Final Report

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

VOLUME 2:
CASE STUDIES

ISBN:

978-1-920838-64-5 (print)

978-1-920838-65-2 (online)

Contents

Volume 2: Case Studies

Glossary

Term	Definition
accrued default amount (ADA)	An amount of superannuation accumulated in a situation where (a), the member has not given the fund's trustee any direction about how the amount is to be invested, or (b), the amount is invested in the fund's 'default' investment option.
anti-hawking provisions	Provisions set out in Sections 736, 992AA and 992A of the *Corporations Act 2001* (Cth) that prohibit offering financial products for issue or sale during, or because of, an unsolicited meeting or telephone call with a retail client.
Australian Credit Licence (ACL)	A licence issued under the *National Consumer Credit Protection Act 2009* (Cth) that authorises a licensee to engage in particular credit activities.
Australian financial services licence (AFSL), Australian financial services licensee	A licence under the *Corporations Act 2001* (Cth) that authorises a person who carries on a financial services business to provide financial services. A licensee is the person who provides the services.
authorised deposit-taking institution (ADI)	A body corporate authorised under the *Banking Act 1959* (Cth) to carry on a banking business in Australia.
Bank Bill Swap Rate (BBSY)	An interest rate used as a benchmark when pricing financial products.
Banking Executive Accountability Regime (BEAR)	A piece of legislation set out in Part IIAA of the *Banking Act 1959* (Cth) and enacted in February 2018, the BEAR establishes accountability obligations for **authorised deposit-taking institutions** (ADIs) and their senior executives and directors. It is administered by APRA.
buyer of last resort (BOLR)	Arrangements whereby a licensee or an authorised representative acquires the business of another representative. The purchase price is determined using a specific formula.

Term	Definition
conflicted remuneration	Any benefit, whether monetary or non-monetary, given to a **financial services licensee**, or their representatives, who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given could reasonably be expected to influence the choice of financial product recommended by the licensee or representative or could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative: see Section 963A of the *Corporations Act 2001* (Cth).
enforceable undertaking (EU)	An undertaking enforceable in a court. Issued under the *Australian Securities and Investments Commission Act 2001* (Cth) and the *National Consumer Credit Protection Act 2009*.
external dispute resolution (EDR)	An independent service for resolving disputes between consumers and providers of financial products and services, as an alternative to the court system.
financial product	Under the *Corporations Act 2001* (Cth), a facility through which, or through the acquisition of which, a person makes a financial investment, manages financial risk and/or makes non-cash payments.
financial services entity	Defined by the Letters Patent as (among other things) 'an ADI (**authorised deposit-taking institution**) within the meaning of the *Banking Act 1959*', 'a person or entity required by section 911A of the *Corporations Act 2001* to hold an **Australian financial services licence**, or who is exempt from the requirement to hold such a licence by virtue of being an authorised representative', and 'a person or entity that acts or holds itself out as acting as an intermediary between borrowers and lenders'.

Term	Definition
Financial Services Guide (FSG)	A guide that contains information about the entity providing financial advice, and explains the services offered, the fees charged and how the person or company providing the service will deal with complaints.
financial services licensee	An individual or business that has been granted an **Australian financial services licence** (AFSL) by ASIC.
Future of Financial Advice (FoFA)	A 2012 package of legislation intended to improve the trust and confidence of Australian retail investors in the financial services sector and ensure the availability, accessibility and affordability of high quality financial advice.
grandfathering arrangements, grandfathered commission	Grandfathering arrangements allow for commissions to continue to be paid to intermediaries who sold financial products prior to the **Future of Financial Advice** (FoFA) reforms that would otherwise be classified as **conflicted remuneration**. This source of revenue is known as a grandfathered commission.
group life insurance	Life insurance where a group of people (for example, members of a superannuation fund) are covered by the one contract.
Household Expenditure Measure (HEM)	A measure of what families spend on different types of household items, calculated quarterly by the Melbourne Institute of Applied Economic and Social Research.
mortgage aggregator	An intermediary between mortgage brokers and lenders. Mortgage aggregators have contractual arrangements with lenders that allow brokers operating under the aggregator to arrange loans from those lenders.
mortgage broker	An intermediary between borrowers and lenders of home loans.

Term	Definition
MySuper products	Low-cost, simple superannuation products for members who make no active choice about their superannuation.
registrable superannuation entity (RSE)	A category of superannuation entity, regulated by APRA, that includes regulated superannuation funds, approved deposit funds and pooled superannuation trusts, but does not include self-managed superannuation funds (SMSFs).
successor fund transfer (SFT)	Where a member's benefits are transferred to a successor fund. This is one of the few situations where benefits can be transferred without the member's consent and is subject to strict regulation.
third party guarantor	A person or business other than the borrower who guarantees to pay back a loan if the borrower does not.
Tier 1 Capital	Capital against which losses can be written off while an **authorised deposit-taking institution** (ADI) continues to operate and can absorb losses should the ADI ultimately fail.
trail commission	A regularly recurring commission to an intermediary, such as a broker, based on a proportion of the current or average loan balance and payable periodically after the loan is made/drawn. Distinct from a commission that is paid up front.
vertical integration	A description of the relationship between entities where financial advice, platforms and funds management are controlled by a single entity.

Abbreviations

ABA	Australian Bankers' Association (now Australian Banking Association)
ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ACBF	Aboriginal Community Benefit Fund
ACCC	Australian Competition and Consumer Commission
ACL	Australian Credit Licence
ADA	accrued default amount
ADI	authorised deposit-taking institution
AFA	Association of Financial Advisers
AFCA	Australian Financial Complaints Authority
AFSL	Australian financial services licence
APRA	Australian Prudential Regulation Authority
ASBFEO	Australian Small Business and Family Enterprise Ombudsman
ASIC	Australian Securities and Investments Commission
AUSTRAC	Australian Transaction Reports and Analysis Centre
BEAR	Banking Executive Accountability Regime
BOLR	buyer of last resort
DRE	dual-regulated entity
EDR	external dispute resolution

EU	enforceable undertaking
FASEA	Financial Adviser Standards and Ethics Authority
FoFA	Future of Financial Advice (legislation reforms)
FOS	Financial Ombudsman Service
FPA	Financial Planning Association of Australia
FSC	Financial Services Council
FSG	Financial Services Guide
HEM	Household Expenditure Measure
IDR	internal dispute resolution
KPI	Key Performance Indicator
LVR	loan-to-value ratio
PDS	product disclosure statement
RE	responsible entity
RSE	registrable superannuation entity
SFT	successor fund transfer
SME	small and medium enterprises
SMSF	self-managed superannuation fund

Key references	
Cooper Review, Final Report	Super System Review: Final Report (30 June 2010)
Murray Inquiry, Final Report	Financial System Inquiry Final Report (November 2014)
Ramsay Review, Final Report	Final Report: Review of the Financial System External Dispute Resolution and Complaints Framework (April 2017)
Ramsay Review, Supplementary Final Report	Supplementary Final Report: Review of the Financial System External Dispute Resolution and Complaints Framework (September 2017)
Sedgwick Review, Report	Retail Banking Remuneration Review: Report (19 April 2017)
Wallis Inquiry, Final Report	Financial System Inquiry Final Report (March 1997)

Legislation

ASIC Regulations 2001 (Cth)

Australian Crime Commission Act 2002 (Cth) (the ACC Act)

Australian Prudential Regulation Authority Act 1998 (Cth) (the APRA Act)

Australian Prudential Regulation Authority Amendment Act 2003 (Cth)

Australian Securities and Investments Commission Act 2001 (Cth) (the ASIC Act)

Australian Small Business and Family Enterprise Ombudsman Act 2015 (Cth)

Banking Act 1959 (Cth) (the Banking Act)

Competition and Consumer Act 2010 (Cth)

Consumer Insurance (Disclosure and Representations) Act 2012 (UK)

Corporate Law Reform Act 1992 (Cth)

Corporations Act 1989 (Cth)

Corporations Act 2001 (Cth) (the Corporations Act)

Corporations Amendment (Financial Advice Measures) Act 2016 (Cth)

Corporations Amendment (Financial Advice) Regulation 2015 (Cth)

Corporations Amendment (Revising Future of Financial Advice) Regulation 2014 (Cth)

Corporations Regulations 2001 (Cth)

Fair Work Act 2009 (Cth)

Farm Business Debt Mediation Act 2017 (Qld)
Farm Debt Mediation Act 1994 (NSW)
Farm Debt Mediation Act 2011 (Vic)
Financial Services and Markets Act 2000 (UK)
Financial Services Reform Act 2001 (Cth)
Income Tax Assessment Act 1997 (Cth)
Insurance Act 1973 (Cth) (the Insurance Act)
Insurance Contracts Act 1984 (Cth) (the Insurance Contracts Act)
Insurance Contracts Amendment Act 2013 (Cth)
Insurance Contracts Regulations 2017 (Cth)
Legislation Act 2003 (Cth)
Life Insurance Act 1995 (Cth) (the Life Insurance Act)
National Consumer Credit Protection Act 2009 (Cth) (the NCCP Act)
National Consumer Credit Protection Regulations 2010 (Cth) (the NCCP Regulations)
Occupational Superannuation Standards Act 1987 (Cth) (the OSSA Act)
Privacy Act 1988 (Cth)
Public Governance, Performance and Accountability Act 2013 (Cth)

Retirement Savings Accounts Act 1997 (Cth)
Royal Commissions Act 1902 (Cth)
Superannuation Guarantee (Administration) Act 1992 (Cth)
Superannuation Guarantee (Administration) Regulations 2018 (Cth)
Superannuation Industry (Supervision) Act 1993 (Cth) (the SIS Act)
Superannuation Legislation Amendment (Choice of Superannuation Funds) Act 2005 (Cth)
Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012 (Cth).
Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012 (Cth)
Superannuation Legislation (Trustee Obligations and Prudential Standards) Act 2012 (Cth)
Superannuation Safety Amendment Act 2004 (Cth)

The Commission’s tasks

In the *Interim Report* I pointed out that the first paragraph of the Terms of Reference obliged me to inquire into whether conduct *might* have amounted to misconduct (as defined) and that the second paragraph required me to consider whether any conduct, practices, behaviour or business activities by financial services entities fell below community standards and expectations.

Although it repeats what has already been said in the *Interim Report*, it is important to set out, again, my understanding of my tasks.

The term ‘misconduct’ is defined in the Letters Patent as including four classes of conduct:

- conduct that constitutes an offence against certain laws;
- conduct that is misleading, deceptive, or both;
- conduct that is a breach of trust, breach of duty or unconscionable conduct; and
- conduct that breaches a professional standard or a recognised and widely adopted benchmark for conduct.

Consistent with the essential character of a Royal Commission (as a non-judicial task) the Letters Patent require me to inquire into whether any conduct *might* have amounted to misconduct. I am not asked to decide whether conduct did constitute an offence, or other contravention of law. If conduct might have amounted to misconduct, I am required and authorised to decide whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency. Any decision about bringing proceedings is a matter for the relevant agency, not for me.

This report sets out conclusions I have reached in relation to the matters explored in public hearings. I set out my conclusions about what happened, what was done or not done, and what legal characterisations might attach to or be associated with those factual conclusions.

The conclusions I reach about whether conduct might have amounted to misconduct are, and must be, based on the information that has been assembled during the course of the Commission's inquiries. Much, but not all, of that information was provided by evidence given in the course of public hearings; some was gathered in other ways, including, for example, from submissions made to the Commission by **financial services entities** and others.

The conclusions that I reach have no binding or enforceable effect, whether against those who are said to have engaged in relevant conduct, against others who have appeared in the course of public hearings or in any other way. I cannot, and do not, decide whether evidence given in hearings conducted by the Commission would support a finding of contravention of law, if this evidence could be, and later was, adduced in properly constituted criminal or civil proceedings.

In their submissions, persons given leave to appear have often emphasised that a conclusion that there might have been misconduct should not be reached lightly. Unsurprisingly, the submissions have been framed in the language of the courtroom, with references to standards and burdens of proof. And references of that kind (especially to notions of burden of proof) originate in the essentially adversarial common law system of judicial trial, in accordance with rules of evidence.

The processes of a Royal Commission, and hence of the inquiry I have conducted, are radically different from those of a court conducting a trial. The Commission is an inquiry instituted by the Executive. It is not bound by the rules of evidence. The notion of a burden of proof has no application. But the essential point made – that a conclusion that there might have been misconduct should not be reached lightly – is undeniably true.

I cannot form a conclusion about what has happened or what has been done or not done without my being persuaded of the relevant fact. And as Dixon J pointed out in 1938, '[t]he seriousness of an allegation made, the inherent unlikelihood of an occurrence of a given description, or the gravity of the consequences flowing from a particular finding are considerations which must affect the answer to the question whether the issue has been proved to the reasonable satisfaction of the tribunal'.[1]

1 *Briginshaw v Briginshaw* (1938) 60 CLR 336 at 361–2.

The conclusions that I express in my reports (interim and final) may have grave consequences. Allegations of misconduct are serious.

Members of society ordinarily do not engage in conduct that is dishonest. Most members of society try to act within legal rules and regulations.

All of these are matters that I have striven to bear at the forefront of consideration when forming the conclusions I express. Most especially has that been so in respect of two kinds of conclusion – first, a conclusion that conduct by a financial services entity (or by directors, officers or employees of an entity or by someone acting on behalf of the entity) might have amounted to misconduct, and second, the related but distinct conclusion about whether the question of criminal or other legal proceedings should be referred to the relevant Commonwealth, state or territory agency.

It will be seen that there are some cases in which I say that particular conduct *amounted to* misconduct rather than that the conduct *might* be of that character. I have thought it right to go so far in cases where the entity concerned acknowledged in its submissions to the Commission that what had happened amounted to misconduct. Apart from those cases, however, I have sought to express no larger conclusion than that conduct might have amounted to misconduct of a particular kind.

It will also be seen that I have referred aspects of the conduct described in the following case studies to the Australian Securities and Investments Commission (ASIC), the Australian Prudential Regulation Authority (APRA) or, in some cases, both. Those references are in addition to the steps I took, in November 2018, under Section 6P of the *Royal Commissions Act 1902* (Cth), to communicate certain information to ASIC that I considered related, or may relate, to contraventions of the *Corporations Act 2001* (Cth), in particular Section 1041G of that Act (engaging in dishonest conduct, in the course of carrying on a financial services business in this jurisdiction, in relation to a financial product or financial service).

Case studies: Superannuation

Introduction

The Commission's fifth round of hearings explored issues relating to the superannuation industry.

The hearings focused on four topics:

- the proper use of members' money, including inappropriate deductions from members' accounts (such as for services that were not provided), failures to diligently manage investments and spending, and retaining money instead of distributing it to members;
- arrangements between superannuation trustees, related parties, and financial advisers, including where the trustee is part of a broader group;
- governance matters, including board composition, the adequacy of the trustee board's oversight, and merger proposals; and
- the response of superannuation trustees to legislative reforms intended to promote superannuation members' interests.

These topics sometimes overlapped within individual case studies.

One overarching theme recurred: the difficulties that trustees (principally retail trustees) faced in dealing with conflicts between duty and interest. A trustee must act in the best interests of members and prefer their interests over the interests of anyone else. It will breach its duties if it disadvantages its members or disregards their interests for its own, or others', profit or convenience. Contrary to many of the submissions made by retail trustees, these duties are easily understood. But compliance with the duties in the face of some competing interests appeared to be difficult.

In a number of cases, what appeared to be a failure by a trustee to discharge its duties concerned MySuper members or members who ought to have been transferred to a **MySuper product**. In respect of those members, trustees have additional and more specific duties. MySuper members' retirement savings are invested through a default product and, in that way, those members have delegated all aspects of their superannuation to the trustee.[1] For that reason, MySuper members may be seen as more vulnerable than those who have made an investment decision: they depend on the trustee's judgment to place them in a position to receive the best return possible, so they can grow their retirement savings.

The legislation imposes certain rules and characteristics on MySuper products offered by trustees. MySuper products are designed to be low cost, simple and transparent and to provide an appropriate investment strategy for the member. They are designed to ensure that the financial interests of members who make no active choice about their superannuation are protected.[2] And they play a significant role in superannuation in Australia: as at June 2018, total assets held in MySuper products was $675.6 billion.[3]

In the cases examined in the hearings, potential breaches of trustee duties yielded no enforcement action by the regulators. It will be necessary to consider whether the Australian Prudential Regulation Authority's (APRA's) response was adequate.

The choices trustees make for their members can significantly affect members' retirement savings. And, in turn, members' retirement savings are affected by the way in which the regulator monitors and enforces trustees' compliance with their duties, particularly in the case of MySuper products.

APRA's mandate is to protect the Australian community by establishing and enforcing prudential standards and practices designed to ensure that,

1 See, eg, Explanatory Memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (Cth).

2 See, eg, Explanatory Memorandum, Superannuation Legislation Amendment (MySuper Code Provisions) Bill 2011 (Cth).

3 See APRA, *Quarterly Superannuation Performance*, June 2018 (reissued 31 August 2018), 6.

under all reasonable circumstances, financial promises made by institutions it supervises are met within a stable, efficient and competitive financial system.[4] For superannuation, the promise to a beneficiary of the trust is that the trustee will meet the reasonable expectations of the beneficiary in providing their retirement benefits to them on their retirement or attainment of 65 years. In this way, APRA is concerned with protecting the interests of beneficiaries, and ensuring that the trustee operates in such a way as to be able to meet those reasonable expectations.[5]

APRA is charged with the general administration of the provisions of the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act) that impose the best interests covenant[6] on trustees and directors of corporate trustees.[7] The Australian Securities and Investments Commission (ASIC) has general administration of those provisions to the extent that they relate to the keeping of reports and disclosure of information.[8]

A breach of the best interests covenant gives a cause of action to a person who suffered loss or damage as a result of the breach.[9] But a breach of the best interests covenant attracts no penal consequence. It is not an offence,[10] and, as the SIS Act currently stands, it does not give APRA a basis to bring a civil penalty proceeding against the trustee (or its directors). APRA's ability to seek a remedy under the SIS Act where there has been a breach of the best interests covenant is limited: APRA may impose a licence condition on the trustee's **registerable superannuation entity** (RSE) licence;[11] seek an injunction to restrain the trustee from engaging in the conduct or requiring it to perform an act;[12] or, after conducting an

4 APRA, *Statement of Intent*, September 2018, 1.

5 See, eg, the definition of 'prudential matter' in SIS Act s 34C(4).

6 The best interests covenant is set out in s 52 (for trustees) and s 52A (for directors of corporate trustees), in SIS Act Pt 6.

7 See SIS Act s 6(1)(b).

8 See SIS Act s 6(1)(d).

9 SIS Act s 55(3).

10 SIS Act s 55(2).

11 See SIS Act s 29E(1). See also the definition of 'RSE licensee law' in SIS Act s 10(1).

12 See SIS Act s 315.

investigation or examination under part 25, cause proceedings to be begun in the name of the beneficiary to recover damages or property.[13]

The breach may be a failure by the trustee to comply with the condition on its licence that the duties of a trustee are properly performed.[14] APRA may be able to direct the RSE licensee to comply with that condition.[15] But on their face, these are indirect means of enforcing compliance with the covenants.

The Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Cth), introduced into Parliament on 14 September 2017, proposes to amend the SIS Act to insert, among other things, a new provision rendering section 52A, which contains the best interests covenant imposed on directors of corporate trustees, a civil penalty provision.[16] The Bill was debated in the Senate in November and December 2017, but, at the time of writing, the government had announced it would table some amendments, and the bill had not progressed to the House of Representatives.[17]

The Bill does not propose to change the administration of part 6 of the SIS Act. Accordingly, if this Bill were to be enacted, APRA would be charged with administration of this provision and consequently with bringing any civil penalty proceedings for a breach of the best interests covenant under section 52A, to the extent that the breach did not involve any keeping of reports or disclosure to members.

---

13 See SIS Act s 298. This power is analogous to ASIC's power to bring proceedings in the name of a person under the *Australian Securities and Investments Commission Act 2001* (Cth) s 50.

14 See SIS Act s 29E(1)(b).

15 See SIS Act s 29EB.

16 Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017 (Cth) s 55AA.

17 See the status of the Bill here: www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=s1089

A question arises as to whether APRA is best placed to enforce compliance with the best interests covenant in this way. As I observed in my *Interim Report*, APRA has not chosen to carry out enforcement activities in the courts. Indeed, such an approach to enforcement may present some conflict with its mandate of ensuring stability in the financial system. The power to bring proceedings may more properly sit with ASIC, which already has responsibility for regulating and enforcing provisions analogous to the best interests covenant under provisions such as those imposing duties on responsible entities of managed investment schemes.[18]

This chapter deals with the issues raised by the case studies in three parts:

- First, issues that arose in respect of particular superannuation trustees, namely:
  - NULIS Nominees (Australia) Limited, part of the NAB group;
  - Colonial First State Investments Limited and Avanteos Investments Limited, part of the CBA group;
  - AMP Superannuation Limited and NM Superannuation Proprietary Limited, part of the AMP group;
  - IOOF Investment Management Limited and Questor Financial Services Limited, part of the IOOF group;
  - OnePath Custodians Pty Limited, part of the ANZ group;
  - Suncorp Portfolio Services Limited, part of the Suncorp group; and
  - Hostplus Pty Limited.
- Second, issues that arose in relation to one or more other superannuation trustees:
  - board governance;
  - consideration of mergers;
  - management of members' money;

[18] See Corporations Act s 601FC.

- payments from investment managers to superannuation trustees or their parent company;
- fees for no service; and
- keeping members in higher fee-paying products instead of a simple, low-cost product.

• Third, the regulatory response.

1 NULIS Nominees (Australia) Ltd

1.1 Background

NULIS Nominees (Australia) Limited (NULIS) is an RSE licensee and a wholly owned subsidiary of NAB. It is one of a number of companies in NAB's 'Wealth division'. NULIS is the trustee of the MLC Super Fund and MLC Superannuation Fund. At the time of the Commission's inquiries, those funds had about $76.4 billion and $18.7 billion funds, respectively, under management and more than 1.3 million members.[19]

Until July 2016, NULIS was one of three RSE licensees within the NAB Group. The two others were PFS Nominees Pty Ltd (PFS) and MLC Nominees Pty Limited (MLC Nominees). The administrator of the funds has varied over time but, at all relevant times, it has been an entity within NAB's Wealth division.

The Commission's inquiries concerned conduct relating to fees charged to members of the funds for no service, the decision of NULIS to maintain grandfathered commissions, and the performance of its MySuper products. The Commission heard evidence from Nicole Smith, the then recently retired Chair of the board of NULIS, Paul Carter, former Executive General Manager for NAB Wealth, and Andrew Hagger, the then Chief Customer Officer for Consumer Banking and Wealth.

19 Exhibit 5.84, Witness statement of Peggy O'Neal, 19 July 2018, 64–6.

1.2 Evidence

1.2.1 Fees for no service

As my *Interim Report* records, ASIC started its 'Wealth Management Project' in 2014.[20] This was a major project focusing upon the financial advice businesses conducted by ANZ, CBA, NAB, Macquarie, Westpac and AMP. And, as also recorded in the *Interim Report*, ASIC announced in April 2015 that it was 'investigating multiple instances of licensees charging clients for financial advice, including annual advice reviews, where the advice was not provided'.[21] In August 2018, the then Deputy Chair of ASIC told the Commission that about $260 million had already been paid in compensation for the charging of fees for no service, that the total amount of estimated compensation (including what had already been paid) was about $850 million and that he 'wouldn't be at all surprised if it ends up being in excess of a billion dollars'.[22]

The Commission's inquiries about NAB's superannuation business and fees for no service examined four matters:

- The charging of 'Plan Service Fees' (PSFs) to members of funds of which MLC Nominees and, later, NULIS was trustee;
- NAB's dealings with ASIC about those matters, in particular in connection with ASIC's publication, in October 2016, of its *Report 499: Financial Advice: Fees for No Service*;
- The charging of 'Adviser Service Fees' (ASFs) to members of funds of which MLC Nominees and, later, NULIS was trustee; and
- NAB's reporting to ASIC of breaches, or likely breaches, of its obligations under section 912A of the *Corporations Act 2001* (Cth) (the Corporations Act).

---

20 FSRC, *Interim Report*, September 2018, vol 1, 124.

21 FSRC, *Interim Report*, September 2018, vol 1, 124.

22 Transcript, Peter Kell, 17 August 2018, 5254.

Plan service fees

Until July 2016, MLC Nominees was the trustee of The Universal Superannuation Scheme (TUSS) fund. Masterkey Business Super (MKBS) and Masterkey Personal Super (MKPS) were divisions of TUSS.[23] MKBS was described as 'the corporate employer division' and MKPS as 'the personal division to which a member is automatically transferred after ceasing employment with the relevant employer sponsor'.[24] MLC Nominees invested the TUSS assets in investment-linked life insurance policies issued by MLC Limited.

From 2012, members invested in MKBS and MKPS were charged a PSF. The PSF was introduced as part of a wider project by MLC Nominees and MLC Limited (called 'Superannuation with Fee Transparency' or 'SWiFT') to change the structure of fees and charges and, in particular, to replace the then existing asset-based commission and employer service fee with a single fee.[25]

The PSF was also subsequently applied to members from other funds or products who were 'traded-up' to the MKBS and MKPS products. The first relevant trade-up, known as 'Encompass', took place in December 2012 and involved the intra-fund transfer of members from other products issued by MLC Nominees to MKBS and MKPS.[26] The second relevant trade-up took place in May 2013 and was also an intra-fund transfer, this time of members in The Employee Retirement Plan (TERP) to the MKBS and MKPS products.[27]

As has been noted, before the PSF was introduced in 2012, members paid an asset-based commission and a fee for general advice services called the 'Employer Service Fee'.[28] The asset-based commission was paid to an adviser for arranging the commencement of an MKBS plan and

23 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [12].

24 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [11].

25 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [14], [17].

26 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [19].

27 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [20].

28 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

for providing members in MKBS and MKPS access to 'ongoing general support services'.[29] The Employer Service Fee was deducted from member accounts of the MKBS where the employer and the adviser had agreed that the fee would be charged.[30] The Employer Service Fee and asset-based commission were deducted by MLC Limited from members' accounts and paid to the relevant advisers. If there was an adviser linked to the member's account then MLC Limited paid the asset-based commission and Employer Service Fee to the linked adviser. Documents produced in evidence suggest that it is possible that the latter fee was deducted even where there was no linked adviser, and was retained by either MLC Nominees[31] or MLC Limited,[32] I cannot say which.

The PSF introduced by MLC Nominees was about equal to the total of the amounts that had been charged as asset-based commission and Employer Service Fee. MLC Nominees deducted the PSF from members' accounts.[33]

On 1 July 2016, the members of TUSS were transferred, by **successor fund transfer** (SFT) under the SIS Act, to the MLC Super Fund. NULIS was the trustee of that fund. As a consequence of the transaction, NULIS became the trustee responsible for MKBS and MKPS,[34] MLC Limited ceased to be administrator, and National Wealth Management Services Ltd (NWMSL) became administrator in its place.[35]

ASIC proceedings

On 6 September 2018, after the Commission's hearings into superannuation had concluded, ASIC commenced proceedings against MLC Nominees

29 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

30 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 5 [13].

31 Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 9 [3.14], 10 [3.18].

32 See, eg, Exhibit 5.20, 8 January 2018, Briefing Note Concerning PSF Events Prepared by Service Provider Management, 5 [2.15].

33 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [17].

34 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [21].

35 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [21].

and NULIS in the Federal Court of Australia.[36] The proceedings sought a pecuniary penalty under section 12GBA of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) and various declarations in relation to the charging of PSFs and related conduct. The documents filed by ASIC alleged that:[37]

- Contrary to the terms of MKBS and MKPS, the trustees had deducted (or authorised the deduction of) PSFs totalling approximately $33.8 million from the accounts of approximately 220,000 members who were not 'linked' to a plan adviser (no-adviser members).
- Documents issued to no-adviser members represented that the trustee was entitled to deduct the PSF and that members were obliged to pay it.
- The trustees had deducted (and NULIS continued to deduct) PSFs exceeding $67 million from the accounts of approximately 305,000 members who were linked to a plan adviser.
- For members who had a plan adviser linked to their account, the trustees were subject to a Licence Remuneration Agreement with each plan adviser's licensee, which did not oblige the adviser to provide any services, but which obliged the trustee to pay the PSF unless the trustee reasonably believed the adviser was no longer providing the services to which it related.
- For linked members, the trustees did not know what services, if any, plan advisers had agreed to provide. They had no system to enable them to know whether advisers were no longer providing the services to which the PSF related and were not aware of any services being provided to linked members in the MKPS division.
- Upon linked members ceasing employment with the employer, they were transferred to the MKPS division and no longer received the services to which the PSF related.

36 *ASIC v MLC Nominees Pty Ltd & Anor* NSD 1654/2018.

37 Concise Statement filed on behalf of ASIC dated 12 October 2018. See also Originating Process filed on behalf of ASIC dated 12 October 2018.

- The trustees did not exercise their right to terminate the PSF for linked members upon that member ceasing employment and being transferred to the MKPS division.
- Documents issued to members, including product disclosure statements, did not inform members that linked members in MKPS had the right to elect to turn off the PSF by notifying the trustee.
- The trustees' documents included statements that positively misrepresented the rights of linked members in MKPS with respect to the PSF.
- The conduct and the representations gave rise to contraventions of law including section 912A(1)(a), 912A(1)(c) and 1041H(1) of the Corporations Act, sections 12DA(1), 12DB(1)(g) and 12DB(1)(i) of the ASIC Act, sections 29E(1)(a), 52(2)(b), 52(2)(c) and 55 of the SIS Act, and certain general law duties of the trustees.

The Commission's Terms of Reference provide that I am not required to inquire, or continue to inquire, into a particular matter to the extent that I am satisfied that the matter is being, or will be, sufficiently and appropriately dealt with by a civil proceeding. I am, of course, satisfied that the matters relating to the charging of PSFs to members, and what the trustees represented to members about the PSFs that are raised in the proceedings, will be sufficiently and appropriately dealt with in those proceedings. I make no findings about the particular contraventions alleged in those proceedings. Whether other forms of proceeding could or should be instituted in respect of these matters in the first instance is a matter for ASIC and I say no more about it.

It remains important, however, to deal here with two matters in respect of the PSFs: first, NAB's internal investigations into the issues with the PSFs and, second, NAB's dealings with ASIC about the PSFs around October 2016, when ASIC published its Fees for No Service report.

Internal investigations

In around August 2015, representatives of MLC Limited and MLC Nominees raised queries internally, including with those in the risk team, in relation to the introduction of PSFs.[38] This led to an event being raised in NAB's risk 'event management system' on 4 September 2015, and investigations into what had happened.[39] The event and investigations focused on the charging of PSFs to members who had been part of the TERP trade-up.

The investigations appear to have been conducted by persons working within NAB Wealth and were preceded by investigations relating to ASFs. As part of the investigations, legal advice was received by NAB Wealth that expressed the view that PSFs should be refunded if there was no adviser linked to the member's account.[40] As NAB had waived legal professional privilege over this advice, a copy was made available to the Commission. The advice noted that employer service fees and ASFs that may have been deducted where there was no adviser linked to the account should also be refunded.[41] A paper presented in October 2015 to the Breach Review Committee (BRC) in respect of the TERP trade-up event expressed the view that the BRC may consider it prudent to notify APRA and ASIC of the event given the large number of members affected. This was said to be 46,875, with the total PSF deducted from the members since the trade-up said to be approximately $4 million.[42] The paper noted that PSFs were still being charged to members who did not have an adviser linked to their account.[43] On 3 December 2015, the boards of NULIS and MLC Nominees were told that a potential issue had arisen in relation to the PSFs. It was not clear from the evidence why the issues were not communicated to the boards until then.

On 24 December 2015, MLC Nominees (as trustee of TUSS) and MLC Limited (then the administrator of TUSS) lodged a breach notification with

---

38 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 7 [22].

39 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 8 [26].

40 Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 5.

41 Exhibit 5.388, 14 July 2015, Legal Memorandum – MKBS and MKPS Fees – Final, 10–11.

42 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 6) [NAB.005.848.0001 at .0007].

43 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 6) [NAB.005.848.0001 at .0005].

ASIC about the issue.[44] The notice said that when implementing the trade-up, MLC Limited established systems to apply the PSF to the accounts of transferring members including non-advised members and, as a result, the PSF was deducted from those members' accounts and retained by MLC Limited.[45] On the same day the breach notification was lodged with ASIC, MLC Nominees lodged a similar breach notification with APRA in relation to that event.[46]

Ms Smith told the Commission that a further investigation was then conducted from around early 2016 to September 2016 in relation to PSFs introduced for members who were part of Project SWiFT and the Encompass trade-up.[47] An event was raised internally on 11 July 2016[48] and further breach notifications were lodged by MLC Nominees and MLC Limited with ASIC on 14 September 2016.[49]

The investigations in relation to the PSFs were conducted by persons working within NAB Wealth. They considered whether it could be said that general advice services provided to members, such as telephone assistance, could justify retaining the PSFs that had been charged to unadvised members.[50] Ms Smith told the Commission that she was aware at 'a very high level' of this[51] and that she understood at the time that there were two pieces of legal advice that had differing views.[52] This further advice, which appears to have been external to NAB, was not before

---

44 Exhibit 5.149, 24 December 2015, Breach Report MLC Nominees.

45 Exhibit 5.149, 24 December 2015, Breach Report MLC Nominees, 3.

46 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [35]; Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, Exhibit NSS-1 (Tab 13) [NAB.005.067.6509].

47 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [37].

48 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 9 [38].

49 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [42].

50 Exhibit 5.14, 3 May 2016, Invitation of 3 May 2016 from Buchanan and Its Attachment Investigation into Project Swift; Exhibit 5.21, 24 August 2016, Email to and from Carter and Others, PSF Management Paper to Trustee, August 2016; Exhibit 5.22, 19 September 2016, Email, Stimson to Carter, Plan for PSF Meeting with Hagger.

51 Transcript, Nicole Smith, 7 August 2018, 4333.

52 Transcript, Nicole Smith, 7 August 2018, 4334.

the Commission. NAB, as it was entitled to do, did not produce to the Commission either the instructions to the external lawyers or the advice itself. At least initially, however, those within NAB Wealth having the carriage of the matter appear to have proceeded on the basis that it may not have been necessary to refund all PSFs charged to members without a linked adviser.

Although Mr Carter did not accept this characterisation of events, what was done at this time was consistent with senior employees in NAB Wealth trying to find a way to retain the revenue derived from PSFs paid by unadvised members.[53] Be this as it may, NAB Wealth concluded that the services provided by the administrator did not provide a basis to retain the fee as the services the administrator offered were services generally available to all members and members paid for those services by the administration fee.[54]

Communications with ASIC in relation to Report 499

After the breach notifications were made in respect of the TERP and other PSF events, representatives of NAB Wealth and NULIS had several meetings and discussions with ASIC. In respect of the TERP event, NAB Wealth and NULIS gave ASIC regular updates of the estimated total of PSFs charged and number of members affected, as well as the manner in which NAB might approach a remediation program. But NAB did not give ASIC the figures that it had arrived at internally for remediation of the SWiFT and Encompass events. In particular, as will later be explained, NAB did not give ASIC these figures before ASIC completed and published its report into Fees for No Service as part of its 'Wealth Management Project' despite ASIC asking for revised figures about identified and estimated remediation.

In February 2016, Mr Damian Murphy of NAB Wealth, wrote to ASIC providing an update on the TERP trade-up event. He told ASIC that the issue was estimated to affect 96,920 members and the PSFs totalled

53 Transcript, Paul Carter, 7 August 2018, 4267; see also 4272.

54 Exhibit 5.25, 15 October 2016, Emails Bourguignon, Carter and Others, October '16, PSF Management Paper Opt-In Compensation.

$10,797,403.[55] An update, provided to ASIC in June 2016, again recorded that the number of members affected had increased from the 47,000 members indicated in the breach report to more than 96,920, but it also said that the financial impact then totalled $14 million.[56]

On 23 August 2016, ASIC wrote to Ms Smith and Mr Hagger confirming that it had told them that ASIC would be prepared to 'formalise' the obligations of NULIS and NWMSL 'under the TERP trade-up and PSF remediation programs' on the basis that NULIS and NWMSL committed to remediation in an open letter and acknowledged that ASIC would monitor the implementation of the remediation programs and report publicly on them. ASIC proposed that the obligations be recorded either in an **enforceable undertaking** (EU) or in licence conditions.[57] ASIC otherwise rejected NAB's proposal that the matter be resolved by what NAB had called 'Negotiated Commitments'.[58] ASIC indicated that it may be willing to resolve the issues arising out of the SWiFT and Encompass matters on a similar basis to the TERP trade-up and PSFs remediation programs.[59] ASIC said that it expected to be informed of the response of the boards of the relevant NAB entities 'relatively soon'.[60] ASIC also said that it considered a separate and more specific 'Assurance Review', by an independent external expert, was required.

