

# Financial Services Royal Commission: Learnings and Implications for the Super Industry

ASFA Legislation Discussion Group  
24 September 2018

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# Background

- Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry established in December 2017.
  
- Six rounds of public hearings completed to date.
  1. Consumer lending
  2. Financial advice
  3. Loans to small and medium enterprises
  4. Experiences with financial services entities in regional and remote communities
  5. Superannuation
  6. Insurance

# Observations – Advice Round

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# Opening Comments

- Financial advice hearings conducted on 16-27 April 2018
- Opening comments from Senior Counsel Assisting, Rowena Orr QC
  - “Financial advisers provide advice on areas of consumer finance, investing, superannuation, retirement planning, estate planning, risk management, insurance and taxation. The financial advice industry has been the subject of considerable scrutiny in recent years. There is good reason for this scrutiny.”
  - “This round of hearings will explore some of the issues that directly impact on Australians in their dealings with the financial advice industry.”

# Topics and Case Studies

Fees for no service	<ul style="list-style-type: none"> <li>• <b>AMP, AMP Financial Planning Pty Ltd, Charter Financial Planning Ltd and Hillross Financial Services Ltd</b></li> <li>• <b>CBA, Commonwealth Financial Planning Ltd and Count Financial Planning</b></li> </ul>
Investment platform fees	<ul style="list-style-type: none"> <li>• <b>AMP</b></li> <li>• <b>CBA</b></li> </ul>
Inappropriate financial advice	<ul style="list-style-type: none"> <li>• <b>ANZ, RI Advice Group Pty Ltd and Millennium 3 Financial Services Pty Ltd</b></li> <li>• <b>Westpac and BT Financial Group</b></li> <li>• <b>AMP, AMP Financial Planning Pty Ltd, Charter Financial Planning Ltd and Genesys Wealth Advisers Ltd</b></li> </ul>
Improper conduct by financial advisers	<ul style="list-style-type: none"> <li>• <b>NAB</b></li> <li>• <b>ANZ and Millennium 3 Financial Services Pty Ltd</b></li> </ul>
The disciplinary regime for the financial advice profession	<ul style="list-style-type: none"> <li>• <b>ASIC</b></li> <li>• <b>Financial Planning Association of Australia Ltd</b></li> <li>• <b>Association of Financial Advisers Ltd</b></li> <li>• <b>Dover Group</b></li> </ul>

# Closing Comments

- Closing comments from Senior Counsel Assisting, Rowena Orr QC
  - “The Commission has heard evidence of misconduct and of conduct falling below community standards and expectations in relation to the provision of financial advice by employees and authorised representatives of financial services entities.”
  - “This conduct has occurred in the context of fees being charged for no service, platform fees, inappropriate advice, improper conduct, and the disciplinary regime.”

# Questions Raised

## Disciplinary Regime

1. Are the general obligations set out in section 912A of the Corporations Act expressed at too high a level of generality to be capable of being effectively enforced?
2. Is the current division of responsibility for professional discipline of financial advisers between employers, ASIC and professional associations operating effectively?
3. Does that division of responsibility create gaps in the disciplinary system?
4. Is it possible to implement a single system for professional discipline of financial advisers? Would a system of licensing at both an individual and an entity level be more appropriate than the existing system of licensing only at the entity level?

# Questions Raised

## Regulatory Approach

1. Is there a particular regulatory culture that has developed in relation to the regulation of the financial advice industry? What is that culture? And what has contributed to its development?
2. Has the existing regulatory culture in the financial advice industry contributed to the occurrence of misconduct in the financial advice industry?
3. What changes in regulatory culture might assist in reducing the incidence of misconduct in the financial advice industry?

# Questions Raised

## Vertical Integration

1. Can financial advisers effectively manage the conflicts of interest associated with providing advice as a representative of an institution that also manufactures financial products?
2. Is it necessary to enforce the separation of products and advice?
3. Should the statutory carve-outs to the ban on remuneration, including the recent carve-out in relation to insurance commissions, be maintained?

# Observations – Super Round

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# Opening Comments

- Superannuation hearings conducted on 6-17 August 2018
- Opening comments from Senior Counsel Assisting, Mr Michael Hodge QC
  - “No dedicated conduct regulator”
  - "Trustees are surrounded by temptation — to preference the interests of their sponsoring organisations, to act in the interests of other parts of their corporate group, to choose profit over the interests of members, to establish structures that consign to others the responsibility for the fund and thereby relieve the trustee of visibility of anything that might be troubling"
  - "What happens when we leave these trustees alone in the dark with our money? Can they be trusted to do the right thing?"

