3 October 2016

Highton, 3216

Ms Angela MacRae

Commissioner

Productivity Commission

Locked Bag 2, Collins St East
Melbourne VIC 8003,

Dear Commissioner

# Re: Efficiency and Competiveness of the Superannuation System

I note that the Productivity Commission is calling for submissions for the next stage of this inquiry.

The High Court of Australian in ***Finch v Telstra Super Pty Ltd*** [2010] HCA 36; (2010) 242 CLR 254 ruled at [35]:

> "The government considers that the taxation advantages of superannuation should not be enjoyed unless superannuation funds are operating efficiently and lawfully. For that reason it has, by procuring the enactment of the *Superannuation Industry (Supervision) Act* 1993 (Cth) ("the Supervision Act") and regulations made under it, imposed quite rigorous regulatory standards."

Please find attached **Submission #1**.

I am posing an important question that the Productivity Commission must consider if not provide a definitive determination.

Yours Sincerely

Phillip Sweeney

# Productivity Commission – Submission #1

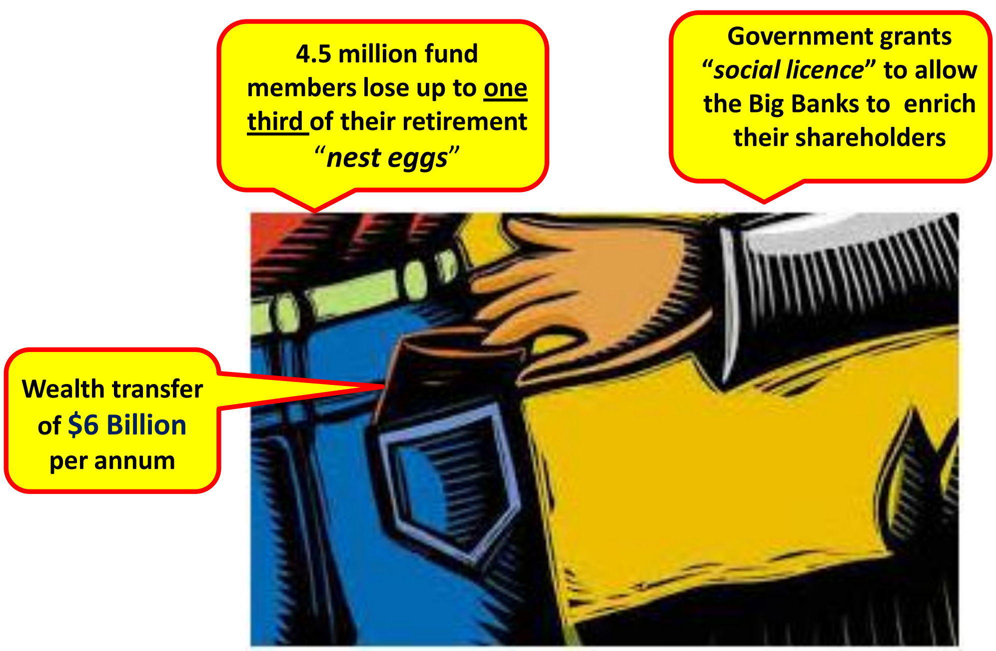
## Legality of "Retail" Superannuation Funds

Now an important question for the Productivity Commission to consider is the following:

> "Does the Productivity Commission believe that the banks' so called "*Retail*" Superannuation funds {or "*profit-for-shareholders*" funds} are operated lawfully and in the ***best interests*** of the fund members?"

Clearly any recommendation for a process dealing with the selection of default superannuation funds in a COMPULSORY superannuation system must insure a "*filter*" is in place to exclude any funds being selected that are operated in breach of the general laws of trusts or any statutory provisions.

## Bank "*Profit-for-Shareholders*" Super Funds



The basis of traditional banking is for the bank to take in deposits and to then make loans, whist bearing the risk that some of the loans may not be repaid in full. The bank makes a profit for its endeavours in many such contractual arrangements.

Superannuation funds on the other hand are based on the laws of trusts, where a trustee is the archetype "*fiduciary*". The trustee's status as a fiduciary requires a trustee to avoid conflicts of interest and also prevents the trustee from making a profit, except in limited and specific circumstances.