Shortly after that, in emails dated 6 and 7 September 2016 between Ms Karen-Anne Herald of the Risk team and Damian Murphy, the Chief Risk Officer, Ms Herald acknowledged that provisions had been booked for the remediation of $13 million for the TERP PSF event and that provisions had been made for the SWiFT and Encompass PSF events in the amount of $21.6 million.[61]

---

55 Exhibit 5.150, 24 February 2016, Letter, NAB Wealth to ASIC.

56 Exhibit 5.151, 18 June 2016, Email, Murphy to Hagger and Attached Tables.

57 Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

58 Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

59 Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

60 Exhibit 5.49, 23 August 2016, Letter ASIC to Smith and Hagger.

61 Exhibit 5.393, 7 September 2016, Email Woolrich to Murphy.

As noted above, when the breach notification was formally provided to ASIC in respect of the SWiFT and Encompass PSF events on 16 September 2016, an estimate was given of the number of members affected by the events, but no estimate of financial loss was given.[62]

On 16 September 2016, ASIC wrote again to Ms Smith and Mr Hagger stating (once more) that ASIC considered that an independent review pursuant to an EU would be an appropriate regulatory outcome.[63] ASIC noted that it had not yet received a response from the boards of the relevant NAB entities: NULIS, NWMSL and NAB Wealth.[64]

On 19 October 2016, Mr Hagger provided an update on the PSF events to the Group Risk Return Management Committee, which included NAB's Chief Executive Officer, Andrew Thorburn, and other senior NAB Group executives.[65] Mr Hagger said that compensation was expected to total $34.3 million for the three events.[66]

On the same day, ASIC sent an email to NAB to say that it would be publishing a public report with respect to fees for no service in the following week.[67] Andrea Debenham from NAB's Regulatory Affairs wrote to Mr Hagger, Mr Carter, Mr Murphy and others noting that ASIC's report would include details of the 'TERP PSF breach' but that it was unclear whether it 'would extend to mentioning the SWiFT and Encompass PSF events'. Ms Debenham asked for agreement and instruction on whether the intention was to pre-emptively communicate about the TERP PSF Event and associated remediation; or all PSF events and associated remediation; or Project Rio in total; or none of these. ('Project Rio', an internal review

62 Exhibit 5.43.17, Witness statement of Nicole Smith, MLCN ASIC Breach PSF for Swift Encompass, 14 September 2016.

63 Exhibit 5.51, 16 September 2016, Letter ASIC to Smith and Hagger.

64 Exhibit 5.51, 16 September 2016, Letter ASIC to Smith and Hagger.

65 Exhibit 5.29, 19 October 2016, Extract from Minutes of Group Risk Return Management Committee Meeting.

66 Exhibit 5.29, 19 October 2016, Extract from Minutes of Group Risk Return Management Committee Meeting.

67 Exhibit 5.405, 19 October 2016, Email, NAB Internal Email about ASIC's Public Report on Ongoing Advice Service Fees.

of the matters raised by ASIC, was considering the appointment of KPMG to conduct an independent 'assurance review' of the adequacy of compliance and risk management practices in NAB's superannuation business as a whole. In about June 2016, there had been some discussions with ASIC about such a review[68] and, as is explained below, in January 2017, ASIC required NULIS to do it.) Ms Debenham said:[69]

> To be clear, I'm not necessarily proposing that we should communicate pre-emptively. Rather, I wanted to flag that if we go down that path I'll need to engage ASIC as soon as possible. Whichever way it falls, we might need to consider how this lines up with EOY results announcements.

On 20 October 2016, Chris Owens from the Corporate Affairs team sent an email to Mr Hagger, Mr Carter and others noting that ASIC 'plans to announce the "TERP Plan Service Fee" event as part of its public report on Ongoing Advice Service Fees' and setting out 'a number of media options to minimise reputation risk for the Group'.[70] The email said that Corporate Affairs' 'preferred option would see NAB proactively announce all aspects of the PSFs issue, including customer numbers and the total remediation amount'.[71] Mr Owens also suggested that NAB approach ASIC and ask it to consider delaying the announcement until after the banking reporting season.[72] NAB's reporting of its annual financial results was scheduled for 27 October 2016.

On 21 October 2016, Ms Louise Macaulay of ASIC sent NAB a redacted draft copy of the ASIC report entitled *Financial Advice: Fees for No Service.*[73] The details of financial compensation in respect of NAB 'fees for no service' events were set out in a table. The equivalent detail in respect

68 Transcript, Andrew Hagger, 13 August 2018, 4734.

69 Exhibit 5.146, 19 October 2016, Emails Entitled ASIC ASF/PSF Reporting between Debenham, Hagger and Others, 26 September 2016 and 19 October 2016.

70 Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

71 Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

72 Exhibit 5.30, 20 October 2018, Emails Carter, Hagger and Others.

73 Exhibit 5.31, 21 October 2018, Email Macaulay of ASIC to NAB Concerning Confidential Draft Report.

of other banks was redacted but the overall totals of compensation paid or agreed to be paid and estimated future compensation by all of the entities the subject of the report were not redacted.[74] The table said that the total compensation paid or agreed to be paid by all the entities examined was $23,098,808 and that the estimated future compensation was between $57 and $63 million (an overall total of $80–86 million).

Later that day, Nathan Goonan, the acting Executive General Manager of Corporate Affairs sent Mr Thorburn and others an email saying that ASIC had invited feedback on the draft report. He said:[75]

> At this stage, having seen the report, our thinking is to be reactive from a communication perspective given, as drafted NAB is seen as just one 'in the pack' rather than called out as an outlier. Andrew H and team are considering this feedback and we will settle on a recommendation over the weekend.

Mr Goonan's email attached a paper entitled *Project Rio Issue Summary – 21 October 2016 at 4:30pm*.[76] The paper said that NAB had been named in the ASIC report as having total exposure of compensation of $16.2 million for about 120,000 customers. It said that the remediation option in respect of the SWiFT and Encompass events was to be presented to NWMSL (the NAB administrator for NULIS's superannuation business) and NULIS for approval on Monday 24 October 2016 and Wednesday 26 October 2016 respectively. The paper went on to say:

> … while we can't see the other bank's compensation details, this probably means that NAB is middle of the pack when it comes to compensation.
> … remediation has not begun for PSF, as we have been attempting to resolve legal differences of opinion. The most likely remediation will be to ~220,000 members for approximately $34 million across TERP PSF, SWiFT and Encompass.
>
> …
>
> ASIC has invited feedback on the draft report by 10 am Monday. The relevant executives for the PSF issue (Andrew Hagger and Paul Carter)

74 Exhibit 5.32, 21 October 2016, Draft ASIC Report Financial Advice Fees for No Service.

75 Exhibit 5.35, 22 October 2016, Email Thorburn to Hagger and others.

76 Exhibit 5.36, 21 October 2016, Project Rio Issue Summary Attached to Email.

> are considering this feedback. There are two possible outcomes of NAB's feedback to ASIC.
>
> …
>
> ASIC's report is published next week in largely the same form that it is now … this would mean NAB is seen as just one of the banks tied up in [the matter] …
>
> [or] ASIC's report is adjusted and/or delayed to include NABs expanded PSF numbers (making NAB the 'worst' of the banks in the report.)

The reference to 'legal differences of opinion' appears to be a reference to the legal advice referred to above.

Mr Hagger was responsible for the feedback that would be provided to ASIC on the draft report.[77] Mr Thorburn forwarded Mr Goonan's email and attached paper to Mr Hagger and Antony Cahill with the request that they 'please discuss Monday, when we meet'.[78] By an email sent shortly after that, Mr Hagger emailed Mr Cahill and copied in Mr Thorburn saying that he had had a telephone call with key stakeholders and that they intended to recommend that the current approach was the most suitable one. He said:[79]

> the additional nuance is that we think I should call Greg Tanzer or Peter Kell on Monday morning to advise the latest as to where we are up to on the PSFs. All in the ongoing interests of openness and transparency. We doubt they will wish to shoe-horn the matter into their report given deadlines, their multi-phased approach and the very substantial rewrite which would be required to their report overall.

On 24 October 2016 at 8:00am the board of NWMSL met. The minutes of the meeting show that the board resolved to recommend to NULIS that NULIS approve full compensation (plus interest) for the PSF events for all non-linked members and to approve NWMSL indemnifying NULIS for the compensation.[80] The minutes noted that a full refund of the PSFs was more

---

77 Transcript, Paul Carter, 7 August 2018, 4297; see also Transcript, Andrew Hagger, 13 August 2018, 4371.

78 Exhibit 5.35, 22 October 2016, Email Thorburn to Hagger and Others.

79 Exhibit 5.153, 22 October 2016, Email Hagger to Cahill and Thorburn.

80 Exhibit 5.41, 24 October 2016, Minutes of Meeting at 8am, NWMS Limited.

generous to members and that NWMSL's preferred approach had been for opt-in compensation.

Mr Hagger left the meeting after the resolution had been passed and telephoned Mr Tanzer. On re-joining the meeting, Mr Hagger told the board about the call.

Later that morning, at 10.56am, Mr Hagger sent an email to a number of NAB employees, including Mr Carter, setting out his account of the conversation that he had with Mr Tanzer.[81] In his evidence, Mr Hagger described this email as his 'file note' of the discussion.[82] The email records that Mr Hagger told Mr Tanzer the NWMSL and NULIS boards were meeting 'that week'. The email does not record Mr Hagger as having told Mr Tanzer that NWMSL had already met and resolved to approve full compensation and indemnify NULIS. The email does not record Mr Hagger as having provided any estimate or range of future compensation or any update to Mr Tanzer in respect of loss or compensation.[83]

Mr Hagger told the Commission that he said to Mr Tanzer:[84]

> … if he wants to know anything further of any of this, so if he said to me what do you think the dollars involved are, I would have referred him to our earlier conversation, which is that they had the number of members and I had given him an indication of approximately what the dollar figure was. So, you know, as an accountant I could have multiplied those two together. He was obviously capable of doing that.

Mr Hagger told the Commission that the 'earlier conversation' was a discussion he had with Mr Tanzer between the date of the breach notification (in respect of the SWiFT and Encompass events) lodged with ASIC in September 2016 and the date of ASIC's draft report into fees for no service.[85] Mr Hagger's evidence was that he gave 'an indication to

81 Exhibit 5.37, 24 October 2016, Email Hagger to Debenham.

82 Transcript, Andrew Hagger, 13 August 2018, 4758.

83 Transcript, Paul Carter, 7 August 2018, 4300.

84 Transcript, Andrew Hagger, 13 August 2018, 4761.

85 Transcript, Andrew Hagger, 13 August 2018, 4757.

Mr Tanzer of the … dimensions of SWiFT and Encompass in roundabout terms' at that time.[86] He said that he told Mr Tanzer, 'You have the number of members, and the approximate dollars involved in terms of the fees is similar, perhaps slightly bigger, per member than the TERP issue'.[87] Mr Hagger described his interaction with Mr Tanzer as 'open and transparent'.[88]

Ms Debenham and others at NAB had met with representatives of ASIC on the preceding Friday, 21 October 2016, to discuss NAB's response to ASIC's draft report, and NAB gave ASIC a document setting out some requested alterations and additions to the report. One of the responses confirmed that the compensation amount for the TERP trade-up PSF event was $12.4 million plus interest and that 108,867 customers had been affected.[89] NAB said in its document that '[t]he figures included in the DRAFT report were sourced from the March 2016 Quarterly Breach Report Update. These amended figures are correct as at 31 August 2016'.[90]

At about 6 pm on 24 October 2016, Joanna Bird of ASIC sent Ms Debenham and others an email setting out ASIC's responses to NAB's request for alterations and additions to the report. Ms Bird's email noted that 'all institutions have now provided us with updated estimates', noted that ASIC proposed 'to give current estimates' in the relevant tables in the report, noted that ASIC would use the figures given in NAB's 7 October monthly update and said that '[i]f you have an October estimate for the MLC Nominees … compensation we will include it … [o]therwise we will use the 108,867, $12.4M figure'. Ms Debenham replied later that evening. In response to the questions Ms Bird had asked about updated estimates, Ms Debenham annotated Ms Bird's email saying 'Thank you. Please use the 108,867, $12.4M figure'.[91]

86 Transcript, Andrew Hagger, 13 August 2018, 4757.

87 Transcript, Andrew Hagger, 13 August 2018, 4757.

88 Transcript, Andrew Hagger, 13 August 2018, 4771.

89 Exhibit 5.157, 24 October 2016, Email Murphy to Hagger and Attached Tables.

90 Exhibit 5.157, 24 October 2016, Email Murphy to Hagger and Attached Tables.

91 Exhibit 5.156, 24 October 2016, Emails between Debenham, ASIC and Others.

Mr Hagger signed a letter dated 24 October 2016, on behalf of NWMSL, to the Board of Directors of NULIS.[92] The letter had been approved at the board meeting on the morning of 24 October 2016 before Mr Hagger's call to Mr Tanzer. The letter told the board of NULIS that NWMSL intended to indemnify NULIS for the PSF remediation. The letter set out the two alternative approaches to remediation, one described as the 'opt-in' approach and the other as the 'full compensation' approach. The letter said that both approaches were reasonably arguable, although the 'full compensation' approach was preferred. The letter said that the decision rested with NULIS as the trustee.

On 26 October 2016, the joint board of MLC Nominees, NULIS and PFS Nominees met and approved the 'full compensation' approach. This approach affected 220,515 member accounts and was estimated to involve a refund of $33.7 million in PSFs charged, plus compensation.[93] There was no suggestion in the evidence that Mr Hagger or anyone else at NAB or NULIS informed ASIC on that day about this meeting or its outcome.

On the following day, 27 October 2016, ASIC published the Fees for No Service report. The report was circulated by email within NAB and NULIS.[94] The email said 'of particular note is that the compensation numbers have increased markedly since the draft was issued on Friday – for example, CBA has $105m to pay'.[95]

Subsequently, on 3 November 2016, representatives of NAB Wealth gave a PowerPoint presentation to representatives of ASIC that provided an update on the PSFs event. The presentation told ASIC that the total PSF amount was approximately $34.6 million.[96] After the meeting, an internal email was sent to Mr Tanzer and others within ASIC which said that:[97]

---

92 Exhibit 5.38, 24 October 2016, Letter NWMSL to NULIS.

93 Exhibit 5.39, 26 October 2016, Minute of Resolution of NULIS Board and Accompanying Paper by Carter, Remediation Plan Service Fee Events.

94 Exhibit 5.40, 28 October 2016, Email Hopwood to Carter and Others.

95 Exhibit 5.40, 27 October 2016, Email Hopwood to Carter and Others.

96 Exhibit 5.159, 3 November 2016, Update to ASIC Slide Pack.

97 Exhibit 5.319, 3 November 2016, Email Mitchell to Mr Tanzer and Others.

- On 14 September, NAB lodged two fresh breach notices covering these PSF events. The notices have scanty information and no estimates of compensation. ASIC has continued to [seek] further information on these two new PSF breaches but the information was not forthcoming.

- Today's update radically revises the previous compensation estimates to a total of $34 million including interest. The revised figure is concerning because the company has known about the events for approximately 11 months and has only just presented the figures in a meeting today (no formal letter and just a hardcopy powerpoint presentation). We are questioning whether the imposition of licence conditions is sufficient in this situation.

The evidence was not clear as to whether Mr Hagger was present at the meeting on 3 November 2016, and no-one who attended the meeting gave evidence before the Commission. The contents of the presentation and emails, however, were not challenged by NAB or NULIS.

Ms Smith said that the PSFs were turned off for MKBS and MKPS members with no linked adviser (including those who were part of the Encompass trade-up and Project SWiFT) by 30 October 2016.[98] She said that a small subset of additional members with no linked adviser was later identified and that their PSFs were turned off by 17 January 2017.

In February 2017, NULIS agreed to ASIC imposing additional licence conditions on NULIS's **Australian financial services licence**. Ms Smith said that NULIS agreed to the imposition of those conditions because it had assumed the rights and liabilities of MLC Nominees as trustee.[99] One of the added conditions was that NULIS engage an ASIC-approved independent expert to assess and report on the adequacy of its compliance and risk management practices for its superannuation business.[100]

98 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [44].

99 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10–11 [48].

100 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 11 [48].

Members affected by the PSF events were paid compensation in June and July 2017.[101]

On 26 July 2018, NAB published an ASX announcement saying that NULIS would stop deducting the PSF from MKPS member accounts from 30 September 2018 and that all MKPS members would be fully refunded for PSFs paid while in the product.[102] The announcement said that the PSF would be switched off for members of the MKBS on 30 November 2018 and that after this time no MLC products would have a PSF attached.

Adviser Service Fees

PSFs were not the only form of fees charged by MLC Nominees, and then NULIS, where there were issues about charging fees for no service. In its 29 January 2018 submission in response to my initial inquiries, NAB said that ASFs had been incorrectly charged to customers between 2008 and 2015. The submissions said that:

> In some cases, ongoing advice fees were charged when no adviser was attached to the client. Estimates (as at 30 September 2017) are that approximately 25,000 customers were affected and approximately $6.6 million of fees were charged.
>
> A further issue that is being investigated is whether, in cases where advisers were attached to the customer, the relevant services were provided to the customer. This is a review into whether the contracted services were provided, not whether the advice was appropriate.

Although NAB's 29 January 2018 submission referred to charging ASFs incorrectly between 2008 and 2015, Ms Smith gave evidence that between July or August 2014 and May 2018, NAB entities had identified four events, and made three breach reports to ASIC and APRA in relation to the charging of ASFs.[103] Something more must be said about each of these identified events.

---

101 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 10 [46].

102 Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 1) [NAB.005.817.0001].

103 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15–16 [70]–[73].

Four identified events

In July or August 2014, NAB identified that members continued to have ongoing ASFs deducted from their accounts despite a request having been received to remove the allocated adviser from a member's account.[104] The event was reported to APRA and ASIC on 22 December 2014.[105] Ms Smith said that 8,126 members were affected and that the quantum of fees (gross of tax) in issue was $1,541,748.[106]

In about August 2015, NAB identified an issue relating to ASFs deducted from members' accounts and paid to advice licensees (both external and related party licensees) where the adviser was 'inactive' or the advice dealer group was 'inactive'. Ms Smith said that the first kind of case (where the adviser was inactive) was determined not to be reportable;[107] the second kind of case was notified to ASIC in correspondence on 25 November 2016 as a non-significant breach.[108] Ms Smith said that neither the number of members affected nor the quantum of fees in issue in respect of the first kind of case was available 'as a remediation plan is being finalised'.[109] She said that the second kind of case affected 4,687 members and that $308,497 fees were in issue.[110]

In about May 2017, NAB identified a control breakdown in the process of adviser remuneration, which resulted in ASFs being retained by the trustee instead of being paid to the advice licensee of the financial adviser listed on the member account.[111] This was known as 'Adviser Remuneration Suppression' and was reported to ASIC and APRA on 20 July 2017.[112]

---

104 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 14 [67], 15 [70].

105 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 17 [78]–[79].

106 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

107 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 19 [95].

108 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 18 [93].

109 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

110 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

111 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [72].

112 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 19 [100]–[102].

The NULIS Board received an update on the Adviser Remuneration Suppression event at a board meeting on 18 April 2018. The update said that the event went beyond ASFs and that members had also paid PSFs and commissions that had not been paid to advisers and had, instead, been retained by the trustee as revenue.[113] An appendix to the paper showed a breakdown of the event's effect that suggests that NULIS retained in excess of $18 million in commissions and in excess of $800,000 in ASFs.[114] Ms Smith told the Commission that 14,663 members were affected and that $1,879,903 fees (gross of tax) were in issue.[115] In March 2018, NULIS told APRA that the 'total suppression' value since 2001 was about $1.5 million, of which about $750,000 would be 'released to members' because the advice licensee was no longer active.[116] In the end I am unable to say from the evidence what amounts would be required to be paid to advisers or returned to members.

In May 2018, NAB identified that, after notification of some members' deaths, ASFs had continued to be deducted from those members' accounts for a period, or until the finalisation and distribution of the benefit.[117] On 15 June 2018, NAB reported the matter to ASIC and APRA.[118] Ms Smith said that 'based on current analysis' 4,135 member accounts were affected and $3,018,945 in fees were in issue.[119] Ms Smith said that, from 25 May 2018, NULIS ceased deducting ASFs from member accounts upon notification of the member's death, and that, by 27 June 2018, it had ceased deducting ASFs from individual members' accounts where notification of death had been received before 25 May 2018.[120]

113 Exhibit 5.398, 18 April 2018, Wealth Entities – Board/Committee Paper Coversheet.

114 Exhibit 5.399, Undated, Appendix 2: Impacted Product Breakdown.

115 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

116 Exhibit 5.436, 4 March 2018, 20180305 NULIS APRA Qrtly Liaison Mtg Briefing Planner Updated 4 March 930pm.docx, 11.

117 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [67], 16 [73].

118 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 20 [109]–[110].

119 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 16 [74].

120 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 21 [112]–[114].

It may be observed that NAB took the steps it did only after there had been a lot of adverse public comment provoked by evidence given to the Commission about other entities continuing to charge advice fees after the death of the client. Ms Smith said in her statement to the Commission in August 2018 that she understood that a remediation plan was then being developed.[121]

Taken together, the four events concerning ASFs that were described by Ms Smith affected more than 31,000 customers and related to more than $6.6 million in fees. But these were anything but final figures. Ms Smith told the Commission that the issue of incorrect charging of ASFs was the subject of continuing investigation and review within the NAB Group, with a particular focus on NAB's advice licensees.[122] When Ms Smith gave her evidence, NAB was still negotiating with ASIC about how NAB licensees should go about compensating affected members.

It is necessary to say something more about NAB's negotiations with ASIC about the issues relating to fees for no service. The negotiations extended over about three years. The various positions taken by NAB in those negotiations appeared primarily directed to minimising the amount that NAB would have to refund.

NAB's negotiations with ASIC in relation to ASFs

On 5 June 2015, Ms Louise Macaulay from ASIC wrote to Andrew Hagger noting that ASIC had commenced an investigation regarding **financial services licensees** charging ASFs without providing advice.[123] Mr Hagger was then Group Executive for NAB Wealth. Ms Macaulay asked Mr Hagger to 'scrutinise the operation of all of the Australian financial services licensees that form part of the NAB Group which provide personal financial advice to retail clients, to ascertain whether there are issues related to

121 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 21 [115].

122 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 15 [69].

123 Exhibit 5.160, 5 June 2015, Letter ASIC to Hagger.

incorrect charging of advice fees', to the extent that this had not already been done.[124]

Mr Hagger told the Commission that NAB disagreed with ASIC about the way to establish whether services had been provided or not.[125] The methodology was financially significant to NAB. NAB entities would have to refund the fees to customers when the chosen methodology identified that they, or the advisers concerned, had not provided the service that had entitled them to the fee.

During 2016, NAB developed a method of assessing service delivery. It depended upon 'sampling' and appears to have begun in May 2016. Deloitte was retained to examine a sample of cases and confirm whether an annual review of a customer's financial arrangements had been provided or an offer of a review had been made by phone or letter.[126] NAB may have expected that the sampling would reveal no failures.[127] However, in respect of NAB Financial Planning, the Deloitte sampling concluded that 54 (92%) 'passed' the requirement, but 5 (8%) 'failed'. The results of the sampling were provided to ASIC in October 2016.

In December 2016, NAB told ASIC about a different approach.[128] NAB introduced the notion that it would look at whether there had been a 'fair exchange of value' rather than whether the specific, and contractually stipulated, ongoing services had been provided.[129] NAB said this was a 'customer centric approach', which would look at a range of factors and would 'outscope clients where we can see evidence points to

124 Exhibit 5.160, 5 June 2015, Letter ASIC to Hagger.

125 Transcript, 13 August 2018, Andrew Hagger, 4795–6.

126 Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 4.

127 Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 5.

128 Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others.

129 Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others, 3.

demonstrating service delivery over a 7 year period'.[130] ASIC rejected the approach. ASIC said that it was not a 'customer centric approach'.[131]

During 2017, NAB made new remediation proposals. In July 2017, Mr Hagger wrote to ASIC outlining an approach that included 'assurance' for one segment of members, for which there was a level of 'interaction data of the nature to be expected consistent with the customer access to services'. For another segment, for which there was 'no digital interaction in the duration of the customer relationship over the period in question', Mr Hagger said that other forms of evidence would be sought 'which may include paper files (where appropriate), adviser attestation and contacting clients'. The letter set out a list of 'information points' that were said to demonstrate that advisers and licensees had met their contractual obligations, including statements of advice and other advice documents, product transaction data, client meeting records, fee disclosure statements and emails and file notes.[132]

In October 2017, ASIC provided NAB with a paper titled *Outline of Suspected Offending by the NAB Group*. The *Outline* set out ASIC's views about fees for no service conduct of NAB and NAB's related entities, as well as other issues.[133] ASIC said it did not accept NAB's proposed methodology of testing whether a 'customer–adviser interaction' had taken place instead of whether the stipulated services had been delivered to customers.[134] ASIC said that NAB's approach might fail to identify and compensate customers who did not receive the ongoing services they paid for. ASIC said that it expected that NAB would

> take all necessary steps to ensure that:

---

130 Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and Others, 3.

131 Exhibit 5.60, 18 January 2017, Emails Concerning Assurance Review of Adviser Service Fees, January 2017 between Hopwood, ASIC and others, 2–3.

132 Exhibit 5.162, 5 July 2017, Letter, Hagger to Macaulay.

133 Exhibit 5.68, 27 October 2017, Outline of Suspected Offending by NAB.

134 Exhibit 5.68, 27 October 2017, Outline of Suspected Offending by NAB, 13.

- affected customers are identified and continue to be remediated; and
- services are provided to clients in accordance with contractual obligations, financial services laws and applicable Australian financial services licence conditions.

On 3 November 2017, Ms Macaulay of ASIC wrote to Sharon Cook, General Counsel of NAB.[135] She noted that Ms Cook had recently taken over responsibility for the fees for no service issues, and attached a timeline of past events. The timeline set out the negotiations that had taken place and NAB's most recent proposal, referred to above. The letter reiterated that NAB's proposal to take account of evidence of, for example, an email with a newsletter to a customer, was not evidence of an annual review and therefore not evidence that NAB had provided the services set out in customer service agreements.[136] Ms Macaulay's letter also said that NAB's approach to remediation was 'out of step with some of its major peers that have reported fees for no service failures and are close to finalising their customer review and remediation programs for these failures'.

At a NULIS Board meeting held on 7 and 8 December 2017, a paper was presented to the board entitled *Risk Review of ASF Controls*.[137] The paper contained an assessment of controls in place in relation to ASFs. Appendix 1 to the paper said that, in relation to the control environment for ASFs:

- The controls for ensuring that all fees were paid to advisers were 'ineffective overall'. One reason for this was that no reconciliation was performed by the Finance division to ensure that all ASFs were paid onto advisers and not retained by NULIS.
- The controls for monitoring the charging of fees against the delivery of services were 'non-existent'. For example, no attestations were obtained from advisers to confirm that a service had been provided for the fee paid and there was too much reliance on member communications.

135 Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook.

136 Exhibit 5.69, 3 November 2017, Letter from ASIC to Cook, 5.

137 Transcript, Nicole Smith, 9 March 2018, 4479–81; Exhibit 5.71, 12 August 2017, Extract from Board Papers, MLC Nominees, PFS Nominees, NULIS.

- The controls for ensuring that customers provided consent to ASFs were 'ineffective'.
- The controls for monitoring that fees are reasonably commensurate with the expected service were 'ineffective'.
- The obligation and control documentation controls were 'ineffective'.
- The adviser on-boarding enhancement controls were 'ineffective'.
- The controls for member communication and disclosure pre/post an ASF being initiated were 'ineffective'.

The paper said, in respect of next steps, that actions to remediate and uplift the control environment would be worked through with executive management.

Ms Smith told the Commission that this review was requested by the board as a result of the succession of events in respect of ASFs. She said that, at the time of giving her evidence, the trustee had not looked back as a result of these findings, but that she expected that any failings would be revealed during the control improvement process.[138]

On 13 April 2018, Ms Cook wrote to ASIC proposing another approach to remediation in relation to the ASFs. She said to ASIC that, for customers who commenced their ongoing service arrangements with NAB Financial Planning prior to the commencement of the **Future of Financial Advice** (FoFA) reforms, NAB would offer ASIC the opportunity to request a review of service delivery under their ongoing service arrangements during the relevant period. That is, she proposed an 'opt-in' method of remediation. She said that:[139]

> Our approach may not be consistent with steps being taken by some of our industry peers, however, we consider a different approach is warranted given NAB led the industry away from commission based adviser remuneration structures …

138 Transcript, Nicole Smith, 9 August 2018, 4484–5.

139 Exhibit 5.76, 13 April 2018, Letter from NAB to ASIC.

> Hindsight suggests that NAB might be better served if we elected, like many of our peers did, to take the easier and more commercially attractive option of placing continued reliance on commission arrangements until the long tail of the generous FoFA grandfathering regime eventually runs out. Instead, NAB backed the views of ASIC, along with our own convictions, as we believed it to be the right thing to do to move the industry away from commissions and give customers visibility over the fees they pay. This was in the best interests of our customers.
>
> Asking that NAB now conduct a historical (pre-FoFA) review of how we transitioned customers, advisers and product issuers to fee for service arrangements (in circumstance[s] where there was no corresponding regulatory requirement to do so) challenges whether NAB ought to have taken a leadership position in this regard. But for the changes, the Pre-FoFA Customers would have continued to be in commission paying arrangements.

The appeal, in this letter, to what NAB might have done is important and revealing. It focused upon how NAB might have charged and retained the revenue that it now faced having to repay to clients. The reference to what NAB might have done, and the letter generally, ignored the more basic facts that NAB entities had promised to provide services, had not provided the services but had charged for what had not been provided. Even up to April 2018, NAB continued to deal with ASIC on a basis that sought to put these basic facts aside.

On 9 May 2018, Mr Mullaly and Ms Bird wrote to Ms Cook and Ms Smith noting that NAB had failed to deal with all of ASIC's concerns raised in the Outline of Suspected Offending ASIC had given NAB in October 2017.[140] The letter said that the 'proposed resolution set out in your letter fails to adequately reflect any insight into the seriousness of the suspected misconduct, which took place over an extended period of time and affects a substantial number of customers.'

140 Exhibit 5.77, 9 May 2018, Letter from ASIC to Cook and Smith.

On 7 June 2018, representatives of NAB, including Ms Smith and Ms Cook, met with representatives of ASIC. NAB provided to ASIC a draft EU in relation to the ASFs.[141]

On 26 June 2018, NAB wrote to ASIC. It said that it would be remediating clients and members who had paid ASFs where there was no evidence to substantiate the provision of service.[142] This proposal was made more than four years after NAB had first reported an ASFs event to ASIC. Ms Smith told the Commission that she expected that the advice licensee, in its review of whether or not a service has been provided, 'will ensure that any superannuation members who have paid an advice fee and not received a service will be identified during that review process and will be remediated by the advice licensee'.[143]

Mr Hagger told the Commission that NAB had agreed to use a methodology in relation to NAB Financial Planning's remediation that was closer to what ASIC had proposed.[144] When he gave evidence, he said that NAB had not yet agreed to this methodology for its other advice licensees.[145]

Breach reporting

As appears from the description given above of events relating to charging fees for no service, NAB did not always notify ASIC of a significant breach, or likely significant breach, within the time required by section 912D of the Corporations Act.

After the Commission's hearings into superannuation had ended, ASIC published its *Report 594*, entitled *Review of Selected Financial Services Groups' Compliance with the Breach Reporting Obligation*. The report examined the breach reporting processes of 12 financial services groups, including NAB. The key findings of the report included that:[146]

---

141 Exhibit 5.81, 28 June 2018, Letter from ASIC to Cook and Smith.

142 Exhibit 5.80, 26 June 2018, Letter from NAB to ASIC.

143 Transcript, Nicole Smith, 9 August 2018, 4485.

144 Transcript, Andrew Hagger, 13 August 2018, 4801.

145 Transcript, Andrew Hagger, 13 August 2018, 4801.

146 ASIC, Media Release 18-284MR, 25 September 2018.

- Financial institutions are taking too long to identify significant breaches, with the major banks taking an average of 1,726 days (more than 4.5 years).
- There were delays in remediation for consumer loss. It took an average of 226 days from the end of a financial institution's investigation into the breach and first payments to impacted consumers. (This was on top of already significant delays in institutions starting and concluding their investigations after the breach had been discovered, which averaged across all institutions as 1,517 days.)
- The significant breaches (within the scope of the review) caused financial losses to consumers of approximately $500 million, with millions of dollars of remediation yet to be provided.
- The process from starting an investigation to lodging a breach report with ASIC also took too long, with major banks taking an average of 150 days.

To the extent that these findings related to NAB or its associated entities, ASIC's finding were consistent with evidence given and other material available to the Commission.

On 26 April 2018, Mr Shipton, Chair of ASIC, discussed NAB's breach reporting with Mr Thorburn, CEO of NAB. The briefing prepared for Mr Thorburn in advance of the meeting said that ASIC was conducting a project on breach reporting and that 'ASIC will likely seek further engagement with NAB about the extent of the issue noting that NAB appears to be an outlier to industry'.[147]

On 27 April 2018, after the meeting between Mr Thorburn and Mr Shipton, ASIC wrote to NAB saying that, during the period between 2014 and 2017, there appeared to be 110 breach reports from licensees within the NAB

[147] Exhibit 5.78, 8 May 2018, Briefing Planner for Meeting of 26/05/2018 between Thorburn and Shipton.

group that were lodged with ASIC in excess of the maximum allowable 10 business days.[148]

On 15 May 2018, NAB responded and said that between 2014 and 2017 there had been 84 reports of significant breaches provided beyond the statutory requirement of within 10 business days.[149] Eighty-three of these were said to relate to NAB Wealth.[150]

Ms Smith told the Commission that a breach review committee for wealth entities within NAB considered breach events and whether they were reportable.[151] She said that, from the trustee's perspective, 'we had probably poor performance on-time delivery to ASIC up until around 2015 where we had an independent review from PwC on the breach review committee process. And I think from that date we've shown improvement in our timing'.[152]

1.2.2 Grandfathering of commissions

As I have previously noted, until July 2016, NULIS was one of three RSE licensees within the NAB Group; the other two were PFS and MLC Nominees.

On 1 July 2016, the members of the TUSS fund previously under the trusteeship of MLC Nominees were transferred to the MLC Super Fund by way of an SFT.[153] NULIS, the new trustee, considered maintaining, and decided to maintain, payments of grandfathered commissions that were being paid by members of the TUSS fund to advisers. Both Mr Carter and Ms Smith agreed that the proposal presented two main issues. First, was it lawful under the FoFA legislation to grandfather commissions after an SFT?

---

148 Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 6) [NAB.005.827.0002].

149 Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

150 Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

151 Transcript, Nicole Smith, 7 August 2018, 4311.

152 Transcript, Nicole Smith, 7 August 2018, 4311.

153 Exhibit 5.43, Witness statement of Nicole Smith, 1 August 2018, 6 [21].

Second, was it in the best interests of members to do so?[154]

The legal issue was thought to be resolved by treating the trustee that paid the commission as a 'platform operator'. For present purposes I need say no more than that this view of how the relevant provisions of the Act operate may be thought not to leap from the page of the statute.[155] But the point need not be examined. It is enough to record that NAB discussed the proposal with ASIC and ASIC did not object.[156]

The issue about best interests was resolved by reference to two points: first, that if commissions were not maintained, advisers would become disaffected and the fund would receive fewer new members and contributions; and second, that the proposal left members no worse off in the sense that they would continue to pay the amounts they would have been paying before the transaction.

On 10 June 2016, the board of NULIS considered a management paper on the issue. The paper gave three options for consideration:[157]

- *Option 1:* Continue the grandfathering arrangements and pay commission to advice licensees.
- *Option 2:* Cease the payment of grandfathered commission by terminating the remuneration arrangements with advice licensees; and
- *Option 3:* Stop commission payments and set up alternative remuneration arrangements for advisers.

---

154 Transcript, Paul Carter, 6 August 2018, 4210; Transcript, Nicole Smith, 7 August 2018, 4386–7.

155 Exhibit 5.7, 10 June 2016, Board Papers MLC Nominees, NULIS and PFS Nominees, 21.

156 Exhibit 5.7, 10 June 2016, Board Papers MLC Nominees, NULIS and PFS Nominees, 22.

157 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

The paper said that management had examined several issues in connection with each proposal: whether the proposal was legally permissible; whether the proposal maintained equivalency of members' rights and was in members' best interests; other member consequences; and implications for the SFT and the associated future member benefits.

Ms Smith accepted that the members' best interests was a question for the trustee to decide.[158] She said that the trustee 'turned their mind to best interests of the SFT as a whole and determined that the SFT, including the grandfathering of commission, was in the best interests of members'.

