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TRANSCRIPT OF PROCEEDINGS

O/N H-919873

THE HONOURABLE K. HAYNE AC QC, Commissioner

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

MELBOURNE

9.30 AM, WEDNESDAY, 8 AUGUST 2018

Continued from 7.8.18

DAY 42

MS R. ORR QC appears with MR M. HODGE QC, MR A. DINELLI and MS E. DIAS as Counsel Assisting with MR T. FARHALL
MR N. YOUNG QC appears with MR D. THOMAS, MS M. ELLICOTT and MR M. SHERMAN for NAB
MR M.H. O'BRYAN QC appears with MR D. PRESTON for AustralianSuper

<NICOLE SUSAN SMITH, ON FORMER AFFIRMATION [9.30 am]

<CROSS-EXAMINATION BY MR HODGE

THE COMMISSIONER: Yes, Mr Hodge. Ms Smith.

MR HODGE: Commissioner, I should probably note you may have observed on walking into the room that it's like walking into a sauna. The air-conditioning is not working at the moment, it seems.

THE COMMISSIONER: I have been told that and observed that.

MR HODGE: Yes.

THE COMMISSIONER: And steps are being taken, as much as they can be.

MR HODGE: Yes.

Ms Smith, what I wanted to do was to take up where we had been yesterday, which is looking at that letter that you had signed with Mr Hagger and sent to Mr Tanzer, that is ASIC.0036.0001.2898?---Yes.

If we go to page 4 of that document. You will recall yesterday I was asking you some questions about subparagraph (c) on that page in relation to compensation methodology?---Yes.

Where it says that – and this, as I understand it, is referring to both NAB and also NULIS because Mr Hagger is writing, in effect, on the NAB Wealth business and you were writing on behalf of NULIS?---Yes.

And you are saying:

> *We are considering the right compensation methodology for these members. This methodology should appropriately reflect any potential legal liability position which we are working through at the moment, and also be practical to implement.*

Now, I want to return to the questions I was asking you yesterday afternoon. Do you have a recollection of what that potential legal liability position was that was being worked through?---So at this point in the review process, the organisation was still reviewing the SWiFT and Encompass matters. So I don't recall from when we wrote this letter what we would have been talking about specifically, but on reflection, I expect that is what it's talking about.

Now, I am afraid that can't be right. If you go back a page to page 3, you see 2.12 says:

In relation to TERP PSF matters, we confirm that we –

So this compensation methodology is not about SWiFT or Encompass, it's about TERP, so TERP has already been identified as a breach at this point?---Yes.

More than six months earlier?---Yes.

So this can't be an issue about SWiFT and Encompass. You agree?---Agree.

It must be about TERP?---Yes.

So do you know what the legal liability issue was that was being worked through in relation to TERP?---Not from the trustee's perspective, I don't.

So you, as far as you can recall, weren't kept informed as to what the issue was with legal liability at this time?---So there hadn't been any updates to the trustee in respect of further legal liability in respect of TERP at this point in time. I would like to make one comment, though. This letter was not about setting out the remediation program, nor was it about describing the event in itself. This letter was intended as a description and a commitment to the review program that the administrator and the trustee were looking to enter into with ASIC to satisfy ASIC in respect of the concerns they had over the control framework.

Thank you for your comment. If we can just return to my question in this paragraph. There is a statement of fact made here about what is going on, which is that "we", that is, the NAB Wealth business and NULIS:

...are considering the right compensation methodology for this – for these members. This methodology should appropriately reflect any potential legal liability position which we are working through at the moment.

?---Yes.

So if we just focus from the perspective of the trustee, did you know what the issue was about potential legal liability?---No, I do not recall.

And then can we bring up NAB.162.011.1706. Thank you. If you look at that screen, you will see this is a chain of emails. You're not on the chain of emails, but you will see there's an email starting on the bottom half of the page which is an email from Paul Carter to some other people within the NAB Wealth business. Can you see that?---Yes.

And it says:

Having spoken to Nicole S –

Which presumably must be you. And then you see it sets out on the bottom half of the page:

...on PSF.

?---Yes.

And I just want to understand a few things. You were obviously speaking to Mr Carter about what was going on with PSFs?---So if I recall what this would have been about, this was about the – the interactions we were having with ASIC at this point in time, and talking about why we thought the control environment was different today or at this point in time, in June '16 to what it was when the events had occurred. And the – the conversation that Paul is reflecting that we've had is about my view on what I thought was different in the control environment and the way I saw that.

Do you remember having had this conversation with Mr Carter?---I – I had many conversations with Mr Carter. On – on looking at the email, I – I do believe that that is what this is referring to.

All right. So you, over the course of 2016, you mean you had many conversations with Mr Carter?---Yes.

And many conversations about the PSF issue?---I would have had a number of conversations about the PSF. Paul was the executive responsible for the superannuation business, and as the chair of the board, we would have spoken weekly to fortnightly.

He was, as you say, an executive for the superannuation business of NAB within NABs Wealth division?---Yes.

And he was also a director of National Wealth Management Services Limited?---Yes.

And National Wealth Management Services Limited was the company that effectively performed the management and administration for the trustee?---Yes.

And in the event that money needed to be repaid to members, which in your view it had to be – that's right, isn't it? It had to be repaid?---Yes.

And that was always your view from the moment you knew about the breach?---Yes.

And it was always your view that the full amount that had been taken in PSFs from members who did not have a linked adviser needed to be repaid to those members?---At this point for TERP members, yes.

All right. Did you understand that Mr Carter had a different view about that?---What I understood and whether it was at June or July or at what point in the cycle, I'm – I couldn't – I couldn't actually say when – when the conversations would have been had. At a very high level, I understood that there had been legal advice received by the administrator that had a different legal liability position to the trustee, and – and the management team, together with the office of the trustee and the chief risk officer, were working through the occurrence of the event and the – the different legal opinions.

And – so at some point in time – you're not sure whether it's June, July, August – you were told that the administrator had obtained a legal advice that suggested that it might not have a legal liability to repay this money. Is that right?---I did not see the legal advice.

No, what I'm interested in is what you were told?---I will just pause to reflect in respect of kind of what my – what I – what I think I knew at the time. I – I had some very high level conversations with Paul, and the office of the trustee regarding the administrator's different position to the trustee's. And my view at the time was, you need to work through it, we need to work through it quickly and we need to come to a conclusion. And I didn't get into a debate about who was right and who was wrong because I did not have all of the facts and all of the information in front of me. So my – my point at the time was I wasn't involved in the – in the detailed conversations. I knew that there was a difference of opinion, and I was pushing the management team and the – who is the administrator – to come to a conclusion and for us to resolve the matter.

You did have all of the facts, though, didn't you, Ms Smith? You had approved the PSFs in the first place in 2012. That's right?---Yes.

In 2015 you were told that there was this breach and the breach was that money had been taken from members who did not have a linked adviser, where the money that was taken was supposed to be for a service being provided by a linked adviser?---Yes.

Those were all the facts you need, aren't they?---No.

Why not?---At the time, I understood that there were two different opinions in the organisation, and that that was being worked through by – by the management team and overseen by the office of the trustee. So I was expecting due process to be taken and for a final determination to come to the board.

So the management team is the management team that Mr Carter is responsible for?---Yes.

And that's the management team in the Wealth division?---Yes.

And it's the Wealth division that has been taking this money?---Yes.

It has been increasing its profit?---Yes.

If it has to pay this money back, it will be the Wealth division that has to pay this money back?---Yes.

It's hopelessly conflicted, isn't it? How can it advise you about what should be done or make representations to you about what should be done if it's the one that has taken the money and will have to pay it back?---So, yes, there is a conflict for the administrator in terms of the – the – the revenue. However - - -

THE COMMISSIONER: Go on?---Okay. However, the administrator wasn't sitting there on its own without appropriate representation from the trustee working its way through the process. As I mentioned yesterday, the breach review process has independence from – from the CRO and from the office of the trustee during that process, and in this particular event there was also independent legal advice that had been sought and obtained by the trustee.

MR HODGE: Is it fair to say the reason that a decision had not been made earlier than 26 October 2016 to fully remediate TERP members was because the administrator was taking a different position or considering a different position as to whether it had to repay the money?---I was not involved in the administrator's conversations. So – I will just finish – to say that the – the administrator was reviewing all of the facts of the circumstances of the events, of which was whether or not there was a liability on behalf of the administrator.

Are you comfortable with the passage of time between December 2015 and 26 October 2016, from when the breach was notified to ASIC and when a decision was made to remediate the TERP members in full?---No, it took too long.

And did you inquire as to why it had taken too long?---I was, during that period, for want of a better word, agitating and require – and asking for the matter to come to a head.

Who were you agitating with?---With senior executives and the CRO.

So the CRO is Mr Murphy?---Yes.

And the senior executives are - - -?---Paul Carter.

All right. Anybody else? Did you agitate with Mr Hagger?---No. Not at the time, I don't believe.

You were signing letters with him to ASIC about the remediation program?---Yes.

But you didn't discuss with him what the delay was?---I don't recall having discussed it with Mr Hagger.

Was it ever explained to you what the delay was?---It was the – the matters I referred to previously, in respect of the process that the administrator was going through in understanding the Encompass and SWiFT events.

Do you think that the trustee acted in the best interests of members by waiting until 26 October 2016 to finally decide to fully compensate TERP members?---Yes.

And why is that?---I – so first of all, members were fully compensated and a decision was made by the administrator – and – and recommended to the trustee to fully compensate members. At the time and on reflection, my view was that management needed to work through the facts of the matter, and that the board shouldn't be used as a blunt instrument to come to the right decision, and that the administrator came to the right decision for members without using the board as a blunt instrument to do so.

Can you see that the problem with the approach that you've outlined is that the board of directors has only one duty, and that is to act in the best interests of members, and that the administrator is conflicted because the administrator is the one who will have to give back the profits?---I – I think that the issue is timing, at which point the member is fully compensated for the extra time.

Well, now, that's not quite right, is it, because the compensation is based on interest, is that right, rather than - - -?---No.

- - - lost earnings? In the case of – your understanding, is it?---No, the trustee's compensation policy requires a – and was a – a minimum of interest. If you are still invested in the fund, it is the higher of the earnings on your account, or the BBSW plus X per cent interest rate as a floor.

Now, I want to show you another document. Can we bring up NAB.047.005.1696. While that is coming up, can I ask you this: in hindsight, as you reflect on the last three years of your term as chairman, do you think this event, that is the wait of 10 months or more than 10 months from the notification of the breach to deciding to compensate, is reflective of a general pattern of the NAB Wealth division delaying in making the right decision by members?---No, I don't.

All right. So if we have a look at this document. This is an email from Ms Debenham within NAB. You can see that you're one of the recipients of it?---Yes.

And it's an email setting out the concerns that have been raised by ASIC in relation to the NAB Wealth business and the trustee entities?---Yes.

And do you recall having read this email at the time it came in?---I expect if I received the email I would have read it at that time.

All right. And – well, you did receive the email. You can see that?---Yes.

And do you recall that ASIC expressed concerns about the adequacy of processes within the NAB Wealth business and specifically the trustee?---Yes.

Did you share those concerns?---So the whole – from this point, there had been reflection with management and the – the entire board around what ASIC was saying to us and what we believed our position in June '16 actually was. And I think I talked about yesterday, and the point of the 22 – 22 July letter and the subsequent meetings that were held with ASIC after this email were about the view that we felt our control environment had gone through enormous uplift since the events had actually occurred. And so while ASIC was raising concerns with us, we felt that the environment that had led to the errors was not the environment we were operating in in June '16.

I see. If we go to page .1700. I think you've got that page?---I do.

And you will see this is part of the chain of emails that has ultimately been forwarded on to you. Do you see a heading halfway down the page which is ASIC Concerns?---Yes.

What is explained there is:

> *Whilst satisfied that the TERP/MySuper breach remediation should proceed as planned ASIC remains fairly concerned about the whole manner of the trustee giving approval for the TERP trade-up and also the MySuper product upgrade.*

If we just pause on that, did you have concerns about the circumstances of the trustee giving approval for the TERP trade-up?---No.

Was there any investigation that you did into those circumstances?---No, not into the TERP trade-up, from the trustee's perspective, no.

All right. We will return to that in a moment. And then you see it says:

> *And also concerned with the mishandling of trustee conditions and the implementation of trade-ups and product upgrades.*

?---Yes.

Did you have any concern about that issue?---There were some errors regarding insurance, so I believe that that – that's what that's referring to.

But that didn't cause you to have any concerns about the system that was in operation?---Not about the entirety of the system, no.

And then you see:

In ASICs view there was too much reliance on the administrator doing things post trustee approval, a classic example being not ensuring that the M100 insurance policy was updated at the time of the TERP/MySuper changes being made.

?---Yes.

Did you have a concern about whether the trustee was too reliant on the administrator?---No.

Do you recall that ASIC was concerned that the trustee was too reliant on the administrator?---Well, in this email it says that ASIC was concerned that we were relying on the administrator doing too many things after our approval.

Do you have a recollection of that concern - - -?---Yes.

- - - being raised with you?---Yes.

And do you have a recollection of whether you responded to that with ASIC?---Through the – the several meetings that I attended, and then the – the result of these concerns was the trustee entering into licence conditions and an independent external review.

All right. So just so I understand, did you share this concern that ASIC had?---I think that there's nuance in the concern that we did have some – we did – we did have some control breakdowns that I think looked like we were relying on the administrator too much, but I don't think that in – in my view that's actually what the issues were.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Yes. Now, I don't think we've – the letter NAB to ASIC of 22 July has been marked yet.

MR HODGE: I think I may have tendered that yesterday with Mr Carter, Commissioner.

THE COMMISSIONER: The letter NAB to ASIC?

MR HODGE: I'm sorry, no. You're quite right, Commissioner.

THE COMMISSIONER: The letter NAB to ASIC of 22 July 2016, NAB.036.0001.2898 is exhibit 5.47.

EXHIBIT #5.47 LETTER NAB TO ASIC DATED 22/07/2016 (NAB.036.0001.2898)

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: The emails between Debenham, Hagger, Smith and others of June '16, the subject line is what, Mr Hodge in these emails?

MR HODGE: NAB Wealth breach events: enforceable undertaking: confidential – not for distribution.

THE COMMISSIONER: Having that subject line NAB.047.005.1696, exhibit 5.48.

EXHIBIT #5.48 EMAILS BETWEEN DEBENHAM, HAGGER, SMITH AND OTHERS OF JUNE '16 RE NAB WEALTH BREACH EVENTS: ENFORCEABLE UNDERTAKING: CONFIDENTIAL – NOT FOR DISTRIBUTION (NAB.047.005.1696)

MR HODGE: Thank you, Commissioner. Can we bring up NAB.005.067.6509. Now, we've gone back in time. This is the breach notification given by MLC Nominees to APRA in – at the end of 2015?---Yes.

And you've exhibited this to your statement?---Yes.

And if we go over the page to .6512. This is the explanation for what occurred in relation to the TERP breach?---Yes.

And at this stage it said:

> *The analysis indicates that approximately 47,000 members have been impacted.*

Do you see that towards the bottom of the page?---Yes.

Ultimately there ended up being many more than that affected. Is that right?---Yes.

Right. And then you see in the middle of the page there is a paragraph which is "unfortunately"?---Yes.

Can we just blow that up with the numbered points. Now, I just want to ask you to read that paragraph and tell me whether you understand that paragraph to be true?---I understand that is the view that management had as a result of their investigations into the TERP event.

I think if we just go back to my question. Do you – do you believe that that paragraph is true?---So I know factually that – that the management paper didn't – did not outline point 1. I have an understanding of point 2 and 3 based on management – management's investigation into the matter, not firsthand knowledge.

All right. So let's just work through it. Point 1 is:

> *The management paper that was prepared by the administrator in April of 2012 didn't say that there would be a group of transferring members who did not have a plan adviser pre and post the transfer.*

?---Yes.

And, in fact, it didn't speak at all about members who didn't have an adviser?---Correct.

In fact, what the management paper said to you is this is a fee, the plan service fee, that is going to be charged for services provided by an adviser?---Yes.

And then point 2 is:

> *It was the administrator's intention to provide non-advised members access to general advice services through a different channel.*

So I just want to understand. Management has ultimately reported to you that the administrator had always intended to provide non-advice members access to general advice services through a different channel. Is that right?---No.

Has management told you that this was always the administrator's intention?---I – I would need to go back and review board papers to see exactly what they said, but the breach review notice is not seen by the trustee at the point it's being lodged, nor lodged with the board paper afterwards. So - - -

So when was the first time you saw the breach notice?---As – for preparation for my witness statement.

So this is the breach notice given on behalf of the trustee?---Yes.

And your recollection is the breach notices are never provided to the board when they're given?---They may have been at some point in our cycle, you know, in terms of our reporting, but reporting changes in the way it goes to the board. So certainly more recently we do not receive them.

Now, if we just stay focused on point 2. Something is missing from this, isn't it, because the administrator was providing the same general advice services to members whether they were advised or unadvised?---I don't know if they would be the same as to what a – the financial planner was providing. Certainly not to - - -

No, no, sorry, you've misunderstood my question. It's my fault. If a member has a linked adviser, the administrator will provide certain general advice services to that member?---Some general advice services, yes.

The member can call up and ask what their balance is or to transfer products or how they do certain things and that will be provided to a member with a linked adviser?---Yes.

And the same services are provided to a member without a linked adviser?---Yes.

There's no difference between the general advice services provided by the administrator to a member with a linked adviser and a member without a linked adviser?---Yes.

All right. And then you see point 3 is:

> *It was intended that the administrator would retain the PSF amounts deducted from the non-advised member accounts.*

?---Yes.

Now, the passive voice is a little confusing there. It wasn't the trustee's intention that the administrator would retain the PSF amounts deducted from non-advised member accounts, was it?---No.

So the only intention that this can be speaking of is the intention of the administrator?---Yes.

So, again, so that we understand, management has told APRA and they've told ASIC the same thing in identical terms, that the administrator intended to retain the PSF amounts deducted from non-advised member accounts?---The chief risk officer who signed the breach notice - - -

Yes?--- - - - has advised that, yes.

And do you understand that that's true, that that was always the intention of the administrator?---Based on what the administrator has said to me, yes.

All right. So did that cause you concern, if that was the intention of the administrator?---Yes.

And what did you do about that concern?---We remediated customers.

But I want you to think about this: you are dependent upon the administrator for providing services to members. Do you agree?---Yes.

You certainly hold the view that there was absolutely no entitlement on behalf of the administrator to retain PSF amounts deducted from non-advised member accounts?---Yes.

You held that view from the moment you were told about what the breach was?---Yes.

The administrator has informed you at some time that it had always been the administrator's intention to retain PSF amounts deducted from non-advised member accounts?---Yes.

Did you say to the administrator, "We need to understand what the process is by which you go about taking money that you are not entitled to"?---Those specific words, no.

Did you say words like that?---No.

Did you make any inquiry as to how it is that the administrator could have formed the view that they should take the PSF amounts deducted from non-advised member accounts?---Yes.

And when did you make that inquiry?---There were reviews undertaken into all three specific events that led to the – this particular remediation program. So TERP, Encompass, and SWiFT as to the root cause of the error, how it occurred.

And what was the root cause of the error, as you understood it?---Essentially, that the administrator had not undertaken appropriate – or had not provided appropriate information to the trustee at the point of the decision of implementing the PSF.

Now, I don't understand that. What was the appropriate information that the administrator should have provided?---It – it should have been clear, of the different categories of members, who would have had a PSF charged against them.

And if the administrator had told you, the trustee, in 2012, that they were going to keep deducting the PSF amounts for non-advised member accounts, what would have been the outcome?---I expect the outcome would have been that they – no.

The trustee would have said "no, you can't do that"?---Yes.

For the obvious reason that there's no lawful basis that you can take money for not providing the service that it's supposed to be charged for?---For the obvious reason that there's no adviser linked to the account and so, therefore, no service in respect of the fee being charged.

And did you inquire as to why the administrator had not informed the trustee of this in April of 2012?---There were several discussions and reviews into the "why". Unfortunately, the relevant management team were no longer in the organisation, and so it has really then a subjective view as to intent and what had occurred.

All right. But this – recognising this problem that the – that (a) the administrator had taken money that it was not entitled to take; you agree with that, that was a problem?---That members should never have been charged the fee?

Yes?---Yes.

And the administrator had taken that money?---Yes.

(b), that the administrator had not told the trustee about what it was going to do; that was a problem?---Yes.

Did that cause you concern in 2016 about whether the trustee could rely upon the administrator to do the right thing?---I think that what it – I would go back to whether – it was unclear from the reviews undertaken as to why the omission – why the trustee had – had not been included in the trustee board papers and clear to the trustee that there were sets of unadvised members that the PSF would be applied to. That was a concern. But at that time, it was not my concern that we could not rely on, nor trust the administrator to fulfil their obligations under the contract and nor to do the – to do the right thing.

I tender that – no, I don't need to tender that document, Commissioner. That's already in as part of the evidence of Ms Smith.

THE COMMISSIONER: Yes.

MR HODGE: Can we bring up ASIC.0036.0002.0927. So then we've looked at the 22 July letter that you and Mr Hagger sent to ASIC. There was a meeting that occurred on 22 August between representatives of NULIS and National Wealth Management Services Limited on the one hand and ASIC on the other?---Yes.

Do you remember whether you attended that meeting?---I attended two meetings with ASIC during this period, and I – I think I was at the August meeting, yes. I think – it's in my witness statement, the two dates of the meetings I attended.

All right. And then ASIC then writes this letter on 23 August where ASIC is confirming that, if you look in 2(a)(i):

> *NULIS and National Wealth Management Services Limited will commit... to undertake remediation programs.*

?---Yes.

And ASIC doesn't consider the negotiated commitments are an appropriate way to resolve its regulatory concern?---Yes.

And then if we go over the page to the third page, .0929, we see ASIC explaining that it does not consider the negotiated commitments are appropriate and that instead it seeks an enforceable undertaking. And it says:

> *An enforceable undertaking is an appropriate regulatory outcome in the circumstances of our concerns. An EU is an administrative settlement and the mechanism we would ordinarily use to resolve serious compliance concerns, even in circumstances where a regulated entity has complied with its statutory obligations to report any breaches, has cooperated and has been prepared to acknowledge ASICs concerns.*

However, NULIS didn't want to give an enforceable undertaking?---No.