# Case Studies

<p>Duties of RSE Licensees</p>	<ul style="list-style-type: none"> <li>• <b>AMP Super and NM Super (AMP)</b></li> <li>• <b>Australian Super</b></li> <li>• <b>Catholic Super (CSF)</b></li> <li>• <b>Colonial First State (CBA)</b></li> <li>• <b>Energy Super</b></li> <li>• <b>Host-Plus</b></li> <li>• <b>IOOF</b></li> <li>• <b>Mercer</b></li> <li>• <b>NULIS (MLC/NAB)</b></li> <li>• <b>Onepath and Oasis (ANZ)</b></li> <li>• <b>Suncorp</b></li> <li>• <b>Sunsuper</b></li> <li>• <b>United Super (CBUS)</b></li> </ul>
<p>Aboriginal and Torres Strait Islander members</p>	<ul style="list-style-type: none"> <li>• <b>QSuper</b></li> </ul>
<p>Effectiveness of superannuation regulators</p>	<ul style="list-style-type: none"> <li>• <b>APRA</b></li> <li>• <b>ASIC</b></li> </ul>

# Focus Points

- Duties to members and adequacy of structural and governance arrangements.
  - Failed mergers and board composition.
  - Conflicts management and related parties.
  - Dual regulated entities – reserves and member compensation.
  - Fees relative to level of investment risk.
  - Erosion of member benefits through insurance premiums.
  
- Selling practices in relation to superannuation.
  - Fees and commissions – fees for no service, adequacy of disclosure.
  - Relationship between trustees and financial advisers.
  - Implementation of MySuper and transition of accrued default amounts.
  - Marketing, entertainment and retention strategies.
  
- Current legal regime and the effectiveness of regulators.
  - Lack of enforcement actions.
  - Respective responsibilities and powers.

# Closing Comments

- Closing comments from Senior Counsel Assisting, Mr Michael Hodge QC
  - “What the evidence as a whole suggests is that it may well be the case that you will conclude that some RSE licensees are not, as they are obliged to do, prioritising the interests of their members over the interests of others, including themselves and the groups of which they are parties”.
  - “Members of superannuation funds, like most beneficiaries, are vulnerable, and in respect of superannuation, many are disengaged and disadvantaged by a lack of financial literacy. They are readily able to be taken advantage of”.
  - “The disengagement of members, amongst other things, may limit the effectiveness of competition, and there are also questions, Commissioner, as is apparent, about the effectiveness of regulation in relation to superannuation”.

# Questions Raised

1. Are there structures that raise inherent problems for a superannuation trustee being able to comply with its fiduciary duties?
2. If so, is structural change of entities, mandated by legislation or otherwise, something that is desirable?
3. Are there other types of relationships that present obvious challenges to a trustee in discharging its duties, or where the member benefits are limited or non-existent?
4. Is it necessary to strengthen existing laws prohibiting misconduct or is it simply necessary to enforce existing laws?
5. What can be done to encourage the regulators to act promptly and is the present allocation of regulatory roles appropriate to achieve specific and general deterrence?
6. Are there further structural tweaks necessary to make it more likely that consumer interests will be best served in the superannuation industry?

# Observations – Insurance Round

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# Opening Comments

- Insurance hearings conducted on 10-21 September 2018
- Opening comments from Senior Counsel Assisting, Ms Rowena Orr QC
  - “Some of the key questions that we will address in this round of hearings are is there an appropriate balance between self-regulation and external regulation in the insurance industry. In particular, is it appropriate that the handling of insurance claims is currently largely outside of ASIC’s jurisdiction”.

# Focus Points

- Sale and design of life insurance products.
  - Minimum balance and employment status conditions.
  - TPD definitions.
- Handling of claims under life insurance policies.
  - Engagement with group insurers.
  - Pursuing claims with a reasonable prospect of success.
- Administration of life insurance by superannuation trustees.
  - Application of default premium rates.
  - Processes for handling cessation of cover and premium deductions (e.g. post death, unemployment event).
  - Conflicts of interest with related party providers.
- Appropriateness of the current regulatory regime for the insurance industry.
  - Adequacy of dispute resolution regimes.
  - Enforcement of industry codes of practice.

# Case Studies

Life Insurance	<ul style="list-style-type: none"><li>• AMP</li><li>• ClearView</li><li>• Commlnsure</li><li>• Freedom Insurance</li><li>• REST</li><li>• TAL</li></ul>
General Insurance	<ul style="list-style-type: none"><li>• AAI (Suncorp)</li><li>• Allianz</li><li>• IAG</li><li>• Youi</li></ul>
Regulatory Regime	<ul style="list-style-type: none"><li>• Code Governance Committee</li><li>• Financial Services Council</li><li>• Insurance Council of Australia</li></ul>

# Closing Comments

- Closing comments from insurance round – as relevant to group life –  
Counsel Assisting, Mark Costello QC
  - “On the evidence, it is open to the Commissioner to find that REST may have engaged in misconduct”
    - Continuing to deduct premiums when a person is no longer covered
    - Failure to do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary if the claim has a reasonable prospect of success (e.g. paraplegic member)
    - Failure to provide reasons for a decision in response to a complaint about the proposed payment of a death benefit

