AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

ASIC Enforcement Review: Industry Codes in the Financial Sector

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AIST Submission to ASIC Enforcement Review

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AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $700 billion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary and key concerns

The Australian Institute of Superannuation Trustees (AIST) welcomes the opportunity to comment on the issues raised in the consultation paper released 28 June 2017.

AIST represents the profit-to-member superannuation sector and as such our comments will primarily focus on the role of industry codes and co-regulation within the superannuation sector.

Our main concerns are outlined in detail below however can be summarised as follows:

- The principal function of codes is to fill gaps, lift standards and promote leading practice rather than being the first-line of defence for serious systemic issues. We believe that industry codes and co-regulation have an important role to play in the overall regulatory framework, however it is unclear whether co-regulation is the preferred regulatory mechanism at this time because:
    - An in-depth review of the current regulatory framework has not been performed. It is premature to favour a co-regulatory approach without conducting an in-depth analysis of the current regulatory framework because other regulatory mechanisms, such as legislative reform, may be the most effective way of resolving systemic issues.
    - It is unclear why a co-regulatory approach is preferred.
    - A full assessment of the current role of industry codes has not been performed.
- It is impossible to assess the suitability of a co-regulatory framework for the superannuation sector due to significant uncertainty within the sector and the lack of clarity within the consultation paper itself.
- We query the focus on industry codes and co-regulatory approach at time when there are significant gaps within the regulatory framework which need addressing as a priority – this is especially true given that these gaps have a detrimental impact on members' retirement savings. Refer to Annexure 1 for a summary of key gaps.
- Sometimes a strong regulatory framework, rather than an industry code or co-regulation, is required to address systemic issues affecting the superannuation industry – this is illustrated by the Regulatory Guide 97 process.

Key Concerns

It is unclear whether co-regulation is the preferred regulatory mechanism

Co-regulation is not necessarily the preferred regulatory mechanism to address issues affecting the superannuation industry because:

- The Taskforce does not fully explore the role of industry codes, including how and when the development of codes might be triggered.
- Co-regulation is inappropriate at this time because there is too much uncertainty within the sector to make the approach workable.
- The seriousness and measureable degree of impact of matters affecting the superannuation industry has not been considered. For example, critical matters relating to consumer protection and superannuation system adequacy and sustainability must be legislated, rather than addressed through co-regulation.
- The purpose of the consultation is unclear.
- There is insufficient detail within the paper to provide meaningful comment.

Role of industry codes

The consultation paper does not examine the various objectives of industry codes within the financial system. Without a full analysis of industry codes, it is difficult to address the preliminary positions and consultation questions.

AIST strongly believes that codes can:

- Provide member rights in areas not covered by the law.
- Cover gaps in the applicability of legislation.
- Set higher obligations on industry participants, thereby raising standards. The aspirational qualities of codes can contribute to member outcomes and it is possible for best practice set out in codes to eventually become codified in law.
- We believe that the impact of existing industry codes should be examined before examining the benefits of transitioning towards a co-regulatory approach.

Uncertainty within the superannuation sector

The paper introduces a number of uncertainties and ignores the many significant policy reviews and legislative change projects currently underway within the superannuation sector. A significant amount of information is needed before a considered response to the issues raised in the paper can be provided, and the current work on key policy areas, such as those in the following table, should be completed before the appropriateness of a co-regulatory approach can be determined.

Projects relating to transparency and comparability of superannuation products
Portfolio holdings disclosure.
Product dashboards – presently only mandated for My Super products and still under development for choice products.
Regulatory Guide 97: Fee and cost disclosure. (RG 97)
Projects relating to improving outcomes for superannuation members
Insurance in Superannuation Working Group.
Indigenous Superannuation Working Group.
Treasury Legislation amendment (Improving Accountability and Member Outcomes in superannuation) Bill 2017 consultation.
Removal of the Salary Sacrifice loopholes affecting the Superannuation Guarantee.
Cross-agency Working Group on superannuation guarantee non-compliance.
Projects relating to dispute resolution within the superannuation sector
Review into Dispute Resolution and Complaints Framework.
Consultation on the External Dispute Resolution and Complaints Framework.

It is impossible to fully consider the impact of moving towards an industry-wide co-regulatory approach at this time due to the high level of uncertainty.

We believe that a number of key projects such as those relating to External Dispute Resolution (EDR), insurance in super and fees and cost disclosure must be completed before the issues and preliminary Taskforce positions outlined in the consultation paper can be fully considered.

