independent person, is another example of inconsistency. That evidence is discussed later in the present submission.

FINDINGS OPEN TO THE COMMISSIONER REGARDING THE PROPOSED MERGER BETWEEN CSF AND SCS

- 23 The Closing Submissions state, at paragraph 436, that it is not open to the Commissioner to find that any of the conduct of CSF in relation to the merger constituted misconduct or conduct falling short of community standards and expectations.²
- 24 SCS does not urge the Commissioner to find misconduct by CSF or conduct by CSF falling short of community standards and expectations.

² What is meant by that is qualified by paragraph 3 of the Addendum to Closing Submissions – 28 August 2018

25 However, the Closing Submissions do not address the position of SCS or the availability of any adverse findings against SCS. Accordingly, SCS respectfully submits that in circumstances where:

- SCS was not the subject of a case study;
- the Statements of Mr Hartley and Mr Cantor show that the conduct of SCS in dealing with the proposed merger with CSF was both reasonable and appropriate, in the best interests of the members of the ACSR Fund;
- neither Mr Hartley nor Mr Cantor was questioned by Counsel Assisting; and
- nothing has been said in the Closing Submissions about the proposed merger that would suggest that SCS engaged in any misconduct or conduct falling short of community standards and expectations;

the Commissioner should make statements to that effect in his findings and that there is no finding that any of the conduct of SCS in relation to the merger constituted misconduct or conduct falling short of community standards and expectations.

CSF'S ASSERTIONS ABOUT ITS FINANCIAL PERFORMANCE

26 In paragraph 410 of the Closing Submissions, Counsel Assisting refers to Mr Haysey's evidence that initially CSF proposed that "due to the superior performance of the Fund", the CEO, CIO and Deputy Chair should come from CSF, and CSF should be the successor fund.

27 SCS submits that the wording of paragraph 410 of the Closing Submissions should not be construed as asserting, as a fact, that the performance of CSF was superior to the performance of the ACSR Fund. Nevertheless, it would have been more accurate to say "due to what CSF regarded as the superior performance of its Fund".

28 However, the wording of paragraph 410 is ambiguous. SCS submits that if paragraph 410 was taken to include an assertion that CSF's fund performance was superior to the fund performance of SCS, that assertion would be contrary to the evidence before the Royal Commission.

- 29 The evidence placed before the Royal Commission, considered as a whole, does not support a finding to the effect that CSF has a generally superior performance to the ACSR Fund. It is necessary to weigh up the evidence given on behalf of CSF regarding fund performance, with the evidence provided by SCS in the Statement of Mr Hartley and Mr Cantor.
- 30 First, some aspects of CSF's evidence should be considered. In his Statement dated 24 July 2018 (Exhibit 5.237), Mr Haysey's statements at paragraphs 152 to 154 imply that in his view, the blockages to merger were:
- (a) disputation as to the chair of the merged fund;
 - (b) identity of the successor fund; and
 - (c) on-going constitutional change.
- 31 Ultimately, Mr Haysey's evidence was to the effect that the merger was not held back by any stand taken by SCS in relation to governance, but by CSF's view of its superior performance and consequently its belief that it would be in the best interests of the funds' members for CSF to be the successor fund.
- 32 The following exchanges between Mr Haysey and the Commissioner (bold text) summarises CSF's perspective (T P-5011):

I'm just saying that the parties were at a point where each – or there was no dispute that the board would be a six plus six. Is that right?---

We accepted six plus six on the grounds that if there wasn't an independent chair that CSF would have the chair. So we sought separate independent legal advice to the – to the view of the importance of the chair in a successor fund arrangement going forward in the best interests of our members to protect their retirement savings, given the superior performance of one fund over a long period of time. We saw no other option.

What does it matter a hill of beans which fund merges into which?---

We felt, to protect our members' interests and given our structural arrangements as I described earlier, that it wouldn't be in our members' best interests for their retirement savings to be put at risk, given that the –

the policies and procedures that were in place to achieve those outstanding returns might, in fact, not be able to be guaranteed going forward.

Well, those policies and procedures are set by the board, aren't they?-

--They are.

33 The evidence given by Mr Haysey referred to above, and in other places (for example, TP-5004.11 and TP-5006.32), indicates that CSF considered its asserted superior past performance as the reason why:

- (a) CSF's CEO should be the CEO of the merged fund,
- (b) CSF's policies and procedures should be retained by the merged fund; and
- (c) CSF should be the successor fund and master trust, into which the ACSR Fund is "merged" as an option.

34 To the extent that CSF tied its assessment of the proposed merger to its view about performance, its position was misconceived, for the following reasons.

35 First, past investment performance should not and cannot be used to project future investment performance. ASIC's regulatory guide RG 53 at section 8 addresses the use of past investment performance in promotional material. Concern regarding CSF's representations regarding its investment performance is reflected in a communication SCS received from Rice Warner dated 24 January 2018 appearing at page 232 of tab M3 to Exhibit DH-1 to the statement of David Hartley (SCS.0012.0013.0425).