# Closing Comments

- “On the evidence, it is open to the Commissioner to find that REST may have engaged in conduct falling below community standards and expectations”
  - Failing to communicate with members about key exclusions such as the prescribed minimum balance exclusion in annual statements
  - Deducting income protection premiums from unemployed members who were unable to claim on their policies
  - Failing to have sufficient systems in place to detect when a member was unemployed and, therefore, at risk of losing cover

# Closing Comments

- “On the evidence, it is open to the Commissioner to find that AMP may have engaged in misconduct”
  - Authorising the deduction of premiums from members’ accounts where those premiums are calculated on a statistically inappropriate basis
  - Continuing to deduct insurance premiums from deceased members’ accounts
  - Failing to notify APRA and ASIC of the continued deduction of premiums from deceased member accounts
  - Failing to ensure that there were adequate systems in place to cease deducting premiums from deceased members’ accounts
  - Not ensuring that at least one of the MySuper members was provided with permanent incapacity benefits on an opt-out basis

# Closing Comments

- “On the evidence, it is open to the Commission to find that AMP may have engaged in conduct falling below community standards and expectations”
  - Not adequately ensuring that members were aware they had been defaulted to an insurance rate that assumed the member smoked in circumstances where it was unlikely that the member smoked
  - Refusing to refund premiums incorrectly charged to the member who was charged the smoker rate in circumstances where that member was not a smoker
  - Failing to stop the deduction of premiums from deceased members’ accounts in a timely way
  - Refusing to provide insurance cover to members who hold a MySuper product

Next Steps

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# Next Steps

- Some calls for extension of the Commission, but unlikely to occur.
- The draft report from the Commission is due for release by 30 September 2018.
- The seventh round of hearings will focus on policy questions arising from the first six rounds of hearings, and will be held on 19 – 30 November.
- The final report from the Commission is due for release by 1 February 2019.

# Learnings for the Super Industry

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# Learnings

## **Governance**

- Greater scrutiny of operational activities, behaviours and outcomes.
- Implementation / enhancement of risk culture diagnostic and reporting processes.
- Review of remuneration structures to ensure alignment with desired conduct outcomes.
- Agreement on board seat allocations at the outset of merger discussions.

## **Corporate Structures**

- Adjustment of corporate structures to minimise inherent conflicts.

## **Responding to Regulatory Processes**

- Be transparent.

# Learnings

## Assurance Processes

- Increased resourcing of second line risk and compliance functions to challenge and enhance operational practices.
- Additional deep-dive assurance reviews on processes involving potential conduct risk issues.

## Operational Processes and Systems

- Enhancement of processes and systems for the application of advice fees and insurance premiums to member accounts.

# Potential Implications for the Super Industry

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# Prudential Regulation

- Assignment of additional powers to APRA (and/or ASIC), including the enforcement of trustee duties relating to MySuper products and the forced exit of funds not delivering appropriate member outcomes.
- Further heightening of requirements / expectations in respect of governance, risk culture and conduct risk management.
- Government / Treasury directive for tougher approach to APRA's supervision style (i.e. less collaborative, more interventionist).
- Increase in both frequency and depth of prudential reviews and prudential consultations.
- Increase in APRA resources and associated industry levies.

# Market Regulation

- Prohibition / restriction of vertically aligned distribution models.
- Expansion of ASIC remit in respect of regulation of super funds, including:
  - Assignment of additional powers to enforce obligations .
  - Transfer and consolidation of powers from APRA.
  - Expectation of increased enforcement action.
- Increased scrutiny of management of conflicts of interest, identification and rectification of conduct risk issues, and adequacy of product / advice disclosure documents.
- Focus of supervision work on behaviors that result in poor member outcomes and erode trust in the superannuation sector.

# Social License

- Further increase in media coverage of adverse consumer outcomes in the super sector over the medium - long term.
- Increase in member queries and complaints as a result of increased consumer awareness.
- Increase in expectations relating to the resolution of member complaints under the scrutiny of the consolidated complaints body, the Australian Financial Complaints Authority (AFCA), from 1 November 2018.
- Further empowerment of consumers through the launch of the Superannuation Consumers' Centre (SCC), which has recently become possible as a result of \$2.5m in enforceable undertakings from ANZ and CBA for the mis-selling of superannuation.

# Market Structure

## Superannuation

- Potential for retail banks to be stripped of ability to offer MySuper products.
- Further escalation of pressures for market consolidation due to regulatory cost drivers.
- Heightened member expectations and switching activity.

## Financial Advice

- Unwinding of vertically integrated structures.
- Exit of licensed financial planning operators.
- Discontinuation of individual adviser appointments.
- Exit of individual financial advisers.

# Market Structure

## Group Insurance

- Further restrictions on the provision of insurance through super.
- Mandatory implementation of the Insurance in Superannuation Voluntary Code of Practice.

# Thank you

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