The management paper set out the background to the then current payment arrangements.[159] It pointed out that there were about 188,000 members 'in commission paying retail super/pension products in TUSS', and that these members made up about 63% of members holding about 47.7% of funds under management in TUSS.[160] It said that approximately '$56 million in commission per annum is paid in respect of TUSS products'.[161]

When discussing termination of remuneration arrangements with advice licensees, the paper said that separate advice would have to be obtained about whether termination would expose MLC Nominees, NULIS or any other entity in the NAB Group to liability for breach of contract.[162] No estimate was given of the compensation that might be payable to advisers if liability arose. The only reference to quantum was to the total commission

158 Transcript, Nicole Smith, 8 August 2018, 4387.

159 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

160 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

161 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

162 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 23.

paid per annum in respect of TUSS Products, which was said to be $58 million.[163]

Ms Smith agreed, however, that NULIS did not have any legal obligation to pay commissions at the time[164] and Mr Carter also agreed that NULIS would not have been in breach of contract, as it did not have any contracts with advisers prior to the SFT.[165]

The paper said that ceasing commissions may lead to significant member attrition due to 'financial adviser dissatisfaction'. It said that this, in turn, may lead to a significant reduction in funds under management, leading to higher costs for remaining members and reduced competitiveness of each product, thereby threatening the sustainability of the fund as a whole.[166] The paper said: 'In a post FoFA world, where monetary incentives are removed, financial adviser satisfaction is paramount'.[167] Mr Carter agreed that if NULIS maintained commissions for financial advisers, then advisers would not look to move their clients to another superannuation provider.[168]

The paper recommended that the directors approve maintaining current grandfathered commission arrangements. The paper said that management believed that the cost and effort required to adopt the third approach (of stopping commission payments and setting up alternative remuneration arrangements for advisers) was not in members' best interests.[169]

The management paper told the board that the SFT may be delayed by as much as 12 months if option three was adopted. It said this would 'impact

163 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 20.

164 Transcript, Nicole Smith, 8 August 2018, 4391.

165 Transcript, Paul Carter, 6 August 2018, 4217, 4219.

166 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6.

167 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 5.

168 Transcript, Paul Carter, 6 August 2018, 4220.

169 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6–7.

future initiatives as the work effort will divert time, resources and funding away from other strategic initiatives'.[170] But Mr Carter's evidence was that all of the benefits of the SFT could be achieved without grandfathering commissions.[171]

As already mentioned, NAB had consulted with ASIC about the intention to grandfather commissions.[172] The management paper said that the purpose of this consultation was to seek ASIC's views on the legal application of the grandfathering provisions given the level of 'interpretation risk' due to the fragmentary and untested nature of the FoFA regulations.[173] A briefing paper dated 20 May 2016 was provided to ASIC and was annexed to the management paper.[174] It set out the bases upon which NAB said that NULIS was a platform operator and told ASIC of its intention to continue grandfathering commission payments.[175] The evidence was that, after providing ASIC with the briefing paper, representatives of NULIS met with ASIC and indicated that it was not seeking a 'no action' letter, but would proceed on the basis of the legal advice it had received.[176]

1.2.3 MySuper

The Commission considered the steps taken by NULIS to transfer **accrued default amounts** (ADAs) to MySuper products and some issues about what appeared to be the poor performance of its MySuper products.

170 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 6–7.

171 Transcript, Paul Carter, 6 August 2018, 4216.

172 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 4.

173 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 3.

174 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, Appendix 4.

175 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 49.

176 Exhibit 5.7, 10 June 2016, Board Papers, MLC Nominees, NULIS and PFS Nominees, 5–6; Transcript, Peter Kell, 17 August 2018, 5256.

NAB RSE licensees initially offered two MySuper products: an MLC MySuper product of which MLC Nominees was trustee and a Plum MySuper product of which PFS Nominees was trustee.[177]

The NAB RSE licensees did not transfer the majority of ADAs into a MySuper product until 2016.[178] They transferred other ADAs to a MySuper product in 2017.[179] The speed of transfer can be indicated by observing that, at 30 June 2014, the total ADAs across the whole superannuation industry were worth about $73.1 billion, of which MLC held $17 billion.[180] By 30 June 2015, the industry-wide value of ADAs had fallen to $59.2 billion but MLC's had fallen only slightly: to $16.1 billion.[181] At 30 June 2016, the equivalent figures were $41.3 billion and $13.9 billion.[182] That is, at the start of the industry-wide process of transferring ADAs to MySuper, MLC had less than one quarter of all ADAs but two years later, at 30 June 2016, it held more than one third of all ADAs.[183]

Ms Smith accepted that one consequence of not moving ADAs into MySuper until 2016 or 2017 was that members paid higher fees, including the PSFs, for longer than they would have paid if the transfers had been made sooner.[184] She also accepted that members with ADAs would have been paying a higher administration fee in MKBS/MKPS than in the MySuper product[185] and may have been paying adviser contribution fees.[186]

Each year, the trustee of a MySuper product must determine whether the beneficiaries of the fund who hold the MySuper product are disadvantaged

177 Transcript, Nicole Smith, 8 August 2018, 4398.

178 Transcript, Nicole Smith, 8 August 2018, 4400.

179 Transcript, Nicole Smith, 8 August 2018, 4405.

180 Transcript, Nicole Smith, 8 August 2018, 4404.

181 Transcript, Nicole Smith, 8 August 2018, 4404.

182 Transcript, Nicole Smith, 8 August 2018, 4404.

183 Transcript, Nicole Smith, 8 August 2018, 4404.

184 Transcript, Nicole Smith, 8 August 2018, 4400.

185 Transcript, Nicole Smith, 8 August 2018, 4401.

186 Transcript, Nicole Smith, 8 August 2018, 4401.

by factors such as the fund's scale, when compared to MySuper beneficiaries of other funds.[187]

NULIS has made the necessary scale determinations each year. The papers put to NULIS's board in October 2016 for the purposes of the 2016 scale determination recorded that various 'MySuper investment structure enhancements had been implemented over the last 12 months'.[188] Among other things, the trustee (NULIS from 1 July 2016) reduced its profit margin on the operations of the product by five basis points.[189]

The papers put to the board noted that 'when standard fees are compared against the ChantWest universe of MySuper products', the MLC Super Fund MySuper product and the NAB Staff MySuper product ranked 66th and 44th respectively.[190] The analysis also said that the MLC MySuper product was in the bottom quartile of MySuper products for performance, after investment fees were taken into account.[191]

Why this was so was explored in evidence.

A quarterly investment report dated June 2017 conducted by JANA Investment Advisers Pty Ltd and considered by the board of NULIS,[192] said that the initial fee budget for the NAB MySuper products placed a significant limitation on the level of illiquid assets in the portfolio and that creating a new option with 'zero dollars' on 'day one' meant that the relevant MySuper option was going to have a lower allocation to illiquid assets relative to peers. The report said that the underweighting of illiquid assets in the MySuper option occurred when illiquid assets were having their strongest historical gains due to a low interest rate environment.[193]

---

187 SIS Act s 29VN(b).

188 Transcript, Nicole Smith, 8 August 2018, 4406.

189 Transcript, Nicole Smith, 8 August 2018, 4406.

190 Transcript, Nicole Smith, 8 August 2018, 4407.

191 Transcript, Nicole Smith, 8 August 2018, 4409.

192 Exhibit 5.58, 22 August 2017, Minute of NULIS Nominees, 22 August '17 and JANA, June '17 Quarterly Investment Report.

193 Transcript, Nicole Smith, 8 August 2018, 4417.

Performance was also affected by fees. NULIS retains the portion of the investment fee charged to members that is not paid to others for managing the assets of the fund. The amounts retained by NULIS are paid as dividends to NULIS's shareholder, NWMSL (the administrator).[194] Ms Smith said she believed that the dividend NULIS paid was usually more than $100 million per year.[195] (She said that dividends were payable quarterly but that 'as a result of the PSF matter' there had been two quarters where NULIS had not paid a dividend.)[196]

Ms Smith said that NULIS had made the decision referred to in the papers for the 2016 Scale Assessment (to take a lower profit margin from the superannuation activities) so that more money could be applied to investments[197] to deal with the underperformance of the MySuper option.[198] She said that the budget for investment options and the profit to the NAB Group comes from the investment management fee and that, if a larger amount of the investment fee collected were allocated to investment options, the NAB Group would take less profit, or the fee would have to increase, so that profits of the NAB Group did not decrease.[199] Ms Smith said that before the SFT in 2016, MLC Limited (not MLC Nominees) had controlled how much of the investment fee would be used for the management of assets,[200] but that since the SFT, NULIS has had control over how much of the investment fee would be used for the management of assets. She said that NULIS had not yet allocated more of that fee to the management of MySuper assets.[201]

194 Transcript, Nicole Smith, 8 August 2018, 4422.

195 Transcript, Nicole Smith, 8 August 2018, 4423.

196 Transcript, Nicole Smith, 8 August 2018, 4422–3.

197 Transcript, Nicole Smith, 8 August 2018, 4406.

198 Transcript, Nicole Smith, 8 August 2018, 4407.

199 Transcript, Nicole Smith, 8 August 2018, 4420.

200 Transcript, Nicole Smith, 8 August 2018, 4422.

201 Transcript, Nicole Smith, 8 August 2018, 4422.

1.3 What the case study showed

1.3.1 Conduct in respect of PSFs

As noted above, I make no findings about the matters alleged by ASIC in its proceedings against NAB in relation to PSFs. I do, however, wish to say something about the actions of those within NAB Wealth after the identification of issues about PSFs and about NAB's dealings with ASIC at the time of ASIC's publication of its *Report 499: Financial Advice: Fees for No Service*.

In the written submissions of NAB and NULIS, and in the evidence, it was said that NAB Wealth had undertaken 'an investigation to identify the nature and character of the PSF'.[202] I do not consider this a sufficient or accurate description of what was done. The description is incomplete, and to that extent inaccurate, because it ignores the purpose for which the inquiries were being made. The overall purpose was to minimise the amount that NAB would have to repay. That purpose was effected in two ways: first, by trying to find some legal basis for retaining what had been paid; second, by devising a remediation approach that would minimise the amount to be repaid.

The former is evident from the documents that discussed whether any of the services provided by the administrator could form a basis for charging PSFs.[203] The latter is clear from the documents that proposed an opt-in approach to any remediation for unadvised members.[204]

The steps taken by NAB showed either that NAB did not grasp that it had charged fees for services it had not provided, or that NAB was unwilling to face the consequences of having agreed to provide services to clients,

---

202 NAB and NULIS, Module 5 Case Study Submission, 11 [61(a)]; Transcript, Paul Carter, 6 August 2018, 4271–2.

203 Exhibit 5.14, 3 May 2016, Invitation of 3 May 2016 from Buchanan and Its Attachment Investigation into Project Swift; Exhibit 5.21, 24 August 2016, Emails to and from Carter and Others, PSF Management Paper to Trustee; Exhibit 5.22, 19 September 2016, Email, Stimson to Carter, Plan for PSF Meeting with Hagger.

204 Exhibit 5.26, 16 October 2016, Email Carter, Hagger and Others, October '16 Concerning PSF Letter.

having not provided the services, and yet having charged clients for what it had not done.

As I said in the *Interim Report*, charging for what you do not do is dishonest.[205] That NAB either did not grasp this basic proposition or was unwilling to face the consequences of having done so is troubling. That its General Counsel should be complaining to ASIC, as recently as April 2018, that having to pay back what had been taken was unfair to NAB, is, if anything, even more troubling. It suggests an abiding blindness to the seriousness of the underlying conduct.[206]

Like any listed company, NAB owes obligations to its shareholders. NAB, like any listed company, is not just entitled, but is bound, to consider carefully whether it should pay compensation to others. And it is entitled, and bound, to take proper steps to pay only such compensation as can be shown to be justified. But NAB's conduct in connection with fees for no service went beyond taking proper steps to ensure that it paid no more than was proper compensation for its wrong. It sought to avoid repaying to customers money to which it was not, and never had been, entitled.

Until it agreed to make full compensation, NAB's conduct fell short of community standards and expectations. Moreover, the conduct that has been described reflected a culture, demonstrated by senior executives within the NAB Group, of unwillingness to put right, wholly and promptly, what was evidently wrong conduct. And the conduct had been allowed to continue for many years.

It is now necessary to say something about NAB's dealings with ASIC in connection with ASIC's publication of its Fees for No Service report.

Both NAB and Mr Hagger described NAB's communications with ASIC as 'open and transparent'. NAB and NULIS submitted that Mr Hagger's communications with ASIC demonstrated 'a willingness to engage in proactive and transparent communications with the regulator'.[207]

205 FSRC, *Interim Report*, September 2018, vol 1, 73.

206 Exhibit 5.76, 13 April 2018, Letter from NAB to ASIC.

207 NAB and NULIS, Module 5 Case Study Submission, 17 [91].

NAB and NULIS submitted that there was no reason to doubt Mr Hagger's account of his conversation with Mr Tanzer and that no ASIC witness offered or was asked to provide any criticisms about the conduct of Mr Hagger or NAB more generally.[208]

I accept that Mr Hagger believed what he said to the Commission in evidence. But, given what was known at the time, I do not accept that what he said to Mr Tanzer is properly described as 'open and transparent'. I do not accept that Mr Hagger told Mr Tanzer that NAB had revised estimates of the amount it would have to pay as compensation. The evidence demonstrates, in my view, that Mr Hagger did not tell Mr Tanzer that the board of NWMSL had decided, by the time of the conversation, to recommend to NULIS that it make full remediation and that NWMSL would indemnify NULIS for the whole cost of that remediation. Instead, he left Mr Tanzer with the impression that these issues had not yet been decided by either the board of NWMSL or the board of NULIS. And that was not right. Why not tell ASIC what had transpired that morning in the board meeting from which Mr Hagger had emerged to make the call?

If, as Mr Hagger may be understood as having suggested, he said enough to allow Mr Tanzer to draw his own conclusions about how much would have to be paid out, why not just tell ASIC the truth? His evidence could be understood as saying that he somehow was inviting Mr Tanzer to 'ask the right questions'. If that is the case, how was that 'open and transparent'? Why not tell ASIC of the internal estimates?

The answer to all of these questions can only be that NAB wished ASIC's report to still show the bank's conduct as 'middle of the pack', regardless of NAB's knowledge when it responded to ASIC's inquiries about the draft report and when Mr Hagger spoke with Mr Tanzer. And NAB wanted to remain 'middle of the pack' lest news of what it had discovered overshadow its CEO's announcement of full year results.

NAB told ASIC of its revised estimates on 3 November 2016, a week or so after Mr Hagger had spoken to Mr Tanzer. ASIC's reaction to these later disclosures tells of the quality of the communications that had taken place

208 NAB and NULIS, Module 5 Case Study Submission, 16 [89].

before ASIC published its report. ASIC was not satisfied with NAB's dealings with it, and rightly so.

NAB's conduct fell short of what the community would expect of NAB, or any other large financial entity, in dealings with ASIC of the kind under consideration.

1.3.2 Misconduct in respect of fees for no service

In NAB's initial submissions to the Commission in January 2018, it acknowledged misconduct concerning ongoing ASFs charged without the provision of services to primarily retail customers between 2008 and 2015.[209] In their written submissions to the Commission dated 31 August 2018, NAB and NULIS submitted that they fully accepted the seriousness of the matters that were the subject of the breach reports tendered concerning ASFs, and that these events involved previously acknowledged and reported instances of misconduct, and conduct falling below community standards and expectations.

The notifications lodged with regulators contained acknowledgments of a breach or likely breach of section 912A(1) of the Corporations Act and section 52(2)(b) of the SIS Act by the relevant RSE licensee. In its written submissions, NULIS accepted that, on the evidence, it was open to the Commission to find that there had been a breach or likely breach of section 912A(1)(a) of the Corporations Act with respect to each notified event.

I agree.

More must be said, however, about fees for no service and the trustee's covenants set out in section 52(2)(b) and 52(2)(c) of the SIS Act. The first of those covenants requires the trustee 'to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments'. The second requires the trustee 'to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries'.

---

209 Exhibit 5.4, 29 January 2018, Extract of NAB Submission, 1.

In their written submissions, NAB and NULIS submitted that there was no support in the text of the Act or in prior authority that the care, skill and diligence covenant imposed an 'absolute standard' on a superannuation trustee in NULIS's position to 'ensure' that a service is provided in each case where there was an arrangement between an adviser and a member by directly monitoring advisers.[210] They submitted that the evidence demonstrated that MLC Nominees or NULIS (as applicable) had complied with the covenant because:

- first, controls existed in the form of underlying contractual obligations and at the point of the member and the adviser agreeing to the payment;[211]
- second, an administrator was legally liable for breaches of its contractual obligations, which were required to be reported to the trustee under the Administration Agreement;[212] and
- third, when specific controls with respect to delivery of service were found to be deficient, measures were put in place to remedy those deficiencies. More generally, it was submitted that measures were taken in response to failures in controls, and to uplift the control environment and introduce reforms (such as an independent customer advocate program).[213]

The general law requires a trustee to discharge its duties to the standard of what an ordinary prudent person of business would do in managing similar affairs of his or her own.[214] The statutory covenant refers to the 'care, skill and diligence … a prudent superannuation trustee would exercise in relation to an entity of which it is trustee'. On its face, the statutory covenant permits,

---

210 NAB and NULIS, Module 5 Case Study Submission, 4 [17].

211 NAB and NULIS, Module 5 Case Study Submission, 4 [14].

212 NAB and NULIS, Module 5 Case Study Submission, 4 [15].

213 NAB and NULIS, Module 5 Case Study Submission, 4 [16].

214 *Austin v Austin* (1906) 3 CLR 516, 525; *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 235; *Cowan v Scargill* [1984] 2 All ER 750, 762.

perhaps requires, reference to the fact that NULIS and other RSE licensees are professional trustees.[215]

In the present context, the question may become whether a prudent person of business, who acts as a professional trustee, would allow payments to be made to a service provider without first verifying that the services have been provided? In this regard, it may be noted that Ms Smith said that, in her view, the trustee had owed members a duty of care – to consider whether services had been provided in exchange for the ASFs and PSFs that had been charged.[216]

NULIS did not monitor advisers or the provision of specific advice. When fees were paid for no service, the trustee had no controls that prevented charging fees for no service. The Risk Review of ASF Controls paper given to NULIS's board recorded many respects in which controls were deficient.[217] The bare fact that the trustee, the administrator, the adviser and the ultimate client were each a party to one or more contracts regulating the charging and payment of fees does not conclude any issue about the trustee taking reasonable care. Whether the trustee exercised reasonable care, skill and diligence asks whether the trustee should have taken steps to determine whether the contracts that had been made were performed in accordance with their terms. And in that regard, it may be that different considerations would arise in cases where the adviser charging the fees in question was an authorised representative of a NAB advice licensee.[218]

What the trustee should have done in the exercise of the required care, skill and diligence should be considered in the light of another and fundamental obligation of trustees. A trustee must not allow the trust fund to be dissipated in an unauthorised way.[219] A trustee who wrongly pays away trust money,

---

215 *ASIC v Drake (No 2)* [2016] FCA 1552 [272]–[273].

216 Transcript, Nicole Smith, 9 August 2018, 4480.

217 Transcript, Nicole Smith, 9 March 2018, 4479–81; Exhibit 5.71, 12 August 2017, Extract from Board Papers, MLC Nominees, PFS Nominees, NULIS.

218 Transcript, Paul Carter, 6 August 2018, 4221; see also Transcript, Nicole Smith, 9 August 2018, 4469.

219 *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR484, 501–2.

like a trustee who makes an unauthorised investment, commits a breach of trust.[220]

Absent express provision to the contrary, the authority a member gives to a trustee to pay an advice fee would be construed as authorising payment in return for the provision of service. (From time to time, advice licensees have suggested that their advice agreements permitted deduction of a fee in return *for the offer* to provide advice. But even in that case, the authority would ordinarily be understood as requiring that offer be taken up before the adviser would be entitled to receive the fee.)

Some of the events reported by NAB and NULIS concerned cases where requests had been received to remove the adviser from members' accounts. In cases of that kind, a necessary part of the contractual foundation for deduction of fees has gone and the trustee has been told that it has gone. Paying away trust money in payment of advice fees in those cases appears to me very likely to be a breach of trust. If it is a breach of trust it would be misconduct.

The trustee's covenant in section 52(2)(c) is to perform its duties and exercise its powers in the best interests of beneficiaries. When the purpose of a trust is to provide financial benefits for beneficiaries, as it is with a superannuation fund, the best interests of the beneficiaries are normally their best financial interests.[221]

NAB and NULIS submitted that the 'best interests' duty, both in the SIS Act and at general law, operates to qualify the performance of a particular specified duty or the exercise of a specified power and that no relevant duty or power had been identified in connection with the payment of fees for no service.[222] As I have explained elsewhere, this may not be a complete statement of the general law, or of the operation of the covenant.[223]

---

220 *Youyang*; see also *Target Holdings Ltd v Redferns* [1996] AC 421, 437, per Lord Browne-Wilkinson.

221 *Cowan v Scargill* [1985] Ch 270, 286–7.

222 NAB and NULIS, Module 5 Case Study Submission, 5 [20].

223 *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* [2010] NSWSC 363 [121], per Giles JA.

But when fees were paid for no service, the relevant duty was the trustee's duty to preserve the trust fund (not paying it away without authority) and the relevant power was to make proper payments on behalf of members by deducting the payment from the member's account.

NAB and NULIS did not dispute that the trustee deducted the ASFs from members' accounts and did not contend that the trustee lacked power under the trust deed[224] to deduct ASFs (if the deduction was authorised by the member).

NAB and NULIS pointed out that it has been said that the best interests test is concerned with process, not outcome.[225] Like all aphorisms, the proposition may very well be too compressed, and obscure more than it reveals. But even if it does sufficiently capture a relevant point, the fact remains that the contractual and other controls that NULIS submitted were in place to ensure proper deduction of ASFs were not sufficient to protect the financial interests of members.

One other, statutory, obligation of the trustee should be mentioned. Section 62 of the SIS Act obliges the trustee to ensure that the fund is maintained solely for the purposes identified in that section.

I consider that it is arguable that the trustee's conduct in using trust funds to pay for services to members that had not been provided may have been a breach of one or more of the covenants that have been mentioned and of the statutory obligation. That conclusion rolls up consideration of several distinct obligations. But separate and sequential consideration of the obligations runs a real risk of attributing to each too confined an operation. Each of the covenants, like the statutory sole purpose obligation, takes its operation and content from the context within which it is to operate: a context in which the trustee has several, related obligations designed to ensure that the funds that the trustee holds are applied only for proper purposes. And the central complaint being considered is that the trust funds were not applied for a proper purpose; they were applied to pay amounts

---

224 The trust deeds of the two funds appeared at Exhibit 5.84, Witness statement of Peggy O'Neal, 31 July 2018, Exhibit PYO-1 (Tab 2) [NAB.005.546.0001], (Tab 3) [NAB.005.546.0089].

225 *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* [2010] NSWSC 363; NAB and NULIS, Module 5 Case Study Submission, 5 [22].

that were not properly charged and payable. A conclusion that the trustee *did not* breach its duties when it permitted that to occur would be surprising. A conclusion that the trustee *did* breach one or more of the obligations that have been mentioned would not.

The conduct of the NAB trustees in connection with the payment of fees for no service might have been a breach of obligation and therefore constitute misconduct. These matters having already been reported to ASIC, it must decide what, if any, further action should be taken.

Next, it is necessary to consider the conduct of NULIS and other NAB entities in connection with remediation.

NAB and NULIS submitted that there was no evidence that MLC Nominees or NULIS had inappropriately failed to exercise any discretion independently of NAB with respect to the remediation of ASF events. It will be recalled that when Mr Hagger gave evidence about these matters, NAB had not at that point agreed to full remediation by all of its licensees. Indeed, much of NAB's and NULIS's correspondence with ASIC involved negotiations toward a different outcome.

I consider that, in allowing remediation proposals to be put forward to the regulator that did not provide for full compensation, it is arguable that the board of NULIS prioritised the financial interests of others within the NAB Group over the interests of members. If the board did this, it may have been a breach of the covenant prescribed by section 52(2)(c). But, if it was a breach, later events overtook it and nothing came of it.

NAB and NULIS submitted that the progression of discussions over time with ASIC with respect to the remediation approach neither established any intention or effect of minimising the quantum of remediation, nor was it 'ethically unsound'.[226] To repeat a point already made, the submission is consistent with NAB either not grasping that to charge a fee for a service not provided was dishonest, or being still unable or unwilling to accept the consequences that follow from its conduct.

226 NAB and NULIS, Module 5 Case Study Submission, 14–15.

One consequence of NAB's protracted negotiations with ASIC was that customers have not been compensated promptly. NAB and NULIS accepted that the ASFs events took too long to discover, investigate and remediate.[227] I agree. But NAB's conduct prolonged the process. The public would rightly have expected NAB not to do that.

1.3.3 Misconduct in relation to reporting of breaches

As noted above, in its communications with ASIC, NAB agreed that 84 significant breach notifications were provided by NAB entities later than the 10 business days required by statute.[228] I have no reason to doubt that this represents at least the minimum number of such cases. Although the number of cases acknowledged by NAB is 26 less than ASIC's calculation of 110 breach reports, the figures are troubling. Each departure from the legislative requirement is a breach of section 912D(1B) of the Corporations Act. The breaches acknowledged in the breach reports were breaches, or likely breaches of sections 912A(1)(a), 912A(1)(c), 912A(1)(ca) and 912A(1)(h).

Each failure to report within the stipulated timeframe is conduct amounting to misconduct. Each breach or likely breach that is the subject of each report might itself amount to misconduct.

As has been mentioned already, ASIC's report into selected financial services groups' compliance with the breach reporting obligation found that industry is taking far too long to identify and investigate potential breaches. At the time the report was released, Mr Shipton observed two related problems:[229]

The first is that industry is taking far too long to identify and investigate potential breaches. Whilst this is not of itself a breach of the reporting requirement, this is the greatest source of delay and thus of most significant detriment to consumers.

227 NAB and NULIS, Module 5 Case Study Submission, 14 [76].

228 Exhibit 5.44, Witness statement of Nicole Smith, 3 August 2018, Exhibit NSS-2 (Tab 8) [NAB.005.827.0006].

229 ASIC, Media Release 18-284MR, 25 September 2018.

The second problem is that even having identified an issue and concluded, following an investigation, that it is a breach, institutions are failing to then report it to ASIC within the required 10 business days. The delays here are much shorter (75% were late by 1–5 days) but still represent a breach of the legal requirements.

NAB's conduct in respect of breach reporting accords with those observations.

Failing to comply with the statutory breach reporting requirements showed NAB to be unwilling, in that respect at least, to obey the law. That is a troubling observation. That the failures to obey the law were so many and occurred over so many years is more troubling because it bespeaks a culture that treated not only the immediate breach (constituted by failure to report), but also the breaches or likely breaches that gave rise to the obligation to report as either matters of no real importance or as matters that need not be brought to the regulator's attention.

When these observations are joined, as they must be, to the other criticisms I have made about NAB's response to fees for no service, they speak poorly of NAB's regard for compliance with the law, they speak poorly of NAB's willingness to face the consequences of breach of the law, and they speak poorly of NAB's willingness to do all things necessary to *ensure* that the financial services it provides are provided efficiently, honestly and fairly.[230]

1.3.4 Misconduct in relation to grandfathered commissions

In their written submissions, NAB and NULIS submitted that the board resolution approving the maintenance of grandfathered commissions cannot be divorced from its context.[231] They submitted that the SFT involved a package of changes that NULIS considered, overall, to be in the best interests of members.[232] They noted that the equivalence of rights was maintained and members were no worse off.

[230] Corporations Act s 912A(1)(a).

[231] NAB and NULIS, Module 5 Case Study Submission, 18 [101].

[232] NAB and NULIS, Module 5 Case Study Submission, 18 [101].

I should say at once, in response to the last point about equivalence of rights, that the best interests duty, whatever its content, cannot properly be understood as no more than an obligation ‘to do no harm’.

A trustee has a duty to identify relevant considerations before making a decision and to use all proper care and diligence in obtaining the relevant information and advice relating to those considerations.[233] It has been said that if the consideration of the trustee is not properly informed, it is not genuine.[234] The duty to take these steps flows both from the best interests obligation and also from the duty of care, skill and diligence.

There are at least two things that are troubling about the management paper upon which the decision was taken to maintain grandfathered commissions. First, the paper focused closely upon the possibility of increased costs due to member attrition because of financial adviser dissatisfaction. No estimates of that loss were attempted. And no particular attention was given to the amounts members would continue to pay if commissions were maintained. Second, the paper identified the need for separate legal advice about claims by advisers if commissions were not to be maintained. Yet management did not obtain this advice before making its recommendation. By contrast, management obtained legal advice about the legality of maintaining commissions.

The relevance and importance of these issues to the decision-making process would seem obvious. It may be that the absence of legal advice about claims by advisers points towards the trustee not having performed its duties properly.

As the High Court has observed, ‘superannuation is not a matter of mere bounty, or potential enjoyment of another’s benefaction … It is “deferred pay”. The legitimate expectations which beneficiaries of superannuation funds have that decisions about benefit will be soundly taken are thus high.

---

233 *Abacus Trust co (Isle of Man) v Barr* [2003] 1 All ER 705, [23]; *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705, 717.

234 *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, [66] citing *Kerr v British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071, 1079; *Stannard v Fisons Pension Trust Ltd* [1992] IRLR 27, 31.

So is the general public importance of them being sound'.[235] I consider this reasoning to be no less forceful when it comes to other decisions that will affect member benefits. The trustee may have breached its duty to act in the best interests of the affected members. The matter not having been drawn to the attention of the regulators so far, I will refer the matter to APRA to consider whether to take action.

1.3.5 Misconduct in relation to MySuper and transition of accrued default amounts

In respect of the transition of ADAs to MySuper, it is to be remembered that the statute required trustees to attribute default contributions to their MySuper products and to do this *by* 1 July 2017.

In its written submissions, NULIS submitted that the evidence as a whole did not establish that either MLC Nominees or NULIS delayed the MySuper transition.[236] NULIS submitted that the transition of all ADAs was completed by 31 March 2017, in advance of the 1 July 2017 deadline, and that the majority of ADAs were transferred to 'transition investment options' in June and July 2017.[237] NULIS referred to a number of impediments to an earlier transition, including the complexity of and risk associated with the exercise.[238]

To observe that ADA balances had to be transferred *by* 1 July 2017 puts unwarranted emphasis on the date fixed as the *outer* limit for compliance and does not take account of trustees' other obligations in the Act, in particular the covenant prescribed by section 52(2)(c). The considerations identified in NULIS's submissions were to be considered in light of the fact that commissions, PSFs and other payments to advisers would continue to be paid by members whilst the transition of their ADAs was delayed. Ms Smith acknowledged that one of the consequences of the delay was that members paid higher fees for longer than they would have had their

---

235 *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, [33] (French CJ, Gummow, Heydon, Crennan and Bell JJ).

236 NAB and NULIS, Module 5 Case Study Submission, 20 [109].

237 NAB and NULIS, Module 5 Case Study Submission, 21 [112].

238 NAB and NULIS, Module 5 Case Study Submission, 20 [110]–[112].

ADAs been transferred earlier.[239] For some members, this was not merely a risk, but a certainty. Advisers, including advisers within the NAB Group, stood to benefit from this to the financial detriment of those members.

Taken as a whole, the evidence shows that NAB and NULIS (and before NULIS, MLC Nominees) did not move with all deliberate speed to effect the transfers. I consider that they did not do that for fear of how advisers would react to the loss of commissions that would follow from the transfer.

I consider, then, that the better view of the evidence is that the trustees did not pay sufficient regard to the financial interests of those members affected by adviser payments and, instead, prioritised the commercial interests of the NAB Group or the interests of advisers, or more probably, both. It would further follow that the trustee might have contravened the covenant set out in section 52(2)(c) of the SIS Act. I refer the conduct to APRA under paragraph (a) of the Commission's Terms of Reference for the agency to consider whether to take action.

1.3.6 Conclusion

This case study demonstrates two things.

First, lack of insight and accountability on the part of those most senior in a retail group can lead to delayed and poor outcomes for the members of a fund. NULIS and other NAB entities were aware of the ASF and PSF issues from at least 2015. Rather than remediate promptly at that time, management and senior executives took steps to negotiate an outcome with ASIC that would minimise the financial and reputational fall-out for the NAB Group. NAB was unwilling to acknowledge that this behaviour was wrong. That in itself is telling.

Second, the case study highlights the importance of a regulator monitoring and enforcing trustees' compliance with their duties. Taking action in response to misconduct is backward-looking. The conduct that gives rise to the action has already occurred. The *purpose* of taking the action, on the other hand, is forward-looking. It sets the standards for trustees' conduct in the future. It should prompt trustees to take steps to embed those standards, and respect for them. Monitoring and enforcement

---

[239] Transcript, Nicole Smith, 8 August 2018, 4401.

by a regulator play an important role not only by dealing with poor outcomes for members, but also by seeking to prevent them in the future.

APRA has the general administration of important parts of the SIS Act. In particular, subject to some exceptions that need not be noticed, section 6 of the SIS Act gives APRA the general administration of part 6, which provides, in section 52, that the governing rules of an RSE are taken to contain the covenants set out in that section. It also gives APRA the general administration of part 7, which includes the sole purpose test prescribed by section 62. As already noted, the covenants set out in section 52 include the covenant to exercise care, skill and diligence,[240] the best interests covenant,[241] and the covenant about conflicts of interest that obliges the trustee to give priority to the duties to and interests of the beneficiaries over the duties to and interests of others.[242]

So far as the evidence goes, APRA has taken no step in response to the reports it received, from NAB entities and from others, about fees for no service. It should be said at once that section 62(1), prescribing the sole purpose test, is a civil penalty provision, but section 52 is not. Hence, contravention of section 62(1) may attract civil and criminal consequences.[243] By contrast, breach of a section 52 covenant is not an offence.[244] A person who suffers loss and damage as a result of conduct that contravenes a covenant may recover the amount of the loss or damage by action against the contravener or against any person involved in the contravention.[245]

APRA is tasked to regulate the conduct of superannuation trustees under the SIS Act. Yet APRA was invisible after repeated instances of fees for no service conduct were reported to it by NAB entities and by ASIC publicly in 2016. Fees for no service conduct is, as I have said already in this report and the *Interim Report*, conduct that is dishonest. A trustee that stands by whilst advisers or advice licensees – particularly related parties –

240 Section 52(2)(b).

241 Section 52(2)(c).

242 Section 52(2)(d).

243 Section 62(2), read with SIS Act s 92 and Pt 21.

244 Section 55(2).

245 Section 55(3).

engage in dishonest conduct at the expense of its members is failing in its promise and duty to act in the best interests of members.

In its submissions, APRA said that it intended to carefully evaluate the evidence that has emerged from this case study and to seek further information to determine the relevant facts and whether there is a need for further action on its part. That submission is surprising when important evidence – the trustee's own admission – has been in APRA's possession all along. APRA did not point to what it had done in response to the notice.

2 CBA superannuation funds

2.1 Background

Colonial First State Investments Limited (CFSIL) and Avanteos Investments Limited (Avanteos) are two RSE licensees in the CBA Group. Each is part of the Colonial First State (CFS) business.[246]

CFSIL is the trustee of Colonial First State FirstChoice Superannuation Trust (FirstChoice fund), a public offer fund with over $71 billion funds under management and around 735,793 members.[247] The fund offers a range of products under the FirstChoice brand.[248] CFSIL is also the trustee of another fund called Commonwealth Essential Super.[249]

Avanteos is the trustee of various funds and the operator of investor directed portfolio services.[250] It provides products and services to around 71,000 investors and members holding superannuation, investment

246 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 1 [2].

247 Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 2 [14], 37, Annexure A.

248 Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 3 [14]–[15]; Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 2 [11].

249 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 3 [14].

250 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 2 [7].

and pension assets invested through Avanteos with an approximate value of $29 billion.[251]

On 25 June 2018, CBA announced its intention to demerge its wealth management business, including the CFS businesses.[252] The CFS businesses (with other CBA wealth and mortgage broking businesses) will be transferred into a new entity, shares in which will be issued to CBA shareholders.

The Commission's inquiries examined four aspects of the conduct of CFSIL and Avanteos:

- the transition of accrued default account (ADA) balances and default contributions to a MySuper product;
- the charging of fees for no service;
- the sale of superannuation in CBA branches; and
- the performance of members' cash investments and related party arrangements.

The Commission heard evidence from Ms Linda Elkins, the Executive General Manager of CFS and a director of CFSIL and Mr Peter Chun, the General Manager of Distribution for CFS.

