

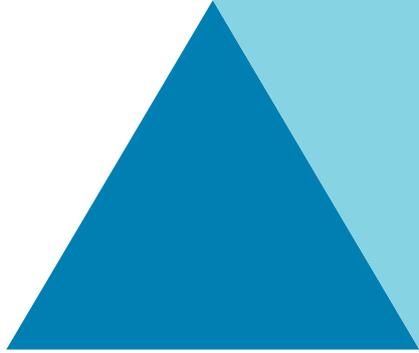
# THE MOVING PARTS OF SUPERANNUATION

A BRIEF SUMMARY OF  
THE ROYAL COMMISSION  
RECOMMENDATIONS

FEBRUARY 2019

# ROYAL COMMISSION SUMMARY

<b>BETTER OUTCOMES FOR CONSUMERS</b>	<b>SUPER FUND MEMBERS</b>	<ul style="list-style-type: none"> <li>• Intra-fund advice is the only advice fee to be deducted from MySuper accounts</li> <li>• New restrictions on paying advice fees from Choice accounts</li> <li>• Tighten hawking of super products rules</li> <li>• One default super account per person</li> <li>• Consider universal terms for group life policies</li> <li>• A new compensation scheme of last resort</li> <li>• Enforceable industry codes</li> </ul>
	<b>FINANCIAL ADVICE CLIENTS</b>	<ul style="list-style-type: none"> <li>• Annual renewal of ongoing fee arrangements</li> <li>• Explanation why adviser is not independent, impartial and unbiased (where applicable)</li> <li>• No grandfathered commissions over time</li> <li>• Reduce commissions on life insurance risk products</li> <li>• A new disciplinary scheme for financial advisers</li> <li>• A new compensation scheme of last resort</li> <li>• Enforceable industry codes</li> </ul>
	<b>INSURANCE CLIENTS</b>	<ul style="list-style-type: none"> <li>• No hawking of insurance</li> <li>• Include funeral policies as a financial product</li> <li>• A cap on commission for add-on car insurance products</li> <li>• Broaden unfair contract terms to include insurance</li> <li>• Include claims handling as a 'financial service'</li> <li>• A new compensation scheme of last resort</li> <li>• Enforceable industry codes</li> </ul>
	<b>BORROWERS</b>	<ul style="list-style-type: none"> <li>• Mortgage brokers must act in best interests of borrower</li> <li>• Borrower, not lender, pays mortgage brokers</li> <li>• A national scheme of farm debt mediation</li> <li>• Amend the Banking Code so default interest is not charged where a natural disaster occurs</li> <li>• A new compensation scheme of last resort</li> <li>• Enforceable industry codes</li> </ul>
<b>GENERAL</b>	<b>GOVERNANCE</b>	<ul style="list-style-type: none"> <li>• All AFSL holders to take action where financial advisers have engaged in misconduct</li> <li>• Super fund trustees not to assume any other role or office</li> <li>• Tighter rules re trustees 'treating' employers (to entertainment etc) to influence default choice</li> <li>• Additional scrutiny for related party engagements relating to insurance</li> <li>• New requirements for remuneration systems, including annual reviews for front line staff</li> <li>• All financial services entities should assess culture and governance and respond accordingly</li> </ul>
	<b>THE ROLES OF REGULATORS</b>	<ul style="list-style-type: none"> <li>• The 'twin peaks' of financial regulation (APRA and ASIC) should be maintained</li> <li>• APRA's prudential regulator remit should include misconduct, compliance and other non-financial risks</li> <li>• Broader powers for ASIC as the conduct and disclosure regulator</li> <li>• A new oversight authority to assess each regulator, including applying BEAR principles</li> <li>• ASIC enforcement approach should consider court action as the starting point</li> <li>• Regular capability reviews of regulators starting with APRA in 2019</li> </ul>
	<b>TRUSTEE AND EXECUTIVE ACCOUNTABILITY</b>	<ul style="list-style-type: none"> <li>• The BEAR should be extended to all APRA-regulated bodies</li> <li>• APRA and ASIC should jointly administer these new provisions</li> <li>• Civil penalty provisions to apply for breaches of trustee duties</li> </ul>



The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established on 14 December 2017 and submitted its final report to the Governor-General on Friday 1 February 2019. The Government released the report on the afternoon of Monday 4 February 2019.

The Royal Commission, led by the Honourable Kenneth Hayne AC QC, received more than 10,000 submissions and held 69 days of public hearings during 2018.

Volume 1 of the Final Report is 496 pages long and makes 76 recommendations.