A sound regulatory framework is the priority

AIST believes that critical matters relating to consumer protection and superannuation system adequacy and sustainability should be legislated.

The Taskforce has signalled a preference of endorsing a co-regulatory model whereby industry participants are required by a legal mechanism (such as a law or a licence condition) to adhere to a code. While in certain circumstances co-regulation may bring value to an industry and its participants, it should not be the go-to mechanism in all scenarios to address issues or change

behaviour. Indeed, there are a number of instances in which legislation or regulation is more appropriate to address an issue, rather than a code, for example where universal application of standards across sectors or industries is required.[1]

The approach taken by the Taskforce appears to be ignoring, or failing to assess, the role that the broader regulatory environment plays in promoting consumer confidence within the superannuation sector.

Accordingly, while we endorse the use of codes in some circumstances, they should not be used as a replacement for a sound and detailed legislative framework. In this regard, we seek further consultation on the role of industry codes and confirmation that the co-regulatory approach is not being adopted as a substitute for advancing the legislative framework.

Purpose of the consultation is unclear

Not only is a sound regulatory framework a priority, but the Taskforce has not stated with sufficient clarity what the actual problem to be addressed is.[2] Despite this, the Taskforce has adopted a preliminary position that the introduction of a co-regulatory model for regulation of the financial sector may be appropriate.[3]

It is imperative that the problem sought to be addressed is clearly articulated, because the approach taken to resolve it will ultimately depend on the problem. We believe it is premature to determine that a co-regulatory approach is appropriate because the merits of co-regulation as a regulatory model will depend on the problem. *The Report of the Commonwealth Interdepartmental Committee on Quasi-Regulation* highlighted that 'understanding the nature of the problem and assessing why the existing regulatory system will not work are important first steps in choosing whether to regulate and which form [of regulation] is best'.[4]

The *Australian Government Best Practice Regulation Handbook* states that:

> *Direct government regulation should be considered when, among other things: the problem is high-risk; of high impact or significance; the community requires the certainty provided by legal sanctions; and there is a systemic compliance problem with a history of tractable*

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[1] Productivity Commission, *Grey-Letter Law: Report of the Commonwealth Interdepartmental Committee on Quasi-regulation* (December 1997) <https://tinyurl.com/y9zaqmmk> 56.
[2] The consultation paper only goes so far as to suggest that the impact on the lives of consumers as a result of poor industry practices should be reduced where possible.
[3] The Australian Government the Treasury, *ASIC Enforcement Review: Position and Consultation Paper 4 Industry Codes in the Financial Sector* (28 June 2017) <https://tinyurl.com/yb9kl6uu> 1.
[4] Above n 1, 50.

> *disputes and repeated or flagrant breaches of fair trading principles, with no possibility of effective sanctions.*
>
> *[…] self-regulation—or by extension, more co-regulation—may be a feasible option if: there is no strong public interest concern, in particular no major public health and safety concerns; the problem is a low-risk event, of low impact or significance; and the problem can be fixed by the market itself—for example, if there are market incentives for individuals and groups to develop and comply with self-regulatory arrangements.*[5]

We believe a considered analysis of the problem has not been performed and it is imperative for such an assessment to take place prior to considering the merits of the various regulatory models.

Insufficient detail within the consultation paper

We support measures that improve consumer outcomes however we are deeply concerned about the insufficient detail around a number of the preliminary positions adopted by the Taskforce and key issues. The evidence base in support of the positions must be presented to allow for a proper consideration of the issues. Continuing the consultation without offering sufficient detail will potentially have an adverse impact on the outcomes.

Gaps in the current regulatory framework

We question the focus on codes at time when there are significant gaps within the regulatory framework which need addressing as a priority especially given that these gaps have a detrimental impact on members' retirement savings.

For details of the gaps regarding choice superannuation products that ultimately have a detrimental impact on fund members please see *Annexure 1- Inconsistent Treatment of Choice.*

Strong regulatory framework

There are times when a strong regulatory framework, rather than an industry code or co-regulation is required to address industry issues. For example a legislative approach to fee and cost disclosure may have been preferable to the actual approach taken. The process of developing RG 97 was difficult because the regulatory framework was insufficient, which resulted in industry confusion and made the development of a code difficult. For example, the industry has been left to determine via industry guidance critical issues such as 'what is a fee or cost', 'how to undertake reasonable estimates of fees or costs', and 'how are the fees and costs of Over the Counter

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[5] Australian Law Reform Commission, *National Classification Scheme Review* (September 2011) <https://tinyurl.com/ycbwyy6x> 191.