And NULIS wanted, instead, to have a change to its licence conditions?---Yes.

And can you explain to the Commissioner why there was a preference for changing the licence conditions rather than giving an enforceable undertaking?---There was discussion at the trustee board with all of the directors, and the preference of the board was to have licence conditions as opposed to an enforceable undertaking.

But why?---I – I – I would have to go back to the minutes to determine kind of the considerations we had at the time. We weighed up, kind of, the benefits of – or the perceived views of either an enforceable undertaking or – or licence conditions. Essentially, they meant we would do exactly the same thing. One just imposed licence conditions on it – on us and the other would have been called an enforceable undertaking.

Out of curiosity, did you – did you regard yourselves as getting off lightly, that ASIC wasn't suggesting that it might actually take enforcement action against NULIS or National Wealth Management Services Limited?---Absolutely not.

Absolutely not?---Absolutely not. We didn't - - -

That is you didn't – sorry, go on?---We didn't take it lightly.

No, no, did you regard yourselves as getting off lightly?---No.

Did you think that there was the possibility that they would take enforcement action against you?---Yes.

Did they write to you and talk to you about that?---Yes.

And what was the type of enforcement action that they took?---Exactly what you can see here in the form of the matters of the licence condition that were imposed. That was what was on the table from ASIC at the beginning of the conversation, and that's what we entered into.

I'm sorry, I think we – one of the difficulties in this area is that I use the word "enforcement action" in a different way from - - -?---From the accounting brain, yes.

Sorry?---From the accounting brain.

No, it's not an accounting brain thing. When I talk about an enforcement action I mean a proceeding commenced in a court alleging a contravention of the Act but for some reason that's not what enforcement action means in this area?---I – I don't believe that ASIC was discussing enforcement action with us in any form other than the licence conditions that we – either through – the licence conditions that we ended up entering into.

All right. So you can't ever recall having to contemplate at the trustee level the possibility that you might face a civil proceeding?---At this time, no.

All right. And was it ever raised with you by management, the possibility of a civil proceeding? I don't mean at the full board level but just with you?---I don't believe so.

All right. And then - - -

THE COMMISSIONER: Any contemplation of a criminal proceeding?---Not at this time, no.

Ever?---I believe in respect of the PSF events that – the latter part of my witness statement, that ASIC is still investigating, and so I – so I should – that's a very longwinded way to say no, but ASIC are still investigating in respect of the latter – the final PSF matter.

Did you think yourself that taking money to which there was no entitlement raised a question of the criminal law?---I didn't.

Go on.

MR HODGE: I tender that document, Commissioner.

THE COMMISSIONER: Letter ASIC to Smith and Hagger 23 August '16 ASIC.0036.0002.0927 exhibit 5.49.

EXHIBIT #5.49 LETTER ASIC TO SMITH AND HAGGER DATED 23/08/2016 (ASIC.0036.0002.0927)

MR HODGE: Can we bring up ASIC.0036.0001.2916. Now, this is a little confusing because you will see this is headed Draft Talking Points: addressing matters from the meeting with ASIC on 22 August 2016 and subsequent correspondence. These seem to be talking points from some later date after 23 August but it's not clear what date it is. Have you seen this document before?---I don't recall seeing it before.

All right. You – and I think you were pointing this out before, that the alternative basis that ASIC offered in that letter of 23 August 2016 to address its concerns was by NULIS consenting to a variation of its licence conditions?---Yes.

And so ASIC had presented you with two options: an enforceable undertaking which was its preferred option or alternatively an amendment to the licence conditions. Is that right? And then if you look down in paragraph 2.4 at the bottom of the page, you can see ASIC was indicating that the assurance review was required and it had to be under either an enforceable undertaking or the licence conditions?---Yes.

And then if we go over the page, you will see a query at the top of the page which is:

> *If NULIS was to choose to consent to a licence condition reflecting similar obligations as outlined in the proposed EU –*

And then effectively it's what's the process by which the licence condition will be satisfactorily completed and then the licence condition revoked?---Yes.

And do you recall whether you were involved in drafting this document?---I don't actually know the purpose of the document, so I – other than it saying "talking points", I don't know what it was used for. So whether or not I would have been involved in the drafting – essentially, I would not be involved in drafting. My role as a director would be to receive a drafted document and I would reflect on that for what I would believe to be accuracy in the trustee's point of view.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Draft talking points – have we a date for it, Mr Hodge?

MR HODGE: It's not dated, Commissioner, but I can tell you it must have been provided before 16 September 2016.

THE COMMISSIONER: And is there any indication of authorship or origin?

MR HODGE: It is likely draft talking points for Andrew Hagger and Andrea Debenham.

THE COMMISSIONER: Draft talking points ASIC.0036.0001.2916, exhibit 5.50.

EXHIBIT #5.50 DRAFT TALKING POINTS (ASIC.0036.0001.2916)

MR HODGE: Then if we bring up ASIC.0036.0001.7353. So this is a letter dated 16 September 2016 to you and Mr Hagger?---Yes.

And you will see in the first line it's referring to a meeting with Mr Hagger and Ms Debenham?---Yes.

And to that document we've just looked at, which is Draft Talking Points?---Yes.

And Ms Debenham – what was her role?---Basically, a liaison with the regulator. So supporting the regulator interaction into NAB Wealth.

All right. And you see then in the second paragraph, the last sentence says:

> *ASIC has not yet received a response from the boards of NULIS, National Wealth Management Services Limited and NAB Wealth.*

?---Yes.

Now, was the decision as to whether NULIS would agree to a change of licence conditions a decision about which you would receive a recommendation from management?---No. The trustee took independent external legal advice in respect of whether or not we would enter into an EU or whether we would ask for licence conditions. I – I would have to go to the board paper as to whether or not there could have been a recommendation from management in that, but essentially, it was a discussion of the board and a full board decision.

Did you discuss with Mr Hagger whether NAB Wealth had a preference between an enforceable undertaking and an amendment to the licence conditions?---No.

Not that you can recall or - - -?---No.

- - - no, you definitely - - -?---No, I – I – two and a half years later, I would probably say the answer is no.

Is it, from your point of view, to be expected that Mr Hagger and Ms Debenham, neither of whom are representing the trustee, would be attending a meeting without anybody from the trustee to discuss whether there would be an enforceable undertaking or change to licence conditions for the trustee?---Well, I think they would both be in there as capacity representing the trustee.

I see. They would be there representing the trustee?---Yes.

Okay.

THE COMMISSIONER: How?---How?

Yes. How?---Well, essentially, the administrator is acting under – is the service provider to the trustee. So the trustee doesn't do everything itself. It has an administrator that undertakes all sorts of activities on – on its behalf. In – in respect of meetings with the regulator, where the trustee believes it needs to put forward its own voice or an independent position, that is – that is actually when I have attended or we've ensured that the COO of the office of the trustee would be attending those meetings. In this instance, this was – ASIC had put forward – we really had a – a view on what ASIC wanted from us. We were in discussion about whether that would – it was exactly the same thing as whether it was an enforcement – whether it was an EU or licence conditions. It was the term – the legal term or the construct that they were getting us to do the review that was different. So we didn't believe that there was a conflict for Mr Hagger or Ms Debenham attending a meeting with ASIC without anyone else present.

MR HODGE: So you considered whether there was a conflict or not?---During this period we considered when I should go or the office of the trustee should go and attend meetings with ASIC, yes.

If an enforceable undertaking was going to be given, it was to be given by both NULIS and also National Wealth Management Services Limited?---I don't believe so, NWSL is not a licence entity, it would be the trustee entering into the enforcement action.

If we go over to page ASIC.0036.0001.7356?---You might tell me I'm wrong now, so - - -

I'm sorry?---You might tell me I'm wrong as I just said that.

Well, if you look in paragraph 12, you see the answer from ASIC is:

> *As stated in the 23 August letter in the event that NULIS and National Wealth Management Services Limited are prepared to offer an EU to ASIC, we confirm that we are willing to meet with you and APRA to discuss the scope of the ASIC assurance review.*

?---Yes.

And that would suggest that both entities would be offering the EU?---It would.

But the licence condition change was only for NULIS?---Yes.

Was there any discussion about whether, that you can recall, that you participated in, as to whether having a change in licence conditions for NULIS would attract less publicity and media scrutiny than offering an enforceable undertaking?---I think we talked about all aspects of the implications of whether it was an EU or licence conditions, one of which would be about adverse publicity.

Yes. So my question I will rephrase to you: was there a discussion that you can recall about differences in adverse publicity depending upon whether an EU or a change to licence conditions occurred?---Yes.

And do you recall that the effect of the discussion was that there would be less adverse publicity if there was a change of licence conditions rather than enforceable undertaking?---Yes.

And was that a reason that NULIS decided to push for a change to licence conditions rather than enforceable undertaking?---No.

So you discussed it, identified that there would be more adverse publicity if there was an enforceable undertaking, but that wasn't the reason why you decided to push for a change to licence conditions?---I don't think we pushed for licence conditions. I think both were on offer from the regulator, and we said our preference was for licence conditions. So that would be my first comment. The second comment I would have would be I did say that there were a number of matters talked about and discussed based on legal advice as to what the differences were between an EU or licence conditions. While we felt that an – an EU might have more adverse publicity, we did feel it was in the margins and was not a driver for the decision around whether we had an EU or licence conditions.

All right. So if we identify what the differences were, as you can recall them, one was that there might be more adverse publicity around an enforceable undertaking?---Yes.

Another was the enforceable undertaking would be given by NULIS and National Wealth Management Services Limited whereas the change to licence conditions would only be a change to NULISs licence conditions?---No, I don't recall that being a discussion or a point at the time.

Okay. What are the other differences that you can recall?---One that comes to my mind was that the – the long-term publication around where an EU sits on ASICs registers versus once we complete the licence conditions, they are removed. And I really – I – I would have to go back to the legal advice to look at the differences between what we felt were – what we thought the differences were. What I can say is it was really in the margin. We really didn't think that there was an enormous amount of difference between an EU or the licence conditions. The point was actually that we were entering into undertake a piece of work that ASIC was requiring of us and the instrument that they did that with, while we did discuss it, because we had a decision to make, I – I think it was really just, on balance, the board preferred the licence conditions.

I tender that document, Commissioner.

THE COMMISSIONER: Letter 16 September '16 ASIC to Smith and Hagger, ASIC.0036.0001.7353, exhibit 5.51.

EXHIBIT #5.51 LETTER ASIC TO SMITH AND HAGGER DATED 16/09/2016 (ASIC.0036.0001.7353)

MR HODGE: Can we bring up NAB.155.027.3782. Now, Ms Smith, this is the letter of 24 October 2016 sent by Mr Hagger to the board of directors of NULIS. Have you seen that before?---Yes.

Have you reviewed it recently in the process of preparing to give evidence?---I would have reread it.

I'm sorry?---I will have reread it during this process.

So - - -

THE COMMISSIONER: Does she need a hard copy, Mr Hodge? There's one available.

MR HODGE: It may assist - - -

THE COMMISSIONER: Yes.

MR HODGE: - - - Ms Smith to have a hard copy?---Thank you.

So by 24 October 2016, the administrator writes to NULIS and makes a recommendation about remediation?---Yes.

And that's this letter?---Yes.

You had already, I think, received a board paper in support of the recommendation?---I believe this was attached to the board paper.

I don't think we're disagreeing about this, but we will see in a moment. The board paper is dated 21 October and would presumably attach a draft of the letter, and this is the final signed letter?---Yes.

And if you go over the page, you see paragraph 5?---Yes.

Continuing:

> *The trustee will need to draw its own conclusion as to whether it prefers the investment policy alternative or the trust expense alternative.*

?---Yes.

Continuing:

Each alternative results in a different compensation methodology.

?---Yes.

The first methodology is the opt-in approach?---Yes.

And the opt-in approach applies on what's described as the investment policy alternative?---Yes.

And the second methodology is the trust expense alternative?---Yes.

And that would provide for full compensation?---Yes.

Were you aware before you received this letter and the relevant management paper that the administrator was considering these two alternatives?---I was aware – no more than what I – what I've said earlier this morning in respect of what I understood the administrator was working through.

That is, you understood that the administrator was working through some questions that affected whether it had to make full compensation or not?---Whether or not – no. What I was aware of whether or not at a high level it was a trust expense or whether it was considered a charge under the investment policy.

All right. And do you remember when you were first made aware of that question?---No. That's – I said earlier this morning I couldn't pinpoint the exact date that I would have been having conversations around what – what exactly management were working through.

If you – can I suggest this to you: the moment you were told that was a question is – were these fees charged as a trust expense or as an investment policy or under the investment policy, you knew what the answer was, didn't you?---I had a reaction to the answer based on not all the information that management had.

Well, let's just think about the information that you had. We looked at this yesterday afternoon. We can go back to it if it would assist you. In April 2012 management came to you and presented a lengthy presentation in which they said that they were going to change from charging money under the investment policy to charging money as a trust expense, didn't they?---So I didn't – my reaction was I don't understand all the facts. If you – you will need to bring forward a – a full – you know, a paper setting out the information for full consideration. I can't give an answer in a fireside conversation as to what my view is. That – that was my response to when I heard it.

But you had an immediate reaction?---I had a reaction that was based on the full – the knowledge that I had about the part of the – the facts and the legal circumstances that I had.

And based on the knowledge that you had, the investment policy idea was impossible, wasn't it?---I wouldn't – that was – my reaction was not "it's impossible". My reaction was, "I can't give you an answer whether I think that's right or wrong without all of the information in front of me."

THE COMMISSIONER: You had a reaction of sitting on the fence?---No, I don't believe that was - - -

That's what I understand your answer to be, Ms Smith?---No. No, I don't believe I was sitting on the fence. I was being asked questions of whether I thought – what my opinion was on the investment policy, and my – my answer to that was I didn't have the information that the management team had in front of them to be able to draw a conclusion one way or the other. And if they wanted my view, then they would need to put forward analysis of the two different views for me to be able to consider the facts and have a considered opinion.

MR HODGE: Can we put that on one side of the page – on one side of the screen, and bring up on the other side of the screen NAB.005.788.0496. On the right-hand side of the screen now, Ms Smith, you can see the document we looked at at some length yesterday, which is the management paper presented to you on 19 April 2012?---Yes.

And if we go to the second page of that document on the right?---Yes.

We can see that – while it's coming up – that the thing that the directors resolved to approve amongst other things was the proposed changes to adviser payments under the trust deed as detailed in section 7 of this paper?---Sorry, which – where are you reading?

THE COMMISSIONER: There is a hard copy. We will give her that hard copy, I think?---Yes, yes.

MR HODGE: You will have a hard copy, Ms Smith, to assist you. Do you see at the top of the page, the second page?---Yes.

So what the – what the board had resolved was:

> *...to approve the proposed changes to adviser payments under the trust deed as detailed in section 7 of this paper.*

?---In 2012, yes.

Yes. Well, that's – that's the only approval that matters, isn't it, because what is approved here determines the basis upon which the PSFs were charged?---Yes.

All right. And then if we go to NAB.005.788.0534 in the document on the right-hand side?---Sorry, which document?

It's in that hard copy that you've got there?---The big one?

Yes?---Yes.

If we go through there's a PowerPoint presentation?---Yes.

If you go to page 35 of the PowerPoint presentation?---Yes, that we were on yesterday.

And it's explained in the PowerPoint presentation which is coming up:

> *The trust deed allows the trustee to debit agreed adviser payments from the member's account as fund expenses and as such these should be approved by the trustee rather than fees or charges to be imposed unilaterally by MLC under the life policy.*

?---Yes.

And then if we go to page .0565?---Yes.

You will recall that the approval that was given was:

> *...the proposed changes to adviser payments under the trust deed as detailed in section 7 of this paper.*

And this is section 7 of the paper?---Mmm.

You can see that?---Yes.

And what you and the rest of the board approved was:

> *The trust deed allows the trustee to debit agreed adviser payments from a member's account as "fund expenses".*

And then it sets out what those expenses are going to be?---Yes.

Given that this is what you approved in 2012, you surely had no doubt in 2016 that the amounts that had been charged were charged by the trustee from the trust?---So I will just go back to the response I provided earlier, which was – so the board's role is one of governance and oversight. Generally, I will not get involved in management process that leads to information coming into the boardroom. I might – at the point that management is bringing information to the board, I might be asked my opinion of you as to the trustee, what the – does it cover what the trustee might want, but I'm not involved in process leading to recommendations or outputs to the board itself. Management were in process of working through information. I was – I was absolutely actively agitating that this process was taking too long. I did – I did understand at a very high level what their – what they were debating. I hadn't been provided – and still haven't been provided or seen the legal advice that led to the two different positions in Mr Hagger's letter. So I – while we made a decision in 2012 and the trustee had taken legal advice as to the validity of the payments and them being under the trust deed, management were working through a process. I was agitating for that process to be faster, and for a – for them to come to the board with a final view of what the position was. And as I mentioned yesterday, while that process took too long, I trusted that there was enough independence in the process with the COO of the office of the trustee representing the trustee, and independent external legal advice for the trustee view. And so I would say I didn't get involved in the process. I allowed the process to – for management to go through due process, and in the end what management brought to the board was a remediation package to remediate members.

The management that you speak of is the management of the administrator. Is that right?---Yes.

All right. And you're saying you thought it should have been done faster. Is that right?---Yes.

But you trusted that because there were some other voices, the chief risk officer and the office of the trustee, that they would be having some influence over the process?---Yes.

And that, therefore, you could trust management, notwithstanding that management was in this, what I would suggest is a hopelessly conflicted position, where if they agree to full compensation, they will have to pay it?---Sorry, can you - - -

Let me break it down - - -?--- - - - actually – no, no, if you just go back to – be specific about the question.

You agree that management of the administrator is in a hopelessly conflicted position?---I believe that they are in a conflicted position. I do not believe it's hopelessly conflicted.

And that the conflict that they have is that if they agree to full remediation, the administrator will have to pay it?---Yes.

And you were satisfied that the way in which this conflict was handled was okay because of the voices of the office of the trustee and the chief risk officer?---The administrator also has a contract in place which sets out what they're entitled to receive fees for. And so – I mean, ultimately, you would go back to what the contract says, what they're entitled to, and – and then the checks and balances that the trustee has in place to ensure that the right – the right information is considered at the right time to determine the right outcome.

I tender that document on the left-hand side of the screen, Commissioner. Actually, I've already tendered that with Mr Carter, Commissioner.

THE WITNESS: And we discussed it yesterday.

THE COMMISSIONER: The letter has gone in, has it, already? Yes.

MR HODGE: Can we bring up NAB.005.562.4413. This is an extract from the board paper – from the board papers of the meeting on 26 October 2016?---Yes.

Now, if we go over the page to .4422. We see what's being recorded here is that the directors noted and discussed a paper from Mr Carter?---Yes.

And that there was a resolution to approve the characterisation of the PSF as a trust expense?---Yes.

And a proposed remediation approach outlined in the paper?---Yes.

And that's the full remediation approach?---Yes.

Do you recall whether before this date there had been a delegation to directors of NULIS in relation to the compensation approach?---No, I don't.

All right. Can we bring up .4423. Now, then, if you look at the bottom of that page, do you see:

> *Following the TERP breach, a compensation approach was recommended by management to MLC Nominees for approval.*

?---Yes.

Do you know what that compensation approach was?---I believe it was full remediation.

Do you think there had already been a recommendation for full compensation before this date?---For TERP.

For the TERP breach?---Yes.

Is that right? And it says:

> *This was approved by two director board delegates of NULIS.*

?---Yes.

And do you recall who those board delegates would have been?---I – I could have been one of them, but no I don't.

Then you see it says:

This approach is now being reconsidered to take into account the legal analysis that has since been finalised.

?---Yes.

Do you have a recollection of what the reconsideration was?---The matters we've been discussing this morning.

Sorry, I'm not sure I understand. Why would – if the approach was full compensation, why would it have been being reconsidered?---So I can only respond to say that the circumstances of TERP, SWiFT and Encompass, as I understand them, all relate to the same primary issue. And so while SWiFT and Encompass were being reviewed, I expect that TERP was part of that overall analysis.

So your recollection was full remediation had already been approved for TERP members?---I – I would have to go back and look at the specific remediation paper but, yes, I do.

All right. So then if we go over to 4425?---Yes.

And this is where what's identified is the total value of PSFs charged for members who don't have a linked adviser?---Yes.

And we see it's $33.7 million at that time?---Yes.

And then there's an explanation of how the compensation will work, and that it's to be full compensation?---Yes.

Do you recall that there was also a discussion at that meeting about the fees for no service report that ASIC was about to publish?---No.

You don't recall - - -?---I don't recall.

You don't recall it having come up?---I recall discussing it but I don't recall if it was at this meeting.

I see. Do you recall that this full amount of plan service fees remediation had not been included in the fees for no service report?---Yes, I did. I do recall that. But the point I knew that whether it was before the ASIC report was released or after, I'm – I couldn't answer.

Do you recall whether you knew why it had not been included?---We – I believe we hadn't approved the remediation and advised ASIC formally of that amount.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Extract from board minutes of MLC Nominees, NULIS, PFS Nominees, 26 October '16 NAB.005.562.4413_E, exhibit 5.52.

EXHIBIT #5.52 EXTRACT FROM BOARD MINUTES OF MLC NOMINEES, NULIS, PFS NOMINEES DATED 26/10/2016 (NAB.005.562.4413_E)

MR HODGE: Can we bring up NAB.153.001.3895. I'm told it may not be on the court book. If that's the case then I will just move to the next document. Can we bring up ASIC.0036.0001.3991. This is a letter dated 12 December 2016. And if we go over to the second page we will see it is again signed by you and Mr Hagger?---Yes.

And is this a letter that you've reviewed in the course of preparing to give evidence today? You're not sure?---There has been lots of documents.

I understand?---But I have read it before because my signature is on the letter.

And you see about two-thirds of the way down the page there's a paragraph 1.5. And in paragraph – subparagraph (a) it says that the reason the product change – or:

> *The product changes were aimed at providing greater fee transparency, improve member control over the fees they paid, all the while not increasing the fees members paid.*

?---Yes.