36 Second, as Mr Haysey accepts, performance is determined by policies and procedures that are set by the board, and accordingly the performance of the merged fund would be determined primarily by the decisions of the board of the merged entity.

37 Third, there has been very competitive investment performance by ACSR Fund in both absolute terms and relative to CSF in the last 12 months (Cantor, Tab B1 of GC-1 SCS.0011.0002.0001) supporting the ASIC guidance that past performance should not be used to project future performance.

38 Fourth, CSF has applied a narrow view of what constitutes good performance, by limiting "performance" to investment performance. Performance of a

superannuation fund is affected by misconduct in matters of governance, such as failure to avoid conflicts of interest or failures to effectively control unauthorised credit card use. Deficiencies in governance cannot be quarantined from observations about performance. Independent SuperRatings assessments referenced in SCS.0012.0013.0090 to 0092 indicate that ACSR Fund is regarded by SuperRatings as being superior to CSF in 4 of 6 categories, including governance, highlighting the potential benefits of a “best of both” merger.

- 39 In those circumstances, SCS submits that the Commissioner, if he refers in his findings to CSF’s belief in its superior fund performance, should note that CSF adopted a narrow view about fund performance and that the Commissioner regards the question of superior fund performance as contestable and makes no finding.

THE ISSUE OF MR CASEY’S INDEPENDENCE

- 40 In paragraphs 411-412 of the Closing Submissions, it is reported that SCS took the view that appointments at board and executive level should be determined by an independent process, and that as negotiations progressed, CSF revoked its proposal for the SCS Chair to be the Chair of the merged fund, and determined that “a new independent chair is essential”.

- 41 It is then reported (paragraph 413) that by September 2017, CSF contended that the Chair should be Daniel Casey, who had been employed by CSF as a consultant to assist with the merger process.

- 42 The following evidence bears on the position of Mr Casey:

- (a) When asked by Counsel Assisting, in Lines 29 to 34 of P-5008 of the Royal Commission’s Day 47 transcript, “...*the position that CSF was putting was that there must be a particular person who should be the independent chair?*” Mr Haysey initially replied “no” but continued to state that CSF’s “*preference, at that point in time, was Danny Casey.*”
- (b) In Lines 36 to 41 of P-5008 of the Royal Commission’s Day 47 transcript, in response to the Counsel Assisting’s question “*Can you explain what involvement Mr Casey had had in the negotiations during this time?*” Mr Haysey’s reply was:

“So Mr Casey had, during this year, 2017, been employed by CSF as a consultant given his background in the Sydney market, in the Sydney community, which we were, obviously, trying to enter into an arrangement with, and become the successor fund for...”

- (c) Mr Haysey’s statements and oral evidence³ before the Commission did not point to any communication by which CSF informed SCS of that pre-existing relationship at the time of or in the lead up to his nomination. The evidence before the Commission records that SCS considered it important to get an understanding of the terms of Mr Casey’s engagement with CSF⁴.

43 SCS submits that the Closing Submissions fail to draw the obvious conclusion to be drawn from the observations in paragraphs 411-413 and the above evidence. The conclusion is that Mr Casey, because of his employment by CSF as a consultant on the merger process, could not meet the criterion asserted by CSF itself, namely that a new independent chair was essential.

44 SCS submits that it would be open to the Commissioner to find that CSF behaved inconsistently in the merger negotiations, not only by revoking its proposal for the SCS Chair to be the Chair of the merged fund (as noted in paragraph 412 of the Closing Submissions), but also by proposing Mr Casey to fill a position that CSF regarded as essential to be filled by an independent person.

SCS’S CONCERNS REGARDING THE CSF BANK

45 The Closing Submissions omit any reference to a consideration that SCS regarded as an important one, in assessing the proposed merger with CSF.

46 As set out in the statement of Mr Hartley (see [180]), SCS was concerned as to whether the continued operation by CSF of banking services, through an associated subsidiary (Haysey, [16]), could be said to meet the sole purpose and best interests tests, in circumstances where the bank is not profitable and shows no evidence of being profitable in the future⁵.

47 SCS submits that any findings by the Commissioner with respect to the approach of SCS to the merger negotiations, and any findings by him with respect to the

³ Transcript P-5008.43-45

⁴ Page 183 of Tab M3 of Exhibit DH-1 being SCS.0012.0013.0376

⁵ See for example page 158 of Tab M3 of Exhibit DH-1 being SCS.0012.0013.0352 and CSF.0005.0001.0151 at 0446, 448 and 451.

reasons for failure of the proposed merger, should take into account the serious and justifiable concerns held by SCS regarding CSF's continued provision of unprofitable banking services.

Dated: 31 August 2018

Signed: 

Norton Rose Fulbright Australia for SCS Super Pty Limited