2.2 Evidence

2.2.1 Conduct in respect of MySuper

CFSIL obtained authorisation to offer a MySuper product in 2013.[253] The product was a life stages offering made available through the FirstChoice Employer Super product.[254] CFSIL also obtained authorisation in 2013 to offer a MySuper product named Essential Super through the

251 Exhibit 5.179, Witness statement of Linda Elkins, 26 July 2018, 2 [14].

252 Exhibit 5.180, Witness statement of Linda Elkins, 26 July 2018, 4 [20].

253 Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 2 [10], 15 [57(a)].

254 Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 2 [10].

Commonwealth Essential Super fund.[255] No MySuper offering was established within the FirstChoice Personal Super product.[256]

Two issues arose in respect of CFSIL's implementation of the MySuper provisions. The first concerned its treatment of the contributions of a cohort of members who were invested in the FirstChoice Personal Super product. The second concerned the transition of accrued default amounts (ADAs) into a MySuper product. An accumulated amount attributed to a member is an ADA if that member has not given the trustee a direction as to how the assets of the fund attributed to the member are to be invested.[257]

The first issue related to about 13,000 members of the FirstChoice Personal Super fund. In February 2014, soon after the MySuper changes had taken effect (on 1 January 2014), CFSIL told APRA that it had no investment directions on file for these members, but it had continued to receive contributions from or in respect of the members and had not treated those contributions as default contributions and paid them into a MySuper account.[258]

In November 2013, APRA had written to RSE licensees reminding them that after 1 January 2014 default contributions could only be paid into authorised MySuper products.[259] APRA's letter also reminded licensees that failure to comply was an offence under the SIS Act.[260] Section 29WA(3) of the SIS Act creates the offence; the offence is one of strict liability. That is, there are no fault elements for any of the physical elements of the offence, but the defence of mistake of fact is available.[261]

At a meeting held on 21 February 2014 between representatives of CFSIL and representatives of APRA, CFSIL told APRA that it may be in breach of

---

255 Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 3 [14].

256 Transcript, Linda Elkins, 14 August 2018, 4879.

257 SIS Act s 20B.

258 Transcript, Linda Elkins, 14 August 2018, 4879–80.

259 Exhibit 5.183, 15 November 2013, Letter from APRA to RSEs.

260 Exhibit 5.183, 15 November 2013, Letter from APRA to RSEs, 1.

261 *Criminal Code Act 1995* (Cth) s 6.1.

section 29WA in respect of the contributions of members who were invested in the FirstChoice Personal Super product, which had not been attributed to a MySuper product.[262] CFSIL later said in its letter to APRA dated 6 March 2014[263] that it could not determine whether about 13,000 members invested in the FirstChoice Personal Super product who had made contributions after 1 January 2014 had given any investment direction about the contributions. The members affected had been transferred into the FirstChoice Personal Super product as a result of a successor fund transfer (SFT) or due to the operation of an automatic transfer from the employer division of the fund on cessation of the member's employment.

In its letter, CFSIL told APRA that it had considered several options in its efforts to comply with section 29WA. These included:

- contacting affected members to encourage them to provide an investment direction;
- implementing a system to allow CFSIL to reject undirected contributions;
- setting up a second account for members in the MySuper product; and
- transferring contributions to a MySuper product at the same time as transferring the member's ADA.

CFSIL asked APRA to agree to a proposal that it:[264]

- continue to accept undirected contributions into the FirstChoice Personal Super product;
- transfer undirected contributions into the MySuper product of the fund at the same time as the ADA balance of affected members was to be transferred; and
- contact all affected members without an ADA balance by telephone in order to obtain an investment direction.

[262] Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA, 1.

[263] Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA.

[264] Exhibit 5.185, 6 March 2014, Letter, Colonial First State to APRA, 2.

APRA wrote to CFSIL on 14 March 2014.[265] It agreed that CFSIL was in breach of section 29WA. APRA said that it considered that CFSIL had had sufficient time to prepare for the introduction of the MySuper requirements to avoid such a breach, that it did not consider CFSIL's proposal to be acceptable and that it expected CFSIL to 'determine a course of action so that it ceases to be in breach of section 29WA of the SIS Act as soon as possible'.[266]

Following a further meeting held on 18 March 2014,[267] CFSIL formally notified APRA on 19 March 2014 that it was in breach of section 29WA and had been since 1 January 2014.[268] CFSIL said in the breach notification that it was unable to determine whether approximately 13,000 members of the FirstChoice Personal Super product who had made a contribution since 1 January 2014 had given an investment direction in relation to all or part of that contribution. It said that CFSIL had not paid those contributions to a MySuper product.

CFSIL set out its proposal to rectify the breach in a separate letter to APRA of the same date. CFSIL told APRA that it had commenced proactive outbound calls to affected members via a call centre to obtain and record a valid investment direction.[269]

CFSIL later gave APRA a copy of the call-out script[270] and the letter that CFSIL proposed to send to affected members.[271] The call-out script directed the caller to tell the member that there had been a recent change to

---

265 Exhibit 5.299, 14 March 2014, Letter from APRA to CFSIL.

266 Exhibit 5.299, 14 March 2014, Letter from APRA to CFSIL.

267 Exhibit 5.186, 19 March 2014, Letter, Colonial First State to APRA.

268 Exhibit 5.184, 19 March 2014, Breach Notice Colonial First State Investment to APRA.

269 Exhibit 5.186, 19 March 2014, Letter, Colonial First State to APRA.

270 Exhibit 5.187, 26 March 2014, Email CBA to APRA and Attached Call Script.

271 Exhibit 5.189, 4 April 2014, Email Sutherland to APRA and Attached Template Letter to Members.

legislation that required confirmation of the investment option or options into which the member would like their superannuation contributions to be paid. Ms Elkins said that call centre operators would record any investment direction provided by a member over the telephone and then complete the form on behalf of the member.[272]

The template letter said that there had been a recent change to superannuation legislation that required CFSIL to hold an investment direction from the member in relation to future contributions paid into FirstChoice Personal Super.[273] The letter said that if such a direction was not held, CFSIL would be unable to accept contributions into the member's account.

Neither the script nor the template letter referred to the possibility of a member giving no direction and contributions being directed to a MySuper account. Both the script and the letter described the issue in a way that was directed to keeping members in the fund and out of a MySuper product.

By a letter dated 29 April 2014,[274] APRA requested further information from CFSIL. It otherwise said that CFSIL's plan was acceptable to APRA. The letter also noted that APRA expected the CFSIL Board and management to satisfy itself that all other new obligations under the SIS Act and prudential standards 'are being implemented appropriately and in members' best interests.'

Thereafter, CFSIL proceeded to contact tranches of members in accordance with its proposal. Each tranche of members corresponded with a particular period of time between 2014 and 2016 during which a contravention of section 29WA was identified. CFSIL gave APRA regular reports on progress.[275] At various times, CFSIL identified further members who had not previously been identified as having ADAs, which required

---

272 Transcript, Linda Elkins, 14 August 2018, 4889.

273 Exhibit 5.189, 4 April 2014, Email Sutherland to APRA and Attached Template Letter to Members.

274 Exhibit 5.190, 29 April 2014, Letter from APRA to Elkins.

275 See, eg, Exhibit 5.191, 29 March 2015, Email, Clemence of Colonial First State to APRA, Re Section 29WA Update Number 13.

a further tranche of members to be contacted. So, for example, CFSIL told APRA by email dated 22 February 2016 that it had identified a sixth tranche of members who were 100% invested in a cash option, which CFSIL had failed to identify as having ADAs.[276] By an update numbered 24 and dated 13 September 2017, APRA was told that the transfer of ADAs for the FirstChoice Personal Super members was complete.[277]

The second aspect of conduct examined in respect of MySuper concerned the transfer of ADAs into MySuper products. The MySuper provisions required RSE licensees who had the authority to offer a MySuper product to attribute ADAs to that MySuper product unless the member directed the RSE licensee in writing to attribute the amount to another MySuper product or investment option.[278] RSE licensees were required to do so by no later than 1 July 2017.

Ms Elkins said that the ADAs of members who were invested in the FirstChoice Employer product were transferred to the MySuper offering in two tranches:[279]

- the first tranche of 98,700 members was transferred on 12 November 2016;
- the second tranche of 3,400 members was transferred on 24 May 2017.

The ADAs of members who were invested in the FirstChoice Personal product were not transferred into a MySuper product. CFSIL told APRA in its letter of 6 March 2014[280] that system restrictions meant that it was not possible for these members to be invested in that product without establishing a second account, which it said might lead to the member paying two sets of fees and insurance premiums.

---

276 Exhibit 5.192, 22 February 2016, Email, Colonial First State to APRA Concerning Section 29WA Update Number 17.

277 Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

278 The legislative framework for this transition was laid down in SIS Act s 387.

279 Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 15 [56].

280 Exhibit 5.185, 6 March 2014, Letter from Colonial First State to APRA.

In its letter of 19 March 2014, CFSIL told APRA that trustee approval would be sought to commence the attribution of ADAs for these members to a suitable MySuper product and that it expected approval by 30 April 2014. The relevant board meeting took place on 30 April 2014. The CFSIL Board determined that Essential Super was a suitable MySuper product for the transfer of ADAs of FirstChoice Personal Super members.[281] The board approved transfers where no contrary instruction was provided by the affected member.

In its letter to CFSIL dated 29 April 2014,[282] APRA noted that CFSIL had informed it of approximately 70,000 FirstChoice Personal Super members with ADAs of whom approximately 14,000 had received a contribution since 1 January 2014. It also noted that the latter cohort were being dealt with via the process outlined above (in respect of the section 29WA breach) and recommended that, for the remaining accounts, CFSIL put in place appropriate controls and monitoring to avoid further breaches of section 29WA. The letter said that:

> From a conversation with CFSIL on 22 April 2014 we understand that work is underway to consider steps CFSIL can take to address this risk such as introducing a phone campaign for the remaining ADA members to obtain a valid investment direction and bringing forward the date for ADA transition earlier than 2016.

At a meeting of the CFSIL Board held on 3 June 2014, management noted the proposed transition plan for ADAs for affected members and 'the recent suggestion by APRA that the Board consider bringing forward the transition for 60,000 members'.[283] Management told the board that this would have 'significant business implications as the original transition date is 2016'. The minutes record that the board considered and discussed the management paper and, in its capacity as trustee of CFSIL:

281 Exhibit 5.197, 30 April 2014, Board Pack for Colonial First State Investments Limited.

282 Exhibit 5.190, 29 April 2014, Letter APRA to Elkins.

283 Exhibit 5.219, 30 June 2018, Minutes CFS Investments Limited.

- noted the updated information regarding the identified breach of section 29WA of the SIS Act and the rectification process being undertaken;
- noted that it may not be in the best interest of members with ADAs to transfer them to Commonwealth Essential Super at that point;
- noted that 'robust processes' were in place for the 60,000 members with ADAs;
- noted the principles and process in relation to the remediation of affected members; and
- subject to the incorporation of the requested changes, approved the changes to the trustee's MySuper Transition Plan giving effect to the proposed rectification process.

The board did not resolve to bring forward the transition date. APRA was later told that there were several reasons: potential operational risk; a possibility of members' interests being adversely affected; a low probability of a section 29WA breach in the future; and the fact that work was already planned to engage with members and advisers regarding their intentions.[284]

At a meeting of representatives of APRA and CFSIL on 29 July 2014, APRA expressed concern that CFSIL's transition approach was 'reactive' and may result in a delay of up to 10 months for members who had made contributions after 1 April 2014.[285]

As well as communicating with affected members during the period of transition of ADAs, CFS also communicated with their advisers. The letters sent to advisers and planners set out the value of assets under management in respect of which commissions were being paid to the adviser or planner and which were commissions that would be lost if

[284] Exhibit 5.198, 4 July 2014, Email, Colonial First State to APRA.

[285] Exhibit 5.420, 29 July 2014, File Note of Meeting Held on 29/07/2014 between APRA and CFS Regarding ADA Transition.

clients moved to a MySuper product.[286] In one standard email sent to financial planners, planners were told that the transfer date for ADAs was approaching; they were reminded of the amount of funds under administration and that commissions would be lost if these were transferred to a MySuper product.[287]

Ms Elkins agreed that emails like the one just described encouraged advisers to stop ADAs being transferred to a MySuper product by obtaining an investment direction.[288] She said that it was never discussed that CFSIL wanted to maximise the time that ADAs remained in default products so as to maximise commissions.[289] But she agreed that one of the purposes of the communications sent to advisers and members asking them to confirm their investment directions was to benefit advisers.[290] Ms Elkins also gave evidence that moving ADAs into the MySuper product early may have affected the relationship between CFSIL and its aligned advisers.[291]

The final tranche of FirstChoice Personal Super member accounts was transferred into the Essential Super product in August 2016.[292] A total of 23,451 ADA accounts, with balances totalling more than $279 million were transferred.

2.2.2 Fees for no service conduct

After the Commission heard evidence in April 2018 about fees for no service, CFS management conducted a review to identify whether adviser service fees (ASFs) had been or were being deducted from the accounts of deceased superannuation fund members. Management identified that

286 See, eg, Exhibit 5.201, 6 July 2016, Email between CFSL and Financial Planner Concerning CFS Updated Transfer ADA Accounts; see also Transcript, Linda Elkins, 14 August 2018, 4907.

287 Transcript. Linda Elkins, 14 August 2018, 4910–11; Exhibit 5.202, 16 September 2016, Email CFSL to Financial Planner.

288 Transcript, Linda Elkins, 14 August 2018, 4911–12.

289 Transcript, Linda Elkins, 14 August 2018, 4884–5.

290 Transcript, Linda Elkins, 15 August 2018, 4946.

291 Transcript, Linda Elkins, 15 August 2018, 4946.

292 Exhibit 5.194, 1 September 2016, Email, Colonial First State to APRA Concerning Section 29WA Update Number 19; Transcript, Linda Elkins, 14 August 2018, 4896.

accounts in Avanteos funds had ASFs deducted following a member's death and that the relevant product disclosure statement (PDS) did not disclose the ongoing deduction of those fees.[293] Ms Elkins said that this issue did not affect any other CBA RSE licensee.[294]

Ms Elkins' said that, before June 2018, Avanteos' business rules had allowed ASFs to be deducted from a member's account even after it had received notification of the member's death.[295] Ms Elkins also acknowledged that Avanteos did not require advisers to provide any positive confirmation that the adviser had supplied ongoing services,[296] unless the adviser was specifically investigated by Avanteos or CFSIL.[297]

The management review also found that in late 2015 or early 2016, Avanteos had become aware that relevant PDSs did not disclose that fees might be deducted after death of the member. Changes were proposed to be made to the relevant PDSs, and the register used to capture and manage proposed changes to PDSs issued by Avanteos included the change. But the change was not made. Ms Elkins said that the relevant entry was moved to the 'completed' section of the register before it was carried into effect.[298] No steps were taken at that time either to switch off the ASFs or report the matter to ASIC or APRA.[299]

Ms Elkins told the Commission that when she was told of the review's findings in late April 2018, she immediately requested that steps be taken to switch off ASFs for affected member accounts and to prevent future

293 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [19].

294 Transcript, Linda Elkins, 15 August 2018, 4963.

295 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [12].

296 Transcript, Linda Elkins, 15 August 2018, 4964.

297 Transcript, Linda Elkins, 15 August 2018, 4965.

298 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [20].

299 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [20].

deductions from accounts of members who died.[300] She also requested that the regulators be notified.[301] This was done on 1 May 2018.[302]

At the time of the Commission's inquiries, the exact amount of ASFs that had been deducted from member accounts after the member's death had not been determined. The preliminary estimates Ms Elkins provided the Commission were that 1,714 member accounts had been affected and a total of $2.93 million had been deducted.[303] A remediation program had also commenced by the time of the hearings and was expected to be substantially completed by February 2019.[304]

On 9 October 2018, after the Commission's hearings into superannuation had concluded, CBA announced certain actions it would take in respect of adviser fees, including:[305]

- rebating of grandfathered commissions for Commonwealth Financial Planning (CFP) customers;
- reviewing any advice fees charged to deceased estates across its advice licensees and refunding with interest any instances where unauthorised fees have been charged;
- taking steps to remove certain fees on legacy wealth products from January 2019, which it said would benefit around 50,000 customer accounts by approximately $20 million annually; and
- providing all customers of CFP with an option to review their ongoing service arrangements every two years.

300 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [21].

301 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 4 [21].

302 Exhibit 5.182 Witness statement of Linda Elkins, 7 August 2018, Exhibit LME-2 [CBA.0002.2558.7264]; see also Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, Exhibit LME-3 [CBA.1004.0085.0001].

303 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 9 [46].

304 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 10 [49].

305 Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

At the time of the announcement, CBA Wealth Management Chief Operating Officer Michael Venter said:[306]

> Charging unauthorised advice fees to deceased estates is unacceptable. A broader review of deceased estates is underway across our advice licensees. It will go back seven years to ensure that any instances where unauthorised fees have been charged are identified and refunded with interest.

2.2.3 Commissions, contribution fees and grandfathering

When considering what CFSIL and other superannuation entities did in response to the introduction of the MySuper arrangements three points need to be borne in mind.

First, the trustee of the MySuper fund could charge only fees of the kinds permitted by section 29V of the SIS Act. Second, when ADAs were transferred into a MySuper account, advisers could no longer be paid any trailing or other commissions out of the amounts standing to the credit of that account.[307] Third, because transferring ADAs to a MySuper account cut the flow of commissions, the transfer worked to the financial detriment of advisers. That detriment could be avoided by the adviser or fund obtaining from an existing member of a fund an investment direction. It followed that superannuation entities that relied on advisers introducing new members to their funds had reasons to delay transferring ADAs to a MySuper product, thus preserving the flow of commissions and providing time to secure investment directions.

[306] Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

[307] This was the effect of SIS Act ss 29SAC, 29S(2)(f) and 29T(1)(a), which together required an RSE licensee to elect that it would not charge a member who holds a MySuper product, in relation to that product, a fee all or part of which relates directly or indirectly to costs incurred by the RSE licensee: (a) in paying conflicted remuneration to a financial services licensee, or a representative of a financial services licensee; or (b) in paying an amount to another person that relates to conflicted remuneration paid by that other person to a financial services licensee, or a representative of a financial services licensee. The definition of ‘conflicted remuneration’ would include trail and other commissions.

CFSIL is a dual-regulated entity. It is both the responsible entity (RE) for managed investment schemes and trustee of superannuation funds. As RE, it charged commissions on funds invested in the scheme. And, as RE, CFSIL paid the amount of commission charged to the client's adviser, if the commission was 'grandfathered'. (The commission was treated as 'grandfathered' if the advice licensee to whom the commission was paid had been engaged by the client before the FoFA changes came into force.) If there was no linked adviser, CFSIL retained the commission for itself.[308] If the member later engaged a new adviser, Ms Elkins said that CFSIL would still retain the trailing commission charged to that account.[309] And trailing commissions would continue to be paid after members died.[310] These commissions continued to be paid by the reversionary beneficiary (the person nominated by the member to receive that member's benefits in the event of their death) even if the beneficiary had been nominated before the effective date of the FoFA legislation.[311]

Ms Elkins told the Commission that, at the time of giving her evidence, CFSIL did not have the capability to rebate commission amounts to members[312] and had not reduced its fees to remove the commissions.[313] She said that, other than at the time of FoFA's introduction and CFSIL's subsequent work to ensure compliance with the legislation's grandfathering provisions, the trustee had not considered whether to continue charging trailing commissions.[314] However, the issue was under review at the time of the hearings.[315] Ms Elkins said that CBA's strategic position with respect to trailing commissions, generally, would need to be determined and taken

---

308 Transcript, Linda Elkins, 14 August 2018, 4920.

309 Transcript, Linda Elkins, 14 August 2018, 4915.

310 Transcript, Linda Elkins, 15 August 2018, 4967.

311 Transcript, Linda Elkins, 15 August 2018, 4967.

312 Transcript, Linda Elkins, 14 August 2018, 4918.

313 Transcript, Linda Elkins, 14 August 2018, 4918; see also Transcript, Linda Elkins, 15 August 2018, 4968.

314 Transcript, Linda Elkins, 14 August 2018, 4920.

315 Transcript, Linda Elkins, 14 August 2018, 4918; see also Transcript, Linda Elkins, 15 August 2018, 4968.

into consideration before CFSIL could make a decision to remove trailing commissions.[316]

As noted above, after the superannuation hearings concluded, CBA announced that it would rebate grandfathered commissions for CFP customers.[317] It was not clear from CBA's announcement whether this would extend to grandfathered commissions paid to other CBA advice licensees. Mr Venter said at the time: 'We support the removal of grandfathered commissions from superannuation and investment products across the wider industry and believe a legislative approach should be considered'. This suggests he believed that CBA may see a first-mover disadvantage if it were to make such changes voluntarily.

CFSIL also paid commissions in respect of members who had joined the fund before 1 July 2014, but who had switched from the accumulation to pension phase between 19 November 2014 and 30 June 2015. This was against the regulations but would have been allowed under regulations made but disallowed by the Senate.[318]

To elaborate, after the FoFA legislation took effect, regulations were introduced that provided that where a member with a superannuation interest in the 'growth phase' before 1 July 2014 elected to receive a pension, the election or receipt of pension was not treated as having occurred on or after 1 July 2014.[319] The effect of these regulations would have been to permit the grandfathering provisions to apply. The regulations were disallowed by the Senate. ASIC announced that it would 'take a practical and measured approach to administering the law' as it stood after the disallowance of the regulations and that it would work with Australian financial services licensees by 'taking a facilitative approach' until 1 July 2015.[320]

316 Transcript, Linda Elkins, 15 August 2018, 4951–3.

317 Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

318 Transcript, Linda Elkins, 14 August 2018, 4926.

319 *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014* (Cth).

320 ASIC, Media Release 14-307MR, 19 November 2014.

In May 2015, CBA wrote to ASIC noting the relevant background and said that confusion had resulted from the disallowance of the regulations.[321] It set out various potential interpretations of the legislation that might permit the fund to grandfather commission payments.[322] CBA said that, if narrower interpretations of the applicable grandfathering provisions were to be adopted, CFSIL would require time to assess and address a number of issues so that there was an orderly and staged implementation process. CBA asked ASIC to consider issuing the affected Group entities with a 'no-action' letter or extend the facilitative compliance period to 31 July 2015 in order to allow the Group time to engage with ASIC.[323]

In a letter dated 22 July 2015, ASIC refused to provide the extension sought, but gave a limited no-action letter.[324] ASIC said that the facilitative compliance period was not equivalent to a transition period and could only be relied upon by licensees that were making reasonable efforts to comply with the law. ASIC said that licensees did not appear to be doing this.[325] However, ASIC said that it understood that the relevant licensees, including CFSIL, may need to undertake a range of steps in order to permanently cease the relevant payments of **conflicted remuneration**. It was on this basis that ASIC said it had decided to provide the limited no-action letter. ASIC confirmed that, subject to certain qualifications, it did not intend to take action for breaches of the relevant provisions where:

- the breach occurred from 1 July 2015 to 22 October 2015; and
- the breach occurred as a result of a benefit being given or received in relation to a client who switched from the accumulation to the pension phase within FirstChoice from 19 November 2014 to June 2015.

Ms Elkins told the Commission of efforts in October 2013 by representatives of CBA and CFSIL (including herself) to lobby Treasury officials and a ministerial adviser to allow the continuation of grandfathered commissions

---

321 Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC.

322 Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC, 7.

323 Exhibit 5.210, 29 May 2015, Letter CBA to Commissioner Tanzer of ASIC, 10.

324 Exhibit 5.211, 22 July 2015, Letter ASIC to CBA.

325 Exhibit 5.211, 22 July 2015, Letter ASIC to CBA.

when a member switches from the accumulation to the pension phase.[326] Ms Elkins said that she lobbied for clarification in the law,[327] but agreed that it was not in the interests of members that grandfathered commissions be continued when the member switched from superannuation to pension. She said, in hindsight, CFSIL should not have been lobbying for that.[328]

The Commission also heard evidence about the grandfathering and payment of ‘contribution fees’. Ms Elkins said that contribution fees are payable as a percentage on each contribution made by a member[329] and were maintained and grandfathered after FoFA. Ms Elkins was not certain whether contribution fees were payable when the member was not linked to an adviser and whether, in that event, parts of the fee flowed to CBA or CFSIL.[330] CFSIL said in its submissions that if contribution fees were grandfathered, they may still be payable after a member had been delinked from an adviser and that, in that situation, CFSIL would retain the fees.[331]

During the Commission’s hearings, Ms Elkins said that, as trustee, CFSIL had not considered removing contribution fees until recently.[332] At a meeting held on 21 June 2018, the Product Governance Forum of CFS endorsed a recommendation to remove contribution fees.[333] On 9 October 2018, as noted above, CBA announced that it would take steps to rebate grandfathered commissions for CFP customers and to remove ‘certain fees’ on legacy wealth products from January 2019.[334] The announcement did not say whether those fees included contribution fees.

326 Exhibit 5.212, 25 October 2013, Email Russel to Rubinsztein and Others.

327 Transcript, Linda Elkins, 14 August 2018, 4926.

328 Transcript, Linda Elkins, 15 August 2018, 4926.

329 Transcript, Linda Elkins, 15 August 2018, 4965, 4950.

330 Transcript, Linda Elkins, 15 August 2018, 4950.

331 CFSIL and Avanteos, Module 5 Case Study Submission, 11 [30].

332 Transcript, Linda Elkins, 15 August 2018, 4950.

333 Exhibit 5.221, 21 June 2018, Minutes of CFS Product Governance Forum.

334 Exhibit 5.437, 9 October 2018, CBA ASX Announcement 9 October 2018.

2.2.4 Selling of superannuation through CBA branches

In 2012, CFS and CBA started developing a program for CFSIL to create a superannuation product that CBA would sell in its branches.[335] The product was to be Essential Super. As already explained, Essential Super was intended to be a low cost, simple, superannuation product. [336] The original target market was CBA customers who came through CBA's branches and distribution network.[337]

In June 2013, CFSIL and CBA made a Distribution and Administration Services Agreement.[338] The Agreement said that CBA would provide 'Services' to CFSIL (including distribution of Essential Super using training and compliant 'resources'), as well as the use of its branches and the development of marketing materials and web content.[339] In exchange, CFSIL was required to pay CBA an annual fee of 30% of the total net revenue earned by the trustee in relation to the fund in the relevant financial year.[340] Mr Chun said this fee was based on the costs that CBA bank incurred versus the costs that CFSIL incurred.[341]

Mr Chun told the Commission the parties presented the proposed distribution model to ASIC in 2012 and early 2013. He said that they did so because they recognised that there were 'potential risks around the general advice distribution model … potentially blurring into personal [advice]' and because the distribution model was a major undertaking of CBA, and a new one.[342]

335 Exhibit 5.233, Witness statement of Peter Chun, 7 August 2018, 4 [14]; Transcript, Peter Chun, 15 August 2018, 4987.

336 Transcript, Peter Chun, 15 August 2018, 4988; see also, Transcript, Linda Elkins, 15 August 2018, 4968.

337 Transcript, Peter Chun, 15 August 2018, 4988.

338 Exhibit 5.233, Witness statement of Peter Chun, 7 August 2018, 4 [16].

339 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3258].

340 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3258].

341 Transcript, Peter Chun, 15 August 2018, 4988.

342 Transcript, Peter Chun, 15 August 2018, 4989.

Under the model CBA presented to ASIC, its branch staff would seek to create customer 'interest' in taking up Essential Super after either a transaction, financial 'health check' or a request or referral involving that customer.[343] Mr Chun told the Commission that 'the person in the branch is not attempting to make any assessment of whether [Essential Super is] appropriate for the member'. He said, '[w]e were not recommending other products to the customer. We were making them aware of this particular superannuation offering.'[344]

After the distribution model was introduced, CBA engaged KPMG to conduct 'mystery shopper' exercises in various branches. CFSIL received copies of the reports for each exercise.[345] In its first report, in respect of an exercise conducted in September 2013, KPMG found that:[346]

- there was a high volume of compliance exceptions;
- 85% of shoppers were not provided with a **Financial Services Guide**;
- 40% of shoppers were not provided with a PDS (for the Essential Super product);
- 95% of customer service representatives did not follow the application process in detail; and
- 85% of shoppers were not provided with a general advice warning as part of the inquiry/sale.[347]

343 Transcript, Peter Chun, 15 August 2018, 4990.

344 Transcript, Peter Chun, 15 August 2018, 4993–4.

345 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 4 [28].

346 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-27 [CBA.0001.0463.6783].

347 Transcript, Peter Chun, 15 August 2018, 4991.

Mr Chun said that further changes and improvements were made to the sales approach as a result of this report, particularly about providing a general advice warning, which he described as 'an important element of the control'.[348]

KPMG conducted further mystery shopper exercises in December 2013 and September 2014. These exercises revealed some improvement, but compliance exceptions persisted.[349] Mr Chun said that CFSIL was aware that the conduct identified in the mystery shopper reports may have constituted breaches of applicable legislation.[350]

CFSIL did not give ASIC the results of KPMG's mystery shopper exercises until December 2014.[351] In the meantime, in August 2014, ASIC had issued a notice to CBA seeking books and records in respect of the sale of Essential Super by CBA branch staff.[352] ASIC had become concerned about the use of the 'financial health check' alongside a recommendation of Essential Super.[353] Mr Chun said that he became aware of ASIC's concerns towards the end of 2016 or beginning of 2017 and that steps were taken by CBA to make changes.[354] The changes included no longer allowing consolidation of superannuation funds in branches in January 2017.[355]

Towards the end of 2016 or in early 2017, ASIC told CBA that it was concerned about CBA's conduct.[356] A position paper provided by ASIC dated 20 February 2017 set out ASIC's concerns.[357] These included that:

---

348 Transcript, Peter Chun, 15 August 2018, 4991–2.

349 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-27 [CBA.0001.0463.6783], Exhibit PC-28 [CBA.0001.0463.6838], Exhibit PC-29 [CBA.0001.0463.6720].

350 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 5 [31].

351 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, 5 [32].

352 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-24 [CBA.0001.0463.0629].

353 Transcript, Timothy Mullaly, 17 August 2018, 5225.

354 Transcript, Peter Chun, 15 August 2018, 4992–3.

355 Transcript, Peter Chun, 15 August 2018, 4992–3.

356 Transcript, Timothy Mullaly, 17 August 2018, 5230.

357 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-16 [ASIC.0041.0002.6128].

- ASIC suspected that branch staff employed by CBA had been providing personal advice, as opposed to general advice, in the sale of Essential Super. This gave rise to contraventions by CBA of a number of provisions of the Corporations Act including sections 961B, 961K, 961L, 952C(1) and 912A(1);
- the general advice model adopted by CBA carried the inherent risk that personal advice would be given – and that CBA was aware of this;
- this risk was exacerbated by the discussion of Essential Super being linked to, or following directly on from, the conduct of a financial health check;
- if personal advice was provided, the customer would not have the benefit of the protections afforded by Chapter 7 of the Corporations Act; and
- ASIC suspected that CBA had contravened its general obligation to ensure that financial services covered by its Australian financial services licence are provided efficiently, honestly and fairly in accordance with section 912A(1)(a).

In its response dated 17 March 2017, CBA said that it 'firmly believed that at all times it has acted in accordance with its legal obligations, ASIC regulatory guidance and, more broadly, its objective to put customers first in respect of the distribution of Essential Super'.[358] Although no particular outcome was referred to in ASIC's paper, CBA said that it did not consider that court proceedings would be an appropriate enforcement outcome and that a 'negotiated outcome' would represent 'the most appropriate and efficient outcome'.[359] CBA also said that '[b]ecause court proceedings are not warranted, we also do not consider that the present is a case in which an enforceable undertaking is required'.[360] CBA proposed some changes

358 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .0408].

359 Exhibit 5.310. Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .4093].

360 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-4 [ASIC.0041.0005.0407 at .0410].

to its distribution model. In July 2017, ASIC told CBA that it remained concerned that CBA's proposal was still likely to result in personal advice being given by staff.[361] ASIC told CBA that it was prepared to resolve the matter on the basis of an enforceable undertaking (EU), the terms of which would include that CBA cease selling Essential Super in conjunction with a financial health check or any other 'needs based discussion'.

In August 2017, CBA discussed internally how the matter might best be brought to an end. An internal email of that time suggested that CBA's preferred approach was to resolve the matter without an EU if possible and by way of a media release, although the email acknowledged that ASIC was unlikely to resolve the matter other than through an EU. Ms Elkins said that CFS and CBA's position was that ASIC should 'put out a media release'.[362]

CBA wanted to ensure that, if an EU was required, the terms of the undertaking would permit retail banking and wealth management to 'move forward with Project Everest', which would put Essential Super 'back into the branches' under a general advice model 'without the risk of straying into the personal advice territory'.[363]

Ultimately, in July 2018, about a year after CBA and CFS had begun to discuss resolution of the issues with ASIC, CBA agreed to give, and gave, an EU.[364] Ms Elkins said that she thought the lapse of time was 'just the normal course of negotiating the EUs'.[365]

2.2.5 Returns to members on cash investments

On 11 June 2018, the *Australian* newspaper published an article saying that many investment options provided by retail superannuation funds were paying returns well below the actual market rates, with those

---

361 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-22 [ASIC.0041.0001.2789].

362 Transcript, Linda Elkins, 15 August 2018, 4968.

363 Exhibit 5.227, 8 August 2017, Email Shafir to Comyn and Others; Transcript, Linda Elkins, 15 August 2018, 4970.

364 Transcript, Linda Elkins, 15 August 2018, 4969; Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-34 [ASIC.0041.0001.4378].

365 Transcript, Linda Elkins, 15 August 2018, 4976.

lower returns not explained by differences in fees. CFSIL and CBA did not accept the criticisms they understood the article to be making and internal communication followed within CFSIL and CBA. But the internal analysis made of returns on cash investments and fees charged showed, among other things, that the fee being charged for the cash option in the FirstChoice Pension product included a trailing commission of 60 basis points.[366]

When asked why members were paying a trailing commission on cash investment options, Ms Elkins said that the cash investment options were under review.[367]

2.2.6 Related party arrangements

Two issues arose about CFSIL's related party arrangements. The first concerned one of its investment managers, Colonial First State Asset Management (Australia) Limited (Asset Management), while the other concerned the group insurance provider, CommInsure.[368] At the relevant times, both entities were part of the CBA group and related to CFSIL.

CFSIL invests money in managed investment schemes of which CFSIL is the RE.[369] Those investments are then managed by Asset Management, which charges CFSIL fees.[370]

Ms Elkins said that the business team for CFSIL would negotiate with the business team for Asset Management to determine the fees that CFSIL would pay to Asset Management. An example was provided to the Commission in the form of a recent negotiation in respect of

---

[366] Transcript, Linda Elkins, 15 August 2018, 4948; see Exhibit 5.220, 11 June 2018, Summary of Page 1 Article, the Australian.

[367] Transcript, Linda Elkins, 15 August 2018, 4948.

[368] Transcript, Linda Elkins, 15 August 2018, 4957.

[369] Transcript, Linda Elkins, 15 August 2018, 4954.

[370] Transcript, Linda Elkins, 15 August 2018, 4954.

the distribution and marketing of investment options that used to reside in CFSIL, but were moved across to Asset Management.[371]

Ms Elkins said that the board of CFSIL did not need to sign off on the agreement reached between CFSIL and Asset Management about the investment management fees – including distribution and marketing fees – which would be paid by members to Asset Management.[372] A benchmarking report produced by ChantWest showed that the majority of products were outside of the benchmarking range.[373]

In respect of CommInsure, Ms Elkins told the Commission that CFSIL conducts an annual review of CommInsure in line with the CFSIL insurance management framework.[374] I take this to mean that CFSIL conducts an annual review of whether CommInsure should be its chosen insurer. The Commission received evidence of various premium comparisons included in a Rice Warner insurance benchmarking review dated 11 April 2017.[375] This contained a number of findings, including that:

- in respect of default insurance for Commonwealth Essential Super members, CommInsure does not distinguish between blue-collar and white-collar workers or between smokers and non-smokers;[376]
- the non-smoker rates for Commonwealth Essential Super are on average 34% more expensive that the median of the peer group for death only cover;[377]

---

371 Transcript, Linda Elkins, 15 August 2018, 4955.

372 Transcript, Linda Elkins, 15 August 2018, 4956.

373 Exhibit 5.223, 24 February 2017, Board Paper 24 February ‘17, Concerning Investment Management Fee Negotiations.

374 See Exhibit 5.179, Witness statement of Linda Elkins, 26 July 2018, Exhibit LME-27 [CBA.0517.0169.4554]; Transcript, Linda Elkins, 15 August 2018, 4958.