The key principles governing the conduct of fiduciaries are described as the "***no conflict rule***" and the "***no profit rule***".

The two related principles have been described in the following fashion by Deane J in the High Court of Australia in ***Chan v Zacharia*** [1984] HCA 36; (1984) 154 CLR 178 at [24]:

> "The first is that which appropriates for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest. The second is that which requires the fiduciary to account for any benefit or gain obtained or received by reason of or by use of his fiduciary position or of opportunity or knowledge resulting from it: the objective is to preclude the fiduciary from actually misusing his position for his personal advantage."

Also refer to **Appendix B**.

***Cowan v Scargill*** [1985] Ch 270 is an important trust case, concerning the scope of discretion of trustees to make investments for the benefit of their members. The judge in this case held that trustees cannot ignore the financial interests of the beneficiaries.

The Superannuation fund was an "*industry fund*" where the trustees of the National Coal Board (NCB) pension fund administered £3,000 million in assets. Five of the ten trustees were appointed by the NCB and the other five were appointed by the National Union of Mineworkers (NUM).

Mr JR Cowan was the deputy-chairman of the board. Arthur Scargill led the NUM and was one of the five member nominated trustees,

The National Union of Mineworkers wanted the pension fund to (1) cease new overseas investment (2) gradually withdraw existing overseas investments and (3) withdraw investments in industries competing with coal.

Megarry VC held the NUM trustees would be in breach of trust if they followed the instructions of the union, saying '*the best interests of the beneficiaries are normally their best financial interests*".

Commenting on the matter of "*ethical investments*" where for example the beneficiaries are members of a religious order and may not wish investments to be made by the trustees in tobacco companies as an example Meggary VC stated:

> "Plainly the present case is not one of this rare type of case. Subject to such matters, under a trust for the provision of financial benefits, the paramount duty of the trustee is to provide the greatest financial benefits for the present and future beneficiaries"

Now these principles can be applied to Australian superannuation funds.

The trustees of "***profit-for-members***" funds {also called "***Industry Funds***"} act in the *best interests* of the members of their fund and invest in a manner that achieves consistently higher investment returns for fund members than "***profit-for-shareholders***" funds operated by the major banks.

## Largest Seven "Profit-for-Members" Superanuation Funds

| "*Industry*" Fund | 10 Year Average Return (#1) | Assets {$ Billion} {2015} |
|---|---|---|
| AustralianSuper | 7.2% | 94.8 |
| Unisuper | 8.0% | 51.9 |
| Retail Employees Superannuation Trust | 7.3% | 39.4 |
| Sunsuper Superannuation Fund | 6.5% | 35.4 |
| HESTA | 7.0% | 33.5 |
| Construction & Building Unions Superannuation (CBUS) | 7.3% | 31.8 |
| HOSTPLUS | 6.6% | 18.4 |
| *Weighted average 10 year annual return* | 7.2% | |
| **Total Assets** | | 305.2 |

**Note (#1) APRA** data 2004-2013

The average return for members over a 10 year period for the seven largest "*profit-for-members*" funds is **7.2%** per annum {Data Source **Appendix A**}.

Trustees of regulated superannuation fund have statutory duty pursuant to **Section 52** of the ***Superannuation Industry (Supervision) Act 1993*** to act in the ***best interests*** of fund members in addition to their general law duty.

The trustees of so called "***Retail***" funds {"***profit-for-shareholders***" funds} have the same investment opportunities as the trustees of "***Industry***" funds {"***profit-for-members***" funds} so if these trustees were in fact acting in the ***best interests*** of their fund members then the average returns over a 10 year period should be similar to those achieved by other trustees.

Trustees themselves are not allowed to make a profit out of their stewardship of a superannuation trust.

However what has been the reality for members of "*profit-for-shareholders*" funds operated by the major banks?