Continuing:

> *And the approach was to be more member-centric in intent than many of our competitors that elected to continue to commission-based legacy products.*

?---Yes.

Now, I'm interested in understanding your view about that proposition. As far as you were concerned, the introduction of fees rather than to replace commissions was a significant change?---It was a change, yes.

It changed the rights of members because they didn't need to pay the fees unless - - -?---They were receiving a service.

- - - the services were provided?---Yes.

And you would regard it as unreasonable to simply retain the fees even if the services weren't provided?---Yes.

All right. And then – and just to confirm one other thing, that has always been your view, that it's – this is an unreasonable proposition to suggest that NAB should be able to retain the fees even if no service was provided?---I don't think NAB, nor financial planners should be able to retain the fees if service is not provided.

All right. And then you see in 1.5(b):

> *The trustee board approval process for the product changes had regard to the intent that plan member services were maintained.*

?---Yes.

Continuing :

> *Importantly, other services were available to members (including phone-based general advice and support) whether there was a linked adviser or not.*

?---Yes.

And that is consistent with the point that you have already made it which is it made no difference whether you were linked or not, whether you had access to these telephone services?---Yes, they were – yes.

And then if we go over the page to .3992. You will see there's then an explanation of the approach to PSF remediation?---Yes.

And it said:

> *Alternative interpretations of the nature of the PSF and, therefore, consequent alternative approaches to remediation were investigated.*

?---Yes.

And that, as you understand it, is referring to this issue of the investment policy as compared with the fund expense alternative. Is that right?---Yes.

All right. And that was investigated, as I understand it, not by the trustee but by the administrator?---Yes.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Letter Smith and Hagger of NAB to Kell of ASIC dated 12 December '16, ASIC.0036.0001.3991 exhibit 5.53.

EXHIBIT #5.53 LETTER SMITH AND HAGGER OF NAB TO KELL OF ASIC DATED 12/12/2016 (ASIC.0036.0001.3991)

MR HODGE: Thank you. Now, there were some other issues that were going on in 2016 along with the PSFs, for the trustee?---Do you mean the successor fund transfer?

There was the successor fund transfer. That was one issue. There was also an issue about advice service fees?---Yes.

And the issue about advice service fees was that NAB Wealth had discovered that there were advisers who were receiving adviser service fees even though they weren't providing services. Is that right?---There's a couple of different events referred to in my witness statement. All of them have permutations of, essentially, fees being deducted in – in some way where a service was not provided. So if you mean the first one, 406 - - -

Well, let's just run through the types of events. One type of event is the event where the adviser service fee was being charged even though there was no adviser linked to the account?---Yes.

Another type of adviser service fee issue was where there was no evidence that the service was being provided?---I don't – I don't believe that any of the – the events that I've referred to in terms of the descriptions I've given for the causes of those I've described any of them as saying – there was not – okay. So yes, because where there's not an adviser and you're being charged an adviser service fee you can't be being provided with a service.

All right. Well you're, I think, on page 14 of your statement?---Yes.

And the events that you're referring to there are four-fold?---Yes.

The first event, which is event 471986?---Yes.

That concerned an issue where members continued to have ongoing advice service fees deducted from their accounts despite a request having been received to remove the allocated adviser from a member's account?---Yes.

And that was an issue first identified in the middle of 2014?---That's correct.

And do you recall when it was reported to APRA and ASIC?---At the end of 2014.

On 22 December 2014?---Yes.

And then the second event was 262512 which was an issue where ASFs were deducted from member accounts and paid to both external and related party advice licensees where there was either an inactive adviser or an inactive dealer?---Correct.

And that issue was identified in August of 2015?---Yes.

And do you recall when that was reported?---The – both of – that particular event was determined to be not a significant event. So it wasn't reported through the breach – ordinary breach review committee process, and I believe that the – the first – the first or – I should say the second part of that event relating to inactive dealerships was advised to ASIC via a letter.

In November of 2016?---Yes.

And then the third event was 40630382 which you've described as:

> *Concerned an issue relating to a control breakdown in the process of adviser remuneration.*

?---Yes.

And that was an event whereby the advice service fees were retained by – I think by the administrator. Is that right?---That's correct.

Rather than being paid to the advice licensee for the relevant financial adviser?---Yes.

And that was an issue identified in May of 2017?---Yes.

And that was reported to ASIC when?---July 2017.

And then the fourth event was 51921166?---Yes.

And that concerned an issue where advice service fees continued to be deducted from a member's account after NULIS or another RSE licensee had been advised that the member had died?---Yes.

And that was an issue identified when?---In May this year.

And when was it notified to ASIC?---May or June. I think it was June.

And that was identified, was it, following some investigation after round 2 of the Royal Commission hearings to determine whether NULIS was deducting fees from people who had died?---Yes.

And can I suggest to you there's another issue that continues to be unresolved, which is going back and doing – and the Wealth business doing a thorough review to determine whether services had been provided in exchange for advice service fees charged?---You might need to be a little bit more specific with your question.

Are you aware of an ongoing issue between ASIC and the Wealth business in relation to reviewing whether services have been provided in exchange for the advice service fees deducted by the trustee?---Yes, it's referred to in my witness statement in respect of the advice licensees with – within the – within the bank.

And we will come to the detail of that in a moment. If we start just with the four events. Are you made aware, as the trustee, of these events at about the time that they are discovered by the Wealth business?---Yes, or shortly thereafter.

Shortly after they're discovered or shortly after they're notified as a breach?---Shortly after they're determined to be a reportable breach.

All right. And in the case of the event that wasn't determined to be a reportable breach, when was the trustee made aware of that?---I – I don't recall if they have been made aware of that. I became aware of it through the preparation of my witness statement.

And does that fact, which is that you became aware of it through the preparation of your witness statement, does that cause you any concern about the adequacy of the reporting to the trustee?---No.

Why not?---That particular event was deemed to be not significant and reportable. It was – I believe at the point that scenario 1 was determined to be – or scenario 2, I apologise, was around $300,000 in compensation to be paid. At the point that scenario 1 was determined to not be reportable, it was $8000 in remediation. The – the trustee does receive regular oversight through risk reporting into the risk and audit committee as well as into the board in respect to the management of events. There has been ongoing uplift in the – in that oversight through the course of time. And there's a – there's still, you know, further uplift on – you know, in respect of the types of information that the board is receiving in respect of events and the management of those.

Has the trustee been satisfied with the level of monitoring of whether services are provided in exchange for adviser service fees?---I think the trustee has done – has turned its mind to, on multiple occasions, the control environment that exists for adviser service fees, and how – and what that control environment is.

Has the trustee been satisfied with that control environment?---I think the – through – starting in 2015 through to 2017, the independent reviews requested by the trustee have – have highlighted need – a need for uplift in the control environment.

So just so I understand what you're saying, you're making the point the trustee has sought reviews of the control environment?---As it relates to adviser service fees, yes.

And based on those reviews, it considers that there needs to be changes made to the control environment?---Yes.

And that is because the trustee considers that the control environment is inadequate in relation to monitoring the provision of advice services in exchange for adviser service fees?---No. There are controls. There need to be more controls. And I wouldn't use the word "inadequate".

All right. Now, one of the other things that was occurring in 2016 was the successor fund transfer?---Yes.

And that was something that you were very significantly involved in?---I think the entire board was significantly involved in the successor fund transfer.

I understand. But you were the chair of the board and this was a very significant undertaking, and you had to shepherd it through?---The role of the chair is to ensure that the board has adequate information at the right time in order to arrive at decisions that are being asked of it. So it – ensuring – that's my role at any point, including through the SFT.

And one of the issues that the board had to consider was whether it should continue to permit commissions to be grandfathered after the successor fund transfer was completed?---Yes, that's correct.

And it considered that at a meeting of the trustees on 10 June 2016? You're not – you don't remember off the top of my head?---I'm sure – I'm sure you're correct on the date. You've got the paper.

I will bring it up. NAB.005.562.2915. This has already been looked at. So it must already be an exhibit. The document ID that I have for it is NAB.005.562.2915. It should say it's – it looks like it's listed as an extract, which is NAB.005.562.3035. Commissioner, is that a convenient time to take a break?

THE COMMISSIONER: Yes. When do you want me to come back, Mr Hodge?

MR HODGE: In 15 minutes, Commissioner. We can make it 10 minutes, Commissioner.

THE COMMISSIONER: I like your second bid more than your first, Mr Hodge. 20 past 11.

MR HODGE: Thank you.

ADJOURNED **[11.10 am]**

RESUMED **[11.20 am]**

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Commissioner, we were looking at an extract from NAB.005.562.2915.

THE COMMISSIONER: Yes.

MR HODGE: And we're trying to go to agenda item 4, which is NAB.005.562.2934. All right. And we can see, Ms Smith, that what happened at the board meeting on 10 June 2016 was that the director of NULIS resolved to approve to maintain the current grandfathered commission arrangements pertaining to the products?---Sorry, I've been given the wrong paper, but yes. Yes.

You agree – I'm sorry, you will have to use the screen while your solicitors look for a hard copy.

THE COMMISSIONER: Just use the screen.

MR HODGE: Do you recall, Ms Smith, the discussion about this issue?---Yes.

Was it the case that the trustee had a preference for not paying commissions any more?---At this time the trustee hadn't turned its mind to – from a strategic sense whether or not it – prior to this, this was the first major deliberation in respect of grandfathering for the trustee.

The trustee, though, back in 2012 had made this significant change to the MasterKey Business Super and MasterKey Personal Super by removing commissions and changing to fees?---Yes.

And presumably it did that because it took the view that it was better for members to have fees, explicit fees, rather than commissions?---So – sorry, I will rephrase my answer which is to say this is the first time since FOFA was introduced, including the grandfathering of commissions, that the trustee had considered in any material way whether or not to grandfather commissions.

All right. Well, it just let it happen. Is that right? That is, it just let commissions keep being paid after FOFA came into effect?---No, the legislation regarding fee for service led to a provision of grandfathering commission. So from a product perspective - - -

Yes?--- - - - that was what occurred at the time.

I want to try to understand this. It's the case, isn't it, that if the trustee wanted to alter the remuneration schedule for advisers to remove commissions, that it could do so?---I – I can't blanket answer "yes" to that.

Well, you know that in 2012, one of the things that you did in relation to the MasterKey Business Super and MasterKey Personal Super was to change those products by removing commissions and putting in fees. That's right?---Yes.

So that is something that it was always open to the trustee to do?---It was for that product at that time, yes.

Did you consider whether it was open to do it for other products?---This was the first time in respect of when we did the successor fund transfer that we considered it in any material way.

I see. I just want to work through what the possibilities are of when the trustee might deal with this. So the second possibility is what you are talking about, which is if a successor fund transfer happened and the old fund had products which had commissions, then the new trustee would have to consider whether or not it should permit those commissions to keep being paid?---Yes.

And another possibility is a product trade-up?---Yes.

And what happens with a product trade-up is that a member is in one product within the fund and the trustee can decide to trade up the member to a different product?---Yes.

And it might trade up the member to a product that doesn't have commissions?---Yes.

And then commissions would cease?---Yes.

And NULIS has, over the course of the last two years, been presented with opportunities to consider that possibility?---Yes.

And to consider whether it should trade up members from a commission-paying product into a non-commission paying product?---Yes.

And it has done that in the case of Ex-Aviva members?---Yes.

And in the case of Ex-Aviva members, there wasn't a very substantial amount of trail commission being paid by them?---I – I wouldn't know the amount off the top of my head of what trail commission was being paid. I think for the Ex-Aviva members, it was more specific that there were not a lot of – there were more members who didn't have an adviser linked to their account than did. So for the – was looking at the entirety of the membership.

And when they were traded up, they were traded up into a non-commission paying product?---Yes.

In relation to the Five Stars product - - -?---Yes.

- - - do you recall what happened in relation to members who were in the Five Stars product?---We haven't traded that product up at this point.

And the Five Stars product is regarded as a legacy product?---Yes.

It's a very high fee-paying product?---Yes.

And at various times, the trustee – the issue has been raised with the trustee as to whether it should trade up those members?---So the trustee has had a program of looking to move its legacy, old business – you know, off sale business into on sale products for – for quite a long time now, and has had an active program of closing down old products and moving them to on sale products. And Five Star/Gold Star is the last of those products to have – to be traded up.

But the question of whether – if we just focus for a moment on Five Star, the question of whether the Five Star product should be traded up is something that has been bounced up to the board on a few occasions?---So it has been part of a plan strategy for trade-up. What happens – so moving members from one product to another is both legally quite complex, but also operationally very complex. So we have a practice of having a workshop at the board, understanding all of the nuances of the rights of members in the old product, how we might deal with them in the new product, before we actually get into decision-making mode in the boardroom of how – of the trade-up program itself. So I believe the first workshop we had in respect of Five Star/Gold Star was about four or five months after the SFT program, and then we've considered it on one or two occasions since then.

And at this time when are the Five Star products scheduled to be traded up? When are they scheduled to be traded up?---Within the next 18 months, I believe is the date.

I see. So the board has decided to trade up that product?---It has had a plan to trade up that product. There – we haven't made the decision to actually trade it up but we have a plan to do so.

I see. Is the issue with trading it up that you need to consider what's going to happen in relation to adviser remuneration?---Yes, and at a high level we have considered that.

And is that the most significant issue for the question of whether to trade up the Five Star product, what's going to happen to adviser remuneration?---No. The – Five Star – it's a series of products, and when we say it's Five Star/Gold Star there's actually many permutations of product design underneath what is labelled as Five Star, and lots of different rights that members have as a result of entering into the product when they first became a member. And so there's a lot of complexity in understanding and making sure that we don't diminish members' rights as part of that product trade-up program.

And how, in the case of the members in the Five Star product, would it be possible that their rights would be diminished by the trade-up?---If we take away a right that a member had at the point of entering into the product and don't ensure that there's equivalency in respect of that right.

And what sort of right would it be in the case of Five Star?---It's a right that exists under the trust deed - - -

No, I'm sorry, what specific right, or are you not sure?---We – so part of the analysis that we go through for the – you know, leading into the – to the actual decision is to obtain a legal review over all of the permutations of the product design, to enable the board to turn its mind to maintaining equivalency of rights.

We might come back – or we will come back to that. That, I think, has reached its most recent consideration at a workshop in about the end of 2017. Is that right?---As I said, we've had two specific discussions on Five Star/Gold Star since the FOFA considerations for the SFT.

Can we look then at this particular document which you believe is the first consideration of grandfathering commissions after FOFA came in. And is it fair to say there were two legal issues that confronted the trustee. The first was whether the grandfathering commissions even permitted commissions to stay on foot?---I might – if – yes.

And the second issue was whether or not it was in the best interests of members to keep commissions on foot?---Yes.

And management came to you and said it's lawful under the grandfathering provisions of FOFA to keep commissions on foot?---Yes.

And did you understand they said this on the basis of the idea that the trustee was providing a platform?---So during the consideration of the legality to maintain commissions, or to – to continue to grandfather commissions, external legal advice and QC opinion was sought in respect of - - -

THE COMMISSIONER: Just a moment, Mr Hodge. Sit down. Go on.

THE WITNESS: In respect of that matter. And I believe that was one of the matters contained in what was quite complex and lengthy legal – legal review.

MR HODGE: I understand. There was a legal issue which was – is it even possible to say - - -?---Can we grandfather.

- - - that we can grandfather?---Yes.

And the trustee had to rely upon whatever advice was provided to it about that question?---Well, the trustee sought legal advice and turned its mind to whether or not, based on that advice, that it was open for the trustee to be able to grandfather.

Yes. What I'm getting at is the trustee isn't going to, I assume, go behind the advice and second guess whether it's actually lawful or not to grandfather commissions?---I think that the trustee was seeking the advice to determine that it was lawful.

Yes. And then the second issue is the question of whether it's in the best interests of the members to maintain commissions?---Yes.

And that is squarely a question for the trustee to decide?---Yes.

And management said, "We think it's in the best interests of members"?---I assume that's probably in the paper, yes.

And management offered a rationale for why it was in the best interests of members?---Yes.

And what was your understanding of that rationale?---I would have to go and see exactly the words that they said on the – in respect of the paper.

Well, what I want to understand is what did you understand to be the rationale for why it was in the best interests of members to grandfather commissions?---So, essentially, the – so I might step back a little bit. In terms of what the trustee does in making a determination about best interests, the trustee ensures that there's a – an appropriate process over – over the decision, that factors into account – takes into account all relevant factors, and, you know, requires due consideration. So that's how the trustee goes about determining best interests. In respect of the FOFA matter, the trustee was considering best interests as a – as a concept for the successor fund transfer as a whole. The FOFA matter was maintaining equivalency of rights. So we didn't – we didn't actually put people in a better position. We put people in an equivalent position, which is required under successor fund transfer requirements. The trustee, in my mind, turned their mind to best interests of the SFT as a whole and determined that the SFT, including the grandfathering of commission, was in the best interests of members.

Now, let's take that in parts. Is it your understanding that if the consequence of an SFT was that the member would be in a better position, that the SFT can't go through?---Sorry, I don't - - -

You said it's required that the member be in the same position?---No, no. So successor fund transfer – and I won't quote the specifics of the piece of legislation that requires us to be able to move a member from one fund to another without that member's position is a series of obligations that the – that we kind of term as successor fund transfer requirements. So we're moving a member from one fund to another and the trustee is doing that unilaterally and making that decision.

Two trustees are doing that?---Yes. There's a transferring trustee and a receiving trustee.

Yes?---As the trustee is doing that, the trustee has legal obligations to ensure that there are equivalent rights in respect of the – from the old fund to the new fund. And so the trustee was considering the successor fund transfer in that context and ensuring that equivalent rights were provided from the fund that they left and the fund that they went to. And the trustee determined that the successor fund transfer was in the best interests of members.

Now, I don't know why you were doing this, but there are two separate issues, aren't there? One is is the successor fund transfer in the best interests of members. A separate issue is whether maintaining the current grandfathered commission arrangements is in the best interests of members. Those are separate issues, aren't they?---The – I – my view would be that the successor fund transfer is considered as the best interests classification, and then there – there could be, in – in the ordinary course of any successor fund transfer, changes to benefits and options and those sorts of things. Some – there – there could be changes to fees. In this instance, there weren't because we were matching from one fund to another equivalency of – of all rights in order to move the superannuation business out of the life company, and into a trust structure.

Ms Smith, look at the resolution. The resolution is a resolution of the directors of NULIS to approve to maintain the current grandfathered commission arrangements pertaining to the products which form part of the TUSS following the proposed SFT to the MLC Super Fund?---So there were many decisions that the trustee had to make in order to give effect to the – to the SFT. Because of the size of that program of work, and the complexity of some of the decisions in order to replicate rights from the life policy into the trust environment, they occurred over multiple meetings and multiple decisions were made. Each of them viewed with maintaining equivalent rights as members moved out of the life policy and into the trust environment.

Do you regard the payment of commission as a right of the member?---I would say it's a – a feature of the product.

Well, you've explained to us that there needs to be equivalency of rights?---Yes.

The entire point, can I suggest, of a commission – as you and I have agreed many times already – is that the adviser gets the commission regardless of whether they provide the service. Agreed?---Yes.

The member doesn't have a right to require the provision of the service?---No, the member has a right to – yes, correct.

No, no, please. Go on. What is it that the member has a right to do?---Okay. No, no. I agree with the comment.

And I'm trying to understand then this idea that somehow the equivalency of rights under an SFT for the members is a justification for maintaining grandfathered commissions. Is there some further explanation that you can offer for that?---I – I would make one final comment, which was the – the SFT came about as a result of the NAB selling the life – life business. There were multiple – there were different ways that that could occur. And the trustee agreed and believed that it was in the best interests of members for us to successor fund transfer all of the funds out – out of the life policy and remove a layer of intermediation that existed between the trustee and its members, that would enable the trustee and provide an operating platform for the trustee to continue its simplification program and its trade-up program.

Again, so that I can understand this, is it the case that the directors of NULIS were satisfied that it was in the best interests of members to maintain grandfathered commission arrangements?---In the context of the SFT and – yes, it was.

And when you say "in the context of the SFT", what does that mean?---Well, at the time that we agreed to the grandfathering, the trustee had turned its mind to grandfathered commission and had asked for and kind of put in – put in motion a requirement to consider grandfathering and how long it should continue for as a – as part of the products offered by the trustee. That resulted in a series of conversations which led up to a strategy put forward to the board at the end of last year which was to move our commission paying products to non-commission paying products as part of the final trade-up program that we will execute through Five Star and Gold Star.

When you came to make this decision that we are looking at on 10 June 2016 to approve maintaining grandfathered commission arrangements, what was the basis you say upon which you concluded that it was in the best interests of members to do so?---That we were not putting members – we were putting members in the same position that they had been prior to the SFT and that the SFT was in the best interests of members.

All right. So that seems to involve two propositions. The first is that members weren't any worse off as a result of grandfathered commissions being maintained because they were already paying grandfathered commissions?---They were in the same position.

They were already paying commissions and they would keep paying commissions?---Yes.

Now, on that point, there were two alternatives available to you. One was to stop paying commissions and one was to keep paying commissions. Is that right?---Potentially.

Do you agree that for a member, if a member is not paying a commission, the member is in a better position than if the member is paying a commission?---Ultimately, I would say the less fees a member pays, the better their retirement outcome will be.

So we agree if the member is not paying a commission, the member is in a better position than if the member is paying a commission?---Yes.

So the first point, can I suggest, can't have led you to the conclusion that it was in the best interests of members to maintain grandfathering - - -?---So I think – I don't want to get into a legal argument - - -

This isn't a legal argument?---No, well - - -

You made a decision?---Best interest is not about the best position. Through – I've tried to explain that in the – in the context of the SFT and the decision to grandfather, there were a whole range of decisions that the trustee was making in respect of rights and product features and ensuring equivalency of those from – from the old fund to the new fund. It was in the context of the SFT being in the best interest of members that a decision was made to grandfather commissions.

Well, that's the second point that you raised, that in the context of the SFT it was in the best interests of members?---Yes.