375 Exhibit 5.224, 11 April 2017, Rice Warner Insurance Benchmarking Review.

376 Transcript, Linda Elkins, 15 August 2018, 4959.

377 Transcript, Linda Elkins, 15 August 2018, 4960.

- the rates for white-collar non-smokers are on average 61% more expensive than the median of the peer group for death only cover;[378]
- the rates for blue collar non-smokers are on average 19% more expensive than the median of the peer group for death only cover;[379]
- for death and total and permanent disability combined cover for female non-smoker white-collar workers aged between 41 and 45, the premium is on average 132% higher than the median;[380]
- when CommInsure does worse than the median in respect of Commonwealth Essential Super insurance, it does much worse than the median; [381] and
- when CommInsure for Commonwealth Essential Super insurance does better than the median, it only does a little bit better than the median.[382]

These annual benchmarking reports go to CFSIL's board,[383] and the Office of the Trustee oversees the annual review of CommInsure.[384] Ms Elkins said that despite the benchmarking results, the board has continued to use CommInsure for its group insurance.[385] She said that the decision to retain CommInsure came down to whether CFSIL would be better off negotiating with CommInsure as the incumbent or selecting a new insurer.[386] She acknowledged that the question of changing insurer has arisen, but said that the discussion has not been minuted.[387]

378 Transcript, Linda Elkins, 15 August 2018, 4960.

379 Transcript, Linda Elkins, 15 August 2018, 4960.

380 Transcript, Linda Elkins, 15 August 2018, 4961.

381 Transcript, Linda Elkins, 15 August 2018, 4961.

382 Transcript, Linda Elkins, 15 August 2018, 4961.

383 Transcript, Linda Elkins, 15 August 2018, 4960.

384 Transcript, Linda Elkins, 15 August 2018, 4962.

385 Transcript, Linda Elkins, 15 August 2018, 4960.

386 Transcript, Linda Elkins, 15 August 2018, 4962.

387 Transcript, Linda Elkins, 15 August 2018, 4962.

2.2.7 Intra-fund advice and a banned adviser

Financial Wisdom Limited (Financial Wisdom), another company in the CBA group at relevant times, provide intra-fund advice to members of funds of which CFSIL is the RSE licensee, pursuant to an agreement between Financial Wisdom and CFSIL.[388] Mr Chun said that the advice was not 'personal advice', but limited to 'factual information and general advice'.[389]

A financial adviser, who was an authorised representative of Financial Wisdom, was permitted to provide intra-fund advice pursuant to an agreement with Financial Wisdom.[390] Under the agreement, the adviser provided intra-fund advice to a subset of members of FirstChoice Employer Super.[391] The adviser received trailing commissions from some of the members to whom he provided intra-fund advice.[392]

The adviser made contact with members in respect of whom the adviser was receiving trailing commissions in relation to the upcoming ADA transfers that would be part of the MySuper transition.[393] Mr Chun said that the particular communication that adviser made[394] did not follow the template provided by CFSIL to advisers. The communication said:[395]

> Around three years ago the government changed super legislation and it's coming into effect now. As a result, if you don't actively make an investment choice in your super account you are deemed to be disengaged and the government will make an investment choice for you.

---

388 Transcript, Peter Chun, 15 August 2018, 4979–80.

389 Transcript, Peter Chun, 15 August 2018, 4980.

390 Transcript, Peter Chun, 15 August 2018, 4980.

391 Transcript, Peter Chun, 15 August 2018, 4980.

392 Transcript, Peter Chun, 15 August 2018, 4981.

393 Transcript, Peter Chun, 15 August 2018, 4982. For an example of correspondence sent by the financial adviser, see Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

394 Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

395 Exhibit 5.235, 3 January 2018, Template Financial Planner Email Concerning Important Superannuation Changes.

> …
>
> Your investment will be moved to a government-selected investment called MySuper. It is different and may not be best for you.

Mr Chun agreed that CFSIL regarded these statements to be potentially misleading.[396] Mr Chun also accepted that CFSIL was concerned that such statements may have influenced members to provide an investment direction and avoid transfer to the MySuper product because they 'might make a member think that it would be bad for them to transfer to MySuper'.[397] Mr Chun accepted that the communication was drafted in a way that may make the member fearful and influence them to make an election.[398] Not only that, the communication did not disclose the adviser's potential conflict of interest in relation to the receipt of trailing commission.[399]

Between 1 July 2013 and 30 June 2017, about 1,380 of this adviser's clients made an investment direction, the effect of which was that their accounts were not transferred to MySuper.[400]

In 2017, the financial adviser was identified by ASIC and notices were issued in respect of his conduct in late 2017.[401] On 26 July 2018, CFSIL took steps to seek information from Financial Wisdom in relation to the financial adviser. At the time of the hearings, the adviser had 'very recently' been suspended from providing intra-fund advice to the fund.[402]

Mr Chun said that CFSIL will require Financial Wisdom to refund the fees for intra-fund advice where advisers were not providing the relevant service to clients.[403] But the refund would not be returned to members. Mr Chun explained that he considered that 'the community would not expect [CSFIL] to be paying fees'. Asked whether 'the community would expect that

---

396 Transcript, Peter Chun, 15 August 2018, 4983.

397 Transcript, Peter Chun, 15 August 2018, 4983.

398 Transcript, Peter Chun, 15 August 2018, 4984.

399 Transcript, Peter Chun, 15 August 2018, 4983.

400 Transcript, Peter Chun, 15 August 2018, 4983.

401 Exhibit 5.432, Witness statement of Mark Ballantyne, 1 August 2018, 19 [102].

402 Transcript, Peter Chun, 15 August 2018, 4984.

403 Transcript, Peter Chun, 15 August 2018, 4984.

if [CFSIL] charged to members an administration fee, that includes the provision of intra-fund advice, and no intra-fund advice has been provided, that [CFSIL] would make some refund to the members', Mr Chun said he did not think this would be the case.[404]

2.3 What the case study showed

2.3.1 The MySuper transition

It is to be recalled that section 29WA of the SIS Act required RSE licensees to treat any contribution to the fund in relation to which no investment direction has been given as a contribution to be paid into a MySuper product of the fund. CFSIL did not do that in respect of contributions it received in relation to about 13,000 members of its FirstChoice Personal Super product. In both its notification to APRA and in its submissions to the Commission, CFSIL accepted that it had contravened the section. CFSIL also accepted that the conduct breached its obligations under section 912A(1)(c) of the Corporations Act and section 29E(1)(a) of the SIS Act.

I agree. CFSIL was right to make the acknowledgments it did.

In its written submissions CFSIL said that, at the relevant time, it held the view that all members of FirstChoice Personal were 'choice' members.[405] This is not what Ms Elkins said but, as I have noted, she said that she was not certain of her recollection of events. CFSIL rightly submitted that a mistake of fact was a defence available in respect of a contravention of section 29WA of the SIS Act,[406] but it accepted that a mistake would not excuse the breach of section 29E of that Act or section 912A(1)(c) of the Corporations Act.[407]

The evidence and submissions from CFSIL did not explain how or why management of CFSIL were unaware in 2013 of the difference between, on the one hand, an investment direction given by a member as to how amounts attributable to that member were to be invested and, on the other

404 Transcript, Peter Chun, 15 August 2018, 4985–6.

405 CFSIL and Avanteos, Module 5 Case Study Submission, 3–4 [10], 20 [53].

406 CFSIL and Avanteos, Module 5 Case Study Submission, 20 [53].

407 CFSIL and Avanteos, Module 5 Case Study Submission, 20 [55].

hand, a choice by a person as to the superannuation fund into which her or his contributions were to be paid. Nor did the evidence or submissions from CFSIL explain how CFSIL could have identified that there were ADAs in FirstChoice Personal but not understood that the relevant members were not ‘choice’ members. Those are matters that may suggest there was no reasonable basis for CFSIL to believe (mistakenly) that all members of FirstChoice Personal were ‘choice’ members. It may further be noted that CFSIL did not submit, and did not invite me to find, that the belief it held at the time was reasonable.

It is not clear to me that a belief about the application of the SIS Act would be a mistake of fact but I need not offer a concluded view. If holding this belief were to be regarded as a mistake of fact, it would then be important to notice that CFSIL was told that it was mistaken about the application of the Act during its meeting with APRA on 21 February 2014. It follows that, even if CFSIL did make a mistake, and if that mistake might be a defence to some contraventions, it could not be a defence after it became aware that its belief was mistaken. Yet CFSIL continued to receive default contributions that it did not attribute to an authorised MySuper product.

On the material available to me, I consider that CFSIL may have contravened section 29WA.

In respect of the transition of ADAs, it is to be remembered that the section required trustees to attribute default contributions to their MySuper product and to do so *by* 1 July 2017. In its submissions CFSIL said that ‘ADA balances were not required to be transferred until 1 July 2017’.[408] This submission puts unwarranted emphasis on the outer limit of the time for compliance. It implies that RSE licensees were entitled to wait until 30 June 2017 before complying. But that is a submission that does not take account of other obligations in the Act, including, among others, the trustee’s covenant to act in the best interests of members. Absent reason to the contrary, and none was identified, trustees were bound to transfer ADAs promptly. CFSIL did not.

---

[408] CFSIL and Avanteos, Module 5 Case Study Submission, 6 [16(b)].

APRA expressed concern about CFSIL's delay in transitioning certain cohorts of ADAs. I have no reason to doubt that APRA's concern was well-founded. In the circumstances, I consider that the failure to transfer at least those cohorts of ADAs identified by APRA might have breached CFSIL's covenants, including its duty to act in the best interests of the affected members, and constitute misconduct.

These matters having already been reported to APRA, it is a matter for it to decide what, if any, further action should be taken.

I also consider that the communications from CFSIL to affected members in respect of the section 29WA breach might also constitute misconduct. CFSIL rejected characterisation of the communications as 'misleading'. Ms Elkins accepted that characterisation but, in its written submissions, CFSIL argued that the communications must be considered in the context[409] and were to be understood as reflecting the belief that the relevant members were 'truly "choice" members'.[410]

CFSIL's communications to members said that the legislation had changed and that CFSIL must have an investment direction from the member. There was no relevant difference in this respect between, the telephone script and the template letter. APRA submitted that the script gives an incomplete picture of the courses of action (or inaction) open to the member.[411] I agree. The focus of the communications was on keeping members in their existing investment option. The words used may be found to have conveyed to the member that the member was required to take steps to achieve that outcome. I consider that the communications to members might have breached CFSIL's covenant to act in their best interests. They also departed from community standards or expectations. The community expects trustees to communicate with members clearly and transparently. The script and template did not do this.

This issue has not so far been drawn to the attention of ASIC. I will refer the matter to it so it can consider whether to take action.

409 CFSIL and Avanteos, Module 5 Case Study Submission, 22 [58].

410 CFSIL and Avanteos, Module 5 Case Study Submission, 5 [14].

411 APRA, Module 5 Case Study Submission, 11–12 [50]–[51].

2.3.2 Fees for no service

When Avanteos reported to ASIC and APRA that it had taken fees for no service, its breach notifications said that Avanteos had breached:

- Section 29E(1)(a) and 52(2)(b) of the SIS Act;
- Regulation 5.08 and 6.21 of the SIS Regulations; and
- Sections 912A(1)(a) and (c) of the Corporations Act.

Ms Elkins said that Avanteos formed the view that it had breached these provisions by way of of a lack of disclosure in relevant disclosure documents.[412] I consider the better view to be that, whatever may have been said or not said in disclosure documents, the charging of ASFs to deceased member accounts when CFSIL had been told that the member had died is the conduct that might constitute breach of the identified provisions. Once Avanteos knew that the member had died, it knew that no services then could be or would be provided to warrant the fee.

As Avanteos was aware of this issue from late 2015 or early 2016 and took no steps at that stage to notify ASIC or APRA, it is also likely to have been in breach of the reporting requirements of section 912D of the Corporations Act. The evidence was that Avanteos itself formed the view that it had contravened the section.[413] I see no reason to disagree with that view. The matters having been reported to the regulators, it is for them to decide what, if any, further action should be taken.

2.3.3 Grandfathering commissions

As explained earlier, two issues about grandfathering arrangements were examined in connection with CFSIL. One concerned CFSIL retaining trailing commissions charged to members who either no longer had any adviser linked to their account, or whose linked adviser was not the adviser who had initially charged the commission or fees. The other arose out of the making and subsequent disallowance of regulations that affected the application of the grandfathering provisions to commissions paid in connection with

412 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [15].

413 Exhibit 5.182, Witness statement of Linda Elkins, 7 August 2018, 3 [16].

members who had joined a fund before 1 July 2014, but had elected, after that date, to receive a pension from the fund. That is, it related to commissions charged to members who had moved from 'accumulation' to 'pension' after 1 July 2014.

CFSIL did not accept that its conduct in respect of these commissions amounted to misconduct.[414] In respect of its own retention of commissions, CFSIL accepted that such conduct may have fallen short of community standards and expectations, but submitted that it was legally permitted to retain those because the relevant trust deed permitted it to charge fees and to use and apply those fees at its discretion upon their receipt.[415] In respect of the grandfathering of commissions for members switching from accumulation to pension, CFSIL submitted that it worked with the regulator to try to understand the complex regime of regulations and to act in a manner consistent with them.[416]

Even accepting those submissions, the question remains whether a trustee acting in the best interests of its members would continue to deduct grandfathered commissions from the accounts of members in the circumstances in which CFSIL did? CFSIL's written submissions set out six matters 'by way of example of the complex considerations that arise in determining whether a trustee has complied [with] its duty to act in the best interests of members'.[417] The matters identified ranged from having regard to the superannuation context to the decision-making process. But ultimately, what the best interests covenant requires will depend on the circumstances.[418] CFSIL's written submissions acknowledged this.[419] In the case of grandfathered commissions, it is necessary to begin by recognising not only that commission payments reduce members' benefits, but also that no service or other benefit is provided to the member in return for the payment. Other considerations, if relevant, must be understood in the light of these facts. The deduction of commissions, and retention of them

---

414 CFSIL and Avanteos, Module 5 Case Study Submission, 26 [69], 27 [73].

415 CFSIL and Avanteos, Module 5 Case Study Submission, 27 [72].

416 CFSIL and Avanteos, Module 5 Case Study Submission, 26 [69], 27 [73].

417 CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

418 See *Cowan v Scargill* [1985] Ch 270, 287–8; *Finch v Telstra Super Pty Ltd* (2010) 242 CLR 254, 270–1 [32]–[33].

419 CFSIL and Avanteos, Module 5 Case Study Submission, 17 [50(c)].

where there is no linked adviser, even if legally permissible, was not in the best interests of members. As stated earlier, the best interests of the beneficiaries are normally their best financial interests.[420] CFSIL did not contend that members obtained any benefit from the commissions that were deducted and retained from their accounts by CFSIL. Regarding the deduction of commissions in respect of members who switched from accumulation to pension, I consider that this also was not in the best interests of members. Again, neither CFSIL (nor any RSE licensee) sought to explain how extending the grandfathering provisions in this way, and the continued deduction of commissions from those members' accounts, would benefit members. The matter not having been reported to APRA, I will refer CFSIL's conduct in deducting commissions to APRA for its consideration of whether there is action it can and should take.

It remains for something to be said about CBA's lobbying in respect of the extension of the grandfathering provisions. In its written submissions, CFSIL accepted that in meeting with Treasury officials and others in 2013 to lobby for the extension of the grandfathering provisions in respect of members who switched from superannuation (accumulation) to pension, it may have failed to meet current community standards and expectations.[421] I agree. The community is entitled to expect that RSE licensees will not lobby for outcomes that are contrary to the financial interests of their members.

2.3.4 Misconduct in respect of distribution through CBA branches

The distribution of Essential Super through CBA branches was conduct that might have amounted to the provision of personal advice to retail clients. If it did, the requirements prescribed by division 3 of part 7.7 of the Corporations Act prescribing additional requirements for personal advice provided to a retail client were not met and the failure to meet those requirements was misconduct.

The premise for distributing Essential Super through the CBA branch network was that the product could be sold without providing personal

420 *Cowan v Scargill* [1985] Ch 270, 286–7.

421 CFSIL and Avanteos, Module 5 Case Study Submission, 35 [102].

advice. The model, as initially presented to ASIC, was that branch staff would seek to create an 'interest' in the customer for the product. And branch staff would do this in circumstances that included, but were not limited to, completing a 'financial health check' designed to identify the customer's 'needs'. The premise for saying that a branch staff member moving from a financial health check that focused on the particular circumstances of the customer to discussing Essential Super would not be providing personal advice, was that the staff member would give the customer a 'general advice warning'. That is, that the advice would not be 'personal' if the staff member told the customer 'I can give you general advice about Simple Super … I won't be able to give you personal advice. You will need to decide if this product is suitable for you.'[422]

It may readily be accepted that the line between personal advice and general advice may not always be marked clearly or easily. But one important feature of the distinction drawn by the Corporations Act between personal advice and general advice is whether the advice has been prepared without 'taking account of the client's objectives, financial situation or needs'.[423] Personal advice is given where the adviser has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters.[424] The central purpose of the general advice warning that staff members were supposed to offer was to mark a boundary between what had been said and done and what was about to be said so that personal advice was not given.[425] More precisely it was to convey to the customer that whatever you, the customer, have just told me, the staff member, is entirely irrelevant to me and will wholly be ignored by me when I tell you what I am about to say. But why would the customer believe that? Why would the customer think that, having learned about at least some aspects of the customer's objectives, financial situation or needs, the staff member would go on to tell the customer about a product that was not suitable to whatever objectives, situation or needs had been revealed?

422 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-20 [CBA.0517.0176.2000 at .2011].

423 Corporations Act s 949A(2)(a).

424 Corporations Act s 766B(3).

425 The warning was also required by the Corporations Act, s 949A.

CFSIL's submissions acknowledged the risks in the branch sales model.[426] It submitted, however, that it was 'utterly transparent with the regulator' about those risks[427] and having identified them, it adopted a risk management process. CFSIL also submitted that it took immediate action to redress non-compliance identified by the mystery shopper exercises and to revise and strengthen compliance controls.[428]

While I accept that ASIC did not take issue with the distribution model before it was implemented, once ASIC had told CBA and CFSIL that it considered the law had been contravened, there could be no doubt that CBA and CFSIL had to reconsider their position. I think the better view of the evidence is that both CBA and CFSIL knew that selling superannuation in the branches was commercially desirable for both but that both also knew, from the outset, that it was legally difficult. But even if that is not right, utter transparency with the regulator, however much it is and must be applauded and encouraged, does not excuse non-compliance with the law. And I did not understand CBA or CFSIL to suggest that it did, whether in this case or more generally.

As I have noted above, ASIC told CBA in February 2017, that it suspected that branch staff employed by CBA had been providing personal advice giving rise to contraventions by CBA of a number of provisions of the Corporations Act, including sections 961B, 961K, 961L, 952C(1) and 912A(1). ASIC also told CBA that it suspected that CBA had contravened its general obligation under section 912A(1)(a). I have no reason to doubt ASIC's concerns. ASIC's concerns that **financial product** advice in connection with Essential Super was given in close proximity to a financial health check was acknowledged by CBA in the EU given to ASIC on 3 July 2018.[429]

---

426 CFSIL and Avanteos, Module 5 Case Study Submission, 30–1 [84].

427 CFSIL and Avanteos, Module 5 Case Study Submission, 30–1 [84].

428 CFSIL and Avanteos, Module 5 Case Study Submission, 31 [85]–[86].

429 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-34 [ASIC.0041.0001.4378 at .4382].

I consider that CBA might have breached the provisions set out above and set out in the undertaking.[430] If it did, its conduct was misconduct. As ASIC has accepted an EU from CBA in respect of its concerns, there is now no reason to refer these matters to ASIC.

Counsel Assisting made a further contention in respect of the distribution arrangement between CBA and CFSIL. They submitted that the payments made pursuant to the Distribution Agreement may have contravened the conflicted remuneration provisions of the Corporations Act. The submission was that the benefit provided to CBA (an Australian financial services licensee) of 30% of the annual total net revenue earned by the trustee in relation to the fund could reasonably be expected to influence the financial product advice given by CBA to retail clients in the branches. Counsel Assisting further noted that:

- Customers of CBA who were offered the Essential Super product in branches were 'retail clients'.[431]
- CBA branch staff were providing 'financial product advice' to customers in the form of a recommendation intended to influence the client to make a decision in relation to a particular financial product (Essential Super).[432] 'General advice' is financial product advice that is not 'personal advice'.[433]
- The distribution model involved general advice being provided by branch staff. This was acknowledged by Mr Chun in his evidence[434] and by CBA in its response to ASIC's position paper.[435] Indeed, this was the reason why a general advice warning was necessary and why CBA staff underwent a course called 'General Advice in Superannuation'.

---

430 The provisions acknowledged in the EU are Corporations Act ss 912A(1)(c), 946A, 961K and 961L.

431 Corporations Act s 761G(6).

432 Corporations Act s 766B(1).

433 Corporations Act s 766B(4).

434 Transcript, Peter Chun, 15 August 2018, 4989.

435 Exhibit 5.421, 17 March 2017, CBA Response to ASIC Position Paper [ASIC.0041.0001.5339 at .5345–.5346].

- The fee provided to CBA under the Distribution Agreement could reasonably be expected to influence the choice of the product recommended by branch staff to retail clients or the financial product advice given to retail clients. The Distribution Agreement was premised on this.

It was not apparent from the evidence that ASIC was told of the revenue-sharing arrangements underpinning CBA's branch sales model. Nor did ASIC provide any submissions to the Commission that might clarify its position on this topic.

CBA and CFSIL submitted that the fee arrangement in the Distribution Agreement could not reasonably be expected to influence either the choice of product recommended by CBA branch staff or the advice given.[436] They submitted that branch staff were not 'directly' rewarded for sales of Essential Super and their incentives were determined on the basis of a balanced scorecard.[437] They also said that the revenue-sharing arrangement was not designed to incentivise CBA to sell Essential Super, but to approximate its share of the costs.[438] For these reasons, they submitted that the fee arrangement was not properly characterised as conflicted remuneration.[439]

It is to be remembered that the Distribution Agreement required CBA to use its branches to distribute Essential Super.[440] In return for that service, and others, CBA was to receive 30% of the revenue earned by the trustee in relation to the fund in the relevant financial year. It follows that the greater the volume of sales of the product, the more revenue CBA would receive. In this way, it could reasonably be expected to influence which product branch staff were trained and told to recommend and the financial product advice given to retail clients. Indeed, it would be surprising if it did not have this effect.

436 CFSIL and Avanteos, Module 5 Case Study Submission, 33 [92].

437 CFSIL and Avanteos, Module 5 Case Study Submission, 33 [93].

438 CFSIL and Avanteos, Module 5 Case Study Submission, 33–4 [94].

439 CFSIL and Avanteos, Module 5 Case Study Submission, 34 [95].

440 Exhibit 5.232, Witness statement of Peter Chun, 31 July 2018, Exhibit PC-1 [CBA.0001.0398.3229 at .3239, .3258].

In my view, the payments to CBA may have contravened the conflicted remuneration provisions of the Act applicable to both CBA (section 963E) and CFSIL (section 963K). As these matters were not the subject of the EU provided by CBA to ASIC, and ASIC is the entity with primary responsibility for enforcement of the relevant provisions, it is appropriate that, pursuant to paragraph (a) of the Commission's Terms of Reference, I refer the conduct to ASIC for its consideration.[441]

2.3.5 Cash investments

In its written submissions, CFSIL accepted that differences in cash investment returns are attributable to the differences in fee structures across different products.[442] It submitted that this was not a consequence of CFSIL having intentionally applied a preferential fee structure for CBA staff.[443] Rather, it said a key reason for the difference was that commissions were payable on legacy products that it said are now closed and that, to the extent that grandfathered commissions are included in the fee, CFSIL continued to be contractually obliged to pay.[444]

CFSIL did not point to evidence showing that it had a contractual obligation to continue to pay grandfathered commission. However, even if that is assumed to be true, it would be surprising if CFSIL was unable to take steps to alter its commission arrangements with advisers or for legacy products. At the time of the Commission's inquiries, CFSIL had not taken those steps. Indeed, the evidence was that it had not turned its mind to it until June 2018. I repeat what I have said elsewhere in respect of commissions and grandfathering and the trustee's conduct in that regard. That is, the charging of grandfathered commissions was not in the best interests of members and there was no suggestion by CFSIL that it was.

441 Corporations Act s 1315.

442 CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

443 CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

444 CFSIL and Avanteos, Module 5 Case Study Submission, 12–13 [36].

2.3.6 Related parties

In its written submissions regarding the arrangements with Asset Management, CFSIL referred to the conflicts management framework that it applied in connection with related party transactions, the structure of its board, the use of separate teams, and disclosures in respect of related party transactions.[445] It pointed to the ChantWest benchmarking report and said that this enhanced CFSIL's position in its negotiations and confirmed the need to take an arm's length approach.[446] It also referred to evidence[447] that CFSIL had decided to appoint other external investment managers, instead of Asset Management, after that company announced in 2018 the closure of its 'Australian equities core' and 'global resource investment' capabilities.[448]

In respect of CommInsure, CFSIL submitted that the suitability of CommInsure's product for members depended not only on the rate of premium charged, but also on other terms and conditions.[449] Yet, even if management did consider more than premium rates, there was no evidence of the fruits of this consideration having been put before the board.[450] CFSIL also pointed to evidence of discussions by the CFSIL Board about whether to continue to use CommInsure and referred to steps taken to ensure the arrangements in place with CommInsure were in members' best interests after the media reports concerning CommInsure's conduct in 2016.[451]

Retention of a service provider is an exercise of the trustee's powers which the covenant in section 52(2)(c) of the SIS Act requires to be done in the best interests of members. In circumstances where third party reviews have revealed deficiencies in the services provided, the trustee has a duty to consider that information and, if necessary, to take steps to ensure those deficiencies are addressed. It is difficult to express a concluded

445 CFSIL and Avanteos, Module 5 Case Study Submission, 13 [41].

446 CFSIL and Avanteos, Module 5 Case Study Submission, 13 [39].

447 CFSIL and Avanteos, Module 5 Case Study Submission, 13 [40].

448 Exhibit 5.181, Witness statement of Linda Elkins, 30 July 2018, 28 [115]–[118].

449 CFSIL and Avanteos, Module 5 Case Study Submission, 14 [42].

450 Exhibit 5.438, 2 September 2016, 00 CFSIL Board Pack 020916.pdf, 6.

451 CFSIL and Avanteos, Module 5 Case Study Submission, 14–15 [44]–[45].

view on the available evidence that CFSIL ought to have taken steps to terminate the contracts with Asset Management or CommInsure or that CFSIL breached any of its covenants.

2.3.7 Intra-fund advice

In relation to the conduct summarised regarding intra-fund advice and the financial adviser authorised by Financial Wisdom Limited, I am satisfied (as CSFIL accepts)[452] that CSFIL engaged in conduct that fell below community standards and expectations by failing to:

- bring to the attention of ADA members that their advisers may have had a relevant conflict of interest in relation to an election to a product from which they would continue to receive trail commissions;
- ask advisers to identify that conflict of interest in their communications with clients; and
- act sooner to investigate the relevant adviser's interactions regarding ADA members.

The conduct in relation to intra-fund advice and the financial adviser authorised by Financial Wisdom Limited demonstrates the potential adverse effect of a conflict between an adviser's interest in maintaining (or obtaining) a financial benefit and the duty to his or her client. Here, it may have led to adverse outcomes for some 1,380 clients of the relevant financial adviser. Other case studies demonstrate similar conflicts and their potential for harm. I return to this issue later in the Report.

2.3.8 Conclusion

One broad theme ran throughout each part of this case study: for each way in which the trustees' conduct was examined, their conduct appeared to be calculated to generate or retain, or weighted in favour of generating or retaining, fees from members, for the trustee's or a related party's own use, in circumstances where that generation or retention was not in members' best interests.

---

[452] CBA, Module 5 Case Study Submission, 41 [126]; see also, Exhibit 5.234, Witness statement of Peter Chun, 12 August 2018, 28–9 [115]–[116].

Within this theme, two points can be made.

First, the trustees' conduct points to a lack of willingness to intervene to prevent or cease conduct that is not in their members' best interests. It points to an unwillingness to recognise the seriousness of the conduct and its effects on the members of their funds. This is particularly stark when considering that consumers are unlikely to identify the conduct, or the harm that it may have caused them. In the case of those members whose contributions were not directed to a MySuper product, those members may not have been aware of that statutory requirement. And they would not know, or expect, that what they were told – by their trustee – about why they should give an investment direction was potentially inaccurate and might disadvantage them, but would advantage the financial advisers who would continue to receive commissions. And, in the case of deceased members who continued to be charged fees, the families of those members were unlikely to be in a position to realise that fees for advice to their deceased relative continued to be deducted.

Second, the regulator's response to the conduct engaged in by the trustees did not seek to address the underlying causes of the problem. Although APRA engaged with the trustees to varying degrees about their conduct, that engagement could be understood as APRA simply managing the conduct, and, in doing so, managing it on the trustees' terms, rather than requiring compliance with the standards and obligations that are imposed on those trustees under statute. The consequences of harm to members flowing from such a regulatory response are seen when considering APRA's regulatory response to the MySuper transition – a response that did not deal directly with the interests of vulnerable members: the default members.

These two points suggest that conflicts for retail trustees, and the resolution of those conflicts in favour of the interests of the retail group rather than the consumer, may be treated by trustees and regulators as unexceptional and, when they are discovered, are treated as part of the ordinary machinery of business. If that is right, it must change. Both retail trustees and regulators must regard, and demonstrate that they regard these failures as unacceptable – as reflecting a fundamental failure of the trustee to carry out its fiduciary duty to the members. If there is such a failure it must bring serious consequences for the trustees and those involved in the contraventions.

3 AMP

3.1 Background

AMP Superannuation Limited (ASL) and NM Superannuation Proprietary Limited (NM) are both within the group of companies for which AMP Limited is the ultimate holding company. The case study examined the way in which, and extent to which, ASL and NM were able to discharge their duties as trustees of their respective funds in light of their arrangements with, and membership of, the AMP Group.

3.2 Evidence

3.2.1 AMP superannuation funds

ASL and NM have common boards of directors, and the boards operate concurrently.[453]

Between them, ASL and NM are responsible for eight superannuation funds.[454] At August 2018, those funds had approximately $120 billion in funds under management.[455] At the date of the hearings, this was the second largest pool of superannuation funds under management in Australia.

453 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 6 [25].

454 AMP, Module 5 Case Study Submission, 1 [2]. ASL is the trustee of AMP Superannuation Savings Trust (SST), AMP Retirement Trust (ART) and AMP Eligible Rollover Fund. The AMP Eligible Rollover Fund was not relevant to the case study. NM is the trustee of National Mutual Pro-Super Fund (PSD), National Mutual Retirement Fund (NMRF), Super Directions Fund (SDF), Wealth Personal Superannuation and Pension Fund (Wealth) and The Retirement Plan (TRP): Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 4 [17]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 4 [17]. The members and assets of TRP were transferred by SFT to Wealth by 30 June 2018: Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [18].

455 AMP, Module 5 Case Study Submission, 1 [2].

Mr Richard Allert, the Chairman and a non-executive director of both ASL and NM,[456] gave evidence to the Commission. The Commission also heard evidence from Ms Rachel Sansom, the Director of Regulatory Governance within the AMP Group. Regulatory Governance was described as the part of the AMP Group that provides trustee services to ASL and NM.[457]

3.2.2 Outsourcing arrangements

The trust deed of each AMP superannuation fund permits the trustee (ASL or NM) to delegate any of its powers, duties and discretions to any person.[458]

Both ASL and NM have made arrangements by which they delegate the day-to-day operation and administration of their funds to related parties within the AMP Group.[459]

---

456 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 2 [1]–[2]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 2 [1]–[2].

457 Regulatory Governance assists the AMP trustees to operate in compliance with their regulatory, fiduciary and licensing obligations, and also assists the Group Investment Committee: Transcript, Rachel Sansom, 16 August 2018, 5108–10; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 2 [1], 4 [15].

458 For ASL, see Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0139.0071 at .0103, cl 10.7]; Exhibit 5.268, Witness statement of Richard Allert (5-34), 1 August 2018, Exhibit RHA-3 [AMP.6000.0174.0044 at .0079, cl 10.8]. For NM, see Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0145.3402 at .3414, cl 6(e)]; [AMP.6000.0145.1891 at .1960, cl 28]; [AMP.6000.0145.2623 at .2716, cl 21.3]; [AMP.6000.0145.2998 at .3030–.3031, cl 20]; [AMP.6000.0145.3070 at .3107, cl 15].

459 AMP, Module 5 Case Study Submission, 1 [6]; Transcript, Richard Allert, 16 August 2018, 5071–2; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [22]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 5 [20].

The arrangements encompass all functions and powers of the relevant trustee, from the collection of funds and the administration of the trusts, to decisions about making investment management agreements.[460]

ASL outsources its functions to AMP Life Limited (AMP Life).[461] AMP Life owns 100% of the shares in ASL.[462] In practical terms, AMP Life operates the two[463] superannuation funds of which ASL is the trustee.

AMP Life provides, among other things, administration services,[464] internal audit services,[465] insurance administration services[466] and investment management services.[467] AMP Life is responsible for preparing product disclosure statements (PDSs) for all of the products offered through the funds of which ASL is the trustee. AMP Life prepares and distributes all new products offered by ASL. It prepares and maintains the product dashboards and other online disclosure material required to be provided by ASL.[468]

460 Transcript, Richard Allert, 16 August 2018, 5075; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100].

461 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0156.1605].

462 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 6 [24(b)].

463 ASL is also trustee of another fund that was not relevant to the case study, the AMP Eligible Rollover Fund, which AMP Life also administers. The case study was concerned only with the trustees' regulated superannuation funds, as defined in SIS Act s 19.

464 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6515 Sched 1 cl 1.1].

465 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6521 Sched 1 cl 1.8].

466 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6523 Sched 1 cl 1.9].

467 Exhibit 5.267, Witness statement of Richard Allert (5–15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6493 cl 8, .6526 Sched 1 cl 2.1].

468 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6515 Sched 1 cl 1.1].

AMP Life (not ASL) is identified as the entity to be contacted on the PDS.[469] AMP Life prepares any breach reports that ASL submits to the regulator.[470]

AMP Life has outsourced its provision of investment management services to AMP Capital Investors Limited (AMP Capital)[471] and some administration services to AMP Services Limited (AMP Services).[472] Both AMP Capital and AMP Services are companies within the AMP Group.

NM is the trustee of five funds. For three of those funds, NM has outsourced its functions to AMP Life.[473] AMP Life holds 100% of the shares in NM.[474]

469 See, eg, the PDS of the AMP Flexible Super product of ART, a fund for which ASL is trustee: Exhibit 5.433, 8 March 2018, AFS-Fact-Sheet-Getting-to-know-your-AFS.pdf, 60.

470 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6520 Sched 1 cl 1.5(b)].

471 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 42 [192]; Exhibit 5.268, Witness statement of Richard Allert (5-34), 1 August 2018, 47 [200]. This arrangement is, relevantly in respect of the MySuper products offered through the ASL funds, governed by an investment management agreement: Transcript, Richard Allert, 16 August 2018, 5072; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 27 [93]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0178.3313]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283].

472 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 5 [20]. This arrangement is contained in the Master Outsourcing Agreement, and ASL also receives resources from AMP Services pursuant to the Master Resourcing Agreement: Exhibit 5.268, Witness statement of Richard Allert (5-34), 25 July 2018, Exhibit RHA-3 [AMP.6000.0125.0252].

473 These are SDF, NMRF and PSD. The arrangement is governed by an Administration Deed: Exhibit 5.265, Witness statement of Richard Allert (5-06), 5 [22]; Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272].

474 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 6 [26].

AMP Life has, again, in turn outsourced the investment management services for these funds to AMP Capital.[475]

For its two other funds, NM has outsourced its functions to NMMT Limited (NMMT).[476] NMMT is another entity within the AMP Group.

The arrangements that have been described are recorded in various agreements between ASL and NM and the relevant AMP entities. But AMP's submissions proceeded from the premise that the apparent generality of those agreements must be understood in the light of the 'Fund Governance Charter' tendered in evidence.[477] The legal character of this document was not explored during the hearings but, in general terms, it describes how ASL and NM are to act as trustees of their respective funds. Its overall tenor is that ASL and NM remain ultimately responsible for the sound and prudent management of their funds, and that the primary role of each is to ensure that there are appropriate governance practices in place for each fund.[478]

The Fund Governance Charter does no more than state what would otherwise be the legal position – that is, it adds nothing to the effect of the trustees' agreements and their obligations under legislation and the general law. Given that all of ASL's and NM's outsourcing arrangements are made only with other entities within the AMP Group, the Charter may be taken

475 Transcript, Richard Allert, 16 August 2018, 5072; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 27 [93]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0178.3313]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283].

476 Being Wealth and TRP (before 30 June 2018). The arrangement is governed by an Agency Agreement: Transcript, Richard Allert, 16 August 2018, 5072–3; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0283]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100].

477 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001].

478 AMP, Module 5 Case Study Submission, 1–2 [6]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001 at .0005, cl 1.1]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

as recognition, within the AMP Group, that ASL's and NM's outsourcing arrangements do not change the position that both are ultimately responsible for their respective funds.