**Largest Seven Bank "Profit-for-Shareholders" Superanuation Funds**

| "*Industry*" Fund | 10 Year Average Return (#1) | Assets {$ Billion} {2015} |
|---|---|---|
| **Commonwealth Bank** | | |
| Colonial First State First Choice Superannuation Trust | 4.8% | 64.9 |
| **National Australia Bank** | | |
| The Universal Superannuation Scheme (MLC) | 5.4% | 45.8 |
| MLC Superannuation Fund | 4.9% | 16.8 |
| Plum Superannuation Fund | 6.2% | 17.7 |
| **ANZ** | | |
| OnePath Materfund (ANZ) | 4.3% | 34.5 |
| **Westpac** | | |
| Retirement Wrap | 4.5% | 54.8 |
| ASGARD Indepedence Plan Division Two | 5.0% | 21.0 |
| *Weighted average 10 year annual return* | 4.9% | |
| Total Assets | | 255.5 |

**Note (#1) APRA** data 2004-2013

The trustees of these funds have all made investment decisions that have resulted in an average rate of return of **2.3%** less that the trustees of "***profit-for-members***" superannuation funds.

The impact of this substandard decision making concerning investments can have a substantial effect on final retirement benefits.

The difference in benefit becomes greater the longer the period of fund membership.

## Multiples of Final Salary

| Years of Fund Membership | Bank "*Retail*" Super Funds | Largest "*Industry*" Super Funds | Percent More |
|---|---|---|---|
| | 4.9% | 7.2% | |
| 10 | 0.95 | 1.00 | 5% |
| 20 | 1.9 | 2.3 | 21% |
| 30 | 2.8 | 3.9 | 39% |
| 40 | 3.7 | 5.9 | 59% |

*10 Year average rate of return*

A member of a large "***profit-for-members***" fund will likely receive around 60% more compared to a member of one of the "***profit-for-shareholders***" funds operated by the major banks after 40 years of fund membership. Using average weekly earnings as a base, this equates to $180,000 into day's money.

So how do the trustees of so called "***Retail Funds***" get around the "***no profit rule***" of fiduciaries?

These trustees are able to exploit the vertical integration of their parent bank by directing the government mandated 9.5% of earnings for each fund member into other investment funds operated their parent banks so that the parent bank extracts profits from these investment funds and not from the trustees themselves.

However these trustees clearly have a conflict of interests which are not properly communicated to the fund members.

In theory trustees should not be subject to direction by the parent bank {**Appendix C**}, however this law is simply ignored by the trustees of bank operated superannuation funds. Who is going to enforce this law?

Such conduct could be considered to be in breach of the "*no conflict rule*" and at the very least be considered to be "*unethical conduct*" that is not in the ***best interests*** of the fund members.

**IMPORTANT:** The banks certainly have the expertise to achieve high investment returns for members. The Commonwealth Bank Staff Fund achieved an average return over 10 years of **8.1%** which exceeds the best return of the top seven "***Industry Funds***" and the National Australia Bank Staff Fund returned **7.3%** which is better than the returns of any "***Retail Fund***".

The regulator ***ASIC*** has determined that last year the major banks paid **$200 million** in compensation to bank customers for "***unethical conduct***" that has been well documented in the media.

There are around 4.5 million members of the "***Retail***" funds operated by the big banks. If the trustees of the big banks actually acted in the ***best interests*** of their members then the additional return for fund members would be **2.3%** of the assets held by these trustees ($255 Billion) or around **$6 billion** per annum.

# Default Super Funds

**The Australian** published an article titled "***Funds battle over default super***" on 3 October 2016 {**Appendix D**}, revealing that a "*cheat sheet*" detailing more than 100 compliance problems at the big four banks and Macquarie Group over the past six years. The article also makes reference to comments made by former Commonwealth Bank CEO, David Murray, who argued that the Labor Party was agitating for a banking royal commission to promote the interests of industry super funds over the retail wealth management industry.

This article also notes the outperformance of Industry funds over the last 10 years quoting a 2.2% performance differential, but does not equate this to a loss of one third of retirement benefits for members of "***Retail***" funds.

David Murray as the CEO of the Commonwealth Bank realised that the making of superannuation compulsory in 1992 and the ongoing increase in the COMPULSORY contribution rate would make Australian Banks the most profitable in the world by the exploitation of a vertically integrated banking model.