And that seems to carry with it the idea that if you didn't grandfather commissions, the SFT would not go through?---I think in the timeframe we had to complete the SFT that is a potential risk that would have occurred.

And is that something that is recorded and explained in this management paper, do you know?---I believe it's one of the items that's called out, yes.

I see. So an issue is that you might have to delay the SFT. Is that right?---Well, what – I think that the – the group would have sought to make the sale of the life company in a different way which could have been through part – I might get the language wrong but part 9A transfer which would have meant that the trustee would have – that the superannuation business would have still been invested through a life policy, and so in – so it could have but there could have been other ways to – for the bank to succeed with the sale of the life business.

So just, again, so that we understand it, the two things in your mind that were relevant to this decision were, first, equivalency of rights. Is that right?---Yes.

And as we've agreed, there are no rights that a member has as a consequence of commission?---So rights are a legal test and whether or not the commission is a – a legal test requirement, I don't know. But essentially, the – we were looking to replicate all benefits and all rights from one fund to another as a result of the SFT.

Surely you can't be saying to the Commissioner that you, as a trustee, believed that maintaining commission was maintaining a right or benefit of the member?---No.

I'm saying to you that when the trustee considered to grandfather commission it believed – it – it did so believing that the successor fund transfer was in the best interests of members.

Now, if we go to page .2938.

THE COMMISSIONER: Yes. Give the witness the hard copy, please.

MR HODGE: 2938, Ms Smith?---Yes.

And you see:

> *Implications for the SFT date and associated future member benefits.*

?---Yes.

And the first sentence is:

> *A decision to approve the continued payment of grandfathered commissions to advice licensees would not impact the ability for the current SFT date to proceed as intended.*

?---Yes.

So is that the point that you're making, that so long as you agreed to grandfather commissions, it wouldn't have any effect on the SFT date?---Yes.

And then the second option that we can see considered halfway down the page is:

> *Cease the payment of grandfathered commissions by terminating the remuneration arrangements with advice licensees.*

?---Yes.

Now, I just want to understand this. NULIS doesn't actually have any legal obligation to pay commissions at the time this is considered. Is that right?---No, that would be – I think that is correct.

So this isn't NULIS terminating the remuneration arrangements; this is some other trustee terminating the remuneration arrangements?---It would be – it would have been MLC Nominees and – and PFS Nominees didn't pay commissions. So MLC Nominees.

And then you see, if we can blow up, under option 2, Member Impact?---Yes.

So the principal issue that seems to be identified by management with ceasing grandfathered commissions is that there would be what it describes as:

A significant impact to member attrition –

which it says is considered possible?---Yes.

Is that a view that you shared?---I think it's a potential impact.

All right. Did you turn your mind to how likely it was that this would occur?---Yes.

And how likely did you think it was?---Likely.

And you thought it was likely that if you turned off commissions, financial advisers would advise their clients to leave the relevant MLC Super Fund. Is that right?---Yes.

And did you ask how many of the relevant members were actually receiving active advice?---So the contents of this paper were heavily debated in the boardroom in the context of the decision to grandfather or not, including the nature of who was paying, what they were paying, and so at the time – in fact, the trustee was asking for what are the alternatives and what are the risks associated with those alternatives as part of the decision-making process in order for it to arrive at an ultimate decision and whether that was the right decision.

Is that – do you mean at the board meeting where this paper was considered?---So leading into the boardroom, we knew we would be considering FOFA grandfathering, and through the office of the trustee, the board had asked for all of the considerations and alternatives to grandfathering to be put to the board, together with the risks associated with those alternatives. And so that's the point of this paper, is for the trustee to understand not only yes or no should it grandfather, but what are the alternatives and what are the risks associated with the alternatives. So when I mentioned before that part of the trustee's best interests considerations are about the process it goes through considering relevant factors in order to arrive at a decision, that's what this paper is endeavouring to do for the trustee.

The board of directors has made the inquiries of the management and this paper is the response?---Yes.

And does this paper say how many members are receiving active advice?---It doesn't.

Wouldn't that be an immediate relevant issue to considering how serious the possibility of attrition is?---I believe it was one of the factors that the board has discussed. And – so it would have come into the boardroom as part of the discussion.

Do you think – you asked for it beforehand. It doesn't feature in the paper but when you're in the boardroom somebody told you?---So what the board asked for was alternatives and for the risk – risks of those alternatives to be brought forward to the board.

But that's what has been done in this paper, isn't it?---Yes, correct.

And the paper doesn't tell you how many members are receiving active advice?---No, but I do know that we did have a discussion in respect of the nature of who was paying what and what it looked like.

Do you recall how many members – what proportion of the member base was actually receiving active advice?---For commission? I don't – I – no. Are you talking commission versus adviser service fees?

Well, that's what this is about, isn't it, it's about turning off commission?---Yes.

So of the members paying commission, how many of them were receiving active advice?---Don't know.

Was that something that was told to the board?---No.

And then it's said that:

> *This attrition will be due to consequent financial adviser dissatisfaction.*

So I just want to understand the board's view of the – the mechanism of this. Why does the board think that financial advisers are going to advise their clients to leave the MLC Super Fund if commissions get turned off?---Probably history of experience of moving to an adviser service fee model before the industry did and the impact that had on – on the sale of MLC products in the market at the time.

Well, that was moving early before a change – before FOFA came into effect?---And so the rest of the industry at this point have grandfathered commissions and no – no one in the industry has made a determination to turn them off.

But, you see, the problem is this: by 2016, if a financial adviser advises their member to move to a different product, a product offered by AMP, for example - - -?---Yes.

- - - you know that the financial adviser can't receive a commission?---Correct.

So they're not going to move to a different product because they can receive commission in a different product. Do you agree?---Yes, but there's a broader impact than – than just that.

And what is the broader impact?---It's the ongoing support of – of the MLC business by advisers. So we're focusing on one point and I understand your point. But I would go to – this was a process – a view of a process that the trustee was trying to understand the risks associated with the decisions put in front of it. It was done so ensuring that equivalent rights were maintained and – and members were put in the same position on day one to day two believing that the SFT was in the best interests of members. It was also done with a view that the trustee believed it needed to turn its mind to a strategy around the continuing and ongoing grandfathering of commissions which I believe we have done.

When I asked my question before which is what is the broader impact, your response was:

> *It's the ongoing support of the MLC business by advisers.*

?---Yes.

Can you explain to the Commissioner what you mean by that?---In answer to the specific question you were asking me at the time?

I mean what – yes, that's right?---What I meant by that is of course when an adviser moves a member to another product, being AMP, they no longer receive the commission, but – but also it would be an active view of moving – moving or not putting members into MLC.

Now, financial advisers also owe a duty to the members to act in the members' best interests?---Yes.

So what I'm trying to understand is was the thinking of the trustee that, consistent with that best interests duty, the financial adviser would move a member from MLC unless they were receiving commission?---I think we were thinking that there was a potential for attrition risk as a result of making a – a decision without a plan for how we would implement that decision to remove grandfathered commission.

And is that because you didn't expect advisers to act in the best interests of their members – of the members; you expected them to respond unfavourably if they lost the revenue stream of commission?---I'm not going to comment on whether – when and how an adviser acts in the best interests of – in giving advice, but I – I think we thought that the risks called out under option 2 were – were real and – and that in the – in the context of the timing of the SFT it was appropriate to grandfather commission.

When you say you're not going to comment on whether the financial adviser was going to act in the best interests of the member, if you just look through these points, you see the first point is:

> *Due to high levels of member attrition a significant reduction in funds under management would arise.*

?---Yes.

And the second point is then that:

> *The remaining members would likely incur increased fees and costs since MLC would have its fixed expenses that it would need to spread over a smaller member base*

?---Yes.

And the third point is:

> *Any increase in member fees would reduce the competitiveness of each product within the market which would negatively impact the ability of financial advisers to fulfil their best interest duties in recommending the trustee's products when compared to similar market options*

Can I suggest in light of that, you must have been thinking about how the best interest obligation of a financial adviser?---I was not thinking about the best interest obligation of a financial adviser.

I understand. And was that because the proposition from your point of view was quite simple. You expected that if you cut off this revenue stream from financial advisers where they weren't obliged to provide a service, that they would move their clients to a different fund?---It was a risk that we considered had – had potential to be real.

It was a risk that had the potential to be real?---I know that was poorly worded. I apologise. I think it was a risk that we considered. So there were three options put to the trustee. Each of those had some advantages and disadvantages. And on balance, the trustee believed that the grandfathering of commission at this point in time and the – the SFT was in the best interests of members.

What I'm struggling to understand is do we agree that if you grandfather commissions, there is a 100 per cent chance that the relevant members will keep paying commission without any right to service?---Yes.

So there is a 100 per cent chance of that which must be to the disadvantage of members compared to not being in that situation, and some chance, not articulated in any real way, that financial advisers will decide to move their members away if their revenue stream is cut off. Is that the balancing that was going on?---No.

And anywhere in this paper does it explain what the effects will be on the MLC Wealth business if commissions are shut off?---No.

But you knew that one of the beneficiaries of grandfathering commissions was the MLC Wealth business?---Related party financial planning businesses, including NAB Financial Planning, yes.

And the people authoring this paper are from the MLC Wealth business?---They are from the MLC Wealth business, yes.

And then if we go over the page – so we've seen one potential detriment of ceasing grandfathered commissions is said to be member impact. And then the second ones over the page under Other Impacts is, first:

> *If the trustee was to contemplate terminating commission payments, separate legal advice would need to be obtained to determine whether commission payments could be terminated without exposing MLC Nominees or NULIS or any other entity of the NAB group to liability for breach of contract.*

?---Yes.

Was that an issue that was relevant to the trustee's decision?---So I can only go to my comment before, that this paper and all of the options in the paper were part of the trustee's decision-making process regarding what it should do and the – the benefits and the risks associated with any decision. So that – that is in the paper and it would have been part of the board's deliberations and considerations at the time.

Right. You don't have any specific recollection of the consideration of that issue?---No. But I do have a recollection of the heavy debate that this had in the boardroom about being in the interests of members. And – and that this wasn't where it stopped for the trustee. While this was a point in time, as we did the SFT, it was with a view that we would go on to have strategic discussions around our view of grandfathering of commission. And as I mentioned to you, that has resulted in a strategy to be implemented to move our members in off-sale products which are commission-based products, into on-sale, non-commission paying products.

That was a strategy that was ultimately arrived at at the end of last year?---Yes.

And that was a strategy that over the course of three years you will move them out of commissions?---Over the next – I don't believe it's three years, but – but yes. Yes, you're right. It is a three-year strategy to – for the entirety. I was thinking about Five Star/Gold Star in my response.

And that is because the reason underlying that strategy is that you recognise that it is not in the best interests of members to be paying commission?---That we think it is in the best interests of members to be in our on-sale modern products that are maintained and have lower fee arrangements all over, better features, better options, an array of reasons.

You recognise, don't you, that it is not in the best interests of members to be paying commissions?---I think – I think it is in the interests of members to be in our on-sale products that have an – that have an array of features that are different to the off-sale commission paying products.

You recognise, don't you, that it is not in the best interests of members to be paying commissions?---I think it is in the best interests of members to have fees that are as low as they can possibly be, and that the member has control over the fees and the services and the features that they are paying for.

You recognise - - -?---And so if that means that – that would be inclusive of it is in the best interests of members to be in products that do not pay commission versus products that do pay commission.

Thank you. Now, then, the other point that is made under the heading Other Impacts is:

> *In addition, the program of work that would be required to remove commission arrangements attached to member accounts would be both costly and time consuming, and would cause delays to the SFT and subsequent plans to trade up legacy products.*

Do you see that?---Yes.

Was there any explanation given to you as to what that program of work would be?---I don't recall if we had a conversation at the time, but I could give you my view.

And what would it be?---That the products that pay commission arose at – you know, anything from over the last 15 to 20 years that those products actually were put in place. And so the contractual requirements, the nature of the – the commission would vary from product to product, and would require us to have a – an understanding of how and when we can change those commission terms. And enable us to have a strategy to engage with members and advisers around the program of turning them off. It's not as simple as just one – one product, same features, flick a switch and turn it off.

Presumably, it's possible within the systems being operated by NULIS and MLC to put commissions down to zero?---Yes.

So when you say there's a program of work, this particular consideration is just about whether you will just put commissions down to zero?---So this particular consideration was not that at all. I think how we – how we go about turning commission off is now subject to a strategy – a – a consideration by the board at a – at an upcoming strategy workshop in – if it hasn't happened this week – I believe it was due for August.

And the strategies around managing engagement with financial advisers?---That would be one element of it. I don't know everything in it. I probably – I was trying to enunciate that I felt it was not necessarily as simple as it sounds as turning it to zero, that it requires consideration of the contractual requirements in place, what they are, how much – whether we – you know, do we need to give notice, in what products and what that looks like.

And it's said that it would cause delays to the SFT if this was to occur?---Yes.

Do you recall what sort of delay was involved?---No, I don't. But we considered that that was a fair and a real proposition that was put forward by management, and if you consider that the – the – I will stop there.

What I'm trying to understand is in this balancing exercise you have a situation where if you turn off commissions, there is a 100 per cent chance that the members will be financially better off as a result of not paying commissions. And you choose not to do that for reasons that presumably do have an effect on the members. For example, it might delay the SFT and that might cause some financial impact to them – effect on them. I'm just trying to understand how you balance the certainty of the detriment of commissions against these other uncertainties?---So I will just go back to the point I was trying to make regarding the successor fund transfer program, which was to match the equivalency of – from one fund to another, and move the superannuation business out of the life policy. That was considered to be in the best interests of members to – to do that. In order to do that in the timeframe that we had and deliver to the successor fund transfer, that meant we had made a decision – it could be 18 months earlier – that we would look to have no change in any features or any elements of offers made to members. We would be matching equivalency from 30 June to 1 July as the SFT was executed.

So at this point, the trustee was not trying to turn its mind to the bigger picture that it has later turned its mind to, around the ongoing grandfathering of commission.

I want to move to another topic. Sorry, Commissioner, did you have any further questions about that issue?

THE COMMISSIONER: None that I will ask, Mr Hodge.

MR HODGE: Thank you, Commissioner.

I want to ask some questions about MySuper?---Yes.

In 2013 two of the trustees were developing MySuper products?---Yes.

One was MLC Nominees, the other was PFS?---Yes.

PFS had a Plum MySuper product?---Yes.

MLC Nominees had, I think, two MySuper products; one was the MLC super product, are the other was the NAB staff product?---NAB - - -

There was a NAB - - -?---NAB was PFS.

Thank you. And it, as part of that process, developed a product but also a transition plan for ADAs?---Yes.

And ADAs are accrued default amounts?---Correct.

And they are amounts that have been contributed by a member pursuant to the default contribution from – or contributed for a member pursuant to the default contribution by their employer?---Yes.

And do you recall for the ADA transition plan that MLC put in place and PFS put in place how quickly it was intended that the ADAs would move over into the MySuper product?---It was – I'm sure you're going to tell me, but it was – I would say a two-year transition. It could have been shorter, it could have been longer.

Well, the obligation was to complete all transitioning by 30 June 2017?---Okay.

Do you recall that?---I know there was an obligation, yes.

Do you – do you recall discussion about the MLC transition plan?---Yes. It was a documented transition plan developed and put forward to the trustee for approval.

Yes. But do you recall board discussion about the transition plan?---There would have been.

Do you recall any issues being raised about the transition plan?---Not specifically but I'm sure that there were – there was discussion around elements of the transition plan, including making sure there was equity for members and those sorts of things. As assets transitioned there were large movements of assets, making sure that as we – that – that fees and assets matched – matched the movement, that fees matched the movement of assets and so members were paying appropriate fees for the assets they were actually invested in as they were transitioned from higher asset growth defaults to lower asset growth defaults, those sorts of things.

Now, one of the features of the MySuper product is that it's a no-commission product?---Yes.

And it's also supposed to be a simpler product. There's not a range of options?---Yes.

You're just in one option?---Yes.

And in the case of MLC, do you recall what the defensive to growth split was for the MLC MySuper product?---The old or the new?

Did it change at some point in time?---Yes. So the ADA transition resulted from, I think, across the two trustees about 40 different defaults going to the one.

Into MySuper?---Into MySuper.

Yes. But the MySuper split, do you recall what that was?---It's a 70/30.

Yes. And one of the things I'm trying to understand – and we might bring up a document which is NAB.005.562.4470.

THE COMMISSIONER: Can we have the number again, Mr Hodge. We're not succeeding.

MR HODGE: Yes. It's NAB.005.562.4470. While we see if we can find that can we try a different document, which is NAB.005.561.4232. Thank you. This is a meeting from December 2013. You can see it's a meeting of the combined MLC Nominees, NULIS and PFS Nominees board?---Yes.

And if we go over to page .4234, you will see this is a paper about the transition from ADAs to MySuper?---Yes.

And then if we go over to page 5 of 14 which is .4236, and you will see this is setting out the – setting out the transition from ADAs over into MySuper products?---Yes.

And I think actually if we – we can probably see this more clearly if we go to .4244, which has some projected cash flow statistics. You will see this is setting out the cash flows into MLC MySuper and what's being planned in 2013 is that there will be a five per cent transfer of ADAs per quarter for 2014/2015. And then gradual transition of the remaining ADAs in 2016?---Yes.

And I'm interested in understanding whether the board considered, so far as you can recall, whether that was too slow?---We did have discussions around timing and how quickly we could give effect to the ADA transfer. And based on the information and the complexity of the merging of multiple different defaults, as well as the change to asset allocation and the resulting movement of – or – or the – the resulting change in underlying assets that that was required to bring about, that this was determined to be the – to be a safe, appropriate, within the requirements of the required ADA transition timeframe, and would deliver a very big asset transition very safely, and ensure that no – you know, no errors or issues arose as a result of the transition of ADAs.

Now, one of the consequences of that – or the speed with which the transition occurs, can I suggest, is that more members remain for longer in a higher fee-paying ADA before moving over into the MySuper product?---So that would have been for the MKBS/PS members.

Yes?---Paying plan service fees.

Yes. Those members would have had higher fee paying - - -?---Yes.

They also have higher administration fees, don't they?---They have different administration fees, yes.

They're higher, aren't they? The administration fees for MKBS and MKPS are higher than the administration fees for MySuper?---Yes, I believe they are.

And, as you say, they would have been paying or could – would have been paying PSFs?---Yes.

And that would be to the disadvantage of their members?---Well, not if they're receiving a valuable service for the PSF which I believe the trustee would have thought that that was the case.

And they could be paying contribution fees?---They could have been paying contribution fees.

And was this something that the board balanced in some way to consider what disadvantages there might be to members who remained in the ADAs?---Yes, it was part of the discussion and deliberation around what's the right balance between safely delivering within the required timeframe and the fact that members would benefit by paying lower fees in the new MySuper option.

Do you recall whether the board considered back in 2013 what the effect on the scale of the MySuper product would be by waiting until 2016 to transfer the majority of members over into MySuper?---I don't recall us having a conversation about that specifically.

Each year the board is required to make a MySuper scale determination assessment?---Yes.

And it has to determine that members in the MySuper product in the, for example, MLC Super Fund are not disadvantaged in respect of scale when compared to members who hold a MySuper interest in other funds?---Yes.

And do you recall whether the board considered the potential problem of this – what I will suggest is a slowness of transitioning ADAs over into a MySuper product in considering that MySuper scale assessment?---No.

You don't recall it having been thought about?---No.

All right. Was it your understanding that it was the common practice within the retail funds to be taking much longer to transition ADAs over into MySuper products when compared with the industry funds?---I – not at the time the plan and the decision around how we would manage the transition was approved but I am aware of subsequent criticism of retail funds and – and how the length of time taken to transition.

So you're aware of subsequent - - -?---Criticisms.

- - - issues that have been raised and criticisms?---Yes.

And do you have a view about the merits of those criticisms?---I think generalising – it's a generalisation would be my first comment.

Sorry, a generalisation - - -?---Of the criticism.

- - - that the retail funds have done - - -?---Of the criticism. So there are two facts that I think are important. The first one is for most industry funds, they actually had one default, which meant they didn't have any, you know, ADAs to transition in the context of the trustees of MLC Nominees and PFS Nominees. So it was a much easier process. So that's a generalisation in itself, from my perspective. But the trustee did turn its mind to how safely could we consolidate the complexity of our default arrangements that had been built up over many years of employers designing a default from both an investment and an insurance perspective and how quickly we could move from – from that and change asset allocation and move to what was designed to be the MySuper option. And in – in the balance of things, I think that the trustee was looking to make sure that we did so in a timely – timely fashion within the required timeframe given to us in a way that we did not cause any issues or errors or events in a – what was a complex asset transition process.

Can we – sorry, I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 5.54, NAB Wealth board papers, 4 and 5 December '13, NAB.005.561.4232, exhibit 5.54.

EXHIBIT #5.54 NAB WEALTH BOARD PAPERS, 4 & 5 DECEMBER '13 (NAB.005.561.4232)

MR HODGE: Thank you, Commissioner. Have we now got NAB.005.562.4470? Commissioner, can I suggest we adjourn for lunch now and come back in an hour.

THE COMMISSIONER: 1.30?

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: Yes. 1.30.

ADJOURNED **[12.30 pm]**

RESUMED **[1.30 pm]**

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Thank you, Commissioner. Can we bring up NAB.005.562.4470. So Ms Smith, this is an extract from the records of the papers of the board meeting of the trustees on 26 October 2016---Yes.

And you can see it's one of the board's annual MySuper scale determination assessments?---Yes.

And what that refers to is that each year the board of the trustee is required to resolve that it is – the members of the MySuper product are not disadvantaged by virtue of the size of the product?---Yes.

All right. And then can we go over to page .4472. We see this is the second page of the two-page paper prepared by management for the MySuper scale determination?---Yes.

And you see there's a heading which is Conclusion. And you can see that what is said there by management is:

> *Having completed the scale test (as summarised in the appendices) management does not believe members in the respective MySuper options are at a disadvantage relative to members of the MySuper products in other superannuation funds as a result of scale, particularly when the qualitative features and aggregate administration and investment fees and costs are considered.*

?---Yes.