The recommendations can be broadly divided into the following categories:

- Banking, including consumer lending, lending to small and medium enterprises and the enforceability of industry codes
- Financial advice including independence, quality of advice, conflicted remuneration and professional discipline of financial advisers
- Superannuation including trustees' obligations, selling, default funds and regulation
- Insurance including hawking, add-on insurance, unfair contract terms, claims handling and group life policies
- Culture, governance and remuneration
- The regulators including conduct regulation in superannuation, co-regulation of the Banking Executive Accountability Regime (BEAR), governance and oversight



# KEY OBSERVATIONS

The Government has broadly agreed with or supported every recommendation. In some cases, the support relates to activity to be taken by a regulator or third party. However, limited legislative action is expected on the recommendations until after the federal election which is likely to be in May.

Overall the recommendations have a strong focus on providing better outcomes for consumers through improved behaviour and governance with greater accountability for directors and executives, better disclosure to clients and stronger action by the regulators. These recommendations have been influenced by the following four observations discussed in the opening pages of the Final Report:

First, in almost every case, the conduct in issue was driven not only by the relevant entity's pursuit of profit but also by individuals' pursuit of gain, whether in the form of remuneration for the individual or profit for the individual's business. Providing a service to customers was relegated to second place.

Second, entities and individuals acted in the ways they did because they could. Entities set the terms on which they would deal, consumers often had little detailed knowledge or understanding of the transaction and consumers had next to no power to negotiate the terms. There was a marked imbalance of power and knowledge between those providing the product or service and those acquiring it.

Third, consumers often dealt with a financial services entity through an intermediary. The client might assume that the person standing between the client and the entity that would provide a financial service or product acted for the client and in the client's interests. But, in many cases, the intermediary is paid by, and may act in the interests of, the provider of the service or product.

Fourth, too often, financial services entities that broke the law were not properly held to account. Misconduct will be deterred only if entities believe that misconduct will be detected, denounced and justly punished.

The recommendations are sensible and represent an important evolution, rather than a revolution. They do not represent a radical overhaul of Australia's financial services industry nor should they represent a threat to well managed operations. Rather, if implemented, they will provide an industry with a stronger focus on the consumer; an improvement in the information asymmetry between institutions and their clients; greater clarity in responsibilities and more significant consequences for misconduct.

This Mercer report concentrates on the recommendations relating to the Australian superannuation system only.

## Superannuation

### Recommendation 3.1 – No other role or office

The trustee of a Responsible Superannuation Entity (RSE) should be prohibited from assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund.

Comment: This recommendation arises from the conflicts that may arise where a super fund trustee has other roles: for example, managing or operating a managed investment scheme. The role of the trustee is paramount and such conflicts should be avoided.

### Recommendation 3.2 – No deducting advice fees from MySuper accounts

Deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited.

Comment: It is pleasing to see that the Royal Commissioner has recognised the value of intra-fund advice where a fund may give advice relating to investment options, insurance or post-retirement options within the fund. However, the recommendation is that MySuper money should not be used to provide more holistic or broader financial advice.

### Recommendation 3.3 – Limitations on deducting advice fees from choice accounts

Deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the requirements about annual renewal, prior written identification of service and provision of the client's express written authority set out in Recommendation 2.1 in connection with ongoing fee arrangements are met.

Comment: Recommendation 2.1 relates to financial advice and recommends that ongoing fee arrangements relating to financial advice must be renewed annually by the client; must record in writing the services provided and fees to be charged; and do not permit deduction of the fees from any account without the client's authority. This recommendation applies to all financial advice and Recommendation 3.3 makes it clear that it also applies to superannuation money.

### Recommendation 3.4 – No hawking

Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme.

The law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact for the express purpose of inquiring about, discussing or entering into negotiations in relation to the offer of that kind of product.

Comment: The Royal Commission notes that superannuation is a very different financial product from banking or insurance. Hence it is reasonable that superannuation should not be sold when a customer is engaged in the purchase of an unrelated financial product. Of course, much will depend on the new definition of "hawking" but this recommendation is broadly consistent with an existing ASIC Regulatory Guide. Such a prohibition should not prevent a trustee or related party advertising the fund's availability.

### Recommendation 3.5 – One default account

A person should have only one default account. To that end, machinery should be developed for 'stapling' a person to a single default account.

Comment: Many Australian workers have been defaulted into multiple superannuation accounts which lead to inefficiencies, higher costs and reduced retirement benefits. Hence the concept of one default account is to be applauded. Of course, a single default account would not prevent individuals from selecting another product, should they wish to do so. We note that the concept of a single default account will require modifications to many industrial awards and EBAs which currently specify particular superannuation funds.

### Recommendation 3.6 – No treating of employers

Section 68A of the SIS Act should be amended to prohibit trustees of a regulated superannuation fund, and associates of a trustee, doing any of the acts specified in section 68A(1)(a), (b) or (c) where the act may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund. The provision should be a civil penalty provision enforceable by ASIC.