By having captive trustees with no member representative directors {like ***Industry*** Funds} the banks could illegally "***dictate***" to these trustees to only invest in in-house financial products on which the banks generate large profits {This is a clear breach of **Section 58** of the ***SIS Act*** – **Appendix C**}.
The parent banks in turn would then offer discounted business loan facilities to employers if they outsourced their existing corporate superannuation funds (which are "*profits-for members*" funds) to the "*profit-for-shareholders'* funds operated by the banks.

This phase of profit gouging has now almost run its course with very few companies now running their own corporate superannuation funds.

The next phase of profit gouging for the banks is to target "*default*" superannuation funds which are generally the higher return "*profits-for-members*" superannuation funds known as "*Industry*" funds.

Not satisfied with gouging **$6 billion** each year from 4.5 million Australians and reducing their retirement benefits by around a third in general and in some cases by one half, the banks are lobbying the Coalition Government to expand what must be the most disgraceful example of Government mandated COMPULSORY wealth transfer from the working class to the shareholder class in Australia's history.

The **Financial Services Council** (**FSC**) Chief executive, Sally Loan said:

> "The Fair Work Commission is an industrial tribunal and has no place choosing financial products for consumers."

It seems that the **FSC** wants this decision to be made by the banks and who will then offer a "*package*" to employers to make the employees captive to profit gouging by that bank!

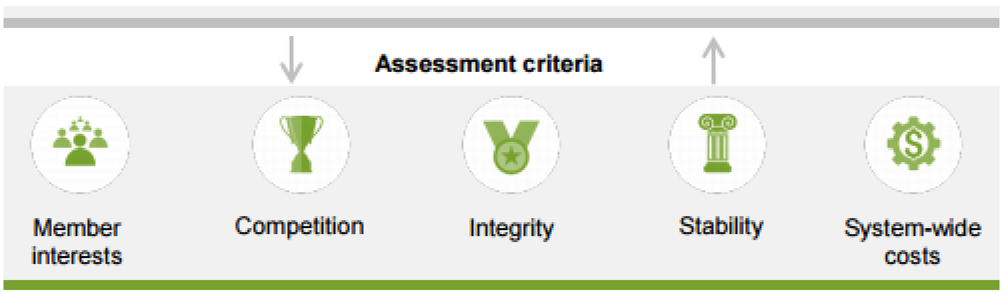
Where employers nominate the "*default*" superannuation fund as a "***Retail***" fund operated by one of the vertically integrated banks, the fund members will not only be handing over a large proportion o f their retirement "*nest egg*" to bank shareholders, they will also be subsidising the borrowing costs of their own employer!

***The Australian*** quoted a senior industry fund source as saying that related party transactions with the retail sector lead to above-market charges on super fund purchases such as insurance.

"The reality is that the unions employ trustees who drive the governance and culture of these institutions, which is driving better returns. Over in the banks, the governance and culture of their institutions are driving scandal after scandal on a daily basis."

# Filters

The assessment criteria proposed by the Productivity Commission are:




This submission proposes that there be five "*filters*" that should be used to narrow the category of funds that would qualify as being able to be selected as default superannuation funds.

### Filter #1 {Member Interests}

A performance filter would be the first priority that would eliminate funds that had a consistence substandard net investment return to fund members over say a 5 to 10 year period.

### Filter #2 {Competition}

An "***Uber***" style member feedback filter that would eliminate funds where fund members would be able to lodge complaints or provide a satisfaction rating with the body that provided an approved list of fund as default funds. Members who experienced extensive delays in obtaining insurance payouts and disputed or delayed superannuation benefit payments would be able to provide feedback on their experience with the fund in question {*Also refer to Maurice Blackburn submission DR-79*} .

Funds that rated poorly on member satisfaction would be excluded from the approved list of default funds.

## Filter #3 {Integrity}

A transparency assessment would be made on the amount and clarity of information provided to members in annual reports and the ability to access other relevant documents such as the original Trust Deed and all amending Deeds on line.