Derivatives to be calculated'. These are all matters which AIST has consistently advocated as needing to be covered by a strong regulatory framework.

Response to Taskforce positions

Our responses to the preliminary positions adopted by the Taskforce are below.

Position 1: The content of and governance arrangements for relevant codes (those that cover activities specified by ASIC as requiring code coverage) should be subject to approval by ASIC.

The consultation paper does not include sufficient information or detail to allow for comments on this position. There are a number of outstanding issues that need resolving and details that must be provided before stakeholders can fully assess and respond to this position.

There are a number of questions that need answering, for example:

- The Insurance in Super Working Group (ISWG) is currently engaged in a large body of work that will inform the development of the code of practice and good practice guidance for superannuation funds regarding the offering of insurance through superannuation. It is unclear how the consultation paper proposal for codes to cover insurance issues will interact with the work being performed by ISWG.
- Which industry participants will the codes apply to?
- What process will the Australian Securities and Investments Commission (ASIC) follow when determining the minimum content that codes must cover?
- How will the ASIC approval process work?
- What will trigger the development of any code?
- What activities will require ASIC code coverage, and how will ASIC determine these activities? The consultation paper notes that ASIC would determine, by instrument, matters that may require code coverage, then notes that the types of matters will likely be similar to those handled by the Australian Financial Complaints Authority (AFCA). This preliminary view introduces a considerable degree of uncertainty into the consultation and makes comment difficult because the legislation that sets out AFCA's establishment is currently subject to industry consultation, and has not been introduced into parliament. This means that AFCA has not been formed and its Terms of Reference have not been drafted. From these statements it is unclear what activities will actually require ASIC code coverage, and how ASIC will determine these activities.
- How will ASIC ensure that it fully understands an industry and the issues affecting it before approving the code?
- How will ASIC set the governance arrangements for the codes?

- A benefit of self-regulation is that it utilises the expertise of the regulated,[6] so greater clarity is required regarding ASIC's role in approving the code and how it proposes to engage with industry to ensure that industry expertise is not lost in the process or diluted. The consultation paper notes 'the content of the code would remain a matter for industry to determine consistent with the broad criteria set by ASIC', however it is unclear how ASIC will set the broad criteria, and the applicability of this criteria across different sectors.
- Will the power to approve codes only apply to consumer-focused codes or will it be broader?

Position 2: Entities engaging in activities covered by an approved code should be required to subscribe to that code (by a condition on their AFSL or some similar mechanism).

As outlined in the previous part, the Taskforce has not sufficiently outlined the particular issues sought to be addressed by adopting a co-regulatory model.

Before the merits of this position can be assessed:

- The panel must articulate the problems sought to be addressed.
- More information around the issues outlined in the consultation paper is required.
- The ongoing superannuation policy projects must be completed.

Assuming the above issues are addressed, our main concerns with this position include:

- The paper does not make it clear how the co-regulatory environment would be utilised to ensure the appropriate sectors are covered and are brought into the regime.
- The paper suggests entities can be made to subscribe to a code by via a condition on their Australian Financial Service Licence (AFSL) or similar mechanism, however it is unclear how this would work in practice. For example not all superannuation funds have an AFSL, so that mechanism would be inappropriate to ensure coverage.
- The paper states that 'similar mechanisms' may also be used, yet does not provide information on how these would actually look, or how scheme participants would be appropriately defined.

We strongly believe that these issues must be addressed.

[6] Australian Securities and Investments Commission, *Submission to the Inquiry on Industry Self-Regulation*, (January 2000) <http://tinyurl.com/ycoz5rre> 7.

Position 3: Approved codes should be binding on and enforceable against subscribers by contractual arrangements with a code monitoring body.

The Taskforce has adopted a preliminary view that codes should be binding and enforceable against subscribers by contractual arrangements, however one of the consultation questions in the consultation paper asks whether contractual arrangements are the most effective enforcement mechanism.

This key issue (and there are others) highlights both the lack of clarity within the paper as well as the need for further consultation.

Position 4: An individual customer should be able to seek appropriate redress through the subscriber's internal and external dispute resolution arrangements for non-compliance with an applicable approved code.

Outlining members' ability to seek redress through Internal Dispute Resolution (IDR) and EDR arrangements is problematic in light of the significant uncertainty around both IDR and EDR within the superannuation sector. IDR and EDR frameworks are currently subject to significant reform and this process must be completed before comment can be offered on this position.