And this is consistent with what would happen each year, which is that management would express a view to the board as to whether or not the members were disadvantaged in terms of scale?---Yes, as – yes.

And then the board would need to rely upon the information presented by management in order to reach a resolution as to whether it accepted or resolved that the members were not disadvantaged in terms of scale?---Yes.

And I think I asked a form of this question before lunch, but in doing that each year, do you recall whether there was consideration given to what would happen if NAB or MLC or the trustees had moved more quickly to transfer ADAs over into the MySuper product?---No.

You don't recall a discussion along those lines? All right. And then can we go to the next page, which is 117/249 at the bottom. So we see this is an appendix provided to the board which sets out calculations across the superannuation industry in relation to MySuper?---Yes.

And it shows the total value of accrued default assets?---Yes.

And it shows what has been happening – or what has changed with respect to accrued default assets over the preceding three years?---Yes.

And you can see that in – as at 30 June 2014, the total accrued default amounts across the entire superannuation industry were worth about $73.1 billion?---Yes.

Of which MLC held $17 billion?---Yes.

And the next year, the value of ADAs across the entire superannuation industry had fallen to $59.2 billion?---Yes.

And the value of MLC ADA funds had only fallen to $16.1 billion?---Yes.

And by 30 June 2016, the value of total ADAs across the industry had fallen to $41.3 billion?---Yes.

And the value of MLC ADAs had now only fallen a small amount again to $13.9 billion?---Yes.

With the consequence that by 30 June 2016, MLC super fund had more than a third of the ADAs across the entire superannuation industry?---Yes.

And did that seem striking to you?---I don't recall thinking at the time it was striking. The ADA transition was being executed in accordance with the plan that had been approved by the board.

Did you wonder why it was that your plan for transition had led you to holding more than a third of the ADAs across the entire industry by 30 June 2014?---I think I made a general comment about that earlier, where I said that the transition for an industry fund was relatively simple, and we didn't go and compare ourselves to other retail funds, nor did we go and compare ourselves to anyone else. What we did was put in place a transition plan, commensurate with the complexity of the program of work that we had in front of us to move from many different defaults to one default with large asset transitions included in that plan.

Well, let's just pick at a few parts of that. These figures that we're looking at for total accrued default amounts, even from 30 June 2014, can I suggest that's unlikely to include any or any significant number of industry accrued default amounts. Do you agree?---Potentially.

Because the point you were making earlier was that, effectively, the industry funds moved their pre-existing default product and made whatever changes were necessary to turn it into a MySuper product. That's your understanding?---Well, I – I expect that to be the case.

All right. And MySuper had come into effect from – in a compulsory way from 1 January 2014?---Yes.

And, in fact, a number of – most funds had already established their MySuper product before 1 January 2014?---Yes.

All right. And when you say, "We didn't compare ourselves to anybody else", isn't that the whole purpose of the MySuper scale assessment?---What I meant when I used that expression was that when we put in place what we believed to be an appropriate ADA transition plan based on our organisation and the complexity of the program of work that we had in front of us, that we didn't go and ask other organisations or look at what other organisations were doing with their ADAs. The trustee turned its mind to the facts of the default funds in front of it and what we believed was the right – the right timeframe for us to make the changes.

But, again, just so that I understand that, the administrator came to you and proposed a timeframe. Is that right?---The administrator developed a timeframe. It was discussed at the board and the board approved it.

And did the board push back and say that timeframe is too slow?---There was a great deal of conversation around are we moving fast enough and testing the tension between how quickly we could transition ADAs and how – how we could manage risk and complexity during that process.

Did the administrator ever manage to accelerate the timeframe?---No, I don't believe so.

In fact, it slowed down, didn't it?---Right at the end of the ADA transition there were a small group of ADAs that were slowed down, yes.

In the end, if we go to page dot - - -?---Just that - - -

Yes?---It's okay.

No, no, please?---No, no, it's right.

Ms Smith, if there's other evidence you want to give to answer that question you should add something?---No, no, that's fine.

All right. Can we go to .4474. So you see then this is appendix 2 of the paper which is the analysis of MySuper experience over the year to 1 July 2016?---Yes.

And by this stage, by the time of the preparation of this paper, we can see that what is now being contemplated is that the completion of the transition of all remaining ADAs won't occur until March 2017. Do you see that?---Yes.

And was it explained to the board why the transition was slowing down?---Yes, it was discussed at the time but I – I would have to reread the – the paper to remember the detail behind why it was slowed down.

Do you see in the bottom half of the page there's the statement:

> *Various MySuper investment structure enhancements have been implemented over the last 12 months.*

?---Yes.

And do you see there's three bullet points, one of which is:

> *Changes to fund managers and portfolios for Australian shares.*

?---Yes.

The second of which is:

> *Increased cost of manufacture budget by five basis points (funded from the profit margin) to enable increased exposure to unlisted infrastructure and private equity which may result in an increase to the actual indirect cost ratio.*

?---Yes.

And the third of which is:

> *Increased allocation to extended credit and low correlation strategies of approximately $620 million.*

?---Yes.

Now, just on the second bullet point, the profit margin that's being referred to there, is that the profit margin of NULIS or is that the profit margin of another entity within the NAB Group?---From 1 July 2016 it's the profit margin of NULIS.

THE COMMISSIONER: I'm sorry, I didn't hear the answer?---Sorry. From 1 July 2016, it's the profit margin of NULIS.

MR HODGE: And is it your recollection then that there was a decision that had to be made by the trustee to take less of the money in profit so that there could be more money applied to managing investment for exposures to unlisted infrastructure and private equity?---Yes.

And do you recall when that decision was made?---No, I don't.

All right?---I – I am looking at – no, I don't.

And then you see the last sentence says:

> *The competitive investment underperformance of the MySuper option has not arisen due to lack of scale.*

?---Yes.

Did that prompt you to ask why it has arisen?---The performance of the MySuper option has been actively monitored and looked into by the trustee from – over the course – since the MySuper option was established, and has resulted in a number of changes and this – this was one of the first – first changes, which was to increase the cost of manufacture so that we could take exposure to different asset classes.

Do you recall whether by this time anyone from management had suggested to you that one of the reasons for underperformance by the MySuper product when compared to what it might be was that the ADAs had not all been moved over into MySuper?---No.

Is that ever something that has occurred to you?---No.

All right. And then if we go over to page .4478. I'm sorry, should we go over to page .4477. And you will see there's an assessment done of the competitiveness of fees?---Yes.

Relative to comparable MySuper funds. And you see in the middle it says:

> *Unfortunately, when standard fees are compared against the Chant West universe of MySuper products MLC Super Fund, MySuper and NAB Staff, MySuper ranked 66th and 44th respectively.*

?---Yes.

Do you recall whether you considered whether that was an acceptable comparative performance in terms of fees for the MLC Super Fund?---Is your question whether or not we thought that was good enough or - - -

Yes?---No, we didn't.

And so what did you do about that?---So – so first of all, fees are just one – one option to review, and what we're really trying to look at is after-fee performance.

That's even worse, isn't it, for your fund?---Well, that's why for MLC MySuper the performance of the fund is not where we believe it should be, not where – or where we – where we want it to be for our members. The NAB Staff Super Fund performance is different to the MySuper fund performance.

Yes, the Staff Super Fund performs much better than the general fund?---There's a different asset exposure as well as a different asset allocation.

Yes. It – and if we just focus on that, I think there's a difference of something like 76 per cent in the case of the staff fund allocated to growth assets as distinct from 70 per cent in the case of the general fund. Does that sound about right?---It sounds about right.

And there's a very marginally higher investment cost with the staff fund compared to the general fund?---I think that is also right.

It's about .66 for the – in the case of the staff fund and .61 in the case of the general fund?---Yes.

Is that .05, is that something that you think is the difference between the performance of the staff fund and the general fund?---No. The staff fund has had longer-term exposure to unlisted assets, and that's, essentially, the differential in performance is exposure to unlisted assets.

And - - -?---As well as the asset allocation of the higher allocation to growth assets.

And one of the difficulties for the MLC Super Fund MySuper product was that there was not sufficient money allocated to investment management to enable proper investment in unlisted assets?---I would rephrase that. So the design of the MySuper option had come from other defaults that we had in – in the Plum environment. And the past performance of those options was competitive. The – additional increase of the five basis points was to try and address some of the lack of exposure to unlisted assets, or – or the comparative lower exposure to unlisted assets which tend to be more expensive. And so that was part of the address of – going towards addressing the underperformance.

THE COMMISSIONER: Can I ask you to keep your voice up, Ms Smith?---Sorry.

We're all having difficulty, even wearing headphones?---Okay.

The transcriber is having her difficulties.

MR HODGE: Is another difference that the MySuper product actually has a significant allocation to passive assets or – I'm sorry, I should put that a different way. Has a significant allocation to passively managed assets?---It does have a significant allocation to passive assets, yes.

Its – its investment style is not actually active, it's active/passive, I think is the way it would be termed?---So asset – all superannuation funds, including our trustee, use – use passive assets to try and keep the costs down. And then use the – use your investment budget to – to gain outperformance in other areas. So it's just a combination of using active and passive managers to come up with a performance outcome.

If we go to page .4478. This deals with the competitiveness of investment performance relative to comparable MySuper funds?---Yes.

And we see – I suppose I should say no fund – or by and large no fund performed particularly well in the financial year ending 30 June 2016 compared to other years. Do you agree?---Yes.

But in that year, we see in the second paragraph:

> *The performance of the MySuper products and the predecessor funds has been relatively weak, producing a one year return of 1.9 per cent which was bottom quartile according to Chant West's universe of MySuper products.*

?---Yes.

And that would be a bottom quartile return before fees, I assume?---No, I believe it's after fees. Investment fees.

After investment fees but before administration fees?---Correct.

That's one of the features of the way Chant West compares things is that it doesn't take into account administration fees?---Yes.

And then it said:

> *However, this is based on comparison of the entire universe of MySuper products without taking into account wide-ranging product differences, in particular varying asset allocations and active versus passive investment management.*

?---Yes.

And that's one of the things that can be difficult, can I suggest, for a consumer, which is just looking at what the fees are that are charged, even if they're investment fees and comparing investment fees, won't necessarily tell you how much of that investment fee is actually being used to actively manage investment and how much of it is being taken as profit?---Yes.

And then this paper goes on to make the point that you've already made which is one of the reasons why MLCs MySuper returns are lagging against the performance from other comparable fund offers is predominantly due to a lower allocation to unlisted assets?---There's – yes.

I tender that document, Commissioner.

THE COMMISSIONER: Extract from minutes of MLC Nominees, NULIS and PFS Nominees, 26 October '16, NAB.005.561.4470, exhibit 5.55.

EXHIBIT #5.55 EXTRACT FROM MINUTES OF MLC NOMINEES, NULIS AND PFS NOMINEES DATED 26/10/2016 (NAB.005.561.4470)

MR HODGE: Thank you. Are the MySuper scale assessments taken seriously by the board?---Yes.

Can we bring up page 4474, again of that document that we've been looking at, and then bring up another document which is NAB.005.562.6778. So this is the 2017 MySuper scale assessment?---Yes.

And if we then bring up – sorry, if we bring up on one side of the screen NAB.005.562.4474. And on the other side of the page – on the other side of the screen NAB.005.562.6782. I just wanted to ask something about the comparison between what had happened over the 12 month period. So on the right-hand side you've got the 2016 changes and you see there's three bullet points. So one is:

> *Changes to fund managers and portfolios for Australian shares.*

?---Yes.

The second is:

> *Increased cost of manufacture budget by five basis points.*

?---Yes.

And then the third is:

> *Increased allocation to extended credit and low correlation strategies of approximately $620 million.*

?---Yes.

And then over on the left-hand side which is 2017, it has first the same words:

> *Various MySuper investment strategy enhancements have been implemented over the last 12 months to improve performance returns for members in conjunction with asset transition for the accrued default amounts.*

But that's the extra words there. It says:

> *In conjunction with asset transition for the accrued default amounts.*

And I just wanted to know, did you understand that the MySuper product was likely to perform better in light of the transition of ADAs over to MySuper?---That – that it would?

Yes?---No.

All right. And then in these two bullet points that are on the left-hand side for 2017 – so it looks like this is the follow-through – in 2016 you had increased the cost of the manufacture budget?---Yes.

And then in 2017 now there was increased exposure to unlisted infrastructure?---Well – and that continues. So getting exposure to unlisted assets is by its very nature they're not – not liquid and not something that happens like you can buy a share on the stock exchange. And so that – to get into good, you know, good unlisted assets takes time and consideration. So while the budget has been increased, actually gaining access to appropriate investments to put into the portfolio takes time.

Yes. That's right. There's two steps involved and the first is you have to have the budget to be able to do that investment?---Yes.

The second step is to be – to actually carry out the investment. As you say, that can take some time because you have to – we're talking about buying unlisted assets. You have to buy the assets and set them up?---Well, and decide that – you know to find appropriate assets that you want to take and exposure to in the portfolio, yes.

Yes. What has happened is in 2016 there has been this increase to the budget?---Yes.

And then in 2017 you start increasing the exposure?---The investment team go away looking for appropriate investments to put into the portfolio, yes.

And that's the investment team in the NAB Wealth business?---Yes.

All right. And is there any reason to think that if your budget – if the manufacture budget had been increased three years earlier that you couldn't have started investing in unlisted assets then?---No.

Did anyone come to you and talk to you about that?---About increasing the budget?

Earlier?---Three years earlier?

Yes?---No.

When you eventually increased the budget, the consequence is that the profit that ultimately goes back to the NAB Group decreased?---Yes.

And you're dependent upon a part of the NAB Wealth business to come to you and talk to you about whether some profit needs to be given up in order to increase the manufacture budget?---From 1 July, yes.

From 1 July 2016?---Yes.

What was the case before then?---It was the same. There's only a distinction in terms of the visibility of the profit to the trustee at that point from 1 July 2016.

Was that because before 1 July 2016 the trustee had even less visibility of the profit or had no visibility of the profit because it was being made at the insurance policy level?---Yes.

All right. And presumably, though, was it still, as you understood it, a decision for the trustee as to how much of the profit would be given up in order to enable better investment?---Yes.

Okay. And did it strike you, looking at this, that, again, there's a conflict of interest here, which is that the – somebody from the NAB Wealth Group needs to come to you and say, "We want to give up some of our profit in order to improve the performance of the members' investment"?---So – yes, there is always a – there's a tension in the conflict of interests of running a fiduciary business for profit as part of, you know, a conglomerate organisation. It – it doesn't – it's not that we're – sitting there waiting for management to come and tell the trustee. It's an – it's an interaction. Performance wasn't where it needed to be. We understood two – the two major elements of that. Partly the – the 70/30 exposure versus where we compare to other trustees who are taking higher allocation of, say, an 80/20 or 85/15 growth/defensive asset split.

Sorry, do you think there are single diversified strategies being employed by some trustees with an 85/15 split of growth to defensive?---Yes, there are.

All right?---And so the Chant West survey covers quite a large asset allocation split. We're not all – not all of the defaults – not all of the options in that are a 70/30 split.

You're not – I just want to be clear. You're not dealing with an issue of the life cycle - - -?---No.

- - - MySuper product?---No.

As you know, for young people in life cycle products, their allocation will not infrequently be something like an 85/15 split?---No, no, I'm just talking single defaults that are in the Chant West survey.

Okay?---So that is one reason for where we sit in the survey. But the second one is the – is the lower allocation to unlisted assets. And it was through that we were – the trustee with management – determining what needed to be done to improve the performance of MySuper. And one of those elements was to increase the budget to obtain greater exposure to growth assets.

I tender that document, Commissioner.

THE COMMISSIONER: NULIS board meeting, 26 October ’17 comprising 2017 MySuper scale determination. NAB.005.562.6778, exhibit 5.56.

EXHIBIT #5.56 NULIS BOARD MEETING COMPRISING 2017 MYSUPER SCALE DETERMINATION DATED 26/10/2017 (NAB.005.562.6778)

MR HODGE: And then can we bring up NAB.005.605.0123. This is a report prepared by Chant West for the trustee?---Yes.

And this was part of a benchmarking exercise?---Yes.

And I just want to ask you about one thing, which is if we go to page NAB.005.605.0147. And this is dealing in this part of the report with benchmarking between the MLC Super Fund and other funds. You may not be able to see that. I just want to ask you about one particular thing, which is, as you know, one of the common explanations that’s given for a difference in performance between retail and industry funds is the level of exposure to unlisted assets. You’re aware of that as a general issue that’s raised?---As a general theme, yes.

And that’s one of the issues with the performance of your product was the lack of exposure to unlisted assets?---The lower allocation, yes.

And it’s said – and this is a point that Chant West is addressing – that:

> *Industry funds can invest in unlisted assets because they’re less concerned about liquidity.*

?---Yes.

And the point that Chant West is making here is that – and you see that in the second last paragraph:

> *We believe these arguments apply less to MySuper funds because of their default nature.*

?---Yes.

And so I just want to make sure we agree that the level of liquidity is not an explanation in relation to your fund’s MySuper product for the lower level of performance or the lower – I’m sorry, I withdraw that. I will put it again. The level of liquidity is not an explanation for the lower level of exposure to unlisted assets in the case of your MySuper product?---No, and off the back of this report the trustee undertook a review of liquidity and as a – in a view to ensure that we could – you know, that we were maximising liquidity requirements and – in order to get greater exposure to unlisted assets. It might not have been off the back of this report but we have undertaken a review into liquidity as we came out of the life company. So we were – we had constraints in respect of liquidity in investing through the life – life policy.

Sorry, you had constraints on liquidity when invested through the life policy?---Yes.

In relation to MySuper?---Well, all of the assets of the superannuation funds were invested through the life policy prior to 1 July 2016.

Right. And could you just explain to the Commissioner how that affected the liquidity of the product?---That the life – the life company has liquidity requirements that – that – that the trustee then had to – or the trustee was then required to meet as a result of the way it invested it through the life policy.

I see. So the – am I right in understanding this: before 1 July 2016 the needs of the life insurance company in terms of liquidity had an effect on how it was that the trustee's money could be invested?---There were liquidity requirements in place, yes.

And the liquidity requirements of the insurance company affected how the super fund's money could be invested?---That we had – potentially, yes.

And in a negative way?---Potentially, yes.

By, for example, reducing the ability to obtain exposure to unlisted assets?---That would be an impact of liquidity investing, yes.

And how was that conflict of interest managed?---So essentially, I'm – I'm not sure that the life company's liquidity requirements ever meant we didn't take investments that we needed to through any of the investment options that we were offering. However, from 1 July the trustee no longer had to – no longer had life – life policy liquidity requirements in terms of its investing, and has looked at whether or not it can increase its exposure to illiquid assets in order to generate better returns for members.

I see. The problem effectively went away because the insurance company was sold?---Yes.

And then the money could be invested directly? Or managed more directly without concern about the liquidity requirements of the - - -?---Of the life policy, yes.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 5.57, Chant West report MLC Super Fund benchmarking January '17, NAB.005.605.0123, exhibit 5.57.

EXHIBIT #5.57 CHANT WEST REPORT MLC SUPER FUND BENCHMARKING JANUARY '17 (NAB.005.605.0123)

MR HODGE: And then can we bring up NAB.005.563.6689. So this is a report to NULIS prepared by – is it JANA -?---JANA.

And JANA is wholly owned within the NAB Group?---They were wholly owned. There has been a management buy-out of JANA and I think the group owns – the group does own less than 50 per cent but I couldn't say if it was, you know, 48 or 40.

Okay. And do you – when did that buy-out occur, do you know?---Last year.

All right. And JANA provides a report in – in fact I think it provides a quarterly report to the investment committee concerning the performance of the fund's investments?---Yes.

And you were on the investment committee?---Yes.

And you would have reviewed these reports?---Yes.

Can we go to page NAB.005.563.6695. And you see in the middle of the page it says:

> *There has been much focus on the performance of the MySuper option given the importance of this option in terms of size of funds under management.*

?---Yes.

And:

> *In JANAs view the performance of this option since inception (December 2013) is in line with expectations.*

?---I see those words.

And then "but under peers"?---Yes.

Then it goes on to say:

> *For the product design and objectives that were understood at the inception of this option and the investment environment that has occurred.*

?---Yes.

I just want to try to understand that. The underperformance of the MySuper option compared to competitors, was that expected by the trustee?---No.

And so when JANA says that "the performance is in line with expectations" but then it does say:

> *for the product design and objectives that were understood at the inception of this option and the investment environment that has occurred.*

What's the – what do those qualifications mean, as you understand it?---I – I'm trying to give you a succinct answer. And they're not my words so I'm trying to imagine what was kind of being written by JANA at that point. I expect what they are saying that – is that based on the asset allocation that was – was put in place for MySuper at inception, that that is – that is the performance is expected as a result of that.

The performance – I think I understand what you're saying, which is having regard to the way the product was designed, the performance over the relevant investment period, which by this stage is the last three and a half years, is in line with what would be expected?---Based on the asset allocation and, in particular, the exposure to the – or – or the – the unlisted allocation we've been talking about, yes.

All right. And do you see then a little further below that there's a sentence before the italicised numeral. The sentence is:

> *As a result, JANA has considered the following three questions.*

?---Yes.

And then number 1 is:

> *Relative to the product design at the inception of the option, how has JCIS performed in managing the mandate?*

?---Yes.

Could you just explain to the Commissioner what JCIS is?---The – the implemented consulting team who are making the asset allocation decisions.

They're the team within NAB that is making the asset allocation decisions?---Yes, that's correct, choosing investment managers, etcetera.

And you see then JANA says:

JANA believes that the initial fee budget (including the budget allocated to ICR) –

Which is indirect cost ratio?---Yes.

Continuing:

Put a significant limitation to the level of illiquids in the portfolio.

?---Yes.

Continuing:

In addition, the operational requirement of the creation of a new option with zero dollars day one and no legacy assets has meant that even if the fee budget had been larger, the MySuper option was always going to have a lower allocation to illiquids relative to peers and there was nothing that JCIS could have done to change this outcome.

?---Yes.

And then if we go over the page, you see:

Four years on, the fee budget has been relaxed slightly and the project to transfer all ADAs has been completed. However, the structural peer relative underweight to unlisted assets occurred at a period in the market where these assets have delivered some of their strongest historical gains due to lower interest rates.