Current it is not a statutory requirement for trustees to hold annual meetings for fund members, however there is no reason why trustees should not hold annual meeting for members on a voluntary basis.

Funds that operated on minimum disclosure standards would be eliminated from the approved list.

Funds whose trustee complies with the "***equal representation***" provisions of the ***Superannuation Industry (Supervision) Act 1993*** should also rank higher than funds whose trustee does not.

## Filter #4 {Stability}

A compliance filter would assist in ensuring confidence in funds regulated by ***APRA*** and would eliminate funds that had a poor compliance record as reported by ***ASIC*** and ***APRA***.

Also the trustees of all qualifying default funds should be required to sign an "***Onus of Proof***" declaration confirming that the trustee is aware of the ruling of the High Court of Australia in ***Finch v Telstra Super Pty Ltd*** [2010] HCA 36 and the Victorian Court of Appeal in ***Aloca of Australia Retirement Plan Pty Ltd v Frost*** [2012] VSCA 238.

These cases confirm that a person with a *beneficial interest* of a regulated superannuation fund does not bear the onus of proof in establishing their credible claim to a benefit entitlement from the fund. Rather the trustee of the fund bears the onus of repudiating the claim if the trustee honestly believes that the claimant is misconceived as to their legal entitlement or the quantum of that entitlement.

That means that the trustee cannot adopt the tactic of: "If you want your superannuation benefit you can take us to court to get it – and we will aim to bankrupt you in the process with legal costs."

Trustees in a COMPULSORY superannuation system do have to act in the ***best interests*** of their members even when claims are the subject of dispute and not under the dictation of a parent company.

## Filter #5 {System-Wide Costs}

Net returns to members can be reduced by explicit fees and charges as well as by related party transactions where the related party, such as an in house insurance provider or fund manager captures profits that the trustee as a fiduciary is unable to capture itself.

Whist explicit costs are easy to document and compare, the impact of related party transactions can only be effectively determined by examining the net returns to members over an extended period (say 5 to 10 years}.

Therefore while a filter covering explicit fees and charges should be included, this filter should be used in conjunction with the first filter – net investment returns.

# Summary

In a compulsory superannuation system is it "***unethical***" for the trustees of "***Retail***" superannuation funds operated by the big banks funds not to apply the same investment decision making process as trustees of "***Industry***" funds so as to act in the ***best interests*** of fund members {*if not actually acting unlawful*}?

As Meggary VC stated:

> "Under a trust for the provision of financial benefits, the paramount duty of the trustee is to provide the greatest financial benefits for the present and future beneficiaries"

The political and media focus has been on the **$200 million** paid last year to several thousand customers of the big banks for "*unethical*" conduct which has been well covered in the media.

This amount is dwarfed by the **$6000 million** that is lost to the 4.5 million members of "***Retail***" superannuation funds each year by another form of "*unethical*" if not unlawful conduct.

The banks are now lobbying to increase this COMPULSORY wealth transfer by competing for the ability to participate as "*default*" superannuation funds.

Does this help explain why Australian banks are the most profitable in the world?

This then brings us back to a question for the Productivity Commission to consider:

> "Does the Productivity Commission believe that the banks' so called "*Retail*" Superannuation funds {or "*profit-for-shareholders*" funds} are operated lawfully and in the ***best interests*** of the fund members?"

Of course a definitive answer to this question may have to await a royal commission into Australia's banking system.