The Fund Governance Charter lists some matters that are reserved to the boards of ASL and NM that cannot be delegated. They include approval of the trustee's business plan, approval of amendments to the trust deeds and policies, approval of the trustee's investment policies and financial statements, and the approval of new financial products to be issued from a fund.[479] But the Charter does not reserve to the boards of ASL or NM decisions about pricing of the products offered by the trustees.

3.2.3 Products offered and fees charged to members

ASL and NM each offer, or have offered, within their funds a large number of 'choice' products – as noted earlier, these are products in respect of which the member has made a choice as to their superannuation investment. Those products are variously open or closed to new members, or open to new members but restricted to employees of existing corporate plans.[480]

Members of ASL's and NM's respective funds are charged various fees.

A member invested in a choice product is charged direct fees against the cash balance in the member's account. Those fees appear on the member's statement as contribution fees, member fees and insurance premiums.[481] Choice members are also charged indirect fees, by deduction from the member's investment return before that return is credited to their account. Those indirect fees include what are described as 'other' fees – such as investment fees, administration fees and transaction cost fees (or buy–sell

479 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0212.0001 at .0022, Sched 1].

480 For a full list of the products offered by the trustees as at December 2017, see the table in Appendix 1 in Exhibit 5.289, 22 November 2017, ASL and NM Board Papers 6 December 2017, 99.

481 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0213.0016 at .0021–.0022].

spread fees)[482] – as well as other indirect fees that reduce the return on the investment but are not specifically identified in the member's statement.[483] Some members are also charged ongoing advice fees.[484]

In addition to the choice products, ASL also offers two MySuper products[485] and NM offers one.[486] Like choice members, MySuper members are also charged direct and indirect costs. The direct costs may appear on the member's statement as a MySuper member fee and as insurance premiums.[487] Members who hold a MySuper product and a choice product are charged both a MySuper member fee, and a choice member fee.[488]

3.2.4 Fees under outsourcing arrangements

In general terms, the related company to which the trustee has outsourced the day-to-day administration of the fund (either AMP Life or NMMT) receives all of the amounts charged to members as fees and retains the balance after expenses. That is, AMP Life and NMMT retain the margins of ASL's and NM's superannuation businesses.[489]

482 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0204.2380 at .2383].

483 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0213.0016 at .0021–.0022].

484 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0214.0018 at .0019], [AMP.6000.0162.0225 at .0226].

485 Through ART and SST: see Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 129.

486 Through SDF: see Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 129.

487 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0188.0065 at .0067].

488 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0188.0065 at .0067].

489 Transcript, Richard Allert, 16 August 2018, 5079; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104.

AMP Life receives all fees charged to members of the ASL funds in exchange for its administration services.[490] For the financial year ended 30 June 2017, the fees paid to AMP Life across ASL's (relevant) funds were approximately $253 million.[491]

Similarly, AMP Life collects all of the fees charged to members of the three NM funds of which AMP Life is the administrator,[492] and NMMT collects the fees and charges owed by members of the two funds of which it is administrator.[493]

AMP Life pays fees to ASL and NM in consideration for them acting as trustees of their respective funds.

Under the outsourcing arrangements, AMP Life must pay ASL a 'Trustee Services Fee' in 'consideration for ASL acting as trustee' of ASL's funds.[494]

490 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0156.1605, cl 7.1].

491 For ART, it was $111,525,000: see Exhibit 6.486, 3 October 2017, [SIGNED] ART Financial Report 30 June 2017 Final 20170927.pdf, 15. For SST, it was $141,390,000: see Exhibit 5.434, 3 October 2017, [SIGNED] SST Financial Report 30 June 2017 Final 20170927.pdf, 21.

492 See the Administration Deed between NMLA and NM: Exhibit 5.265, Witness statement of Richard Allert (5-06), Exhibit RHA-1 [AMP.6000.0125.0272 at .0293, cl 8.1]. NMLA novated its rights under the Administration Deed to AMP Life on 1 January 2017: see Exhibit 5.435, 3 October 2017, [SIGNED] SDF Financial Report 30 June 2017 Final 20170927.pdf, 16.

493 Transcript, Richard Allert, 16 August 2018, 5076, 5080–1; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0100, Annexure C, cl 1].

494 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6492 cl 7.1(b)]; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0261, cl 5].

ASL then pays that fee to AMP Services for providing services to ASL.[495] That fee is paid to AMP Services 'to cover the costs of providing trustee services and to enable Trustee Services to execute its obligations under the trust deeds'.[496] The same arrangements exist between NM and AMP Life and AMP Services.[497]

For the year ended 31 December 2017, AMP Life paid ASL trustee services fees of $5.878 million, and ASL paid AMP Services fees of $5.331 million.[498] For the year ended 31 December 2017, AMP Life paid NM trustee services fees of $1.187 million,[499] and NM paid AMP Services fees of $1.065 million.[500]

495 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]; Exhibit 5.269, August 2017, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0262, cl 7].

496 See Exhibit 5.269, Board pack of meeting held on 16 August 2017, 4.

497 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 52 [227]; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 105–6; Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements.

498 Exhibit 5.268, Witness statement of Richard Allert (5-15), 25 July 2018, 41 [188]. The trustee services fee paid by AMP Life to ASL is calculated on the basis of $2.17 per member per annum, and the fee paid by ASL to AMP Services is calculated on the basis of $1.96 per member per annum: Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 104–5; Exhibit 5.268, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0125.0252 at .0269, Sched A].

499 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 52 [227]. This fee was previously a fixed amount of $1 million per annum, but since 1 January 2017, the amount paid by AMP Life to NM has been $2.16 per member per annum in line with ASL: see Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106.

500 Exhibit 5.265, Witness statement of Richard Allert (5-06), 53 [227]. This fee was previously a fixed amount of $1.32 million per annum, but since 1 January 2017, it has been $1.96 per member per annum in line with ASL: see Exhibit 5.361, 11 December 2017, Side Letter – Fee Arrangements; Exhibit 5.269, Board Pack of Meeting Held on 16 August 2017, 106.

3.2.5 Consequences of outsourcing arrangements

What were the consequences of ASL and NM delegating the day-to-day administration of their funds to other entities in the AMP Group? How did the trustees monitor what was done? How did they decide whether the members of their respective funds received value for what was paid to the other entities?

It is useful to answer those questions by first describing the general arrangements in place to monitor performance by the related entity and then considering some particular issues that emerged in connection with: performance of cash investments, performance of MySuper products, the trustees' arrangements in relation to distribution of their products, indirect costs, transition to MySuper, decisions as to pricing of the trustees' products and termination of the trustees' outsourcing arrangements.

3.2.6 Monitoring of outsourcing arrangements

The formal, and primary, way in which the trustees monitor their outsourcing arrangements is through the Business Monitoring Model (BMM).[501]

Trustee Services

Trustee Services, an administrative and governance function within the AMP Group, is responsible for assisting the trustee boards with the day-to-day monitoring and oversight set out in the BMM.[502]

The BMM approved on 15 March 2018 said that the trustee boards' successful discharge of their obligations in relation to 'monitoring and oversight of each Trustee's business operations [relied] on successful implementation of the BMM *by Trustee Services*'.[503]

---

501 AMP, Module 5 Case Study Submission, 3 [14]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 5 [23]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552].

502 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 5 [23]; Transcript, Rachel Sansom, 16 August 2018, 5109.

503 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553] (emphasis added).

Operation of the Business Monitoring Model

The BMM framework has a number of parts: preparation of quarterly reports, stakeholder meetings – being meetings between Trustee Services (or Regulatory Governance) and senior staff such as directors or the heads of particular departments or teams within AMP – and reporting to the board.[504] More specifically, the BMM has operated as follows.

First, Trustee Services receives quarterly reports from six areas of the trustees' business operations: finance, product management, risk management and compliance, operations, investment management and insurance.[505]

The reports are designed so that Trustee Services receives reporting from the heads of the relevant business area on that business area's compliance with the trustees' legal and regulatory obligations and performance of contractual obligations.[506] Any incidents of non-compliance are identified as 'exceptions' in the report.[507] Exceptions are identified according to an exceptions framework, which contains criteria that are developed by reference to the trustees' legal and regulatory obligations, the contractual obligations of the trustees' outsourced service providers and the performance metrics under the outsourcing arrangements.[508]

Second, Trustee Services reviews the reports and meets with the directors or heads of the relevant business area at 'stakeholder' meetings.[509]

504 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 56 [247].

505 AMP, Module 5 Case Study Submission, 3 [14(a)]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

506 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553–.0555].

507 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

508 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0556].

509 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, 56 [247]; AMP, Module 5 Case Study Submission, 3 [14(b)-(c)]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

Any identified exceptions that require escalation to the trustee boards are discussed at those meetings.[510] The BMM does not require all exceptions to be reported to the trustee boards – only those that are agreed at the meeting as those that should be brought to their attention.[511] The reports contain the exceptions criteria that identify an exception, and the circumstances in which an exceptions report is prepared.[512]

Third, Trustee Services prepares reports for the trustee boards that, among other things, detail any exceptions that are required to be reported and any other material information that Trustee Services considers should be brought to the attention of the board.[513]

Last, Trustee Services presents the report to the trustee boards.[514] Mr Allert said that, where an exception is identified, the 'part of the business [responsible for the exception] comes to the board meeting and explains what has happened and what they're doing about it'.[515]

The BMM recognises that the AMP trustee boards need to remain 'properly informed about the [trustees'] activities and monitor the [trustees'] affairs and policies' to ensure that they discharge their trustee and individual director duties.[516] The BMM says that it is important that the reporting

---

510 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

511 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

512 Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

513 AMP, Module 5 Case Study Submission, 4 [14(e)].

514 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

515 Transcript, Richard Allert, 16 August 2018, 5082; see also AMP, Module 5 Case Study Submission, 4 [14(e)].

516 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

structure and exceptions criteria for each business report ensure that this can be achieved.[517]

Exceptions criteria for underperformance

One example of the exceptions criteria relevant to underperformance of the investments of the trustees was put to Mr Allert. These criteria were set out in the quarterly investment management report prepared by the AMP Investment Committee under the BMM in August 2016.[518]

The report explained that the 'Trustee Exceptions Criteria' proceeded by three steps or 'phases': identification, further investigation of investments identified, and creation of an exceptions list. For underperformance, identification of the investment required '[s]ignificant underperformance against peers/benchmarks over [a] rolling 36 month period', and the report said that an exceptions report would be issued where '[a]n investment option remains under investigation or on the Exceptions List for a period of 8 or more quarters'.[519] That is, on the face of the statement of the Exceptions Criteria, underperformance of a product could continue for five years before it would be reported to the directors of the trustees.

Mr Allert did not accept that this was the position – he said that 'if there was something that was *really bothering* the Group Investment Committee [of AMP] … or was bothering our trustee services representative on the [Group Investment Committee], they would alert the board to that fact'.[520] And an exception report could be issued for '[a]ny matter' regarding investment reporting that Trustee Services thought 'should be brought to the attention of the Boards'.[521]

---

517 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0555].

518 Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

519 Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084.

520 Transcript, Richard Allert, 16 August 2018, 5086–7 (emphasis added).

521 Exhibit 5.270, 12 August 2016, Trustee Quarterly Investment Management Report, 3; Transcript, Richard Allert, 16 August 2018, 5084, 5087.

But the relevant question, not answered by what Mr Allert said about how *other* elements within AMP might respond, was whether the trustees were in a position to know whether they in fact should be 'really bothered' by what was happening. On the face of the exceptions reporting framework, the board would not be informed of the matter until there had been five years of significant underperformance.

3.2.7 Performance of cash investments

Evidence

In May 2018, Trustee Services reported an issue to NM's board outside the BMM reporting framework.[522] Trustee Services told the board that members in the Super Directions Cash Management Trust investment option (a product offered through one of NM's funds, the Super Directions Fund [SDF]) had received negative net returns over a three year period.[523]

On 1 March 2018, APRA had requested information from NM about its Super Directions Cash Management Trust investment option, as part of its targeted review of cash options to assess whether trustees were complying with the 'reasonable expectations' principles in Prudential Standard SPS 530: Investment Governance with respect to cash investment options.[524] AMP discovered the negative net returns for members invested in cash when it was preparing its response to APRA's targeted review.[525]

Member statements of members invested 90% or more in cash through the Super Directions Cash Management Trust were tendered in evidence. One statement showed that, as at 28 February 2015, a member, born in May 1960 and invested 100% in cash, received a net rate of return of 0.47%, amounting to $381.59 after total fees of $1,723.47 were deducted

522 Transcript, Richard Allert, 16 August 2018, 5086–7, 5091.

523 AMP, Module 5 Case Study Submission, 9 [37], 10 [43]–[44]; Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40; Transcript, Richard Allert, 16 August 2018, 5089–91.

524 Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

525 Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40; Transcript, Richard Allert, 16 August 2018, 5090.

from the return.[526] A further statement for that member showed that as at 28 February 2018, the member had an account balance of $105,304.69 and after investment fees and administration fees were deducted, ended the period with an account balance reduced by $451.12 – a net return of -0.39%.[527]

Mr Allert accepted that the member had received a negative net return.[528] Mr Allert also accepted that a member invested in an interest bearing account with AMP Bank would have received a higher return than they would through this cash investment.[529] When asked why a member who invests their retirement savings 100% in cash with NM achieved a substantially lower return than they would had they invested their retirement savings in an interest bearing account with AMP Bank, Mr Allert's response was that '[y]ou would have to ask the client' why they would do that; '[t]hey left the cash there knowing the return [they were] getting'.[530] That is, the Chair of the board of the trustees treated *charging* the member for retaining the member's account wholly in cash (which was the effect of providing a negative return) as a matter wholly for the member and not a matter of concern to the trustee.

A statement from a different member, born in October 1948, showed that the member received net investment earnings of $3.23, or an investment return of 0.02%, for the year ending 30 June 2016.[531] This member had a financial adviser, and had adviser service fees (ASFs) automatically deducted from their account each month.[532] Because the AMP trustees do not monitor the provision of services by the adviser to the member, the trustee could not say

526 Transcript, Richard Allert, 16 August 2018, 5092; Exhibit 5.272, 11 April 2015, Member Statement Super Directions for Business for Year Ended 28 February 2015.

527 Transcript, Richard Allert, 16 August 2018, 5093; Exhibit 5.273, 8 June 2018, Member Statement Super Directions for Business for Year Ended 28 February 2018.

528 Transcript, Richard Allert, 16 August 2018, 5093.

529 Transcript, Richard Allert, 16 August 2018, 5095.

530 Transcript, Richard Allert, 16 August 2018, 5095.

531 Transcript, Rachel Sansom, 16 August 2018, 5148; Exhibit 5.294, 13 August 2018, Member Statement Super Directions for Business Year Ended 30 June 2016].

532 Transcript, Rachel Sansom, 16 August 2018, 5148; Exhibit 5.294, 14 October 2016, Member Statement Super Directions for Business Year Ended 30 June 2016.

what services the adviser had provided.[533] It is enough to observe that, whatever the services were, they did not yield any immediate real return to the member for this aspect of the member's investments.

AMP submitted that the issue of negative net returns affected a minority of the cash options offered by the AMP trustees, and was restricted to some cash options within two of NM's funds.[534] But observing that the issue was confined does not mean it is unimportant to those affected or unimportant when considering the trustee's performance of duties.

In any event, the issue was not as confined as AMP had sought to characterise it. At the meeting of the trustees' boards on 25 July 2018, the boards were told that nine products across two of NM's funds had instances of negative net returns.[535] In total, approximately 12,000 current members, with $43,367,658 funds under management, were affected, and a total amount of approximately $5 million was to be paid as remediation.[536] Over the relevant period, the total number of members affected (both existing and exited members) was estimated to be 47,000.[537] Ms Sansom said that she thought that the current members were to be remediated by reducing the administration fee 'across all cash options' applied retrospectively for three years.[538]

NM notified APRA and ASIC on 15 May 2018 that it had breached section 52(2)(b) of the SIS Act and section 912A(1)(a) of the Corporations Act by generating negative net returns to members invested in cash through the Super Directions Cash Management Trust investment option over the

533 Transcript, Rachel Sansom, 16 August 2018, 5149.

534 AMP, Module 5 Case Study Submission, 10–11 [45].

535 Transcript, Richard Allert, 16 August 2018, 5103; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

536 Transcript, Richard Allert, 16 August 2018, 5103; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

537 Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

538 Transcript, Rachel Sansom, 16 August 2018, 5148; see also Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 19.

previous three years.[539] As noted above, NM said in that breach report that it had identified the negative net returns while preparing its response to a request for information made by APRA on 1 March 2018 as part of APRA's targeted review of cash options.[540]

Since reporting the breach in relation to cash investments, NM has lowered the administration fees on products affected by the negative returns to 0.5% per annum for open products, reducing the fee from as high as 1.72% per annum, and to 0.7% per annum for mature products, reducing the fee from as high as 2.70% per annum.[541] Why fees had been set at the rates they were for investment in cash or cash equivalents is not immediately apparent. At least on the face of it, investment in cash or cash equivalents, when interest rates are as low and as steady as they have been in recent years, seems unlikely to need as much skill and work as some other forms of investment.

The evidence demonstrated that the poor performance of the Super Directions Cash Management Trust investment option went unnoticed by NM due to a 'gap' in reporting on investments to the trustees – that was that the reporting reflected an investment management view of performance of the investment, rather than performance of the investment from the member's perspective, net fees and costs.[542] This was explained in a report to the trustee boards in June 2018, which said 'the SDF Cash breach highlighted the broader monitoring gap that performance of the SDF cash option was not reviewed on a net return to member basis (after application of all investment, AMP product/platform and administration fees)' and the Group Investment Committee said that 'enhanced oversight of performance after product fees would be required'.[543] I deal with the adequacy of the

---

539 AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

540 AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

541 AMP, Module 5 Case Study Submission, 11 [49]; Exhibit 5.290, 25 July 2018, ASL and NM Board Papers, 22; Transcript, Richard Allert, 16 August 2018, 5094, 5096.

542 Transcript, Richard Allert, 16 August 2018, 5089–90, 5104; Exhibit 5.407, 2 July 2018, ASL NM Super Board Papers, 107; Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 40.

543 Exhibit 5.407, 2 July 2018, ASL NM Super Board Papers, 107–8.

reporting on investment performance to the trustees below. It is enough to note at this point that AMP identified a 'gap' in reporting that required remedying, and a result of that gap caused NM to significantly reduce the administration fees charged to members and to lodge a breach notification with APRA and ASIC.

One other aspect of investment in cash or cash equivalents was briefly examined in evidence. It focused on the elasticity of the notion of 'cash equivalents'. Ms Sansom said in her witness statement that AMP Cash Plus and AMP Secure Cash, products of an ASL fund, were investments that comprised 'Cash/Cash Equivalent with Other Guarantee', and for which the lowest credit rating was BBB+.[544] Ms Sansom also said that AMP Capital Wholesale Cash Management Trust, which comprised 'Cash/Cash Equivalent', had a lowest credit rating of BBB-.[545] Ms Sansom explained in her statement that Cash/Cash Equivalent investment options 'will have exposures to cash/cash-like investments … and may also hold other fixed interests securities (eg mortgage-backed securities and corporate debt)' and that 'Cash/Cash Equivalents and Other with Guarantee' comprised the same investments, but also had a guarantee.[546]

Credit ratings of BBB+ and BBB- point to a level of credit risk not associated with investing in cash. They are ratings that suggest to me that the investment is not being made in cash or an instrument or asset properly described as the equivalent of cash. They are investments of a kind that may not readily be reflected by product names such as 'Cash Plus' or 'Secure Cash'.

When Ms Sansom was asked if she knew whether any decision had been made by AMP about whether it would continue to describe as 'cash' things that are not cash, her evidence was that she believed there is 'analysis and a project underway at the moment to review that', which analysis was being undertaken by AMP Capital.[547]

544 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 45 [165].

545 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 45 [165].

546 Transcript, Rachel Sansom, 16 August 2018, 5147.

547 Transcript, Rachel Sansom, 16 August 2018, 5147.

It should go without saying that expressions like ‘cash equivalents’ might be used in ways that are likely to mislead or deceive. I do not say that AMP has done this. But the use of expressions such as ‘cash’ and ‘cash equivalents’ is a matter to which ASIC should consider giving close attention.

What this part of the case study showed

The 15 May 2018 breach report, in which NM notified APRA and ASIC that it had breached section 912A(1)(a) of the Corporations Act and section 52(2)(b) of the SIS Act, recorded that members in Super Directions products had received negative net returns over the preceding three years.[548] The report said that APRA’s targeted review of cash options had ‘highlighted that the current monitoring processes and framework did not provide the Trustee with an adequate level of information to effectively monitor performance of the investment options at a net of fees and taxes level’.[549]

In its submissions AMP accepted that NM had breached section 912A(1)(a) of the Corporations Act and section 52(2)(b) of the SIS Act in relation to its monitoring of the performance of the cash investment options offered by NM.[550] I see no reason to doubt that this is so. It follows, of course, that NM’s conduct amounted to misconduct as defined in the Commission’s Terms of Reference.

Counsel Assisting submitted that it was open to me to find that NM’s conduct might amount to other forms of misconduct – in particular, that NM may have breached its duty under section 52(6) of the SIS Act and obligations under SPS 530. AMP disagreed.[551]

---

548 AMP, Module 5 Case Study Submission, 11 [47]; Exhibit 5.406, 15 May 2018, Breach Report.

549 Exhibit 5.406, 15 May 2018, Breach Report.

550 AMP, Module 5 Case Study Submission, 11 [47], 17 [81], 20 [91].

551 AMP, Module 5 Case Study Submission, 20 [92].

Trustees have particular obligations under the SIS Act and Prudential Standards[552] with respect to investments. Section 52(6)(a) of the SIS Act requires trustees, among other things, to regularly review an investment strategy for *each investment option* offered by the trustee, having regard to the likely return from the investments,[553] and any other relevant matters.[554] Section 52(6)(b) requires trustees to exercise due diligence in developing, offering and reviewing regularly each investment option. As noted above, the breach report identified deficiencies in providing the trustee with 'an adequate level of information to effectively monitor *performance of the investment options* at a net of fee and taxes level'.[555]

SPS 530 requires the board of an RSE licensee[556] to monitor and assess regularly whether the investment objectives are being met,[557] and to have an investment governance framework[558] to manage investments so that they meet the RSE licensee's obligations to beneficiaries.[559] SPS 530 also requires an RSE licensee to determine appropriate measures, approved by the board, to monitor the performance of each investment in each investment option, and each MySuper product, on an ongoing basis.[560]

552 Prudential Standards are made by APRA pursuant to SIS Act s 34C(1), and are part of the RSE licensee law: see the par (aa) of the definition of 'RSE licensee law' in SIS Act s 10(1). Section 29E(1)(a) imposes a condition on all RSE licensees that they must comply with the RSE licensee law.

553 See SIS Act s 52(6)(a)(i).

554 See SIS Act s 52(6)(a)(viii).

555 Exhibit 5.406, 15 May 2018, Breach Report (emphasis added).

556 For the purposes of Prudential Standard SPS 530, 'RSE licensee' has the meaning given in SIS Act s 10(1).

557 APRA, Prudential Standard SPS 530, 15 November 2012, [6(c)].

558 SPS 530 describes an investment governance framework as the totality of systems, structures, policies, processes and people to address the RSE licensee's responsibilities with regard to investments of each RSE (fund) within the RSE licensee's business operations, which includes generating returns to meet investment objectives while managing and monitoring all identified sources of investment risk: see APRA, Prudential Standard SPS 530, 15 November 2012 [9].

559 APRA, Prudential Standard SPS 530, 15 November 2012, [8].

560 APRA, Prudential Standard, SPS 530, 15 November 2012, [24].

AMP submitted that it was not open to me to find that NM may have breached section 52(6) of the SIS Act or SPS 530 in generating a negative return on cash investments.[561] AMP submitted that there was no evidence that the AMP trustees failed to formulate, review regularly and give effect to an appropriate investment strategy for their *funds*.[562]

I am unpersuaded by AMP's submissions for the following reasons.

First, as has been noted above, NM's report identified that the monitoring processes and framework of NM did not provide it with an adequate level of information to effectively monitor performance of the investment options at a net of fee and taxes level.[563] It said that 'reporting and monitoring at the member level at a net of fees and taxes position was not being performed'.[564] Mr Allert[565] and Ms Sansom[566] reiterated this in their evidence. So did AMP in its submissions.[567]

Second, the breach report proposed that, as part of the rectification of the incident, 'more appropriate reporting and processes in respect of all investment options available to all members will be established to ensure that the requirements of SPS 530 will be met going forward'.[568] This was consistent with information considered by the board on 14 May 2018,[569] and the change to the reporting was confirmed by Mr Allert in his evidence.[570]

Third, AMP's submission directs attention to the investment strategy of the fund as a whole. But section 52(6)(a) expressly distinguishes between the investment strategy 'for the whole of the entity' and the investment strategy

561 AMP, Module 5 Case Study Submission, 20 [92].

562 AMP, Module 5 Case Study Submission, 20 [92]; see also 8 [30].

563 Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

564 Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

565 Transcript, Richard Allert, 16 August 2018, 5089–90.

566 Transcript, Rachel Sansom, 16 August 2018, 5132.

567 AMP, Module 5 Case Study Submission, 11 [46], 17 [81].

568 Exhibit 5.406, 15 May 2018, Breach Report to ASIC.

569 Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 41.

570 Transcript, Richard Allert, 16 August 2018, 5090–1.

'for each investment option offered by the trustee in the entity' and section 52(6)(b) expressly requires regular review of 'each investment option'.

SPS 530 complements the obligation in section 52(6) by requiring measures to be established for ongoing monitoring of the performance of the investment.

Contrary to AMP's submissions, I consider that NM may have breached its obligations under section 52(6)(a) and (b) and SPS 530. The matter having already been reported to the regulators, it is a matter for them to decide what, if any, further action should be taken.

3.2.8 Performance of MySuper products

Evidence

NM's decision to reduce the administration fees in respect of its cash investments was not prompted solely by the negative net returns on cash investments. The decision was also a result of APRA identifying in October 2017 that MySuper products offered by ASL and NM had high costs per member relative to other MySuper products, as well as continued net cash outflows.[571]

On 25 July 2018, the administration fees of the AMP trustees' generic MySuper products[572] were halved to 0.29%.[573] In its submission AMP described these reductions as 'very significant'.[574] A memorandum considered by the AMP trustee boards on 25 July 2018 said that the proposed changes would move the pricing from Quartile 4 to Quartile 3, and that 'the proposed pricing change [would] deliver an immediate and ongoing improvement in outcomes for ~700k members', with the price reductions

571 Transcript, Richard Allert, 16 August 2018, 5097; Exhibit 5.274, 16 October 2017, Letter from APRA to Sansom and Allert.

572 For the SDF and SST generic options, and the choice lifecycle option in ART: AMP, Module 5 Case Study Submission, 13 [59].

573 AMP, Module 5 Case Study Submission, 13 [59].

574 AMP, Module 5 Case Study Submission, 13 [59].

being ‘borne by the AMP Shareholder in the form of reduced revenue from fees’.[575]

The fee reductions in July 2018 were the first time that changes had been made to the pricing of the AMP trustees’ MySuper products since they were initially approved by APRA in 2013.[576] However, Ms Sansom said that she had held the view for ‘[q]uite some time’ that fees should be reduced.[577] Ms Sansom said that she had advocated for the change to pricing throughout 2017, but that any change in fees was dependent on the AMP Product Team’s view.[578]

Ms Sansom had noticed poor performance in the AMP trustees’ MySuper products in September 2016, and the issue was raised then with the AMP trustee boards.[579] At that time, two of the AMP trustees’ MySuper products were reported in a news article as being the second and third poorest performing products for the 2016 financial year.[580]

The same ‘gap’ in reporting of investment performance identified above (in connection with the negative net returns on cash investments) was identified by AMP Investment Regulatory Governance in April 2017 in respect of reporting of investment performance of the AMP trustees’ MySuper products.[581]

---

575 Exhibit 5.275, 8 July 2018, ASL and NM Super Board Papers for meeting of 25 July 2018, 14.

576 Exhibit 5.275, 8 July 2018, ASL and NM Super Board Papers for meeting of 25 July 2018, 9; Transcript, Rachel Sansom, 16 August 2018, 5113.

577 Transcript, Rachel Sansom, 16 August 2018, 5140.

578 Transcript, Rachel Sansom, 16 August 2018, 5140.

579 Transcript, Richard Allert, 16 August 2018, 5088; Transcript, Rachel Sansom, 16 August 2018, 5131–2; Exhibit 5.286, 19 September 2016, Board Papers AMP Super and NM Super for Meeting of 20 September 2016, 359.

580 Transcript, Richard Allert, 16 August 2018, 5088; Transcript, Rachel Sansom, 16 August 2018, 5131–2; Exhibit 5.286, 19 September 2016, Board Papers AMP Super and NM Super for Meeting of 20 September 2016, 359.

581 Transcript, Rachel Sansom, 16 August 2018, 5132.

This was recorded in a memorandum prepared by AMP Investment Regulatory Governance for Trustee Services (along with Superannuation Retirement and Investment Platforms, Corporate Super, and AMP Capital) dated 3 April 2017.[582] The memorandum contrasted APRA's reporting methodology, which 'focuse[d] on the *net* member experience by incorporating all fees and taxes that apply', with AMP Capital's reporting, which reported performance 'on a *gross* basis (before fees and taxes)'.[583] The memorandum said that, given the 'gross investment performance lens … ignores the impact of fees, costs and taxes, the investment updates have not addressed the "net member experience" aspect of MySuper performance'.[584] The memorandum ranked the AMP trustees' products in comparison to those of their competitors, recording that, for example, one product ranked 26 out of 29 for administration fees and costs and 23 out of 29 for net returns to members, and another ranked 59 out of 63 on administration fees and costs and 49 out of 63 for net returns to members.[585]

Neither Ms Sansom, nor anyone else, reported the results of the April 2017 memorandum to the AMP trustee boards.[586] There was no evidence that any changes were made to investment performance reporting to the AMP trustee boards at this time.

The third and fourth annual MySuper scale assessments, performed in November 2016 and November 2017 respectively, identified that the AMP

---

582 Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement.

583 Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 2 (emphasis in original).

584 Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 2.

585 Transcript, Rachel Sansom, 16 August 2018, 5134; Exhibit 5.287, 3 April 2017, Memorandum 3 April 2017 from AMP Investment Regulatory Governance Concerning MySuper Performance Measurement, 7.

586 Transcript, Rachel Sansom, 16 August 2018, 5135.

trustees' generic MySuper products were 'below median' or in the 'bottom quartile' when fees were considered.[587]

What this part of the case study showed

Section 29VN(a) of the SIS Act obliges the trustee of a regulated superannuation fund that includes a MySuper product to promote the financial interests of the beneficiaries of the fund who hold the MySuper product, in particular the returns to those beneficiaries (after the deduction of fees, cost and taxes).

The Explanatory Memorandum to the Bill for the Act that inserted section 29VN said that the requirement to promote the financial interests of MySuper members:[588]

> heightens the obligations trustees owe to members of a MySuper product reflecting that members of a MySuper product have effectively delegated the responsibility for making decisions regarding their superannuation to the trustee. This requires a trustee to make informed judgments regarding the MySuper product, for example in relation to the composition of assets in the investment strategy, so that it secures the best financial outcome for these beneficiaries.

The Memorandum expected that section 29VN would 'lift the standard required of trustees'.[589]

Counsel Assisting submitted that it was open to me to find that ASL and NM may each have breached section 29VN(a) to promote the financial interests of their MySuper members. AMP submitted that such a finding was not open. AMP said that the evidence showed that the AMP trustees have consistently advocated for the financial interests of the MySuper members,

---

[587] Exhibit 5.408, 6 December 2016, ASL and NM Super Board Papers, 128–36; Transcript, Rachel Sansom, 16 August 2018, 5138; Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 69.

[588] Explanatory Memorandum, Superannuation Legislation Amendment (Trustees Obligations and Prudential Standards) Bill 2012 (Cth), 13 [1.16].

[589] Explanatory Memorandum, Superannuation Legislation Amendment (Trustees Obligations and Prudential Standards) Bill 2012 (Cth) at 13 [1.17].

including to improve the outcomes of members in the generic MySuper products 'by securing a significant reduction in fees'.[590]

There are two problems with AMP's submission.

First, the evidence did not support AMP's submission. There was no evidence that, before the MySuper fees were reduced in July 2018, the *boards* of either ASL or NM had ever advocated for the financial interests of *MySuper members*.[591] The highest that AMP's evidence rose was Ms Sansom's. She said that *she* had held the view that fees were too high and that *she* had advocated since 2017 for lower fees but that lowering the fees was ultimately a matter for the AMP Product Team.[592]

AMP relied on the July 2018 reduction in fees as supporting its position. That reduction was made after APRA had identified, in October 2017, the high costs to members of AMP superannuation funds who held MySuper products. And the reduction pertained to the reduction in fees brought about by the negative net returns over a three year period to members who were invested in NM's Super Directions Cash Management Trust cash investment option.

The third and fourth annual MySuper scale assessments, performed in 2016 and 2017 to satisfy the trustees' obligations under section 29VN(b) of the SIS Act, had identified that ASL's and NM's MySuper products were 'below median' or in the 'bottom quartile' of fund performance when fees were taken into account.[593] There is no evidence that any step was taken by the AMP trustees at or around those times to inquire into, or to address, the effect of fees on net performance.

---

590 AMP, Module 5 Case Study Submission, 20 [93].

591 AMP, Module 5 Case Study Submission, 13 [58], 18 [80]. In respect of the trustee boards, AMP references Transcript, Richard Allert, 16 August 2018, 5103 as evidence that the 'Trustees continued to advocate for the fees to be lowered in the interests of members'. This is a reference to Mr Allert's evidence that he had advocated for the fees to be reduced and compensation to be paid to those members invested in cash who received a negative net return over the last three years – not MySuper members.

592 Transcript, Rachel Sansom, 16 August 2018, 5140.

593 Exhibit 5.408, 6 December 2016, ASL and NM Super Board Papers, 128–36; Transcript, Rachel Sansom, 16 August 2018, 5138; Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 69.

No step was taken by the AMP trustees to address the effect of fees on performance until, following the identification of the negative net returns on cash investments, Trustee Services brought to the boards' attention, in May 2018, the gap in reporting that underpinned the later breach reports to APRA and ASIC.[594] As I noted earlier, the trustees identified this issue because they were prompted by APRA and the work required by APRA's targeted review.

The second problem with AMP's submission is that it reduces to meaningless the obligation imposed upon the AMP trustees by section 29VN(a) to promote the financial interests of the MySuper members. On AMP's approach, the AMP trustees satisfied their obligations by Ms Sansom advocating for reduced fees in 2017. But, as Ms Sansom acknowledged, changes to fees were out of her (and the trustees') hands. Any changes were a matter for AMP's Product team. It was only in July 2018, in response to APRA's enquiries and in the midst of this Royal Commission, that fees were lowered to competitive levels. Yet AMP says that the response was sufficient for the AMP trustees to have discharged their duties. That cannot be correct. If anything, the lowering of fees in the circumstances described points to the trustees having failed, until then, to promote the financial interests of its members in satisfaction of section 29VN(a).

Ms Sansom said that the reporting to the AMP trustees about the 'net member experience' through the MySuper scale assessments is currently being strengthened.[595] AMP submitted that Trustee Services and the Group Investment Committee are working with the Product Management team to establish investment reporting to the AMP trustees that is net of fees and taxes.[596] If this is right, and I have no reason to doubt it, it follows that at the time the Commission took evidence about these matters, and at the time of AMP's submissions to the Commission in August 2018, investment performance reporting to the AMP trustees still did not sufficiently report investment performance net of fees and taxes.

594 Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 41; see also Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 107–8.

595 Transcript, Rachel Sansom, 16 August 2018, 5141–2.

596 AMP, Module 5 Case Study Submission, 11 [51].

It follows that since at least the third MySuper scale determination performed in 2016, ASL and NM may not have complied with section 29VN(a). And failing to comply with that obligation would evidently be misconduct. Under section 29VP of the SIS Act, contravention of section 29VN, though prohibited by section 29VP(1), is not an offence[597] but persons who suffer loss or damage as a result of the contravention may recover that loss or damage from the contravener and from any person involved in the contravention.[598]

3.2.9 Distribution of trustees' products

Evidence

The BMM approved on 15 March 2018 stated that '[n]o standalone BMM is required from any Advice/Distribution area as financial planners do not directly undertake activities on behalf of' the AMP trustees.[599] The BMM also said that, given the 'nature of the services that advisers provide to members as well as the importance of effective distribution of the [AMP trustees'] products', the AMP trustees were to receive reporting about advice and distribution through Product and Risk and Compliance reports.[600]

Ms Sansom said that, because of the trustees' outsourcing arrangements, effective distribution of superannuation products is a responsibility of AMP Life: the AMP trustees rely on the terms of their outsourcing arrangements and the measures in place within AMP to oversee distribution.[601]

597 SIS Act s 29VP(2).

598 SIS Act s 29VP(3).

599 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [207]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

600 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [207]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0554].