A secondary issue is that under the proposed EDR reforms it is unclear whether it is even possible for the EDR framework to consider fund non-compliance with approved codes. The *Treasury Laws Amendment (External Dispute Resolution) Bill 2017* sets out provisions for the establishment of an external dispute resolution body (likely to be AFCA). The Bill acknowledges that superannuation complaints are unique and therefore AFCA needs a special set of powers to resolve these complaints, and goes on to define a 'superannuation complaint' for the purpose of enlivening the extra powers. The draft meaning of 'superannuation complaint 'does not envisage AFCA having regard to industry codes of conduct in addressing a complaint.

We believe that the ongoing body of work on IDR and EDR must be completed before an accurate assessment of this position can be undertaken.

Position 5: The code monitoring body, comprising a mix of industry, consumer and expert members, should monitor the adequacy of the code and industry compliance with it over time, and periodically report to ASIC on these matters.

The consultation paper does not include sufficient information or detail to allow for a considered answer to this question. We believe the following questions must be answered:

- What will the code body will be?
- How it will be established?
- How it will operate in practice?
- How it will be suitably comprised of industry, consumer and expert members?
- How will the difficulty of combining different groups and sectors to sit on one body will be resolved?

Response to consultation questions

Our responses to the questions contained in the consultation paper are below.

1. Would a requirement to subscribe to an ASIC approved industry code result in improved outcomes for consumers?

It may be appropriate for the Taskforce to assess the efficacy of codes within the superannuation sector to answer this question. A review of code efficacy may affect the preliminary position adopted by the Taskforce that a co-regulatory approach is preferable.

Notwithstanding this, in principle we believe that codes, when developed appropriately and with a clear objective, can improve outcomes for consumers.

2. In respect of which financial sector activities should the requirement apply?

Issues regarding the requirement to subscribe to an industry code should be considered once the uncertainties and our concerns detailed above have been addressed.

4. What costs or other regulatory burden would the requirement imply for industry?

The total cost will ultimately depend on the problem that the co-regulatory approach seeks to fix. A simple problem, such as lack of disclosure on straightforward and uncontentious issues can be relatively inexpensive as all it would require would be for entities to make more information publicly available. On the other hand, if there are bigger or systemic issues that are sought to be addressed there may be sweeping changes necessary, which would carry significant costs.[7]

Potential costs include:

- Compliance costs – any form of regulation, whether self-regulation or otherwise will require funds to allocate resources to ensure compliance with the regulation.[8]
- Administrative costs– updating the code, monitoring compliance, and running the code body are all ongoing administrative costs.[9]
- Costs associated with IDR and EDR complaints handling.
- Regulatory costs – there will be costs incurred by ASIC in light of their proposed oversight and approval role. These costs may then be passed on to industry participants, and thus superannuation fund members, through the ASIC Industry Funding Model.

[7] Taskforce on Industry Self-Regulation, *Industry Self-Regulation in Consumer Markets*, (August 2000) <https://tinyurl.com/ya938vu4> pp 80–85.
[8] Ibid.
[9] Ibid.

In light of the potential costs it is imperative that the problem sought to be addressed by the Taskforce is clearly articulated, especially if superannuation fund members would ultimately be incurring the costs associated with the proposed framework.

6. Will ensuring enforceability provisions of codes meet a minimum standard improve consumer outcomes?

Whether consumer outcomes will be improved depends on the issues that the co-regulatory approach is seeking to address.

In principle we believe that codes, when developed appropriately and with clear objectives, can improve outcomes for consumers.

7. Do any problems arise with imposing these requirements in relation to particular financial sector activities?

The full impact of the imposition of the requirements is currently unknown because additional information is required.

9. Is it appropriate that, where feasible, code content be incorporated into contracts with customers?

It is unclear how this will apply within the superannuation context.

10. Should the composition of individual code monitoring bodies and arrangements for enforcement be subject to ASIC approval?

Please refer to our answer to 'Position 1' above.

Annexure 1 – Inconsistent Treatment of Choice

This is an extract from AIST's submission[10] to the Senate Inquiry into consumer protection in the banking, insurance and financial services sector:

The following table summarises the numerous exemptions, gaps and inconsistencies afforded through the legislative environment to choice superannuation products. At 30 June 2015, choice superannuation products cover $904,556 million of members' pre-retirement superannuation moneys compared with $428,300 million in MySuper. More detail regarding these may be found in AIST's submission.