# Appendix A

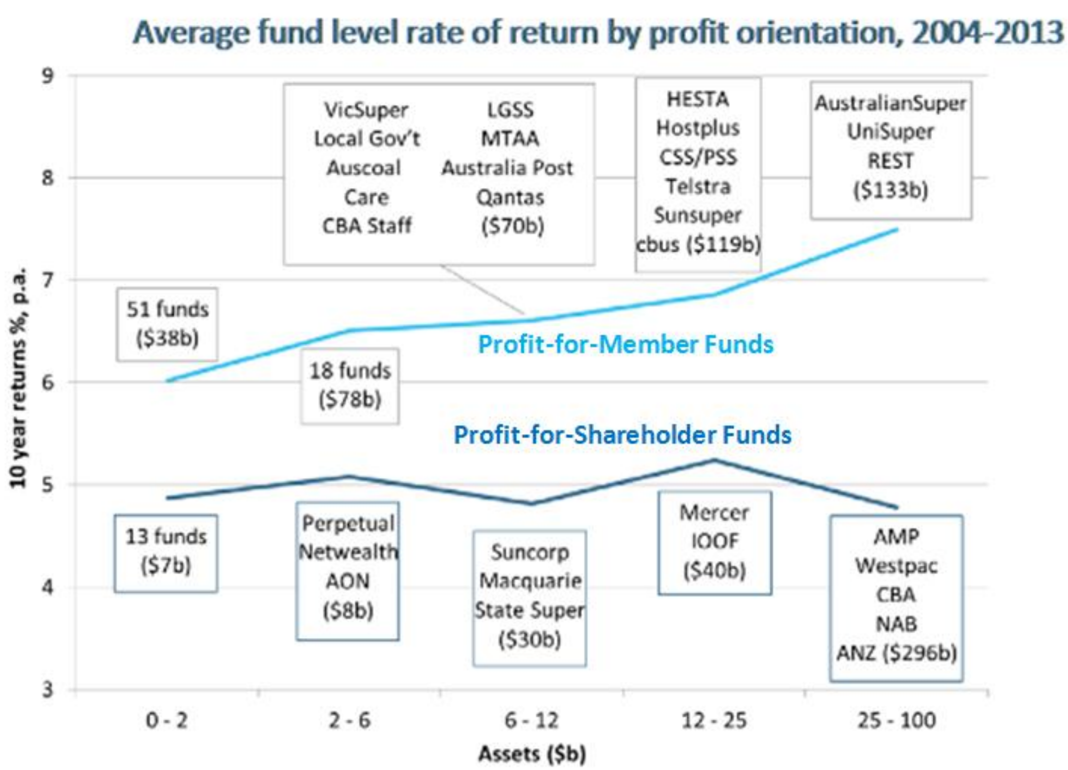
## Data Source

# Statistics

## Superannuation Fund-level Rates of Return

June 2013 (issued 8 January 2014)

## Fund Type Comparison




Source: APRA (2013) Fund level performance data and profiles, ISA analysis.

# Appendix B

## The "No Profit/No Conflict" Rule

This principle was expressed in the following manner by Lord Herschell in ***Bray V Ford*** [1896] AC 44:

> "It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule".

# Appendix C

**SUPERANNUATION INDUSTRY (SUPERVISION) ACT 1993 - SECT 58**

## Trustee not to be subject to direction

(1) Subject to subsection (2), the governing rules of a superannuation entity other than a superannuation fund with fewer than 5 members or an excluded approved deposit fund must not permit a trustee to be subject, in the exercise of any of the trustee's powers under those rules, to direction by any other person.

(2) Subsection (1) does not apply to:

(a) a direction given by a court; or

(b) a direction given by the Regulator; or

(c) a direction given by a beneficiary or a group of beneficiaries that relates to benefits payable to that beneficiary or those beneficiaries, as the case may be; or

(d) a direction given by a beneficiary to take up, dispose of or alter the amount invested in an investment option, where:

(i) the entity is a registrable superannuation entity; and

(ii) the direction is given in circumstances prescribed by the regulations for the purposes of this paragraph; or (da) a direction given by a member of a regulated superannuation fund to attribute (or continue to attribute) an amount that is an accrued default amount for the member to a MySuper product or an investment option within a choice product in the fund; or

(e) if the entity is an employer-sponsored fund--a direction given by an employer-sponsor, or an associate of an employer-sponsor, in circumstances prescribed by the regulations; or

(f) a direction given by the Superannuation Complaints Tribunal; or

(g) a direction given by a member (within the meaning of the *Superannuation Contributions Tax (members of Constitutionally Protected Superannuation Funds) Assessment and Collection Act 1997* ) that is permitted to be given by subsection 15(8A) of that Act.

(3) If the governing rules of a superannuation entity are inconsistent with subsection (1), that subsection prevails, and the governing rules are, to the extent of the inconsistency, invalid.