601 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53–4 [208].

APRA undertook a review of the BMM in March 2017.[602] APRA identified as part of that review that the BMM does not provide the AMP trustees with 'visibility of the advisers who direct members to invest in their superannuation products or [advise] whether the strategies for members are appropriate'.[603] Ms Sansom's evidence was that, in response to that review, the AMP Advice licensees ensured that AMP 'Enterprise Risk Management' (ERM) distribution reports, and risk reporting by AMP Advice, would be made available to Trustee Services, and that commentary related to distribution risk would be included in ERM's regular BMM reporting to Trustee Services.[604]

APRA considered the issue of the trustees' visibility over distribution closed on 30 January 2018.[605] However, Ms Sansom's evidence was that the AMP trustees considered that further improvements could be made.[606] A review of the BMM completed in June 2018 showed that there was a need for more direct oversight of advice related activities.[607] AMP acknowledged in its submissions that the AMP trustees' monitoring through the BMM of distribution of their products through financial advisers was being, and had recently been, strengthened.[608]

In particular, as noted above, Trustee Services now receives risk reporting about the AMP Advice business through the BMM.[609] Further, in May 2018, the trustee boards requested that a senior executive in AMP Advice provide them with direct reporting, and the reporting model for this is being

602 Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom, 3, 5.

603 Transcript, Rachel Sansom, 16 August 2018, 5142; Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom.

604 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [209].

605 Exhibit 5.410, 30 January 2018, Email from APRA to AMP; Exhibit 5.411, 30 January 2018, Letter from APRA to AMP.

606 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [205].

607 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [211].

608 AMP, Module 5 Case Study Submission, 5 [15].

609 AMP, Module 5 Case Study Submission, 2 [9]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [209].

developed.[610] The trustees also requested more oversight through the BMM of open incidents and reported breaches.[611]

The timing of these requests should be noted. They followed evidence heard in the second round of the Commission's hearings.[612] During those hearings, the Commission heard evidence that the conduct within the AMP Advice business of charging ongoing service fees to members in circumstances where those services could not be provided appeared, to at least some extent, to have been intentional.

ASL and NM had not been aware of, or told by AMP about, any *intentional* aspect of the conduct until they heard AMP's evidence during the Round 2 hearings.[613] Until then, the AMP trustees had been aware of the conduct to the extent that ASIC and APRA had been told it was due to an 'administration error'.[614] The AMP trustees were named as the 'AMP Product Issuers' on the breach notification given to APRA and ASIC on 27 May 2015.[615]

On 8 June 2018, in response to the trustee boards' request in May 2018, ASL and NM were provided with information about the current open incidents recorded in the incident management system that affected the trustees.[616] One of those incidents was the charging of planner servicing

610 AMP, Module 5 Case Study Submission, 5 [15]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [210].

611 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [210].

612 Transcript, Rachel Sansom, 16 August 2018, 5143.

613 Transcript, Rachel Sansom, 16 August 2018, 5143.

614 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [212]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0051.0612].

615 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 54 [212]; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0051.0612].

616 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53 [204]; Exhibit 5.407, 8 June 2018, ASL NM Super Board Papers, 220–1.

fees where they should not have been charged.[617] This incident was discovered within the AMP Advice business on 26 July 2017, and at that time it was thought to have affected 553 members with total fees of $76,113.50.[618] The Advice Breach Committee did not determine the incident to be a reportable breach.[619] This incident would not have otherwise been brought to the attention of the trustee boards as it did not qualify as an exception under the BMM – to do so, the compensation would have had to have exceeded $100,000.[620] The information provided to the trustee boards in June 2018 indicates that, as at 17 May 2018, the incident had not been resolved, nor had the number of members affected been ascertained.[621]

Separate from, but similar to, this incident, ASL notified APRA and ASIC on 26 June 2018 that it had breached sections 912A(1)(a) and 1017D of the Corporations Act by continuing to charge PSFs in circumstances where they should not have been charged.[622] ASL provided an estimate that approximately 6,300 members were affected with an 'initial financial impact' of approximately $1 million.[623]

What this part of the case study showed

The ASL and NM Boards have had little reporting and monitoring through the BMM about issues with the distribution of their products. That is because, as Ms Sansom said, AMP Life is responsible for the distribution

617 Transcript, Rachel Sansom, 16 August 2018, 5145; Exhibit 5.293, 28 August 2017, Licensee Incidents Panel Agenda.

618 Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

619 Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

620 Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 221; Transcript, Rachel Sansom, 16 August 2018, 5145.

621 Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 215.

622 Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

623 Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

of the trustees' products, and the trustees rely on their outsourcing arrangements and the measures within AMP to oversee distribution.[624]

However, following the second round of the Commission's hearings, the trustee boards requested that they be provided with a list of the open incidents within AMP that affected the trustees.[625] The list provided to the trustees, at their June 2018 board meeting, revealed that there were many open incidents that had not been reported as an exception to the boards including, in some cases, where the incident had been reported to the regulator. Presumably it was possible for an incident to be reported to the regulator without it also being reported to the trustees because under the outsourcing arrangements, AMP Life prepares breach reports to the regulator.[626]

An example provided in the list at the June 2018 meeting, which had not been reported to the trustees through the BMM, was an open incident where MySuper members had been charged PSFs after 1 January 2014 contrary to legislative requirements.[627] AMP Advice attributed this to a systems error in that 'the appropriate systems did not correctly reflect the rules following FoFA changes as at 1 July 2014'.[628] AMP Advice identified in July 2017 that this incident affected approximately 553 members with total fees charged of $76,113.[629] AMP Advice considered that this incident was a breach, but not a significant or reportable breach, based on the circumstances including the number of affected members.[630] However, by the time the trustees were

---

624 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 53–4 [208].

625 Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 221.

626 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6520, Sched 1 cl 1.5(b)].

627 SIS Act s 29SAC charging fees deemed to be conflicted remuneration on MySuper products.

628 Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 3.

629 Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 3; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

630 Exhibit 5.412, 9 November 2017, Licensee Incidents Panel – Meeting Agenda, 4; Exhibit 5.413, 9 November 2017, Licensee Incidents Panel – Meeting Minutes.

given information about this incident, based on information as at May 2018, the number of customers affected by this incident was still 'TBC'.[631]

This incident was similar to a separate incident that was reported to APRA and ASIC on 26 June 2018 – ASL told the regulators that it had breached sections 912A(1)(a) and 1017D of the Corporations Act by continuing to charge PSFs to employees who had 'delinked' from their employer plan post-1 January 2014.[632] But just like the incident described above, those members were being charged PSFs contrary to legislative requirements. AMP also attributed the incident to a systems issue – it said in the breach report that 'the product administration system has continued to charge the [fee] to delinked members … contrary to product rules set in place in June 2014'.[633] The breach report estimated about 6,300 AMP Flexible Super members were affected, and that the amount involved was $1 million.[634] This incident had not been reported to the trustees through the BMM by the time the breach report was made.

These incidents show three ways in which the trustees' visibility and monitoring of distribution of their products was inadequate.

First, even at May 2018, the level of reporting that the trustees received through the BMM did not capture all incidents in which members were being charged fees incorrectly and contrary to the law.

Second, the two incidents were both cases where AMP Advice charged or allowed the charging of fees to the trustees' members in circumstances where they should not have been charged. Yet the trustees were not aware of this and apparently had no way of monitoring the charging of fees to members.

Third, the trustees only asked to be provided with information about the open incidents after the evidence given at to the Commission in April 2018.

631 Exhibit 5.407, 8 June 2018, ASL and NM Super Board Papers, 222.

632 Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

633 Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

634 Exhibit 5.292, 26 June 2018, AMP Superannuation Breach Report.

This is so even though APRA identified as early as April 2017 that the trustees did not have adequate oversight of distribution of their products.[635]

The trustees accepted there were 'opportunities for enhancement of their oversight of distribution of their products' and said that they were 'taking steps to do so'.[636] I agree that the trustee boards do not have a level of oversight over distribution of their products that would be reasonably expected of trustees with the number of members and funds under management as the AMP trustees. But this is not a recent revelation to the trustee boards. APRA alerted them to the danger last year but they had not recognised it themselves and did not move swiftly to address it.

3.2.10 Performance of investments and indirect costs

Evidence

AMP trustees do not know the indirect costs charged to members beyond what they are told by AMP Life or AMP Capital.[637] Ms Sansom said that 'the level of monitoring [done by Trustee Services] would not pick up' those costs.[638]

Two recent 'incidents' highlighted the trustees' lack of knowledge of the indirect fees charged to members.

AMP referred to the first incident as the 'Expense Recovery Incident'. It happened because AMP Capital recovered expenses, such as fund services expenses, at a fund level and charged fees on a pro-rata basis, rather than recovering fees from the relevant members' investment options.[639] AMP Capital had been recovering these expenses pursuant to an

---

635 Transcript, Rachel Sansom, 16 August 2018, 5142; Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom.

636 AMP, Module 5 Case Study Submission, 19 [88].

637 Transcript, Rachel Sansom, 16 August 2018, 5151.

638 Transcript, Rachel Sansom, 16 August 2018, 5152.

639 Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 57 [220].

‘expense recovery project’, clarifying which expenses it was permitted charge under the terms of the relevant agreements with AMP Life.[640]

Ms Sansom said that the expense recovery project was not intended to affect other AMP Group entities, and so there was no report to the AMP trustees in respect of it.[641] This is so even though the Expense Recovery Incident ultimately affected 31 of the trustees’ products (being products offered through one fund of NM, and each of the funds of ASL).[642] Nor was any report made about the project to the board of AMP Capital or any other AMP Group entity.[643]

The second incident was referred to by AMP as the ‘Fee Rebate Incident’. It happened because AMP Capital charged its investment management fee in respect of external direct property and infrastructure funds in circumstances where the fees should have been rebated to the member.[644]

The trustees’ members were among those affected by the incorrect fees charged by AMP Capital in respect of both the Expensive Recovery Incident and the Fee Rebate Incident.[645] Ms Sansom estimated that the value of the fees incorrectly deducted for the Expensive Recovery Incident is approximately $1 per member, and an aggregate amount of $3 million to $3.5 million.[646] For the Fee Rebate Incident, Ms Sansom estimated that the value of the fees incorrectly charged is approximately $6 to $8 per member, with approximately 3 million to 4 million members affected,

---

640 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

641 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

642 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [221].

643 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 58 [222].

644 Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 60 [236].

645 Note that not all of the products affected were the AMP trustees’ super products – AMP Life products, which were not held by the AMP trustees’ members, were also affected: see Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [238].

646 Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228].

and an aggregate amount of more than $23 million provisioned for remediation.[647] The amounts to be remediated include the 'amount wrongly charged plus the impact on performance'.[648]

The Expense Recovery Incident could be traced back to 2014.[649] AMP Capital became aware of the Incident in August 2017 and reported it to ASIC[650] – at that time, AMP Capital had understood that it did not affect superannuation members.[651] It was not clear when the issue was subsequently identified by AMP Capital as extending to superannuation products.[652] The Fee Rebate Incident likely existed since fund inception or when the funds held direct property or infrastructure funds for the first time, which was estimated to be between four and at least 10 years, depending on the fund.[653] AMP Capital reported the Fee Rebate Incident to ASIC as a potentially significant breach on 22 March 2018.[654]

The two incidents were revealed to ASL and NM only because of analysis done so that they could comply with ASIC's new Regulatory Guide 97. ASL and NM were required by the new Regulatory Guide to disclose those fees, which had previously been undisclosed, charged to the return on the investment.[655]

What this part of the case study showed

Where a trustee engages an investment manager to manage the investments of the fund, section 102(1) of the SIS Act obliges the trustee, among other things, to have in place an agreement that enables the trustee

647 Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 60 [237], 61 [239].

648 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [237].

649 Transcript, Rachel Sansom, 16 August 2018, 5152.

650 Transcript, Rachel Sansom, 16 August 2018, 5151; Exhibit 5.295, 3 August 2017, AMP Capital Breach Notice to ASIC.

651 Transcript, Rachel Sansom, 16 August 2018, 5151.

652 Transcript, Rachel Sansom, 16 August 2018, 5151.

653 Exhibit 5.271, 12 May 2018, ASL and NM Super Board Papers May 2018, 36.

654 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 62 [241].

655 Transcript, Rachel Sansom, 16 August 2018, 5151–2.

to require the investment manager to provide information wherever it is necessary or desirable to do so.[656] Such information may include that related to the making of, and return on, the investments.[657]

The directors of the AMP trustees use a 'directors' roadmap' to assist them to monitor their obligations, including their obligations under the SIS Act.[658] The roadmap says that the duty imposed under section 102 does not apply, as the AMP trustees do not 'directly engage Investment Managers'.[659] This is because AMP Life has engaged AMP Capital to provide investment management services on behalf of the AMP trustees.

Counsel Assisting submitted that, by entering into the outsourcing arrangements, the trustees owed no duties to their members under section 102(1) of the SIS Act to seek information in accordance with that section from AMP Capital.

AMP submitted that the trustees' 'outsourcing arrangements are in full compliance with [section] 102(1) – the agreement with AMP Life requires it to comply with this obligation'.[660] It is not clear what AMP means by this. The obligation in section 102(1) is on the *trustee*.

In any case, AMP did not identify the agreement, or the provision within that agreement, upon which it relies in making this assertion of compliance. Neither of the trustees' agreements with AMP Life (the Master Outsourcing Agreement[661] for ASL, and the Administration Deed[662] for NM) refer to section 102(1) of the SIS Act. Nor do they impose obligations identical to those that would lie under section 102(1) on a trustee that has directly engaged an investment manager, though the agreements with AMP Life

656 See SIS Act s 102(1)(b).

657 See SIS Act s 102(a)(i).

658 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6646].

659 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6646].

660 AMP, Module 5 Case Study Submission, 19 [89].

661 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472].

662 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0272].

do impose a general obligation on AMP Life to monitor the performance of each investment on an ongoing basis.

As I have explained, the trustees' 'directors' roadmap' said only that the obligations under section 102(1) are not applicable – it did not say that AMP Life has been required to cause the trustees to comply with the obligation imposed by section 102(1). The point made by the 'directors' roadmap' is that because the trustees do not directly hold the contracts with investment managers, they have no obligations under section 102(1). That is correct. I do not accept the submission that AMP made to the contrary.

AMP also said that information is sought from the investment manager whenever the Group Investment Committee, to which investment performance monitoring had been delegated, thought it necessary or desirable to seek information.[663] The only reference given by AMP to support this submission was to the Terms of Reference for the AMP Group Investment Committee. AMP did not point to a specific obligation in the Terms of Reference. AMP did not identify any evidence of the Group Investment Committee requesting information to assist the trustees or AMP Life to discharge their investment-related obligations.

The weakness in the trustees' monitoring of performance is demonstrated by the Expense Recovery Incident and the Fee Rebate Incident. As a result of these incidents, AMP is paying customers approximately $26.5 million in fees incorrectly charged or withheld by AMP Capital.[664] The customers who are being compensated include members of ASL's and NM's funds and include some of their MySuper members.[665]

The conduct referred to as the Expense Recovery Incident occurred over about three years from 2014; the conduct referred to as the Fee Rebate Incident may have occurred over as many as 10 years. This overcharging of fees was not discovered by AMP Life monitoring the performance of

---

663 AMP, Module 5 Case Study Submission, 19 [89].

664 Transcript, Rachel Sansom, 16 August 2018, 5150; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [237], 61 [239]. Note that not all of the products affected were the AMP trustees' super products – AMP Life products, which were not held by the AMP trustees' members, were also affected: see Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 59 [228], 60 [238].

665 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, 57 [221], 60 [238].

investments in accordance with its agreements with the trustees. Whatever information was being provided by AMP Capital to AMP Life (or the Group Investment Committee), it was apparently insufficient to show that fees were being incorrectly charged to members.

Nor was the overcharging of fees discovered by the Group Investment Committee requesting information to assist AMP Life or the trustees to discharge their respective investment-related obligations. There was no evidence of the Group Investment Committee requesting, on behalf of AMP Life, information with a level of detail that would enable it to identify the incorrect charging of fees (and therefore the reduction in net returns).

The overcharging of fees was only revealed to ASL and NM because the new version of Regulatory Guide 97 required the trustees to disclose indirect costs of investments and so those costs needed to be identified.[666]

The evident purpose of the Regulatory Guide was to require trustees to make disclosure so that consumers could be informed of the costs of investment. It says little for the merits of AMP's outsourcing arrangements that in order to comply with the guide it was first necessary to inform the Group Investment Committee, AMP Life, ASL and NM about these costs.

3.2.11 Transition to MySuper

Evidence

The transition plan prepared for moving members' accrued default amounts (ADAs) into a MySuper product was not designed by the AMP trustees, but by a special-purpose team within AMP known as the 'FoFA and Stronger Super program'.[667] Ms Sansom said that it was not unusual for a special purpose team to be set up for such a large program.[668]

666 Transcript, Rachel Sansom, 16 August 2018, 5151–2.

667 Transcript, Rachel Sansom, 16 August 2018, 5112–3, 5124.

668 Transcript, Rachel Sansom, 16 August 2018, 5116.

The transition plan for one of ASL's funds showed that the transfer of members' ADAs to MySuper products was done in tranches.[669] All tranches were to be completed by 30 June 2017.[670] That was the last day by which trustees had to attribute ADAs to MySuper products.[671] AMP Life, as administrator of the fund, was responsible for ensuring that each tranche of transfers occurred at the determined time.[672]

From the trustees' perspectives, the timing of the transitions was designed to manage the operational risk of the transitions.[673] An update given to the trustees in March 2015 regarding the transitions said that the 'ADA transitions have been spread over a few years due to the large volume required to be transferred (over $10bn in assets) and complexity involved in asset movements of this size'.[674] That update did not record any commercial considerations that affected others in, or aligned with, the AMP Group.[675]

Since commencing in her role in 2015, Ms Sansom could not recall anyone discussing with her or the trustees any assessment AMP had made about the effect the timing of the ADA transfers may have on revenue.[676]

There were documents in evidence before the Commission, however, that did consider the effect of the timing of the ADA transfers on the AMP Group's profits.

A pricing paper prepared by actuaries for the consideration of AMP's Product and Insurance Risk Committee (PIRC), at a meeting on 29 May 2013 (PIRC Pricing Paper), set out a proposed schedule for the timing of

669 Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

670 Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

671 See SIS Act Pt 33.

672 Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

673 Transcript, Rachel Sansom, 16 August 2018, 5123.

674 Transcript, Rachel Sansom, 16 August 2018, 5153; Exhibit 5.296, 24 March 2015, AMP Super and NM Super Board Papers, 73.

675 Transcript, Rachel Sansom, 16 August 2018, 5154.

676 Transcript, Rachel Sansom, 16 August 2018, 5118.

transfer of ADAs to MySuper products.[677] One section of the PIRC Pricing Paper dealing with 'Risks and sensitivities' considered how profits would be affected by the transfer patterns of the ADAs. It said that there would be a $3 million or 0.2% reduction of inforce profits if a higher proportion of ADAs were to be transferred in 2017, whereas there would be a $86.5 million or 7.5% reduction of inforce profits if 100% of ADAs were to be transferred in 2014.[678]

The PIRC Pricing Paper also considered the effect that MySuper would have on distribution. It said that PwC had been engaged to build an economic model and 'planner heat maps' to identify planners affected by the introduction of MySuper.[679] The financial planners or advisers who were affected by the transition to MySuper products were referred to as being 'MySuper exposed', in that the advisers would have been receiving revenue from clients' ADAs and would lose that revenue if those clients were transferred to a MySuper product.[680] The modelling to be done by PwC would, among other things, allow AMP to build 'comprehensive value propositions for the financial planners, employers and members' to help 'minimise impacts on AMP's net cash flow and operating earnings arising from the introduction of MySuper products'.[681]

The PIRC Pricing Paper recommended that PIRC endorse the proposal set out in the paper for the subsequent approval by the CEO and Managing Director of AMP Limited, and the Managing Director of AMP Financial

---

677 Transcript, Rachel Sansom, 16 August 2018, 5117; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 17.

678 Transcript, Rachel Sansom, 16 August 2018, 5117; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee re MySuper Pricing Report, 25.

679 Transcript, Rachel Sansom, 16 August 2018, 5119; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee re MySuper Pricing Report, 29–30.

680 Transcript, Rachel Sansom, 16 August 2018, 5122–3.

681 Transcript, Rachel Sansom, 16 August 2018, 5119; Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 29–30.

Services under delegation from the boards of AMP Life and National Mutual Life Association of Australasia Limited (NMLA).[682]

Heat maps prepared by PwC identified that 11 practices had greater than $400,000 in corporate super revenues, with over 50% of that revenue predicted to be MySuper exposed,[683] and said that '[s]everal of the decisions regarding MySuper, such as [**buyer of last resort**] and timing of ADA transition, may be informed through leveraging the heatmap data and complementing it with further qualitative and quantitative research to test solutions'.[684]

The PwC heat maps also set out 'headline calculations' of revenue, listing the gross margin summary for each product based on the size of revenue exposed to MySuper.[685] The two highest gross margin exposures were for the products Flexible Lifetime Super and CustomSuper.[686]

The majority of members in Flexible Lifetime Super and CustomSuper were not transferred to MySuper until April 2017.[687] That was only about two months before the date by which the trustees were required to transfer ADAs to MySuper products (30 June 2017).[688]

There was no evidence that either the PIRC Pricing Paper or the PwC heat maps were provided to the AMP trustees. Indeed, Ms Sansom's evidence was that the PIRC Pricing Paper was not a document that she

---

682 Exhibit 5.279, 29 May 2013, Paper for Product and Insurance Risk Committee Re MySuper Pricing Report, 5.

683 Transcript, Rachel Sansom, 16 August 2018, 5122; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 9.

684 Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 31.

685 Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 43.

686 Transcript, Rachel Sansom, 16 August 2018, 5123; Exhibit 5.281, 1 May 2013, AMP MySuper Heat Map Analysis, 43.

687 Transcript, Rachel Sansom, 16 August 2018, 5125–6; Exhibit 5.282, 22 June 2017, Board Papers AMP Limited, AMP Life and NMLA, 71.

688 See SIS Act Pt 33.

would typically see within the office of the trustee, or that would typically be provided to the AMP trustees.[689] It contained information that Ms Sansom would not generally expect to be provided or communicated to the AMP trustees.[690] Ms Sansom did not recall reading any documents detailing any discussion with the trustee about adviser revenue streams being exposed to MySuper.[691] And Ms Sansom did not know whether the PwC heat map analysis was used to guide the MySuper transition process.[692]

The same information given to the AMP trustees about the complexities of the transfers affecting the timing of the transfers was also communicated to APRA.[693] The information provided to the AMP trustees was also consistent with information provided to ASIC.[694]

Ms Sansom believed that, if the MySuper transition program was happening today, the current trustee boards would ask questions about profit.[695]

What this part of the case study showed

AMP submitted that it was 'entirely unexceptional' that other entities within the AMP Group analysed and modelled the effect the proposed timing of the transfer of ADAs would have on them and developed plans to mitigate any adverse effects.[696]

The 'other entities' that AMP refers to are AMP Life and PIRC – they were the entities responsible for developing the transition plans for the transfer of the ADAs. AMP Life was also one of the entities that was contractually obliged to act in the AMP trustees' members' best interests in performing the AMP trustees' powers, duties and discretions.

---

689 Transcript, Rachel Sansom, 16 August 2018, 5115–16.

690 Transcript, Rachel Sansom, 16 August 2018, 5121.

691 Exhibit 5.283, 27 April 2017, Memorandum to AMP Life and NMLA Audit Committee, 121.

692 Transcript, Rachel Sansom, 16 August 2018, 5123.

693 Transcript, Rachel Sansom, 16 August 2018, 5117–18.

694 Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6935].

695 Transcript, Rachel Sansom, 16 August 2018, 5119.

696 AMP, Module 5 Case Study Submission, 7 [28].

The ADA timing was ultimately determined by AMP Life as the entity responsible for the transitions.[697] The determination of timing involved a potential conflict between the interests of members and the interests of the AMP advice business. PIRC or AMP Life were acting on information in the PIRC Pricing Paper, or the PwC heat maps, which was relevant to mitigating adverse effects on the advice business. But none of this was revealed to the trustees. AMP may well be right that all of this is 'entirely unexceptional' within AMP. That does not make it right.

AMP also submitted that there was no evidence that the considerations as to profit being made in other parts of the business affected the timing of the ADA transitions approved by the AMP trustees.[698] I accept that the trustees' approval of the transition plans did not take into account the consequences for other parts of the business. The trustees simply endorsed the transition plans, prepared by another team within AMP.[699]

The trustees were not told about the detail in the PIRC Pricing Paper or the preparation of the PwC heat maps. The AMP trustees received updates from AMP Life about the progress of the transitions, and information about why the transitions were spread over a number of years.[700] This was the same information provided to the regulators,[701] and it did not record commercial considerations about the effect the timing of the transfers would have on the AMP Group profits.[702]

697 Exhibit 5.280, 3 May 2013, Trustees MySuper Transition Plan, 8, 10.

698 AMP, Module 5 Case Study Submission, 7 [27].

699 Transcript, Rachel Sansom, 16 August 2018, 5112.

700 Transcript, Rachel Sansom, 16 August 2018, 5153; Exhibit 5.296, 24 March 2015, AMP Super and NM Super Board Papers, 73.

701 Transcript, Rachel Sansom, 16 August 2018, 5117–18; Exhibit 5.277, Witness statement of Rachel Sansom, 9 August 2018, Exhibit RCS-1 [AMP.6000.0190.6935].

702 Transcript, Rachel Sansom, 16 August 2018, 5154.

AMP also submitted that the AMP trustees 'completed all [ADA] transfers within the mandated timeframe'.[703] As noted, the evidence was that the largest ADA transition was completed two months before the time by which the SIS Act required the transfers to be completed.[704] That the AMP trustees did not breach the SIS Act obligation to complete the transfers by a certain date because AMP Life transferred all ADAs by the required date is not the point. The question is whether the AMP trustees otherwise considered all relevant circumstances and discharged their duties to the members in accordance with the law.

There was no evidence that the AMP trustees took any steps to enquire into the financial effect that the timing of the transition of their members' ADAs to MySuper products would have on those members. This is so even though Ms Sansom's evidence was that, if the ADA transition were happening today, the boards that she currently serves would certainly ask questions relevant to profit.[705] Instead, the evidence suggests that the AMP trustees were content to leave these decisions with AMP Life and other parts of the AMP Group and be provided with information that those entities thought relevant and necessary to provide to them. That is not conduct consistent with the AMP trustees' obligations to inform themselves of any relevant matters to a decision being made, and does not demonstrate an exercise of the same degree of care, skill and diligence as a prudent superannuation trustee would in the circumstances.

3.2.12 Pricing decisions

Evidence

There were various delegations in place within the AMP Group for approving fees.[706]

---

703 AMP, Module 5 Case Study Submission, 7 [28].

704 Transcript, Rachel Sansom, 16 August 2018, 5125; Exhibit 5.282, 22 June 2017, Board Papers AMP Limited, AMP Life and NMLA, 71.

705 Transcript, Rachel Sansom, 16 August 2018, 5119.

706 Transcript, Rachel Sansom, 16 August 2018, 5113–14.

One committee that approved fees was PIRC.[707] Ms Sansom's understanding was that PIRC was a pricing committee within the AMP Business, but that it was not the role of Trustee Services (or Regulatory Governance) to interact with that committee.[708]

PIRC was responsible for determining the initial pricing of the AMP trustees MySuper products in 2013.[709] Ms Sansom's understanding of this process was that a proposal was brought to the AMP trustee boards for approval from another part of the business.[710]

The AMP trustees approved the initial pricing of their MySuper products in 2013,[711] and the subsequent changes to that pricing in July 2018.[712] In each case, the fees also had to be approved by the boards of AMP Limited, AMP Life, or both AMP Limited and AMP Life, before they could take effect.[713] This was because of the significance of the fees to the AMP Group's profits.[714]

707 Transcript, Rachel Sansom, 16 August 2018, 5113.

708 Transcript, Rachel Sansom, 16 August 2018, 5114.

709 Transcript, Rachel Sansom, 16 August 2018, 5113; Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application.

710 Transcript, Rachel Sansom, 16 August 2018, 5113. The proposal was brought to the trustee boards in a memorandum titled 'MySuper Fee basis' dated 13 May 2013: Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application; Transcript, Rachel Sansom, 16 August 2018, 5113. This memorandum was to be read with a memorandum dated 7 May 2013 regarding the applications for MySuper product authorisations: Exhibit 5.278, 7 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application.

711 Exhibit 5.278, 13 May 2013, Memorandum to Board of AMP Super and NM Super Concerning MySuper Fee Basis and MySuper Authorisation Application; Transcript, Rachel Sansom, 16 August 2018, 5113–14.

712 Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42; Exhibit 5.290, 25 July 2018, ASL and NM Super Board Papers, 10.

713 Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42.

714 Transcript, Rachel Sansom, 16 August 2018, 5113–14, 5139–42.

Ms Sansom said that, since the initial pricing was approved in 2013, various reviews of the pricing have taken place, but the first time a price change was brought to the trustee boards in relation to MySuper products was July 2018.[715] Ms Sansom said that 'the opportunity to endorse a price change [had not] been there until quite recently'.[716]

What this part of the case study showed

As I have explained, the pricing of AMP's MySuper products was determined by parts of the AMP Group other than the trustees.

AMP submitted that the fact that pricing required approval by others in the AMP Group did not mean that the AMP trustees failed to properly exercise their functions as, without the AMP trustees' approval, 'the products would not have been offered to members'.[717] AMP submitted that the trustees were required to ensure that their products could operate sustainably, which required input and approval from others in the AMP Group.[718]

There is no doubt that a trustee can rely on information from others, within or outside a corporate group, to inform themselves as to whether the fees charged through their products are 'sustainable' for the trustee. But there was no evidence that ASL or NM sought analysis about the anticipated effect the fees would have on investment returns, or whether the fees were competitive. Indeed, as already seen, this level of reporting is only now being incorporated into the BMM – more than four years after the introduction of their MySuper products. Again, the AMP trustees appeared to rely on the assumption that the pricing provided by PIRC in 2013 was consistent with the AMP trustees' discharge of their duties to their members.

Ultimately, the fees that were approved by the trustees in 2013 were not competitive. They were significantly reduced in 2018 because they were affecting the net performance of members' investments, and in some cases, they were generating negative returns for the members.

715 Transcript, Rachel Sansom, 16 August 2018, 5113.

716 Transcript, Rachel Sansom, 16 August 2018, 5113.

717 AMP, Module 5 Case Study Submission, 7 [26].

718 AMP, Module 5 Case Study Submission, 7 [26].

3.2.13 Termination of arrangements

AMP submitted that the AMP trustees were able and would be willing to terminate their outsourcing arrangements in appropriate circumstances if necessary to protect members' interests.[719]

In November 2017, following APRA's review of the BMM in March 2017, AMP Enterprise Risk Management and Trustee Services prepared a list of events that could trigger a review, and lead to termination, of the AMP trustees' outsourcing arrangements.[720] There were 12 events listed.[721] Each was a significant event.

In the context of the negative net returns on cash investments, Mr Allert said that, beyond lowering the fees, the AMP trustees were not in a position where they could say to AMP Life that the current arrangements were not acceptable to the AMP trustees' members and move the investments out of AMP Life.[722] Mr Allert said that, in the current circumstances, there was no sensible possibility that would happen.[723]

I explain what this part of the case study showed as part of the wider considerations of the case study as a whole. I now turn to these.

---

719 AMP, Module 5 Case Study Submission, 12 [53]; see also Transcript, Richard Allert, 16 August 2018, 5099.

720 Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 125.

721 These were: change of ownership; insolvency of AMP Limited (and subsequently AMP Life); significant reputational impact to AMP; change in regulatory requirements that has a significant detrimental impact to AMP; significant change in AMP's strategy and/or its implementation resulting in a diminished commitment to superannuation; failure to adequately remediate breaches that have an impact on members; AMP's inability to provide necessary capital requirements; majority of BMM reports not received over two consecutive quarters; sustained underperformance by AMP against agreed standards with no commitment to rectify; significant increase in member fees; material fraud or non-compliance event; and breakdown in relationship that cannot be rectified within agreed timeframe: Exhibit 5.289, 30 November 2017, ASL and NM Board Papers 6 December 2017, 67, 164–7.

722 Transcript, Richard Allert, 16 August 2018, 5099.

723 Transcript, Richard Allert, 16 August 2018, 5098–9.

3.3 What the case study showed

3.3.1 Key problem

The central point to be made from the evidence detailed above, and what I have said each aspect of the evidence showed, is that ASL and NM have implemented their outsourcing arrangements with other entities in the AMP Group in a manner that has presented, and, on the face of the evidence, continues to present, real and serious difficulties to each trustee in the proper performance of their obligations.

The problem is not outsourcing in general. Trustees are not, and should not be, prohibited from outsourcing or delegating their powers and duties.[724] The problem is the extent to which ASL and NM can discharge, and are discharging, their duties to their members in light of their *particular* outsourcing arrangements and the approach they adopt to those arrangements in light of their position within the AMP Group. They have made themselves submissive to the decisions of those to whom they have outsourced their tasks.

Two themes emerged from the evidence that are particularly important in considering ASL and NM's compliance with these covenants.

The first theme is the deficient reporting to ASL and NM. The evidence illustrated four examples in which the reporting to the trustees under the BMM may be said to be deficient: performance of cash investments; performance of MySuper products; monitoring of investments and indirect costs; and issues concerning distribution of the trustees' products.

The second theme in the evidence was the failure of the trustees to take steps to remedy the deficiencies in information provided to them, or to seek information that would give them a proper understanding of decisions being made by others in the Group. Nothing prevented them from actively testing the information provided to them by parts of the AMP Group, or from seeking further information to satisfy themselves that they had discharged their duties. But they did not do this.

---

724 See SIS Act s 52(5), which confirms that a trustee is not prevented from engaging or authorising persons to act on its behalf. See also APRA, Prudential Standard SPS 231 and APRA, Prudential Standard SPS 510, which requires the trustee board to have in place frameworks for outsourcing and delegation of duties and powers to others.

The evidence suggests that the trustees did not do this because they relied on the relevant parts of the business, to which the trustees' powers, duties and discretions had been outsourced, to ensure compliance with the trustees' obligations. This was so even where relevant parts of the Group had interests in conflict with those of members of the trustees' funds. To the extent that something went wrong, the trustees expected that it would be brought to their attention. Indeed, that was the premise central to the BMM and the exceptions reporting.

The trustees' exception reporting framework through the BMM is not unlike arrangements in other companies where the board is notified about particular issues within the business on an exceptions basis. There is commercial sense in this type of arrangement. However, problems arise where, as it does in the case of the AMP trustees, the board receives reporting that is deficient. That problem is compounded where the board does not actively seek to test the information or ensure it is sufficient.

I have noted some of the failures to take action in the face of deficient reporting already. This reliance on other parts of the business to act in members' best interests, or to act in a way that would discharge the trustees' duties, was also illustrated through the ADA transition, and decisions as to pricing of the trustees' products.

3.3.2 Overarching conclusions about the trustees' outsourcing arrangements

What conclusions should be drawn from the two themes in the evidence about the extent to which the trustees' particular outsourcing arrangements are consistent with the trustees meeting their duties?

AMP submitted, in effect, that nothing can be drawn from these matters. It submitted that its outsourcing model was effective. It submitted that no findings of possible misconduct were open to me save where AMP had already admitted possible misconduct in a breach report to ASIC or APRA or both. It said that '[t]he evidence received by the Royal Commission demonstrates the prudent and effective management of the funds by the Trustees'.[725]

I do not believe that the problems can be so easily swept aside. There are three covenants imposed on the trustees under the SIS Act that require careful consideration in relation to the trustees' outsourcing arrangements: section 52(2)(c) of the SIS Act, which requires the trustee to perform its duties and exercise its powers in the best interests of the beneficiaries; section 52(2)(d), which requires, in general terms, the trustee to prioritise the interests of the beneficiaries over its own and others' interests; and section 52(2)(h), which requires the trustee not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers.

The way that the trustees carried out their outsourcing arrangements may have given rise to breaches of the covenants in section 52(2)(c), (d) and (h) in the following ways.

Section 52(2)(c)

AMP submitted that the duty in section 52(2)(c) of the SIS Act was not a duty to 'achieve particular outcomes for members' and that, 'although the [AMP trustees] will always strive to achieve this, the provision certainly does not impose a strict duty to achieve *the best* outcome for members' (emphasis in original).[726] Like others who appeared before the Commission in the fifth round of hearings, AMP submitted that the duty was directed at a proper process not at particular outcomes.[727] But again the aphorism may conceal more than it reveals.