Comment: This recommendation represents a strengthening of current legislation which, in broad terms, prevents trustees from providing goods or services (e.g. entertainment) to an employer on the condition that one or more of their employees will join their fund or the fund becomes the employer's default fund.

### Recommendation 3.7 – Civil penalties for breach of covenants and like obligations

Breach of the trustee's covenants set out in section 52 or obligations set out in section 29VN, or the director's covenants set out in section 52A or obligations set out in section 29VO of the SIS Act should be enforceable by action for civil penalty.

Comment: This recommendation represents a stronger penalty for the relevant trustee's covenants, director's covenants or obligations (such as the duty to act in members' best interests). This will require some broadening of legislation currently before Parliament, which would introduce civil penalties for directors but not trustees.

## Superannuation (continued)

### Recommendation 3.8 – Adjustment of APRA and ASIC’s roles

The roles of APRA and ASIC with respect to superannuation should be adjusted, as referred to in Recommendation 6.3.

Comment: This recommendation, together with Recommendation 6.3, realigns the different roles of APRA and ASIC with APRA being the prudential regulator and ASIC being the conduct and disclosure regulator. This means that ASIC should be given the power to enforce all provisions in the relevant legislation that may give rise to a cause of action against an RSE licensee or director that may harm a consumer. Recommendation 6.2 suggests a much stronger approach to enforcement by ASIC.

### Recommendation 3.9 – Accountability regime

Over time, provisions modelled on the BEAR should be extended to all RSE licensees, as referred to in Recommendation 6.8.

Comment: The Royal Commissioner believes there is no reason why the Bank Executive Accountability Regime (BEAR) recently introduced in the banking sector should not be extended in a similar manner to the directors and the senior executives of at least the large superannuation funds. That is, they are to conduct the responsibilities of their positions:

- by acting with honesty and integrity, and with due skill, care and diligence;
- by dealing with APRA and ASIC in an open, constructive and co-operative way; and
- by taking reasonable steps in conducting those responsibilities to prevent matters from arising that would adversely affect the prudential standing or prudential reputation of the fund.

It is noteworthy that Recommendation 6.8 recommends that, over time, provisions modelled on the BEAR should be extended to all APRA-regulated financial services institutions.

The Government, in its response, states that it will introduce a similar regime for non-prudentially regulated financial firms focused on conduct.

## Group life policies

There are a further three recommendations relating to group life policies in the Insurance chapter which are relevant to superannuation.

### Recommendation 4.13 – Universal terms review

Treasury, in consultation with industry, should determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.

Comment: There can be significant differences between definitions, terms and exclusions within group life insurance policies used with superannuation products. It is not surprising that such differences and misunderstandings lead to confusion and disputes. Universal terms should make it simpler for both insurers and consumers, as has been acknowledged by the Insurance in Super Working Group.

### Recommendation 4.14 – Additional scrutiny for related party engagements

APRA should amend Prudential Standard SPS 250 to require RSE licensees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, to obtain and provide to APRA within a fixed time, independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements.

Comment: The Royal Commissioner has highlighted the potential risks of related party transactions. Importantly, he has not recommended prohibiting them. Rather, he comments that they should be subject to a higher level of scrutiny to ensure that the trustees are acting in the best interests of members.

### Recommendation 4.15 – Status attribution to be fair and reasonable

APRA should amend Prudential Standard SPS 250 to require RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.

Comment: The recommendation means that trustees will need to ensure that any status given to a member for insurance purposes, such as blue collar worker or smoker, is fair and reasonable. This may require additional work by trustees and/or insurers.

## Culture and governance

Not surprisingly, the Royal Commissioner made recommendations relating to culture and governance within financial services entities.

### Recommendation 5.6 – Changing culture and governance

All financial services entities should, as often as reasonably possible, take proper steps to:

- assess the entity's culture and its governance;
- identify any problems with that culture and governance;
- deal with those problems; and
- determine whether the changes it has made have been effective.

### Recommendation 5.7 – Supervision of culture and governance

In conducting its prudential supervision of APRA-regulated institutions and in revising its prudential standards and guidance, APRA should:

- build a supervisory program focused on building culture that will mitigate the risk of misconduct;
- use a risk-based approach to its reviews;
- assess the cultural drivers of misconduct in entities; and
- encourage entities to give proper attention to sound management of conduct risk and improving entity governance.

Comment: It is clear that all financial services entities must now have a much stronger focus on culture and governance and that APRA will expect it. This approach is also consistent with APRA's self-assessment exercise that has recently been conducted by many fund trustees and wealth management companies.



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