?---Yes.

And that passage seems to suggest that there were two issues with the MLC MySuper product. The first was the lower initial fee budget. I think you agree that that was an issue?---Yes.

And the second was that given that the MySuper product started with no assets and also by implication, I would suggest, by the length of time it was taking to transfer the ADAs over, that it was not possible to build up an exposure to unlisted assets earlier. Do you agree with that?---So I haven't thought about that before, notwithstanding the words on the page, but the my – the unlisted assets that were held in the previous defaults were transitioned into the current MySuper default. And so the MySuper default did have exposure to unlisted assets as a result of the ADA transition.

All right. I think what we're agreeing on is the words on the page from the investment consultant appear to suggest that the delay in transferring ADAs over to the MySuper product was one part of the explanation for the lack of exposure to unlisted assets?---The words on the page do read like that, yes.

But you don't remember that having been something that was discussed at the investment committee level?---No. And there's – I don't recall any attribution analysis in respect of that element of underperformance of the fund.

And you don't – well, sorry, if there's going to be attribution analysis, it would be here, wouldn't it, in this report? Isn't this the attribution analysis that you get?---There will be – it could be in this report. There's multiple reports that the committee receive, both from the managers managing the money, as well as JANA kind of overseeing that.

And the other thing that I want to suggest is that the statement:

> *Four years on the fee budget has been relaxed slightly.*

Suggests that JANA did not consider that the fee budget was adequate. Do you have a view about that?---I won't opine on JANAs view, but I will say that it has been discussed at the investment committee with both JANA and the investment team as to the adequacy of the fee budget and based on a fully allocated portfolio where we can expect the – the performance to be for MySuper.

I'm not quite sure that's an answer to my question but it might be helpful if we - - -?---So I won't opine on JANAs words but what I will say is that the investment committee has turned its mind to the adequacy of the fee budget, and whether or not that will produce performance in line with the trustee's expectations of where it expects MySuper to perform for our members.

If we go to page 123/174 which is .6704. And do you see at the top of the page there's a table. What it's setting out is how the MLC MySuper product has compared over the quarter, one year and three years compared with the performance of the 60^{th} percentile of MySuper products in the super rating survey?---Yes.

And you can see – the reason this is dealt with is because the trustee had recently decided to add a secondary investment objective in relation to the MySuper product?---Yes.

And the secondary investment objective was to exceed the 60^{th} percentile of the super ratings balanced option crediting rate survey over a rolling five-year period?---Yes.

And because the product is not yet five years old it's not possible to say definitively that it won't achieve that?---Yes.

But the portfolio manager doesn't think that it can achieve that?---The portfolio manager now believes it can achieve that. That's the point I was trying to make when I said notwithstanding I won't comment on JANAs words, there has been an active conversation about the – the fee budget and the portfolio's and manager's ability to achieve the – the performance requirements that the trustee believes are appropriate for MySuper.

All right. So just if we work through that. You see the last sentence of the paragraph is:

> *MySuper is behind this secondary objective, although we note that the portfolio manager has voiced a strong objection that this objective will be very* - - -

THE COMMISSIONER: A strong opinion.

MR HODGE: I'm sorry, Commissioner?

THE COMMISSIONER: The portfolio manager has voiced a strong opinion. I think you said "strong objection".

MR HODGE: I beg your pardon:

> *A strong opinion that this objective will be very hard to meet at the current fee budget and JANA shares a similar view.*

?---Yes.

Is that – so that's the issue that was presenting itself as at the August 2017 meeting?---Yes.

And has the fee budget since been increased again?---Not at this stage. We've – that conversation, as I said, went on with the portfolio manager coming to the view that the – the fee budget was adequate in order to achieve the objectives set by the trustee.

I see. Is the constraint on the trustee in allocating a greater fee budget simply the need to remit profit to the group?---No.

What other constraint is there?---The – it – it's finding a balance between how much you will spend in the portfolio for the return that you will achieve. And so part of some of the success that the portfolio manager has achieved is – has been kind of the creation of and exposure to alternative assets at much lower fee budgets than we would have expected in the past which is kind of the – the pressure of testing price. So trying to keep price down and trying to make sure that in doing that you've got a tension between performance and cost to the member.

When you say "cost to the member", that's what I'm trying to understand. The MySuper product will have two fees in it or at least two fees. One will be an administration fee, the other will be an investment management fee?---Yes.

And the budget for investment management presumably comes from the investment management fee?---Yes.

And if you allocate more of the investment management fee to investment management, that reduces the profit to the group?---Yes, or alternatively it increases the price to the member.

I see. Whatever happens – what you're saying is, "Look, the group wants to make a certain level of profit so if we have to spend more money on investment then we will have to increase the price"?---Potentially.

Can I tender that document, Commissioner.

THE COMMISSIONER: Minute of NULIS Nominees, 22 August '17 and JANA, June '17 quarterly investment report NAB.005.563.6689, exhibit 5.58.

EXHIBIT #5.58 MINUTE OF NULIS NOMINEES, 22 AUGUST '17 AND JANA, JUNE '17 QUARTERLY INVESTMENT REPORT (NAB.005.563.6689)

MR HODGE: Can we bring up NAB.005.563.5083. This is an extract. So this is a JANA report from a year earlier which has gone to the investment committee, Ms Smith?---Yes.

And if we go to page .5093. So we see the same running theme in relation to MySuper. You will see the sentence which is:

> *Performance has been weak over the past year due to the unlisted exposure issue highlighted below.*

?---Yes.

And then you see the second sentence of the next paragraph:

> *As mentioned last quarter, CIW and NAB Asset Management recently agreed to expand the investment fee budget for MySuper to enable the strategy to partially address significant investment capability gaps that exist in the portfolio relative to that of peers.*

?---Yes.

What is CIW?---It's an acronym that just doesn't spring to mind.

It's not the trustee, though, is it?---No, it's not.

It's some other part of the NAB Wealth business?---Yes.

And NAB Asset Management, is that effectively the investment manager that's being referred to by NAB Asset Management?---Yes.

So this seems to suggest that the agreement to expand the investment fee budget wasn't something for the trustee to agree with the investment manager, it was something that was agreed between one part of the NAB Wealth business and another part of the NAB Wealth business?---So prior to 1 July – and so this investment committee meeting is in August 2016 – the trustee was charged a fee in respect of MySuper by the life company. And the profit bearing occurred and cost bearing occurred in all of the other – in the life company and then NAB Asset Management. So prior to 1 July, which was the previous quarter, it wasn't the trustee's decision to decide to increase or decrease profit. It was the relevant other entities. What they did do was increase the exposure to assets, reduce profit and the fee to the member stayed the same.

Let me see if I've understood. Before 1 July 2016, the trustee couldn't control how much of the investment management fee got allocated to Investment Management?---Essentially, that – the – the cost of – of manufacture was within the life company. So how much the life company was – how much profit they were taking and the cost of manufacture sat with the life company and the underlying trusts, yes.

The life company would decide how much of the investment fee was taken as profit and how much was used in order to manage the investments for the benefit of members?---Yes.

And the trustee was unable to control that?---Effectively, yes.

And then once the sale of the life insurance company happened, it was then for the trustee to decide, as you understand it, how much of it will be taken as profit?---Hence my point earlier about the SFT being in the best interests of members and the removal of – of the entity – I can't say that word – the entity sitting in between the trustee and – and taking – for the trustee to enable the trustee to be the decision-maker of how and where those decisions were made, yes.

Your point is the SFT was linked to the sale of the life insurance company?---Yes.

The sale of the life insurance company removed one related party that was having control and being able to take from the members' money?---That – that – that the trustee had to – had to go through to invest members' money, yes.

All right. Does that suggest to you any conclusions you might draw generally about dealing with related parties with members' money?---I – you could ask me a specific question. I can – I can – I think the answer I would give is 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.

Now, since 1 July 2016, the trustee, as you understand it, has had control over how much of the investment fee will be used for management of assets as distinct from profit?---Yes.

But the trustee hasn't made a decision to allocate more of the investment fee to the management of assets?---For – for MySuper at this stage, no.

All right. And is the way that it works that the entirety of the investment management fee gets paid over to the asset manager?---No.

I see. So the – it's just whatever is agreed is the fee budget gets paid over to the asset manager?---No, there's – it's a – a percentage basis point.

A percentage of whatever the investment management fee is gets paid over to the asset manager?---Yes.

And the rest of it is retained by the trustee?---Yes.

And then the trustee makes a distribution back to its holding company of the profit that it makes?---From – at the end of the financial year, yes.

Now, just so I know, does it do that on a quarterly basis or on an annual basis?---Sorry. Yes, it pays dividends quarterly on the profit it earns throughout the year.

And what company owns NULIS?---NWMSL is the immediate shareholder.

So the administrator owns the trustee?---Yes.

And do you know what amount of profit was distributed back to NWMSL last quarter?---I can't remember what the dividend payment was and whether we made one or not. There were – I believe two quarters were – we didn't make dividend payments as a result of the PSF matter.

As a result of the PSF matter?---There were two quarters where I believe we didn't make a dividend payment and whether we did one last quarter, I – there – there could have been.

Because the profit had to be used to compensate members. Excluding the PSF matter, what's the typical level of dividend payment that's made back on a quarterly basis?---I don't know on a quarterly basis. Cash earnings – I could tell you what the cash earnings are but I don't know what the - - -

On an annual basis?---The full dividend. I would have to add up the four but I can't tell you what the cash earnings are.

THE COMMISSIONER: I can't hear you, Ms Smith. Speak up?---Sorry, I apologise.

Start your answer again?---I am not used to speaking loudly.

Speak softly, carry a big stick?---I don't know what they are on a quarterly basis.

Yes, go on.

MR HODGE: Well, on an annual basis would it be $50 million, $100 million?---$100 million, at least.

At least. $200 million?---No.

All right. Somewhere between 100 and 200 million dollars?---Yes. Less.

Sorry, less than?---Less – I mean - - -

Closer to 100 than 200?---Yes.

All right. I tender that document, Commissioner.

THE COMMISSIONER: Minutes NULIS Nominees, 25 August 2016 and JANA MLC Super Fund performance report June 2016 NAB.005.563.5083, exhibit 5.59.

EXHIBIT #5.59 MINUTES NULIS NOMINEES, 25 AUGUST 2016 AND JANA MLC SUPER FUND PERFORMANCE REPORT JUNE 2016 (NAB.005.563.5083)

MR HODGE: Now, I want to move to a different topic than the last topic which is to understand what has happened over the course of the last 18 months in relation to the dealings between the trustee and the NAB Wealth business and ASIC. Do you recall that by the end of 2016 there was an issue as to a review that needed to occur by NAB as to whether services had been provided in exchange for adviser service fees?---Do I recall at 2016?

As at the end of 2016?---I – I am not sure when I would have become aware that the licensee within the group – the advice licensee within the group had an issue with ASIC.

Well, it would have been well – you were aware from mid-2015, weren't you, of when the first event notification – or first breach notification started to be given - - -?---They're not the same - - -

Sorry, December - - -?---They're not the same matters.

I understand. Or I think I understand. You were aware from at least December of 2015 that there was an issue between the NAB Wealth Group and ASIC as to the charging of adviser service fees where services hadn't been provided?---For the trustee, yes.

Yes. And that began with a narrow focus which was where there was no adviser allocated to the account?---For – where a member had called us up and asked for the adviser to be taken off their account, their – in some instances, not all, but in some instances, the – there was a breakdown in some – in elements of the controls that meant the adviser – the adviser was taken off the account but fees continued to be deducted.

And did you become aware at some point that the issue with respect to adviser service fees had expanded to deal with a question of whether advisers were providing services in exchange for the fees they were being charged?---Yes, but I don't know that when I became aware of that being a problem for the advice licensee.

All right. Now, were you aware that at the end of 2016, NAB proposed a methodology whereby it would review the provision of services based on a concept of fair exchange of value?---Only as I prepared for my witness statement was I privy to that letter and that proposal.

All right. And the proposal – you tell me if I'm accurately summarising it – the proposal was that NAB would review the delivery of services not based on whether the service that had been agreed to be provided had been provided, but whether there was a fair exchange of value?---So I have had the opportunity to read that letter, if it's a letter – it is – very briefly through the course of my witness statement preparation – witness statement preparation. So I don't know whether what you've just said is accurate or not.

All right. Can we bring up NAB.079.005.5287. This is a chain of emails – I was just interested in understanding whether it's a chain of emails you've looked at in the course of preparing to give evidence?---It could be one of the emails I reviewed to give evidence. It's in respect of the advice business.

And if we go to page .5289. So what we see is an email sent on 22 December from Ms Hopwood who's within the NAB Wealth Group?---Yes.

And she's explaining that NAB is refining the methodology for assessing the provision of services based on the principle of fair exchange of value?---Yes.

And then if we go over to the next page which is .5290. I'm sorry, if we go over to – if we go to the preceding page which is 5288. That's my fault, Commissioner. Do you see that same afternoon ASIC emails back and says that it doesn't agree to the fair exchange of value concept?---Yes.

And you're aware now that the position ASIC took was if you agree to provide a service, you have to actually provide that service in order to retain the fees for it. You can't say, "But there was a fair exchange of value"?---But you can't say there was a fair - - -

You can't say "There was a fair exchange of value and, therefore, I will keep the fees"?---Sorry - - -

Let me take it back and break it down?---Yes.

You're aware the position of ASIC was an unsurprising position which was if you agree to provide a service and you've charged a fee for that service, you have to have actually provided that service?---Yes.

And NABs initial position was to want to retain the fee without having to establish that it had provided that agreed service?---If that's what is meant by a fair exchange of value, then having not read the – I would have to read the entirety of the email but I am sure that you are right.

You had not been aware of this - - -?---No.

- - - while you were the trustee?---No.

You only - - -?---No, sorry, I will clarify that. I was aware that there were – that ASIC were having discussions with the advice licensee around the concept that was in the market around fee for no service. So I conceptually understand that that's what ASIC is talking about. You can't charge a fee unless you've actually provided a service.

And that's the position you agree with?---It is a position I agree with.

And were you aware that it was not necessarily a position that the NAB Group agreed with?---I haven't had a conversation with anyone in the advice licensee group or the – the broader management team, or even the CRO as to whether or not that was their view.

I tender that document, Commissioner.

THE COMMISSIONER: Exhibit 5.60, emails concerning assurance review of adviser service fees, January 2017 between Hopwood, ASIC and others, NAB.079.005.5287, exhibit 5.60.

EXHIBIT #5.60 EMAILS CONCERNING ASSURANCE REVIEW OF ADVISER SERVICE FEES, JANUARY 2017 BETWEEN HOPWOOD, ASIC AND OTHERS (NAB.079.005.5287)

MR HODGE: Then at some point in time, in either October, November, or December of last year, you were provided with a copy of a document from ASIC entitled Outline of Suspected Offending by the NAB group?---Yes.

Can we bring that document up. It's ASIC.0036.0002.2531. This is the document we're talking about?---Yes.

And you read the document?---Yes.

And did it concern you, the document?---Yes.

And what were the aspects of it that concerned you?---In the context of – I was thinking as the trustee at that point, so in the context of fee for no service as it relates to what the trustee may have done at that point.

It identifies various contraventions that it thinks the trustee may have engaged in?---I'm sure that it does.

But it also identifies various contraventions in relation to advice licensees?---Yes.

And the advice licensees were taking money or being paid money by the trustee from the trust funds?---Yes.

And presumably, that also concerned you, quite apart from whether there was a contravention by the trustee, it concerned you that the advice licensees were taking this money?---If they were not providing a service, yes.

And then if we go to page 7 of that document, .2537, we see:

> *In relation to ongoing customer complaints documents produced under notice regarding amounts paid in response to customer complaints during the period 1 January 2012 and 24 February 2015 disclose some 40 complaints dating back to 2011... which were resolved either fully or partially in favour of the client.*

?---Yes.

Had you been aware before receiving this document that the NAB Wealth business had been receiving complaints dating back to 2011 about ongoing fees and poor service?---So I will be specific in my answer. These are complaints in respect of the advice business.

Yes?---I don't receive reporting – the trustee does not receive reporting for complaints in respect of advice provided. If – if it – we would receive complaints as they relate to superannuation members, yes. So - - -

Go on?---So in terms of the nature of the complaints listed here and the – their date of history, no, I don't recall being advised to – for these specific ones.

So that I understand, do you mean the trustee is advised if an advice licensee has been paid by the trustee but not provided services?---I don't believe we get specific reporting on that, no.

Okay. So the – I just - - -?---The advice licensee would be remediating and making good the customer on those – under those circumstances.

Yes, but the trustee is deducting money from the member's account and paying it to the advice licensee?---Yes.

And I had thought from an answer you gave a moment ago that you were suggesting the trustee would know or would be aware if there were complaints about the adviser where the adviser was being paid out of superannuation money?---I think there – I don't know, actually.

All right. And then if we go to page - - -

MR YOUNG: Mr Commissioner, we have not been notified that this document would be the subject of publication. There is a passage towards the end of the document that we may wish to make a claim for confidentiality. We have not been notified of the intended use of this. We would seek an opportunity to take instructions about that matter towards the end of the document before it is displayed.

THE COMMISSIONER: Mr Hodge, what do you say?

MR HODGE: Commissioner, if that's the case, then we should adjourn - - -

THE COMMISSIONER: If I come back at 5 to 3.

MR HODGE: Thank you, Commissioner.

ADJOURNED **[2.47 pm]**

RESUMED **[2.55 pm]**

THE COMMISSIONER: Mr Young.

MR YOUNG: Commissioner, at 1.37 pm we were provided by email, that is to say my solicitors were, with a list of 18 documents it was desired to tender this afternoon. We don't have access to those documents aside from four of them. So we're not in a position to ascertain our position with respect to confidentiality. The documents go to an ongoing exchange with ASIC that is explicitly the subject of without prejudice privilege. It goes to issues that are continuing as between ASIC and NAB. The documents do not concern an investigation affecting NULIS. We would like an opportunity of making a considered confidentiality application in respect of those parts of the documents that concern without prejudice privilege material that is the subject of ongoing exchanges between ASIC and my client.

This is a factor not present in the document that was the subject of the Commissioner's ruling yesterday. Those documents concerned without prejudice privilege in respect of matters that had concluded as between ASIC and my client. These documents go to an ongoing exchange and a continuing exchange of without prejudice communications between ASIC and my client. And if they are to be - - -

THE COMMISSIONER: Just a moment, about past conduct?

MR YOUNG: About not only past conduct, about past conduct and current remediation proposals.

THE COMMISSIONER: About remediation for past conduct?

MR YOUNG: Yes. But it concerns exchanges about the detail of remediation proposals that have been advanced by either ASIC or NAB or both and discussed between them. Now, we are concerned, Commissioner, that if these matters are published at this stage of events, it will affect or may affect the future of those discussions. It may prevent future exchanges taking place between ASIC and my client if matters cannot be raised and discussed confidentially. Now, they're the matters about which we wish to take instruction.

THE COMMISSIONER: Just pausing there, Mr Young, so that I understand this properly. You mentioned remediation for past conduct. Is that the point that provokes the question?

MR YOUNG: Well, it – as I said, it's one aspect of it.

THE COMMISSIONER: Well, one aspect is one thing. I need to know what it is that you say is to be borne in mind in considering the course I should take.

MR YOUNG: Commissioner - - -

THE COMMISSIONER: You mentioned past – current remediation proposals in respect of past conduct. I understand that. Is there any other matter to which you wish to draw my attention?

MR YOUNG: Well, we're hampered, Commissioner, because we have not had access to the documents it is proposed to display. The – so I can't tell you precisely what those documents go to. We have a concern that they go to ongoing exchanges between ASIC and my client concerning – remediation is one matter I have mentioned, and ongoing proposals, to and fro concerning remediation. But we're also concerned that the ongoing negotiations concern other aspects of liability or culpability relating to previous conduct, and how those matters might be resolved between ASIC and ourselves. Those sorts of exchanges commonly occur between the regulator and a party, but they always take place confidentially and on a without prejudice basis, and this is no exception. Now, I asked yesterday - - -

THE COMMISSIONER: Mr Young - - -

MR YOUNG: Yes.

THE COMMISSIONER: - - - is one of the issues which I will have to consider whether allegations of regulatory breach are matters for negotiation and resolution or to be determined according to processes of law?

MR YOUNG: No, that's not a matter that you will have to determine, Commissioner.

THE COMMISSIONER: No?

MR YOUNG: No.

THE COMMISSIONER: Under my terms of reference?

MR YOUNG: No.

THE COMMISSIONER: I'm a little surprised by that answer, Mr Young. I would have thought that it fell within the terms to know – or to consider how the regulator should deal with allegations of regulatory breach.

MR YOUNG: The regulator has powers to resolve matters at the moment under statute in a variety of ways, many of them not involving court processes. So that's the established legal position as it stands.

MR HODGE: Commissioner, I'm sorry, can I just – I apologise for interrupting my friend but just make a suggestion for how we deal with this? I'm – the instructions I've got are different from what has been the instructions that Mr Young has received because I'm told these documents have been in the court book and are available to be accessed by all of the parties for some days. Now, perhaps there's some misunderstanding and perhaps there's some issue that for some reason NAB has been unable to access those documents. They obviously haven't had the time in the last five minutes to be able to check whether in fact they have already looked at these documents. Can I suggest that we stand down Ms Smith, interpose the next witness, and that will give - - -

THE COMMISSIONER: Yes.

MR HODGE: - - - the NAB team some time to actually look at those documents.

THE COMMISSIONER: And is the next witness from NAB?

MR HODGE: No, the next witness is from AustralianSuper, Commissioner.

THE COMMISSIONER: Well, if I say to Ms Smith, not before 9.30 tomorrow morning?

MR HODGE: I would be content with that, Commissioner. I'm told by Mr Dinelli, who will be taking the next witness, that we probably won't see out the day with the next witness. So it's really – we're in your hands, Commissioner. One possibility - - -

THE COMMISSIONER: I would be minded to stand it over till not before 9.30 tomorrow morning for Ms Smith so that – and we go on with the AustralianSuper matter as far as we can.