Table 1 – Overview of exemptions from regulatory framework

Different treatment	Comments	Impact on consumers
No explicit duties on trustees to promote the financial interests of beneficiaries, or apply a scale test for choice products/investment options.	The value of retirement savings in pre-retirement choice products /investment options is double the value in MySuper products. In 2014 SuperRatings found substantial differences between fees for MySuper and choice products, particularly within retail superannuation funds – even when the underlying asset allocations were almost identical. According to APRA there are 120 MySuper products but over 40,000 member investment choices.	The compounding effect of higher fees over long term reduces retirement incomes for members of choice products. Choice overload baffles members. The choice sector of the superannuation system is not achieving efficiencies of scale.
The Government deferred the requirement for choice dashboards in 2014, 2015 and 2016.	The Super System Review, Financial System Inquiry, and the Grattan Institute have all concluded that the level of fees paid by members is too high.	Members of choice products/investment options do not have a dashboard and so cannot easily compare their

[10] AIST, (2017). *Senate Inquiry into consumer protection in the banking, insurance and financial services sector.*

Different treatment	Comments	Impact on consumers
It plans to amend the law so funds would only need to produce dashboards for their 10 largest choice options.	SuperRatings has criticised the poor level of disclosure of fees, noting there is still a long way to go to achieve comparability of fees across MySuper and choice products/investment options.	returns, fees or costs with MySuper products. Under the Government's proposal, dashboards will not be required for most choice investment options.
APRA does not collect or publish statistics on choice products/investment options equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for choice dashboards.	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of choice products/investment options. Lack of data hampers this.
No requirement to ensure switching funds is in the best interests of the member when giving general advice or under no-advice business models.	ISA analysis of Roy Morgan research found an increase in cross-selling retail superannuation using general advice and no-advice business models.	Members are switched from a MySuper product to an inferior choice product/investment option, when it is not in the best interests of the member.
New fees and costs disclosure requirements do not apply to superannuation held via a platform.	According to Rainmaker, over 70 per cent of retail superannuation assets in Australia are held via platforms. According to Lane Clark Peacock, UK members may be paying up to 20 basis points per annum to access an active fund through a platform	Disclosure for superannuation held via a platform understates fees and costs paid by the member. ASIC admits it would be misleading to compare the fees and costs of platforms and non-platform superannuation funds.

Different treatment	Comments	Impact on consumers
	when compared with the cos of going direct to the fund manager. According to the UK Financial Conduct Authority, platforms add 20-90 basis points to costs.	The compounding effect of higher costs over long term reduces retirement incomes for members.
The (unimplemented) dashboard regime for choice products/investment options will not include platforms.	While the Government amended the regime to require dashboards for products/investments held via a platform, platforms themselves will be exempt.	Members who hold their superannuation via a platform will not have a dashboard for it, compounding an existing difficulty comparing their returns, fees or costs with MySuper products.
APRA does not collect or publish statistics on platforms equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for choice dashboards.	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of superannuation held via a platform. Lack of data hampers this.
No requirement to produce a shorter PDS for legacy products.	According to Rice Warner, around 30% of personal superannuation assets are held in legacy products.	This makes it difficult for members in legacy products to compare the performance, fees or costs of the product with a contemporary product, understand the exit costs and assess whether they would be better off switching to a contemporary product.
The (unimplemented) dashboard regime for choice products/investment options will not	Rice Warner found fees and costs for legacy products are on average more than double those for contemporary products.	Members who hold legacy superannuation products will not have a dashboard, making it difficult to compare their

Different treatment	Comments	Impact on consumers
include legacy products.	UK Independent Project Board found £26 billion in legacy pension schemes had investment manager fees above 1%, with nearly £1 billion exposed to fees over 300 basis points per annum.	returns, fees or costs with contemporary products.
APRA does not collect or publish statistics on legacy products equivalent to the comprehensive statistical collection derived from the MySuper reporting standards.	APRA deferred collecting data for choice products/investment options for consideration during the development of the requirements for choice dashboards.	Members rely on APRA, employers, advisers, Government, researchers, commentators and trustees to analyse the characteristics and performance of legacy products. Lack of data hampers this.
Conflicted remuneration is banned for most of the financial services industry, but there is an exemption for advice about retail life insurance.	In 2014 ASIC found more than one third of advice about retail life insurance reviewed did not comply with the law. 96% of non-compliant advice was given by advisers paid an upfront commission.	Consumers are at significant risk of being recommended a life insurance policy that is not in their best interests. Industry and Government proposals to address this do not include banning commissions.

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