# Appendix D

# Funds battle over default super

MICHAEL RODDAN
RETIREMENT

The highly charged dispute between union-dominated industry superannuation funds and the bank-backed retail funds is hotting up as the Productivity Commission looks at cracking open default super options to increased competition from retail funds.

Documents circulating between senior levels of the industry fund network, obtained by *The Australian*, reveal the tactics of a public relations battle being waged for billions of dollars in future super contributions.

The "cheat sheet" detailing more than 100 compliance problems at the big four banks and Macquarie Group over the past six years is helping to provide a quick reference guide for those in industry funds arguing against handing default super over to retail funds.

Similar documents are reportedly circulating between Labor MPs ahead of this week's parliamentary inquiry into banking.

This comes after former banker and financial system inquiry head David Murray recently argued that the Labor Party was agitating for a banking royal commission to promote the interests of industry super funds over the retail wealth management industry.

At stake are the rivers of gold flowing into default industry and retail super funds, worth more than $70 billion a year and growing fast, through a system known as MySuper.

Data from the prudential regulator shows industry funds receive the lion's share of employer contributions — a proxy for the amount of default super flows. But a Productivity Commission review is looking at the possibility of breaking open the existing default super rules, which currently benefits industry funds.

Around 80 per cent of workers accept their employer's preferred fund, which are often brokered through enterprise bargaining agreements. Industry funds received more than $30bn in default flows last financial year — 50 per cent more than retail funds, which garnered $21bn.

When workers contribute of their own accord, retail funds receive much more than industry funds — $12.4bn last year compared with $5.3bn for industry funds. However, retail fund members are, on average, wealthier than their industry counterparts.

The Productivity Commission's discussion paper for the review into a tender system for default superannuation funds, released last month, has reignited the public rivalry between industry and retail funds.

It has also brought into focus the Fair Work Commission's expert panel that was tasked with allocating default super flows. The panel has idling since the Financial Services Council won a 2014 court case to dismiss the Bill Shorten-appointed group of experts on the basis it was not independent.

Minister for Employment Michaelia Cash has the power to appoint new panel members. Industry and not-for-profit funds have called for the default selection process to be restarted, but the government has declined to move.

The Financial Services Council, which represents the retail funds, has campaigned strongly against the default fund process and wants to open up consumer choice for default super.

"The Fair Work Commission process has for decades prevented half the superannuation funds in the country from competing for $9bn of consumers' retirement savings every year," FSC chief executive Sally Loan told *The Australian*.

"The Fair Work Commission is an industrial tribunal and has no place choosing financial products for consumers," she added.

But senior industry fund executives believe the banks are worried they will not benefit from a "quality filter" applied by the Fair Work Commission, as retail funds generally underperform their industry fund rivals. Over the past 10 years, industry funds have delivered an extra 2.2 per cent in annual returns each year compared to retail funds over the last decade.

Retail funds argue that administration fees charged by industry funds are far higher — at an average of 31 basis points above the average of 1.1 per cent.

Former ACTU assistant secretary and Host-Plus director Tim Lyons said these figures weren't comparing apples with apples. Low fees in retail funds were achieved by creating low-maintenance indexed funds under the MySuper regime that were largely passive and continually underperforming, he said.

"Their performance is shithouse," Mr Lyons said.

"What they've done is dumbed it down: instead of paying for active management where you can get an advantage in unlisted assets — where you pay for actual expertise in infrastructure and direct property — they've indexed the bloody lot to reduce the fees."

Mr Lyons said fees in industry-run active management funds were historically lower than similar run actively managed retail-owned funds. He added that retail funds would often "run their own money" within their vertically integrated organisations, meaning there was little incentive to reduce the fees from the trustee.

The vertical integration model has been a key plank of Opposition Leader Bill Shorten's attacks on the financial services sector.

Senior industry fund sources say related party transactions within the retail sector lead to above-market charges on super fund purchases such as insurance.

"The reality is that the unions it employs as trustees drives the governance and the culture of these institutions, which is driving better returns. Over in the banks, the governance and the culture of their institutions are driving scandal after scandal on a daily basis," a senior industry fund source said.