MR HODGE: Thank you, Commissioner.

THE COMMISSIONER: Yes, Mr Young.

MR YOUNG: Two things, Commissioner. Yesterday, I asked for a list of all documents that it was proposed to be gone to in the course of cross-examination and displayed so that we could consider overnight any confidentiality concerns and objections we may have - - -

THE COMMISSIONER: Mr Young, I think it may be better if these matters are taken up between solicitors rather than with competing propositions being advanced from the bar.

MR YOUNG: Yes.

THE COMMISSIONER: Can I suggest - - -

MR YOUNG: Can I - - -

THE COMMISSIONER: - - - you direct yourself as to whether we should stand Ms Smith down and NAB down until not before 9.30 tomorrow.

MR YOUNG: Well, that's the second matter I wish to mention. The documents in question are documents that Ms Smith had no involvement in and was not a party to, and the ongoing investigation we are concerned with does not concern the conduct of NULIS. Now – but that is the matter that is the subject of this documentation. We fail to apprehend at the moment why this matter and the tender of these documents need involve Ms Smith at all, nor detain her, because on our instructions, her answer will be that she had no involvement - - -

THE COMMISSIONER: Well, you will not give - - -

MR YOUNG: In these matters.

THE COMMISSIONER: You will not give her her answer, Mr Young. You will not. Do you understand me?

MR YOUNG: I'm not attempting to give any answer, Commissioner. I'm attempting to explain the situation why we think this matter ought not to detain Ms Smith.

THE COMMISSIONER: Yes. You will not indicate what answer you think she may give.

MR YOUNG: I've done nothing of the sort, Commissioner.

THE COMMISSIONER: Do go on.

MR YOUNG: I repeat my submission that in our submission, there is no reason why this documentary issue need detain Ms Smith, unless Mr Hodge can point to a reason why he needs to ask questions of Ms Smith concerning these documents and this course of events.

THE COMMISSIONER: These are matters that we will take up at not before 9.30 tomorrow morning. Ms Smith, you're excused. If you could be good enough to be back at the hearing room at 9.30 tomorrow morning unless you are advised to the contrary. It may be that you will be advised to the contrary. We will see?---Thank you.

Thank you.

<THE WITNESS WITHDREW [3.06 pm]

THE COMMISSIONER: Yes, Mr Hodge.

MR HODGE: Commissioner, we will just need to stand down for two minutes while we rearrange the bar table.

THE COMMISSIONER: I will come back at 10 past.

ADJOURNED [3.06 pm]

RESUMED [3.11 pm]

THE COMMISSIONER: Mr Dinelli.

MR DINELLI: Thank you, Commissioner. We now move to the next case study concerning AustralianSuper. And I will invite my learned friend, Mr O'Bryan, to call Mr Peasley.

THE COMMISSIONER: Mr O'Bryan.

MR O'BRYAN: Yes, thank you, Commissioner.

<JASON ROBERT PEASLEY, SWORN [3.11 pm]

<EXAMINATION-IN-CHIEF BY MR O'BRYAN

THE COMMISSIONER: Do sit down?---Thank you.

Yes, Mr O'Bryan.

MR O'BRYAN: Thank you, Commissioner.

Mr Peasley, is your full name Jason Robert Peasley?---Yes.

And is your business address level 26/50 Lonsdale Street, Melbourne?---Yes.

And is your current position head of mid-risk portfolios at AustralianSuper Proprietary Limited?---Correct.

Mr Peasley, have you received a summons dated 31 July 2018 to give evidence and to produce your signed witness statement?---Yes.

Do you have that summons with you there?---I do.

Yes. I tender that summons, Commissioner.

THE COMMISSIONER: Exhibit 5.61, summons to Mr Peasley.

EXHIBIT #5.61 SUMMONS TO MR PEASLEY DATED 31/07/2018

MR O'BRYAN: And Mr Peasley, have you made a witness statement dated 1 August 2018 in response to the Royal Commission's Rubric 5-72?---Yes.

Yes. And do you have that – the original of that witness statement with you in the witness box?---Yes, I do.

Yes. And Mr Peasley, is there one correction you wish to make to that witness statement?---Yes, there is.

Would you turn to page 4 of that witness statement. And in the table beneath paragraph 4.2, in the last row of that table opposite the date 31 March 2016, in the third column do you wish to correct that – the figure of 0.60 per cent to 0.43 per cent?---Yes.

Yes. Thank you. Commissioner, is the practice for Mr Peasley to hand mark that - - -

THE COMMISSIONER: Make the amendment and initial it, please.

MR O'BRYAN: Yes, thank you, Mr Peasley. If you would do that. And with that correction, Mr Peasley, are the contents of that witness statement true and correct to the best of your knowledge?---Yes, they are.

I tender that witness statement and the annexures to it, Commissioner.

THE COMMISSIONER: Exhibit 5.62, witness statement of Mr Peasley, 1 August '18 and annexures.

EXHIBIT #5.62 WITNESS STATEMENT OF MR PEASLEY AND ANNEXURES DATED 01/08/2018

MR O'BRYAN: Thank you, Commissioner.

THE COMMISSIONER: Thank you. Yes, Mr Dinelli.

<CROSS-EXAMINATION BY MR DINELLI [3.14 pm]

MR DINELLI: Thank you, Commissioner.

Good afternoon, Mr Peasley, my name is Albert Dinelli and I am one of the Counsel Assisting the Commission. I understand your role at AustralianSuper is head of mid-risk portfolios. Is that right?---Yes, correct.

Can you explain to the Commissioner, please, Mr Peasley, what that role involves?---As a portfolio head I am responsible for the overall coordination and implementation of portfolio strategies involving the asset classes of infrastructure, property and credit.

And the term "mid-risk", can you explain how that is to be differentiated between low risk and high risk?---Certainly. So we will characterise low risk portfolios or asset classes to be cash and fixed income in nature and like. And the higher risk portfolio as being the likes of equity and private equity.

And in – and in your role as the head of mid-risk portfolios, who do you report to?---I report to the chief investment officer, Mark Delany.

And I understand you have a number of staff that assist you. How many staff assist you in your – in your role?---In the current role there's approximately 30 people in the mid-risk portfolio teams.

And uncontroversially the evidence of your colleague, Mr Silk, will be that as at 30 June 2017 there was approximately $120 billion of funds under management in the fund?---That sounds correct, yes.

In fact, there will be further evidence tendered from a – one of your colleagues, Mr Schroder, who says that it's now actually some one year later approximately $140 billion?---Yes, that sounds correct.

And what proportion of those funds would be part of the mid-risk portfolio?---The mid-risk portfolio is currently approximately 28 billion. So that would make it roughly as percentage terms 22, 23 per cent in broad whole of fund terms.

Thank you. Now, AustralianSuper was asked to provide a statement to the Commission dealing with various questions it wished to explore regarding AustralianSuper's investment in Pacific Hydro via a fund manager Industry Funds Management. And your statement does that. Can you explain perhaps to the Commissioner what Pacific Hydro is?---Certainly. So Pacific Hydro at the time was a renewables development and operating company. It was initially publicly listed and then taken private by IFM in 2005 whereby it developed wind renewable farms and hydro generation assets in Australia, Chile and one small asset in Brazil.

Am I right to say that during the time it formed part of AustralianSuper's fund – and I will let you explain shortly that it was an indirect investment – but am I right to say that it was one of AustralianSuper's largest company exposures during the time that AustralianSuper invested in it?---So at the time that I joined in 2011, it was probably in the top five of what they call single asset exposures within the AustralianSuper portfolio. That is correct.

Now, Pacific Hydro, you indicate in your statement, was an indirect investment through Industry Funds Management which you've already referred to, or IFM. Can you explain, please, to the Commissioner what IFM is?---So IFM is a fund manager who offer as an investment product a portfolio which comprises infrastructure investments. And so AustralianSuper's investment is the investment in the portfolio that is the Australian Infrastructure Fund and that fund of itself owns percentages of various equity stakes in various infrastructure assets throughout Australia.

You give some examples in your statement, I think, of the sort of assets that IFM has invested in through the infrastructure fund. What sort of assets are they, Mr Peasley?---Broadly, in sector terms, airports, toll roads, power networks, ports and specific examples include the Port of Brisbane, small stakes or partial ownership stakes in Melbourne Airport, Adelaide Airport, Eastern Distributor in Sydney, the M5 toll road in Sydney, Brisbane Airport and also a small suite of equity stakes in public/private partnership projects. Yes.

Thank you, Mr Peasley. Now, IFM invests obviously on behalf of a number of entities. It might assist to explain the background to IFM to the extent you're able, and the nature of those who perhaps initially invested in their funds and those that presently invest in their funds?---So to the best of my knowledge, the history is that IFM was formed in 1995 by Australian Industry Funds. The investment rationale for that was at the time the industry funds identified owning directly Australian infrastructure assets as an attractive suite of assets to hold for superannuation members over the long term. The challenge with doing so is that infrastructure assets are quite large in size and, therefore, the funds – the superannuation funds needed to pool their resources and capital in order to be able to participate in that investment opportunity. That led to the formation of IFM, which acted on its behalf, amongst other fund managers at the time, in seeking to acquire infrastructure assets on behalf of the initial investors, being industry funds. Over time, IFM has proven to be very successful as a fund manager. So by way of example, it currently manages approximately 100 billion Australian dollars of institutional capital. There are some 200 clients, we understand, of IFM, and they are obviously now broader than just industry funds, they're Australian and, indeed, global institutional investors.

Thank you. And does AustralianSuper itself have an interest aside from the interest in the funds in IFM?---Yes. AustralianSuper has an interest in the sense that it is a part owner of ISH which is the holding entity of IFM.

And I would like to focus, if I may, on the infrastructure fund in which, as I understand it, Pacific Hydro was held. In relation to the decisions that are made in relation to the infrastructure fund, those decisions are made by IFM. Is that right?---That is correct.

And is the fund – and forgive me, there's a number of funds here. I will refer to the IFM – infrastructure fund is infrastructure fund and the fund as the AustralianSuper fund. Is the fund, that is AustralianSuper, consulted on decisions that are made by IFM?---No, it's general practice that the manager who has the discretion to invest capital that the fund has makes those decisions and investors are informed of those decisions after the event.

And you give evidence to that effect in your statement. But can I ask, that being the case, what oversight is in place via your role or the roles of others at AustralianSuper in relation to the oversight of decisions that are made by the infrastructure fund?---So as a starting point, the reason investors like AustralianSuper would give capital to a manager like IFM is that it has the skill to implement a stated investment strategy and it has the processes in place to do so with respect to its own internal expertise decision-making processes. Therefore the oversight given by funds such as AustralianSuper and investor such as AustralianSuper would be through the regular engagement – structured engagement and reporting that is part of the duty of the manager to the fund investors. There's regular quarterly reporting. There's provision of monthly valuation unit pricing statements. There's formal meetings, presentations of the manager, and in some cases there's also formal committees that some of the investors can be invited to attend. All of those forums and forms of reporting provide information to the investors that allow them to engage with the manager to understand that the manager is executing in accordance with their stated investment strategy and that they're carrying out their duty in managing the fund to the best of their abilities for the benefit of the investors. On top of those formal arrangements there's also the opportunity for informal engagement. I guess you could say at the – at the pleasure of the investor. And so that form of informal engagement at an executive level is something that we would undertake on a regular ad hoc basis throughout the time that I've been with AustralianSuper.

And are you, in your role as the head of mid-risk portfolio the contact person for IFM in relation to its infrastructure fund, specifically?---In my former role as head of infrastructure, that was my direct responsibility and I sought to have that direct engagement alongside several of my colleagues. As we stand here today, one of my direct reports is the head of infrastructure, and so he has that duty currently.

And I didn't explore that with you, but it does appear from some of the documents I'm about to take you to that you were the head of infrastructure for a period, that is from when you started at AustralianSuper in 2011 until your promotion. When were you promoted to the role that you currently have?---December 2016.

So from 2011 to 2016, which is that timeframe which we're concerned with today, you were in the role of the head of infrastructure. Is that correct?---Yes, correct.

And so it was your responsibility as part of that to be the contact person for IFM in relation to the infrastructure fund?---Yes, as the person responsible for the portfolio, I would just note that there was multiple contact points between the two organisations, but within my team and more broadly across the investment department.

And you've indicated that various reports were given on a formal and informal basis and you referred to quarterly reports that were given. When those reports were given to AustralianSuper, what did AustralianSuper – what did your team do with those reports and how did it deal with any issues raised by them within AustralianSuper?---So as a standard approach we would digest the information provided by the manager, usually those quarterly reports are accompanied by quarterly presentations held by the manager that we would attend, have the opportunity to engage in that forum. If there's nothing particularly controversial or new in those reports, they may well just be filed and to the extent necessary, we may report upon it in the regular reporting that we have internally to our own investment committee. If there are more – if there are new or unusual matters or matters of particular concern to us, we may seek to elevate the engagement or activity around that particular issue in order to understand it, potentially to engage or convey a view on that to the manager, and, indeed, up through our internal reporting process to the investment committee. It is by and large an engagement function that we seek to undertake, recognising where the duties and the responsibilities of that fund lie.

And when you say – I think you used the word "elevate". I think you were using it in the context of elevating it within – if there is an issue with IFM, that would be something that would be raised by you or would it be raised by a member of the investment committee with IFM?---So we would seek to engage directly with the infrastructure team within IFM who are responsible for the Australian infrastructure fund. It is quite possible and, indeed, it has been the case that my senior colleagues have also engaged directly with IFM on matters pertaining to that particular fund.

Can I come to Pacific Hydro. As I understand it, and you've given evidence that IFM wholly acquired Pacific Hydro in 2005. You started, of course, with the business in 2011. To the extent you can, can you assist the Commission by explaining broadly about the general performance of Pacific Hydro during – during the time that you've been with AustralianSuper?---So having joined in 2011, we did undertake a review of that asset. At that point in time it had underperformed what we would say was their original investment case, albeit still performing at a reasonable return, in our mind, of – I think it was 8 or 9 per cent, if I can recall. Since that point until about 2014, the return had been mediocre, I would say, and required a level of regular engagement between the manager and investors as a result of that. Overall, going right back to when part of the stake was acquired by IFM in 1995, the return from first ownership to last ownership was, as we understand it, 7.2 per cent, from an IFM fund level point of view, if that makes sense.

Thank you. Perhaps we can go to some of those matters in just a little bit more detail, if I may. Your evidence was that you did a review soon after starting with AustralianSuper. When did you start with AustralianSuper in 2011, do you recall?---Early 2011, I think April or May, from memory.

And it must have been then soon after your appointment that you prepared the paper which is JRP-6.1 which I might ask be called up which is ASU.0018.0001.0028. And you prepared this paper on 7 June 2011?---That's correct.

And you prepared it with what I assume are two of your colleagues?---That is correct.

Whose names are there. And can you explain why this paper was prepared by you and your colleagues for the investment committee?---Certainly. So the catalyst at that time was that there was a refinancing occurring with respect to the asset, and at that time we were a financier of the particular instrument in question. There was also a restructure.

THE COMMISSIONER: Sorry I missed the last sentence?---Sorry, we were a financier of a particular subordinated note facility that was the subject of a brief financing. The second reason was there was a restructure proposal with respect to the ownership of Pacific Hydro being put by the manager to the AIF investors at that time, and the third AustralianSuper specific reason was it was a large exposure, one of the largest exposures within AustralianSuper. It had not performed as originally expected and I was asked to perform a deep dive analysis to better understand the nature of that investment and our exposure to it.

MR DINELLI: In paragraph 1.2 you say that:

> *The review has been undertaken for two reasons.*

And I understand this summarises what you have said. One was:

> *The concern over the size (both current and prospective) risk profile and return volatility associated with our indirect investment in Pacific Hydro and (2) to assess two proposals made by IFM in respect of Pacific Hydro being a refinancing of an investor funded subordinated note facility and a restructure proposal which will materially alter the way in which our investment in Pacific Hydro is to be held.*

?---Correct.

And you noted there in 2.1 that:

> *Pacific Hydro has underperformed its original acquisition case to date both operationally and in investment performance. Originally forecast to complete 875 of new projects with 548 million of new investor equity and generating free cash flow by 2010.*

Just pausing there, was the fact that it wasn't generating that free cash flow by that time what prompted this work?---I think that was one of the reasons. So by not having met its original acquisition case, it was not performing in an investment sense as expected and that was leading to a review of the asset because of its underperformance from an investment point of view.

Is that a common – moving away from Pacific Hydro for a moment, is that a common task in your role to do an evaluation of that type?---It's an unfortunate hazard of investing that we do tend to get things wrong sometimes and under invest – underperform specific investments. When that's the case we do have a process in place that seeks to understand the source of that underperformance and determine whether action to the extent we could take action, should be taken with respect to the fact we have the investment and what would be the best course of action having regard to the best outcome for the use of those – that invested capital.

If I can just go ahead to .0030. You and your colleagues prepared this paper and set out then at paragraph 6.1 some recommendations. And summarising those, the first was that you would:

> *support the proposed refinancing of the existing RECN –*

which is the note to which you have made reference –

> *on the proposed terms of the new note and rolling over our existing investment in the current facility. And rejecting the proposed ownership restructure of Pacific Hydro on the terms proposed. (3) reducing our exposure to Pacific Hydro over a determined period of time to a level which allows the AustralianSuper portfolio to adequately absorb the risk and volatility inherent in the underlying business.*

Can you explain in a little bit more detail that third point, what was intended by your recommendation in this paper to the investment committee?---So having regard to the – the potential earnings volatility of the asset by its nature and being a generation asset, that gave rise to a level of volatility when you work through the performance consequences with respect to our – our indirect investment in that. And given it was one of the largest single asset exposures to the fund, it was our recommendation that it would be prudent to see that exposure size reduce and, therefore, the volatility or potential performance impact on our fund reduce accordingly.

And the fourth point is that you recommended:

> *formally approaching IFM to put forward our preferred position and seeking a framework designed to produce a long-term solution which satisfies the objectives of all stakeholders.*

It was your earlier evidence that generally IFM or the fund manager makes the decisions. What prompted you to approach IFM in this particular case - - -?---So - - -

Was that you to recommend that that be the case. We will come to what actually happened in a moment?---So, yes, of course it's true that it's the manager's responsibility. Having said that, we don't necessarily sit passively if we have a particular view. We had a view that we felt reflected the best interest of our members and we felt a duty to engage with the manager and convey those views accordingly in an attempt to seek some sense of alignment or outcome that we felt was in the best interests for our fund members.

And after that recommendation had been made in your paper, what occurred?---So there were several conversations with IFM involving various members of AustralianSuper where we put our views and concerns of the asset and its potential investment performance to them, and that was certainly heard by the manager. The manager responded with respect to acknowledging our views, with respect to our position on a particular restructure that had been put forward by the manager which we were not supporting, and as a result of our position of not supporting the restructure, that particular initiative ceased.

And am I right that ultimately AustralianSuper determined that it was – that it wished to reduce its exposure to Pacific Hydro?---So that certainly remained the case and that view was conveyed to the manager on several occasions throughout those engagements.

And when you say "throughout those engagements" that's a reference to the various meetings that you had in the period after you wrote your paper?---Correct and the formal communication as late as, I think, November that year.

In fact, I think you might be referring to 6.4, exhibit JRP-6.4 which is a letter dated 19 December 2011?---Yes, correct.

Which is ASU.0018.0001.0076. And when you – when you said previously a formal notification, is that what you were referring to, Mr Peasley?---Yes, correct.

And you say there – or at least Mr Delany, who is the chief investment officer, says:

> *We are writing to confirm earlier verbal of AustralianSuper's position with respect to its economic interest in Pacific Hydro via IFMs Australian Infrastructure Fund.*

And then setting out that it's – what you have already given evidence about, the size of that exposure. And you then say – sorry, Mr Delany says in the second last substantive paragraph:

> *From this analysis, the investment committee has concluded that we wish to reduce our exposure to Pacific Hydro over time in a way which does not harm the value of our investment.*

Perhaps you can assist there. Why – it's obvious, of course, why you wouldn't want to harm the value of your investment, but why was that a necessary matter to raise in this correspondence with IFM about reducing one's exposure?---I will try to answer it this way: so recognising the nature of the fund, and it was within the manager's discretion to determine how it wishes to deal with that investment. There was also a practical reality as to what it could do with respect to that investment in the sense that what can you do, can you improve the operational performance, do you sell the investment and the inference being there that one way to reduce the exposure is encourage them to sell the investment. But by doing so if that is detrimental to investors because for instance you can't realise the value that you think is fair, then that would be against the interests of all investors in the fund and would be against the duty – fiduciary duty of the manager to do such a thing. So it was recognising, I think, implicitly recognising the duty of the manager to all investors, but trying to convey our concern and seek to find a way that all stakeholder interests could be – could be aligned.

Was it – was it of particular moment the fact that Pacific Hydro was wholly owned by the infrastructure fund?---Can you repeat the question.

Was it of particular moment, particularly important in terms of this particular aspect that it was wholly owned by the infrastructure fund?---As far as a decision by the manager to sell that investment I don't think the percentage ownership of the underlying investment is fundamental to that. So they will own a portion of the business. They could still like to sell a portion of the equity. I don't think that was determinative to seeking to sell the business.

And the letter then goes on to say:

> *As manager of the Australian Infrastructure Fund and by extension Pacific Hydro we are seeking your guidance and leadership in the development of a strategic plan which facilitates the objectives of all stakeholders including the specific objectives of AustralianSuper.*

?---Yes, correct.

Now, your statement which deals with Pacific Hydro deals with, if I may say, two parts, that is the sort of first period when you started with AustralianSuper, and the next period I would like to deal with is 2014 to which you've already made brief reference. But your statement says nothing about what happened in the period in between. Was there ever a response to this letter to IFM that was sent by Mr Delany?---I can't recall seeing a formal response. The – the engagement with the manager through both our regular periodic engagement and ad hoc ensured that Pacific Hydro was a regular topic of conversation. The natural conclusion out of this exercise was that the proposed restructure did not go ahead. A refinancing went ahead but with other providers of the subordinated note, to the best of my recollection, and the ownership remained within the fund and we remained regularly engaged with the manager on the performance of that investment thereafter.

And I take it that you had your regular reporting done and your regular analysis within your team during 2012 and 2013?---We – we did, and I would also note that through that period, the – the engagement and disclosure of information pertaining to that asset was elevated by the manager. So we were provided direct presentations by the management of Pacific Hydro, all ad hoc requests concerning the asset were responded to by the manager, and so there was, I would say, a much – a more transparent and heavier level of engagement and information pertaining to the asset over that period of time.

And in 2014 to which you've already referred, I understand, that there was a material deterioration in Pacific Hydro's value, and you deal with this in your statement. It might be useful to ask for paragraph 4.1 to be brought up of your statement, which is ASU.0018.0001.0365 at 0368. Just to put this in context, previously you had given evidence about the – sorry, previously in your statement you had explained the market value of the investment in the Infrastructure Fund by AustralianSuper. As a percentage, and you can go to your statement if it would assist, but as a percentage, what percentage of the AustralianSuper fund was invested in the Infrastructure Fund?---So as at 30 June 2013, the total weight of the Australian Infrastructure Fund in our fund assets was 3.55 per cent.

And a proportion of that then, coming to Pacific Hydro, a proportion of that then was the exposure to Pacific Hydro itself?---That's correct.

And can you explain, perhaps, the – what did occur during 2014 and the deterioration to which you refer at 4.1 of your statement?---Certainly. And for clarity, back in 2011, the implied exposure the fund had to Pacific Hydro was approximately 1.8 per cent. So in 2014 the business – or the investment suffered a series of devaluations as a result of a deteriorated outlook with respect to the market that it operated in. That is, the future expected price of electricity declined. There was also issues with the potential volume output that the assets could generate. There was also a number of other external factors pertaining to the value of renewable energy certificates which these assets generated and were of value and could be sold on the market. There was also changes in Chile to tax policy that had adverse impacts on owners. I think, if my recollection serves, foreign owners particularly of assets. And there were also consequential impacts pertaining to the operations of the business that led to a revaluation as to the costs of running the business, and all of these things colluded to a lower valuation based on a lower future expected earnings to be derived from the assets.

And, in fact, it was a very – as you say, a material deterioration but in fact a very significant one in 2014?---It was indeed significant, yes.

And no doubt in your role at the time, having responsibility for infrastructure, this was of great concern to you?---Indeed, yes.

And you prepared a paper. If I can take you to ASU.0009.0004.14545. You won't find this in your materials, Mr Peasley. But it's a document dated 8 July 2014 which is just being called up.

THE COMMISSIONER: Do you have the number again, Mr Dinelli? It's 0009.0004 – what's the last four digits?

MR DINELLI: 1545. And I take it this was a document that you prepared for an investment committee meeting. Is that correct?---Yes. So this would be our standard portfolio report that we submit to each investment committee.

And I think we had earlier gone to one you had written with two of your colleagues, Ms Finlay and Mr Berger. This one had been written by you and quite a number more of your colleagues on 8 July 2014. Is that right?---That's correct.

At paragraph 1 you set out the strategy of the infrastructure portfolio and you say that:

> *They are to deliver low double digit returns (bonds plus 4 per cent) with low volatility and low fees. The portfolio strategy advocates the predominant use of direct investment techniques for new investment opportunities given their comparative advantages over pooled investment structures namely facilitates portfolio construction decisions within AustralianSuper, facilitates our preferred risk exposure and scope of the portfolio's investment mandate, reduces costs and improves liquidity.*

That strategy that you describe there, is that a strategy that's consistent with the strategy now?---Yes, it is.

And was it the case that there was a move towards more direct investments rather than indirect investments of the type we're here discussing?---Yes. So since about that time we have sought to introduce that capability and aspect into our strategy.

And why – well, you identify some of the reasons but why is that of benefit to AustralianSuper and why is AustralianSuper able to do that?---So the broad portfolio strategy – I will take a step back. So the nature of the asset class, it's not something that's easily transactable. There's no stock exchange that we could make investments or divestments from. And I've mentioned the difficulty in securing very large assets. From our point of view, AustralianSuper, through the benefits of scale that it had developed, afforded us the ability to bring in internal capability and start to engage directly in the marketplace under our own name. That had certain advantages for us in the sense that it brought the investment decision closer to the members and, therefore, in the context of the overall funds through which the members invest and we felt that would be supportive to making the right overall decisions over a long period of time. It also afforded us the ability to do it on a more cost effective basis than using external agents. Having said that, we could not easily replicate external agents. They're well established platforms with skill and expertise that we did not have. So evolving a portfolio that would have a combination of both the pooled fund investments and direct investments would allow us to continue to have access to the underlying existing exposures we had, the expertise of certain managers, and complement that with our own direct engagement with the marketplace that gave us sufficient control over our portfolio construction at a lower cost which we felt would benefit members.

If I can just jump ahead to 1547 where you deal specifically with Pacific Hydro. You note there that the value of Pacific Hydro decreased by 307 million or 18.2 per cent before hedging in June. That's quite a significant decrease in that period of time?---That is significant, yes.

And you then go on to identify towards the bottom of the page Pacific Hydro having requested a funding support package which comprised a cash injection – a $200 million cash injection. And over the page, a deferral of the repayment of insurance proceeds of $13 million and extension of a standby facility to 2022. They were obviously significant – or a significant request for a funding package at that time?---Yes. So obviously there was a confluence of events at that point in time which created a liquidity issue with respect to the operations of the business. And some of those events were outlined in that paragraph.

And the committee did agree to that funding, as I understand it?---The – the IFM - - -

Sorry, the IFM investment committee had agreed that funding would be available for that, but there were certain conditions which were placed on it?---Yes, that's my understanding.

And that was to be done by IFM, that is, a review by the new CEO?---Correct. So obviously, the – the investment performance was significant and that was of significant concern to the manager. The manager in assessing the situation and providing that funding has rightly sought to take action and we listed there that involved undertaking a strategic review of the business, providing the funding, and putting a cap on new capital expend sure until such matters are complete.

And what role did AustralianSuper play in that review?---So as obviously a large investor and a concerned investor we engaged with the manager. We sought to outline the specific areas that we felt the strategic review should look to undertake. I would say, I guess pleasingly, at least in the circumstances, the manager had already initiated many of the aspects of the review that we felt were important, and that afforded us the ability to monitor and engage with them as they undertook that process.

If you go back to the next page, 1549, where it says the portfolio team – about point 6 of the page:

The portfolio team considers the key issues which should be addressed are –

It might actually be the one above that. With the five dot points. When you refer there to the portfolio team, though, you're referring to AustralianSuper's portfolio team?---Yes, that was - - -

Of which you were the head at the time?---That's correct.

And these were particular issues. Why were you concerned about particular issues such as governance, forecast, sustainability of the business, options for the business and options for ownership. Why were you keen to ensure that those key issues were addressed?---So given the state of the business at that time, in short, we wanted to see all options were on the table to make sure the business – or we could realise the best possible outcome from that situation for our members. And they were the areas that we felt needed to be assessed in order to – in order to inform whether the business was viable as an investment going forward, whether it should be sold, and more able in the hands of a third party.

Thank you. Commissioner, if I can tender that document, if I may.

THE COMMISSIONER: Exhibit 5.63, AustralianSuper investment Committee Infrastructure Portfolio Activity Report, 15 July '14, ASU.0009.0004.1545.

EXHIBIT #5.63 AUSTRALIANSUPER INVESTMENT COMMITTEE INFRASTRUCTURE PORTFOLIO ACTIVITY REPORT DATED 15/07/2014 (ASU.0009.0004.1545)

MR DINELLI: It might be 8 July.

THE COMMISSIONER: 8 July, was it?

MR DINELLI: - - - Commissioner.

THE COMMISSIONER: I was reading the footer.

MR DINELLI: You are right. One of the two, I think, Commissioner. The date at the top does appear to be the 8th.

Sorry, Mr Peasley, then a letter was ultimately sent by AustralianSuper to IFM, wasn't it?---That's correct.

And that is at JRP-6.5, ASU.0018.0001.0001. And that set out AustralianSuper's expectation of the review that was being done by IFM. Is that right?---That's correct.

And is it common, moving away from Pacific Hydro for a moment, but is it common for you to in circumstances where there's a review or ongoing work being done in relation to a particular investment for AustralianSuper to write to a fund – sorry, to a fund manager and make such matters clear?---It's not at all common. But this was not at all a common circumstance.

And was that – and I assume you say that because the evidence you've given previously about the very significant deterioration in the value?---That's correct.

And you individually when you wrote that letter and as part of your portfolio team took the view that it was important to put this in writing to IFM?---The letter was written by our chief investment officer, Mark Delany, but yes, we certainly had input into the drafting of that letter and we felt it important to make sure this was formally tabled to IFM as we felt it was important to protect, as best we could, our investment in the fund.

It does pick up, doesn't it, the matters that you had in your earlier – the document we went to a moment ago in your earlier report?---It does indeed. It does also note that it is covering areas that the manager had already indicated would be undertaken as part of its review.

Thank you. No doubt you were spending considerable time on this particular issue around this time in 2014?---Yes, that's correct.

And you prepared another report for the investment committee on the – sorry, perhaps I will give a number, ASU.0009.0003.8505. Now, perhaps you can assist me and others, perhaps. This does appear to be dated 5 September 2014. But much like the other document, it has a different date. Is that because the different date in the footer is when the committee meeting is being held?---Yes, I'm sorry about that. The practice (1) is the time the paper is submitted, the other is the scheduled date of the committee meeting.

I see. So this was prepared for the meeting on 12 September but a week prior you and your colleagues had prepared the document?---Correct.

If you go to the second page of that document, again you see a heading Pacific Hydro, 4.1:

> *The strategic review of Pacific Hydro being undertaken by the new CEO and the IFM team is approximately 50 per cent complete. AustralianSuper and other investors have met with the IFM review team on at least two occasions since the review commenced.*

Were you part of those meetings at the time?---I don't have specific recollection but I expect I would have been in my capacity of my role.

And, in fact, is it fair to say that you would have become during the course of this review even more concerned about your investment in Pacific Hydro?---I think at that point in time we probably knew – we thought we knew all we needed to or what was to be known about the investment in Pacific Hydro. I recall that we were focused on the actions the manager was taking at the time, the thoroughness of the review that they were undertaking to ensure that we got to the right outcome on a fully informed basis, and that was generally the basis of those – those early engagements to understand what the manager was doing and being comfortable that it was going to produce the best possible outcome in the situation.

In fact the next paragraph, though, does suggest that IFM had confirmed – sorry, perhaps I will read what it says:

It has been confirmed by IFM that in the absence of shareholder support approved by IFM in July Pacific Hydro would be technically insolvent.

?---Yes, that's what we were informed.

And you then go on in this paper to say that:

IFM will be attending the investment committee meeting to address any committee questions and provide a verbal update of various matters including the review.

?---Yes, that's correct.

And was that something that you required of IFM to attend the investment committee meeting for that purpose?---I can't recall who specifically made the request. I suspect it would have been made at the request of the investment committee or, indeed, agreed by senior executives of the investment staff to make that request on behalf of the investment committee.

Thank you. Commissioner, can I tender that document, please.

THE COMMISSIONER: AustralianSuper Investment Committee Infrastructure Portfolio Activity Report, 12 July '14, ASU.0009.0003.8505 exhibit 5.64.

EXHIBIT #5.64 AUSTRALIANSUPER INVESTMENT COMMITTEE INFRASTRUCTURE PORTFOLIO ACTIVITY REPORT DATED 12/07/2014 (ASU.0009.0003.8505)

MR DINELLI: Thank you, Commissioner. So these very significant issues in relation to the Pacific Hydro investment had been raised by you with the investment committee. They were also elevated to the board of AustralianSuper?---So subsequent to the events, yes, I have seen board papers which reference the situation.

And can I take you to, if I may, a further document which is a paper of your then and present CEO, Ian Silk. It is ASU.0009.0002.7126. And this is the chief executive report dated 20 October 2014 in advance of the October board meeting. And perhaps if I can go to page 2. An issue was raised by Mr Silk at paragraph 5.1 about:

The negative publicity surrounding the Pacific Hydro write-down –

He identifies that issue and he goes on then in the last four lines to say:

The Pacific Hydro case has been cited as an example of ideological investment that has occurred to the detriment of industry fund members.

Do you see that?---Yes, I do.

And what do you say to that issue that was raised there by Mr Silk?---It would be difficult for me to comment on the decisions made by a third party in 1995 and 2005. I would observe, by my engagement with IFM since 2011 and, indeed, prior, by being an industry participant that they are particularly hard-nosed people with respect to making infrastructure investments and managing those investments. I don't get the impression at all that they make investments for ideological reasons.

Commissioner, can I tender the chief executive report of Ian Silk.

THE COMMISSIONER: Chief executive report AustralianSuper board 20 October '14 ASU.0009.0002.7126 exhibit 5.65.

EXHIBIT #5.65 CHIEF EXECUTIVE REPORT AUSTRALIANSUPER BOARD DATED 20/10/2014 (ASU.0009.0002.7126)

MR DINELLI: You prepared another report later that year in December, ASU.0009.0003.5773, on 1 December 2014 in anticipation of the investment committee meeting the week after. And on 5775, you note – or you and your co-authors note at 5.1:

> *The internal IFM team has completed its report on the Pacific Hydro review. We will receive it in the second week of December. It will provide options and recommendations for the future.*

Do you see that?---Yes.

Now, I won't take you to that report because it's the subject of a confidentiality order, but you then see in the next paragraph that Garry Weaven – can you assist by explaining who he is?---He was the chair of IFM Investors.

And he has advised that investors in the fund that he, Mr Coffey and Mr Himbury – Mr Himbury of course is the CEO who your colleague, the chief investment officer, had written to previously?---That's correct.

Continuing:

> *Will be resigning from the board of Pacific Hydro to facilitate the appointment of new directors by IFM.*

?---Yes.

He then goes on to say:

He states that as much as 18 months to two years ago the board arguably could have judged that the changing political climate in both Australia and Chile in different ways would have had a severe impact on the value of Pacific Hydro.

Do you see that?---Yes.

Continuing:

Equally they could have more strenuously questioned the energy demand forecasts of the Australian Energy Market Operator and the discount rate applied by the independent valuer. They did not foresee the manner in which a range of factors could conspire to have such a dramatic compounding impact on valuation. Had they done so they could have arranged an asset sale at a price well above current valuation.

?---Yes.

Continuing:

For that reason and in order to enhance investor confidence for the future the IFM infrastructure management team was asked to conduct a search for new directors including a new chairman and a new chairman of audit, risk and finance. IFM will be able to appoint these directors as soon as it has determined the preferred future structure and direction of Pacific Hydro.

And was that an appropriate response in your view, from IFM after having done its work?---So I don't think we were aware at the time of the work that was complete – we were aware that I think they had completed their report. And so I think in those situations, you would look back and assess the governance and capability of management and board over that time to see whether they made the right decisions or not. Taking accountability for the responsibility that they had and seeking to renew the board having regard to the findings that the review had identified at the time was certainly an appropriate step to take. And so we were supportive to have seen that outcome.

Commissioner, if I could tender that - - -

THE COMMISSIONER: Exhibit 5.66, AustralianSuper investment committee infrastructure portfolio activity report, 1 December '14, ASU.0009.0003.5773.

EXHIBIT #5.66 AUSTRALIANSUPER INVESTMENT COMMITTEE INFRASTRUCTURE PORTFOLIO ACTIVITY REPORT DATED 01/12/2014 (ASU.0009.0003.5773)

MR DINELLI: Thank you, Commissioner.

And you continued then to report to the investment committee over the following year as well, didn't you, Mr Peasley?---That's correct.

And I won't take you to that further report but I will take you back to your statement, if I may, to paragraph 4.2, which is on page 0368. And you say there that:

> *The fund successfully disposed of Pacific Hydro in 2016 on terms which delivered pre-tax proceeds to the fund of $2230 million.*

?---Yes, proceeds – pre-tax proceeds to the AIF fund of $2.23 billion.

Correct. And, of course, a percentage of which was - - -?---Which our investment would be the beneficiary of, yes.

Correct. And when you referred before to an internal rate of return of approximately seven point – when you referred to 7.2 per cent before, was that to the – a figure in this paragraph, that is:

> *The sale proceeds significantly exceeded the valuation of Pacific Hydro prior to its write downs and generated an overall internal rate of return of approximately 7.2 per cent over the life of the investment.*

?---That's correct.

Can I take you to one perhaps final document, if I may, which is another of your reports, albeit – bear with me – ASU.0009.0004.5391. This is only an appendix but it's to a paper that was put to the investment committee meeting on 22 March 2016. You will have to look on the screen, I think, Mr Peasley?---Yes.

And this – what was the purpose of this document being prepared for the investment committee?---That was following the completion of the sale of Pacific Hydro by IFM Investors and allowed us to provide a look-back assessment on – on that process, and the lessons learned and the consequences for our investment in AIF.

And is that a common procedure once there's a sale of an asset to prepare a document like this for the investment committee?---I wouldn't say common but given the history that had gone on with respect to that investment and the scrutiny that it had attracted by ourselves and our committee, and indeed by IFM and other investors, we felt it important to highlight the outcomes, and particularly given there were salient lessons to be learned by us and by the manager, and particularly because the outcome, I think, was quite a contrast to the experiences we had and our members had in 2014, ie, the write-downs that we incurred as investors were by and large erased with the sale in 2015/16.

And you referred to lessons learned at 5395 under that heading you and your colleagues writing this paper said in the second sentence:

Reflecting on the past two years, Pacific Hydro has highlighted the importance of strong governance and through the manager company relationship especially on assets which are wholly owned.

?---Yes, that's correct.

Was that one of the lessons that you say came out of this?---Yes. So it was our observation that that relationship wasn't as clear in its allocation of roles and responsibilities as it could have been, particularly for an asset that was wholly owned and, therefore, didn't have other shareholders as part of that dynamic.

When you say "the relationship", what relationship are you referring to there?---So the manager, IFM, is the representative of the shareholder. And as that sole shareholder would engage and should engage with the board and management of the company with respect to its activities, its strategy, all with a view to overseeing and protecting its investment as the owner of that business.

Do I understand that you say that, therefore, there was a failure by reason of that, the fact that there was a – there wasn't a distinction, effectively, between the shareholder and the board of the – of the investment?---So it was – it was our contention that by the history that the business had gone through operationally, and some of the insights derived from the review conducted by IFM in 2014, that clearer alignment of responsibilities and engagement could have helped the business achieve better alignment with the – with the interests of the investors. To be specific, the business was still very much in a development phase and yet the – the owners, by virtue of the fund investors did not have great appetite to be putting more capital in that business. And so it was our observation there was a disconnect between management's desire as in the Pacific Hydro management's desire to continue to build out the development of assets and the ultimate shareholders' desire to see the business become, or at least AustralianSuper's desire as an investor, to see the business become more operationally focused and efficient.

And you – if the last paragraph under that heading you say:

Whilst 100 per cent ownership of Pacific Hydro contributed to its downfall the same sole ownership facilitated relatively swift corrective action and the freedom to implement a preferred strategy to exit.

?---Yes. So pleasingly and somewhat impressively the review undertaken by IFM and the newly appointed CEO provided corrective action to the business. They right-sized its operations, achieved operational improvement but then, importantly, allowed IFM to conduct a sale process without intervention of any other owners and so it had the sole discretion to make that – make that decision to sell the business, and they did that sales process in, frankly, an exceptional way which produced a very good outcome for investors.

And ultimately that paper concluded that it was a positive outcome for the infrastructure portfolio and for the fund?---Yes, indeed.

And in your role – and you can only talk about obviously your mid-risk portfolio of which you are now - - -

THE COMMISSIONER: Are you tendering that document, Mr Dinelli.

MR DINELLI: Sorry, yes, thank you.

THE COMMISSIONER: AustralianSuper investment committee infrastructure portfolio activity report 22 March ’16 ASU.0009.0004.5391, exhibit 5.67.

EXHIBIT #5.67 AUSTRALIANSUPER INVESTMENT COMMITTEE INFRASTRUCTURE PORTFOLIO ACTIVITY REPORT DATED 22/03/2016 (ASU.0009.0004.5391)

MR DINELLI: In your role – and you can only talk obviously about the mid-risk portfolio for which you’re now responsible but looking back would there be things that one could do differently in assessing investments?---As investors you’re always learning and so we constantly look at what those lessons are. As an investment team that now make direct investments of its own account, we do have regard to the lessons from this and other experiences and we seek to apply those in our job going forward. And I would say it’s a never-ending exercise. Investing fundamentally, you don’t always get right. There are always mistakes made. And it’s about learning from those and improving. So the overall outcome produces that – that proper outcome for members. And that is important, for instance – or that is why, for instance, we seek to invest in diversified portfolios. It’s a fundamental recognition that we as investors will not get everything right. But we do try to get enough right such that the overall outcome, which is what matters to the members, is the right outcome for those members.

You referred there to the more direct investment. Is that – is that also a product of scale too? Obviously, the AustralianSuper – its predecessor was at a very different stage in 1995 to what it finds itself today. Is that also a factor that informs how AustralianSuper can invest?---Very much so. And particularly in the case of infrastructure where I’ve mentioned, they’re very large assets requiring very large amounts of capital. They’re quite complex structurally so your capacity to access those through auction processes or bilateral negotiations require skill and in order to have that skill you either enlist the services of a competent skilled manager like IFM or you build that capability yourself internally. You would need scale in order to build that capability internally.

Nothing further, Commissioner. Thank you, Mr Peasley.

THE COMMISSIONER: Have you got anything, Mr O'Bryan?

MR O'BRYAN: No questions, thank you.

THE COMMISSIONER: Thank you very much indeed. You may step down. You are excused.

<THE WITNESS WITHDREW [4.16 pm]

THE COMMISSIONER: Shall we say 9.30 tomorrow or, Mr Hodge, do you have something - - -

MR HODGE: Commissioner, I would be content with 9.30 tomorrow.

THE COMMISSIONER: 9.30 tomorrow it is, then.

MR HODGE: Thank you.

MATTER ADJOURNED at 4.16 pm UNTIL THURSDAY, 9 AUGUST 2018

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