It may be accepted that the duty in 52(2)(c) is breached by an inadequate process. It may also be accepted that an inadequate outcome does not demonstrate breach. Neither Counsel Assisting nor any person making submissions suggested otherwise. But it does not follow that the outcome of the process is to be disregarded.

---

725 AMP, Module 5 Case Study Submission, 1 [5].

726 AMP, Module 5 Case Study Submission, 16 [74].

727 AMP, Module 5 Case Study Submission, 16 [74].

A poor outcome for beneficiaries may point to a specific inadequacy in the process used by the trustee. In general, the poor outcomes achieved by the AMP trustees require an explanation as to why they occurred and went undetected for so long if the trustees' processes were adequate. Indeed, one of the most basic tasks undertaken by a trustee acting in the best interests of its members and exercising the care, skill and diligence of a prudent superannuation trustee would be to engage in a process of self-evaluation to pinpoint the reasons for a poor outcome.

But, outcomes aside, having regard to the deficiencies in reporting, and lack of steps taken by the trustees to satisfy themselves that they were doing the best they could for their members, I am satisfied that the trustees' implementation of their outsourcing arrangements may be conduct that was inconsistent with the covenant in section 52(2)(c). The poor outcomes for members points towards that conclusion.

Section 52(2)(d)

AMP did not accept that its outsourcing arrangements presented difficulties for it in complying with section 52(2)(d) of the SIS Act.[728]

AMP submitted that the AMP trustees are 'cognisant of the potential for conflicts that may arise within the outsourced model' and are 'mindful of their duties and obligations with regard to conflicts', including Prudential Standard SPS 521: Conflicts of Interest.[729] AMP said that the AMP trustees have 'robust policies and frameworks in place for the identification and management of conflicts', and that the outsourcing arrangements expressly deal with conflicts and require the interests of members to be preferred.[730]

The outsourcing agreements do not require any potential conflicts to be reported to the trustees so that the trustees can monitor how the conflicts are resolved. For example, the Master Outsourcing Agreement between AMP Life and ASL requires AMP Life to prefer the interests of the

728 AMP, Module 5 Case Study Submission, 15–16 [73], 19–20 [90].

729 AMP, Module 5 Case Study Submission, 6 [21].

730 AMP, Module 5 Case Study Submission, 6 [21].

beneficiaries where there is a conflict[731] but it does not require AMP Life to report that conflict to the trustee.

The circumstances of the ADA to MySuper transition plan illustrate this problem of being uninformed about conflicts. AMP submits that the trustee acted appropriately in approving the transition plan because the trustee was concerned about the management of risk. But the trustee was concerned about the management of risk because that was what AMP Life told the trustee was the reason underlying the transition plan. AMP submitted that '[t]hat other members of the Group had regard to the particular interests of their stakeholders in relation to particular matters does not mean that the Trustees failed to properly exercise their functions'.[732] But the trustee was not told about the use of the PwC heat maps to determine effects on advisers or made aware of the obvious possible conflict between the interests of other parts of the AMP Group and the interests of the superannuation beneficiaries in relation to the transition plan.

The decisions about pricing of the trustees' products also illustrate the conflicts inherent in the trustees' operations. AMP submitted that the trustees had the ultimate decision regarding pricing, and that the trustees 'were not forced to accept the pricing offered or approved elsewhere'.[733] That may be true. But the reality is that the pricing of the trustees' products was determined elsewhere in the Group, and the trustees did not seek to be informed of the information underpinning the pricing, or whether that pricing was the best that could be done for their members. And once the fees proved to be uncompetitive and produce poor outcomes for their members, they could only be reduced once there was also approval from other parts of the Group. Mr Allert's evidence was plain that despite the high costs, the trustees had no intention of investing the assets of the funds somewhere else or engaging another investment management service provider.[734]

---

731 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6490–.6491, cl 2.6].

732 AMP, Module 5 Case Study Submission, 6–7 [25].

733 AMP, Module 5 Case Study Submission, 19 [86].

734 Transcript, Richard Allert, 16 August 2018, 5099.

Indeed, Mr Allert's evidence was that the trustees were not in a position where they could say to AMP Life that the current arrangements were not acceptable to the AMP trustees' members and move the investments out of AMP Life.[735] Mr Allert said that, in the current circumstances, there was no sensible possibility that would happen.[736]

These instances show that the trustees were not arming themselves with knowledge of conflicts that existed, or may exist, because of their outsourcing arrangements. And trustees cannot properly exercise their functions as contemplated by section 52(2)(d) without being aware of the conflicts that arise and, with that awareness, being prepared to take steps to test whether the interests of the beneficiaries are truly being preferred.

Section 52(2)(h)

The trustees acknowledged that their outsourcing arrangements have not relieved them of their duties to the members of the funds.[737] Indeed, AMP said that the primary intent of the BMM was to ensure that the AMP trustees could and would successfully discharge their obligations to their members.[738] And this proposition was central to the Fund Governance Charter, on which AMP relied in its submissions.[739]

AMP submitted that it was not open to me to find that the AMP trustees may have breached the covenant set out in section 52(2)(h) of the SIS Act by maintaining their outsourcing arrangements.[740] AMP submitted that its trustees' 'outsourcing agreements do not prevent or hinder the Trustees from exercising their powers and functions … Rather, the outsourcing agreements are the means by which the Trustees properly perform and

735 Transcript, Richard Allert, 16 August 2018, 5099.

736 Transcript, Richard Allert, 16 August 2018, 5098–9.

737 AMP, Module 5 Case Study Submission, 1–2 [6].

738 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

739 AMP, Module 5 Case Study Submission, 1–2 [6].

740 AMP, Module 5 Case Study Submission, 19–20 [85]–[89].

exercise many of their functions … they explicitly require the outsource providers to act in accordance with the Trustees' obligations'.[741]

I accept that AMP Life and NMMT are required under the outsourcing agreements to act so as not to cause the trustees to breach their obligations.[742] But the trustee is still the trustee. It is the trustee that must fulfil its obligations.

The submissions of AMP help to identify the fundamental problem with the trustees' outsourcing arrangements: in practice, it was and is assumed by the AMP Group and the AMP trustees that the outsourced providers can and will fulfil the trustees' duties for the trustees, so that the trustees can be, and are, passive.

The trustees' passivity is manifest in three ways.

First, the passivity is reflected at the most basic level in the contractual agreements. ASL and NM do not pay AMP Life to provide it with services. Rather, ASL and NM are paid by AMP Life to be the trustee of the funds.

Second, it was evident in the evidence given by Mr Allert. His evidence, relied on by AMP in its submissions, was that he did not consider that the issues concerning negative net returns warranted terminating the relationship with AMP, because he had 'complete confidence' that the issues would be fully dealt with by AMP.[743] Yet Mr Allert was seemingly indifferent about why the issues had arisen in the first place and why they had been allowed to continue for so long.

Because of this unquestioning trust, the trustee boards depended on exception reporting to bring to their attention any matters that may cause, or may have caused, them to breach any of their duties. The BMM expressly

---

741 AMP, Module 5 Case Study Submission, 18 [83].

742 Exhibit 5.267, Witness statement of Richard Allert (5-15), 25 July 2018, Exhibit RHA-2 [AMP.6000.0190.6472 at .6488–.6489, cls 2.2 and 2.3]; Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0125.0272 at .0292, cl 7.1].

743 AMP, Module 5 Case Study Submission, 12 [53]; Transcript, Richard Allert, 16 August 2018, 5099.

recognised this.[744] And although, as I noted above, at a general level there is nothing objectionable in an exceptions-based reporting structure, reliance on such a structure to the extent that the directors do not interrogate or enquire further into the information provided to them leads to the difficulties that the trustees have faced. And reliance without interrogation and enquiry is not consistent with the duties of the trustees.

AMP sought to meet the inadequacies in the detailed formal rules for reporting to the trustee boards by relying upon the general discretion of Trustee Services and outsourced providers to bring important matters to the attention of the trustee boards. But that directs attention to how the reporting worked in practice if left to the discretion of outsourced providers. The reporting was inadequate. The reporting by AMP Life of investment performance did not provide the AMP trustees with the performance of their products net of fees and taxes. The reporting through the BMM did not enable the AMP trustees to identify the fees being wrongly charged by AMP Capital as a result of the Expense Recovery and Fee Rebate Incidents at the time that the fees were being wrongly charged.

Third, the passivity is demonstrated in the trustees' inability or unwillingness to influence outcomes for members without the agreement of the AMP Group.

Mr Allert's evidence was that the AMP trustees were not in a position to move the investments out of AMP Life. And Ms Sansom said that she had considered the fees to be too high for some time but that it was a matter for the AMP Product Team. Nothing was done until APRA identified the problem, and even then no steps were taken until a month before the Royal Commission's superannuation hearings were due to commence.

AMP submitted that Counsel Assisting had not articulated how the AMP trustees had exercised their powers in a way that was contrary to the interests of the members, relying on the BMM framework to support their argument. In AMP's submission, the BMM was 'plainly a prudent exercise of the [AMP trustees'] responsibility to provide proper governance'.[745]

---

744 Exhibit 5.265, Witness statement of Richard Allert (5-06), 25 July 2018, Exhibit RHA-1 [AMP.6000.0124.0552 at .0553].

745 AMP, Module 5 Case Study Submission, 15 [73].

But, as AMP has acknowledged, its trustees have breached their statutory obligations in several respects in the last few years because of the conduct of the related parties to whom they have outsourced their functions. The contractual obligations imposed on the related parties did not prevent these breaches. The contractual obligations did not cause the AMP trustees to be made promptly aware of the breaches. In one case (negative net returns to members invested in cash), the AMP trustee became aware of the problem after it had continued for three years and only because of an APRA investigation.

AMP has not sought to explain how it reconciles these breaches with its proposition that the outsourcing arrangements are adequate. Taken as a whole, AMP's outsourcing arrangements allow and encourage the trustee to be passive and both the trustees and the other parts of the AMP Group assume and believe that this is appropriate and acceptable. The trustees, by implementing their outsourcing arrangements in the manner in which they have, and rely upon as the explanation for their passivity, may have contravened the covenant in section 52(2)(h) of the SIS Act.

The potential breaches of the covenants set out in section 52(2)(c), (d) and (h) not having been so far drawn to the attention of the regulator, I refer AMP's conduct to APRA in accordance with paragraph (a) of the Commission's Terms of Reference, for that agency to consider what action it can and should take.

Conclusion

This case study demonstrates two things.

First, the ease with which a trustee within a retail group may substitute the rigour and discipline required to fulfil its duties to members, with leaving others within the group to carry out its tasks, believing that copious process would ensure compliance.

Second, the readiness of APRA, the responsible regulator, to accept, or not identify, this substitution of form for substance.

APRA conducted a review of the BMM in 2017, and found that the BMM largely complied with prudential and legal requirements – indeed, APRA characterised the BMM as 'robust',[746] a characterisation that AMP sought to rely on in its submissions.[747] APRA's characterisation of the BMM suggests that its assessment may not have grappled with the way in which the trustees were conducting their outsourcing arrangements, and what that meant for the trustees' members.

APRA was aware before the hearings for Round 5 of at least some of the issues that I have identified – it had brought the poor performance of MySuper products to the trustees' attention, and prompted them to identify issues such as the negative net returns to members invested in cash.

But, like the trustees, APRA did not seem to make the link that the trustees' absolute reliance on the BMM and outsourced arrangements constituted failures of duty when those mechanisms, themselves, failed.

This suggests that APRA needs to do more in its evaluation of how trustees of vertically integrated institutions are complying with their fundamental duties to their beneficiaries. In particular, it highlights the need for APRA to consider whether the Standards and Guidelines for which it is responsible should be revised to improve the ability of both APRA and the trustee within a vertically-integrated group to adequately evaluate whether the trustee is promoting the best interests of members. For example, certain types of decisions by such trustees might be required to be reviewed by an external expert to certify that they are consistent with their obligations owed to members. APRA might also consider whether additional licence conditions should be imposed on some RSE licensees to report particular decisions to APRA for the purpose of evaluating conflicts. But any such developments in APRA's approach must be more than merely an additional layer of regulatory process. What is required is improvement in the quality of APRA's evaluation of conflicts management within retail groups, not merely more regulatory boxes to be ticked.

746 Exhibit 5.291, 7 April 2017, Letter from APRA to Sansom, 3.

747 AMP, Module 5 Case Study Submission, 2 [15].

4 IOOF

4.1 Background

IOOF Holdings Ltd is a publicly listed company. IOOF Investment Management Limited (IIML) and Questor Financial Services Limited (Questor) are subsidiaries of IOOF Holdings.

IIML is an RSE licensee and the trustee of various superannuation funds, including the IOOF Portfolio Service Superannuation Fund (IPS Fund).[748] Questor was an RSE licensee and was the trustee of various superannuation funds, including The Portfolio Service Retirement Fund (TPS Fund).[749]

IIML is, and Questor was, a dual-regulated entity (DRE). That is, in addition to being the trustee of one or more superannuation funds, the entity is also the responsible entity (RE) for one or more managed investment schemes. Subject to some conditions, an entity that is the RE of a managed investment scheme may itself acquire and hold an interest in the scheme.[750] And, of course, an entity that is trustee of a superannuation fund can acquire and hold an interest in the scheme. Hence, an entity that is a DRE may, and IIML and Questor did, invest the assets of superannuation funds of which it was trustee in the managed investment schemes of which it was RE. As REs, IIML and Questor also acquired and held interests in those schemes. Arrangements of this kind present a real and continuing possibility of conflict between the interests and duties that attach to each role.

The Commission looked at three aspects of conduct relating to IOOF's superannuation business.

- The examined Questor's conduct in connection with the recovery of an amount that it had wrongly paid to unit holders in a managed investment scheme of which it was RE and in which, as trustee, it had invested, and in which, as RE, it held interests. This event was referred to as 'Questor's over-distribution'.

[748] Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [14]–[16].

[749] Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [14]–[15].

[750] Corporations Act s 601FG.

- The second aspect of conduct examined related to IOOF's dealings with APRA about questions of governance, management of conflicts of interest and culture more generally.
- The third focused upon IIML's decision, in 2018, to change the fees and charges (the 'pricing') for the IPS Fund by applying the new and lower pricing to new members but only applying the new pricing to existing members if and when the member asked for it to be applied.

Both at the times relevant to the issues examined by the Commission and when the Commission took evidence about those issues, Christopher Kelaher was Managing Director of IOOF Holdings. The Commission heard evidence from Mr Kelaher, Mark Oliver, the General Manager, Distribution, for IOOF and Stephen Glenfield, a General Manager of APRA's Specialised Institutions Division who, at relevant times, was the general manager of APRA's supervisory team supervising IOOF.

On 6 December 2018, after the Commission received evidence, APRA commenced proceedings in the Federal Court against IIML, Questor, Mr Kelaher and four other individuals.[751] I summarise the allegations in that proceeding below. That proceeding having commenced, I make no comment or findings about the matters referred to in the papers filed by APRA. It remains appropriate, however, to say something about a letter Questor sent to members in 2016 in connection with Questor's over-distribution, and IIML's conduct regarding the pricing of the IPS Fund. Both issues lie outside the subject matter of the APRA proceeding.

A related issue arose in the ANZ case study. At the time of the hearings, ANZ had two superannuation trustees, OnePath Custodians (OPC) and Oasis Fund Management Limited (Oasis). In October 2017, ANZ agreed to sell both trustees, along with some other parts of its business, to IOOF. A condition precedent of that sale was that OPC approve a successor fund transfer (SFT) – in other words, the sale agreement could not proceed without OPC's co-operation. The Commission heard evidence from the Chair of OPC and Oasis, Victoria Weekes, about the way OPC approached that decision.

751 *APRA v Christopher Francis Kelaher & Ors*, Federal Court of Australia, NSD 2274/2018.

4.2 The APRA proceedings

On 6 December 2018, APRA commenced proceedings against IIML, Questor, Mr Kelaher, and four other individuals holding senior positions at IOOF: the Chair, George Venardos; the Chief Financial Officer, David Coulter; the General Manager – Legal Risk and Compliance and Company Secretary, Paul Vine; and the General Counsel, Gary Riordan.[752] The documents filed by APRA alleged that:[753]

- Until January 2014, Questor was the RE of two managed investment schemes, known as the Cash Management Trust (CMT) and The Portfolio Service Plan (TPS MIS). Questor invested the funds of the TPS Fund and the TPS MIS in the CMT. In May 2009, Questor as RE for the CMT made an overpayment to unitholders that was distributed to individual investors in the TPS Fund and TPS MIS. Questor did not identify the error until 2011. To address the overpayment, it caused a reduction in distributions from the CMT. This prejudiced new members in TPS Super who had not received any of the overpayment. The board of Questor then approved a plan to (a), use the amount received from a settlement with Questor's custodial services provider to wholly compensate investors in a managed investment scheme of which it was RE, and (b), to compensate superannuation members from the remainder of the settlement amount while using the TPS Fund's general reserve to make up the shortfall. The compensation plan continued to be implemented by IIML following an SFT from TPS Super to IPS Super. IIML did not replenish the general reserve of TPS Super or IPS Super until October 2018, following repeated requests from APRA.
- From around 2007, IIML failed to reinvest certain income distributions in accordance with instructions from clients of its Pursuit investor directed portfolio service product. The failure was not detected until 2014, and affected both superannuation beneficiaries and non-superannuation investors. In 2015, IIML approved a plan to pay compensation to non-superannuation investors from its own funds, and to pay superannuation beneficiaries from the superannuation fund's Operational Risk Financial Reserve (ORFR).

---

752 *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

753 Concise Statement filed on behalf of APRA dated 6 December 2018. See also Originating Process filed on behalf of APRA dated 6 December 2018.

- In around 2011, Questor failed to reinstate automatic investment plan instructions given to it by approximately 1,300 clients. The failure was not detected until January 2015, and affected both superannuation beneficiaries and investors in managed investment scheme products. In 2015, Questor approved a plan to compensate non-superannuation investors from Questor's own funds, and superannuation beneficiaries from the superannuation fund's ORFR.
- In 2015, Singtel Optus Pty Ltd requested that IIML transfer the Optus employee default superannuation arrangements from the IPS Fund to an AMP fund. IIML and Mr Kelaher rejected the proposed SFT without taking any or adequate steps to consider whether the transfer was in the best interests of beneficiaries.
- Until 2018, the boards of IIML and Questor did not distinguish between when they were acting as the board of a superannuation trustee or as the board of an RE of a managed investment scheme, and did not identify potential or actual conflicts of interest arising from these dual roles.
- In responding to APRA's concerns about these and other matters, Questor, IIML, and the five individuals demonstrated a lack of understanding of their obligations under the SIS Act and the general law; failed to properly implement a robust conflicts management framework as required by SPS 521; failed to ensure that Questor and IIML complied with APRA's requirements and recommendations in a timely manner or at all; and failed to comply with SPS 520, which requires responsible officers of a superannuation trustee to be aware of their legal obligations.
- The conduct gave rise to breaches of sections 52(2)(b), 52(2)(c), 52(2)(d) of the SIS Act by Questor and IIML, and breaches of sections 52A(2)(c), 52A(2)(d), 52A(2)(f) and 55(1) of the Act by Mr Kelaher and the Chair of IOOF Holdings, George Vernardos.

In the same proceeding, APRA sought disqualification orders under section 126H of the SIS Act against Mr Kelaher, Mr Venardos, Mr Coulter, Mr Vine and Mr Riordan.

On 6 December 2018, APRA also sent a 'show cause' letter to IOOF's legal representatives, setting out its intention to direct IIML to comply with its RSE licence and to impose additional conditions on the licences of IIML and two other IOOF subsidiaries. The proposed directions to IIML related to 'breaches, or potential breaches, of the SIS Act and relevant prudential standards identified by Ernst & Young in their report dated 4 September 2018'.[754] The proposed additional conditions related to what APRA said were 'failures to adequately identify and manage conflicts of interest throughout the IOOF Group, and failures to comply with legislative requirements and prudential standards'.[755]

The Commission's Terms of Reference provide that I am not required to inquire, or continue to inquire, into a particular matter to the extent that I am satisfied that the matter is being, or will be, sufficiently and appropriately dealt with by a civil proceeding. I am, of course, satisfied that the matters described above will be sufficiently and appropriately dealt with in those proceedings. I make no findings about the particular contraventions alleged in those proceedings. Whether other forms of proceeding could or should be instituted in respect of these matters is a matter for APRA and I say no more about it.

As I said at the outset, however, it remains appropriate to deal here with one related matter: a letter Questor sent to members of the TPS Fund in respect of Questor's over-distribution.

754 Letter APRA to King & Wood Mallesons, 6 December 2018, 1, <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

755 Letter APRA to King & Wood Mallesons, 6 December 2018, 1, <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

4.3 The 2016 letter

4.3.1 Background

In order to understand the issues relating to the letter, it is necessary to set out some background.

Before 2016, Questor was the RSE licensee for the TPS Fund.[756] Before 2014, Questor was also the RE of the CMT.[757] The CMT was a managed investment scheme that invested in cash deposits and short to medium term securities.[758]

Before 2016, Questor held some units in CMT as RSE licensee of the TPS Fund.[759] In its capacity as RSE licensee of the TPS Fund, Questor held the relevant units in the CMT on trust for the members of the TPS Fund.[760]

NCS was a subsidiary of NAB. NCS was the custodian of the assets of the CMT.[761] As custodian, it was responsible for holding CMT's assets for safekeeping.

In 2009, Questor as RE of the CMT made an over-distribution of $6.16 million to the unit holders in the CMT.[762] The over-distribution occurred because NCS mistakenly treated an asset of CMT as income.[763] The error was discovered in 2011, when a new custodian of the assets of the CMT audited the assets of which it had been appointed custodian and found the asset was missing.[764]

756 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [14].

757 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 3 [15].

758 Exhibit 5.120, 20 October 2013, Memorandum from Head of Risk to General Counsel, 3–4; Transcript, Christopher Kelaher, 10 August 2018, 4608.

759 Transcript, Christopher Kelaher, 10 August 2018, 4608.

760 Transcript, Christopher Kelaher, 10 August 2018, 4608.

761 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 7 [34].

762 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 7 [33].

763 Exhibit 5.129, 18 August 2016, Memorandum Concerning Conflicts and Decision-making Map, 2.

764 Transcript, Christopher Kelaher, 10 August 2018, 4610.

In 2011, Questor sought to recoup, or ‘claw back’, the over-distribution and ‘restore’ the CMT.[765] From September 2011, Questor, as RE of the CMT, ‘reduced’[766] the distributions that it paid, including to itself as RSE licensee of the TPS Fund.[767] The ‘reduction’ in distribution was intended by those who implemented it to continue over three years.[768] The calculation had apparently been made that, by the end of three years, the ‘over-distribution’ would have been recouped.[769]

The Questor Board was told about the issue in early 2013.[770] There is no evidence that the board ever approved the ‘reduction’ in distribution.

The reduced distributions affected all members of the TPS Fund for whom some part of the amounts attributable to them in that fund were invested in the CMT. Some members of the TPS Fund had not been invested in the CMT at the time of the over-distribution and therefore did not receive the over-distribution. Some members may have increased their interest in the CMT since the time of the over-distribution. All of these members would suffer loss as a consequence of the reduction in the distribution.

At some time, before October 2013, somebody within Questor formed the intention to compensate those members who suffered loss as a result of the reduction in distribution, and to provide the compensation after the clawback had finished, in amounts that would be assessed then.[771] It is not clear when that intention was formed.

765 Transcript, Christopher Kelaher, 10 August 2018, 4645–6.

766 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 9 [50(a)].

767 Transcript, Christopher Kelaher, 10 August 2018, 4611.

768 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 17) [IFL.0029.0001.1190 at .1191].

769 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, [50(a)–(b)].

770 Transcript, Christopher Kelaher, 10 August 2018, 4617.

771 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, 11 [55(h)]; Exhibit 5.129, 18 August 2018, Memorandum Concerning Conflicts and Decision-making Map, 2.

In October 2015, the board approved compensation to the TPS Fund members.[772] It decided that part of the compensation would come from the general reserve of the TPS Fund.[773]

The TPS Fund general reserve was made up of money from various sources, including unallocated interest and asset/liability mismatches.[774] It did not contain money taken from individual members' contributions or returns. Although not allocated to individual members' accounts, he general reserve was an asset of the TPS. It was vested in Questor on trust for the members.

4.3.2 The letter to members

In 2016, Questor wrote to members of the TPS Fund. The letter said:[775]

> Following a periodic review of the CMA, we identified a historical distribution error in an underlying investment of the CMA that resulted in income distributions being credited to your CMA at a lower rate than it should have been.

As is apparent from what has been set out above, this statement was untrue. There was no 'periodic review of the CMA' that identified a historical distribution error. There was no historical distribution error that resulted in income distributions being credited to members' CMA at a lower rate than it should have been. The lower distributions were not an error by Questor. The lower distributions were the result of a deliberate decision made by some employees within Questor. The lower distributions continued after Questor's Board was informed of the decision.

In its written submissions, IOOF submitted that the statement was not misleading. I say more about those submissions later when considering

772 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 10) [IFL.0029.0001.2611 at .2615].

773 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 10) [IFL.0029.0001.2611 at .2615].

774 Exhibit 5.305, 19 August 2013, Reserves Policy, 5.

775 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164 at .1164].

whether it is open to me to find that there may have been misconduct by Questor in relation to the letter.

The letter sent to members of the TPS Fund in 2016 also said that 'to ensure you are not disadvantaged, we have calculated compensation to 30 June 2016'.[776] It then set out the amount that would be applied to the member's account.[777] The letter did not explain why the over-distribution occurred or where the compensation money was coming from.

4.4 Changing the pricing for the IPS Fund

In 2018, IIML decided to make some pricing changes as part of 'Project Evolve', a broader strategy to simplify IIML's administration systems.[778]

According to an internal analysis presented to IIML's leadership group, 29,263 members of IOOF Employer Super (IES) would be better off under the new pricing.[779] The same paper identified an 'arbitrage risk': a risk that existing members would move to the new pricing and pay lower fees.[780] However, the analysis said that this risk was different from the risks associated with other repricing decisions because of grandfathered commissions, an 'unengaged membership', and the fact that many members would be only marginally better off.[781] The analysis noted that there had been very little member movement after a fee reduction in 2014.[782]

776 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

777 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

778 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

779 Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

780 Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

781 Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

782 Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

Mr Oliver said that the analysis reflected two assessments made by IOOF.[783] The first was that members who did not have a financial adviser, 'and were therefore unengaged', were unlikely to move to the new pricing.[784] The second was that members with a grandfathered trail commission were unlikely to move to the new pricing.[785] Mr Oliver said this reflected IOOF's experience that 'products with grandfathered trails tend to take longer to move to a new price point', even though members would be better off under the new pricing.[786]

In February 2018, a management paper was given to IIML's board. The paper proposed that *new* members would be charged according to the new pricing, but that *existing* member pricing would not change; existing members would be 'grandfathered'.[787] The paper referred to the 'arbitrage risk', but assessed it as a low risk.[788] At the meeting, the board asked management whether the new pricing *should* apply to all existing clients.[789]

Mr Oliver's team considered this question. They found that applying the new pricing to existing members would cost $8 million per year.[790] They also found that of the 29,000 members who would be better off, about 20,000 had a grandfathered commission.[791]

Management prepared a revised paper for the board.[792]

[783] Transcript, Mark Oliver, 10 August 2018, 4599–600.

[784] Transcript, Mark Oliver, 10 August 2018, 4599.

[785] Transcript, Mark Oliver, 10 August 2018, 4600; see also Exhibit 5.113, 31 January 2018, Memorandum, Broom and Mason to IOOF Leadership Group, 5.

[786] Transcript, Mark Oliver, 10 August 2018, 4600.

[787] Exhibit 5.107, 12 February 2018, Board Papers for Meeting of Directors of IIML, 66.

[788] Exhibit 5.107, 12 February 2018, Board Papers for Meeting of Directors of IIML, 66.

[789] Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 9; Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

[790] Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

[791] Exhibit 5.109, 13 February 2018, Emails between Oliver, Mason and Others.

[792] Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15.

The revised paper, dated 2 March 2018, pointed out that:

> The setting of fees for superannuation products gives rise to a potential conflict between IIML's best interests duty to members in its capacity as Trustee and its corporate objective of deriving income from a retail product.
>
> Where there is a conflict, IIML as Trustee of the Products is required to give priority to the duties to, and interests of, members, and act fairly between and within classes of members of the fund.[793]

The revised paper said that about half of the existing members 'may potentially benefit under the new pricing'.[794] It said that those members would not be automatically moved to the new pricing[795] but that, to manage the conflict identified in the paper, there would be a communication plan where:[796]

> All financial advisers will receive notification of the new product pricing and features prior to launch in April 2018. The notice will recommend that advisers review their clients' current situation and needs, before advising whether it is in their best interests to transfer to the new product offering.

Members would also receive a letter in the mail about the 'new features and benefits' and refer them to the updated PDSs that would be available on IOOF's website 'if they would like more information'.[797] The revised paper did not say that the letter would tell members about the lower fees. The paper also did not say how many members had grandfathered commissions, or how likely those members were to move to the new pricing of their own accord.[798]

Sometime before 22 March 2018, a director sent an email to management about the matters dealt with in that paper.[799] The director observed that it

793 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 28.

794 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15.

795 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

796 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

797 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 16.

798 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 15–16.

799 Exhibit 5.110, 22 March 2018, Email Mota to Broom and Others with Attachment, March IIML Papers.

was in members' interests to have the lower pricing, but in IIML's interests for them to have the higher pricing and said that IIML had to prioritise the interests of members.[800]

Management prepared a further paper, dated 22 March 2018, providing more information to the board.[801] This further paper said, as part of the background to the proposal, that upon completion of the simplification project (Project Evolve), IIML 'will be better placed to deliver lower fees to all members and minimise account erosion, while continuing to invest in the future growth and value enhancement for all members'.[802]

The paper then dealt with a number of matters relevant to members' best interests.

First, the paper said that IIML could not tell whether individual members would actually be better off.[803] It suggested that if a member moved to a new fee arrangement without grandfathered commissions, 'they may be charged a separate advice fee from their adviser' but, as the paper went on to say, that would depend on whether the member sought advice.[804]

Second, the paper said that applying the fee changes to all members who would be better off would reduce the income to the fund by approximately $10 million per annum, which would make any change 'unsustainable and unviable'.[805]

Third, the paper said that the strategy was 'not revenue-driven', but was intended to 'facilitate a sustainable and viable transition to a more cost-effective structure for all members'.[806]

---

800 Exhibit 5.110, 22 March 2018, Email Mota to Broom and Others with Attachment, March IIML Papers.

801 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

802 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 206.

803 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

804 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

805 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

806 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

Fourth, the paper said that appropriate communications would 'minimise risks of disengagement'.[807]

The general tenor of the paper was that an 'approach which sees the recommended pricing only apply to new members, while allowing all members to access the new pricing on request, based on their personal circumstances and needs, would seem to provide an optimal approach'.[808] The paper did not explain that members without advisers, or members with advisers who received grandfathered commissions, were unlikely to switch to the new pricing.

On 23 March 2018, the board considered the matter. Only the two independent directors voted. They approved the changes and communication plan.[809]

4.5 ANZ transaction

As already noted, ANZ has agreed to sell its superannuation business to IOOF. The Commission looked at how the ANZ trustee approached its role in that transaction.

OPC, Oasis and OnePath Life Limited (OnePath Life) are all subsidiaries of ANZ. They operate within the Pensions and Investments (P&I) business unit of ANZ Wealth, which is in turn a division of ANZ.[810] OPC and Oasis are both RSE licensees of regulated superannuation funds. OnePath Life is a life company. OPC is the RSE licensee of two regulated superannuation funds, the OnePath MasterFund (the MasterFund) and the Retirement Portfolio Service (the Retirement Portfolio). OPC issues a number of superannuation products through the MasterFund. Contributions into those products are invested through investment-linked life policies issued to OPC

807 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

808 Exhibit 5.111, 12 March 2018, Board Papers for Meeting of IIML Board, 208.

809 Exhibit 5.112, 30 May 2018, Board Papers, Meeting of IIML Board, 10.

810 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 6 [11].

by OnePath Life. OnePath Life is also the administrator and group insurer of the MasterFund.[811]

ANZ has agreed to sell OPC and Oasis, and other parts of the P&I business, to IOOF Holdings.[812] At the time of the relevant hearings, the transaction had not been completed. ANZ has separately agreed to sell OnePath Life to Zurich Financial Services Australia Limited.[813]

The boards of OPC and Oasis were not consulted about the transaction.[814] They have no direct control over whether the transaction proceeds. However, a condition precedent of the transaction is that OPC redeem the investment-linked life policies issued by OnePath Life, and transfer the assets of the MasterFund to another superannuation fund. Either OPC or an IOOF company must be the trustee of that other fund.[815] The purpose of this condition is to separate the business being sold to IOOF Holdings from the business being sold to Zurich.[816]

The OPC Board must approve the redemption and transfer.[817] At the time Ms Weekes gave evidence, the board had given 'in principle' approval to consider an SFT from the MasterFund to the Retirement Portfolio.[818] The board preferred this option, as it would have the least impact on members.[819] It would also have some benefits, including removing the complex investment structure (currently in place through OnePath Life's life policies) without incurring capital gains tax.[820] However, the board had not decided whether to make the transfer. Ms Weekes said it would

811 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [18].

812 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [13].

813 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [18].

814 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [14].

815 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 7 [19].

816 Transcript, Victoria Weekes, 15 August 2018, 5027.

817 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 8 [22].

818 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 11 [36].

819 Transcript, Victoria Weekes, 15 August 2018, 5027.

820 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [94].

only do so if the transfer was in the best interest of beneficiaries of both the MasterFund and the Retirement Portfiolio.[821]

Two specific issues about the transaction arose.

The first related to grandfathered commissions. ANZ management had given the board a number of papers about the transaction that dealt with grandfathered commissions. One noted a 'working assumption' that commissions would continue to be grandfathered, and that 'support from the advisor network is critical' to the transaction.[822] Another referred to risks that could arise if grandfathered commissions were 'disturbed'.[823]

Ms Weekes said that the management papers did not necessarily reflect the view of the board.[824] Both she and others on the board had queried those statements.[825] In particular, Ms Weekes did not accept that 'disturbing' grandfathered commissions would have any negative effects on members.[826] The board had asked for legal advice and would consider the issue further.[827]

The board had not previously considered whether it was in the best interests of members to keep paying commissions.[828] However, the advice it asked for would cover grandfathered commissions both 'in the status quo' and after the transaction.[829] Ms Weekes was clear that she and the OPC Board

821 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 22 [106].

822 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, Exhibit VW-2 [ANZ.801.042.0085].

823 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, Exhibit VW-2 [ANZ.801.042.0085].

824 Exhibit 5.252, Board Meeting Papers Onepath Custodians, 26 February 2018.

825 Transcript, Victoria Weekes, 15 August 2018, 5031.

826 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [92].

827 Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 20 [90].

828 Transcript, Victoria Weekes, 15 August 2018, 5032.

829 Transcript, Victoria Weekes, 15 August 2018, 5032.

would make any decision about grandfathered commissions regardless of the wishes of the parent company – whether ANZ or IOOF.[830]

The second issue related to IOOF Holdings. Ms Weekes said that as part of deciding whether the transfer was in members' best interests, the board needed to consider matters that 'pertain to IOOF'.[831] Ms Weekes said that the board was not just concerned with the 'technical transaction' or the systems and structures that would be in place after the transaction was complete.[832] The board was also concerned with IOOF's view about the business and future.[833] To that end, the board had received media reports about IOOF and a legal report identifying some issues.[834]

In January 2018, the board had requested a meeting with IOOF 'to give comfort to the Board that members best interest obligations will be met going forward'.[835] At the time of her evidence in August 2018, that meeting had not occurred. This was a deliberate decision. Ms Weekes said that considering the transfer was a complex process, and the board was focused on getting the information it needed.[836] Engaging with IOOF too early could 'confuse the very deliberate and careful considerations and the component parts of our decision'.[837] Once the board was ready, it would consider engaging directly.[838]

---

830 Transcript, Victoria Weekes, 15 August 2018, 5032.

831 Transcript, Victoria Weekes, 15 August 2018, 5029.

832 Transcript, Victoria Weekes, 15 August 2018, 5029; Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 15 [62(c)].

833 Transcript, Victoria Weekes, 15 August 2018, 5029; Exhibit 5.251, Witness statement of Victoria Weekes, 14 August 2018, 15 [62(c)].

834 Transcript, Victoria Weekes, 15 August 2018, 5035.

835 Exhibit 5.253, 29 March 2018, Board Meeting Agenda OnePath Custodians, 16.

836 Transcript, Victoria Weekes, 15 August 2018, 5033.

837 Transcript, Victoria Weekes, 15 August 2018, 5033.

838 Transcript, Victoria Weekes, 15 August 2018, 5033–4.

Ultimately, Ms Weekes was clear that if the board was not satisfied that joining the IOOF group was in the best interests of members, it would not approve the SFT.[839]

Following APRA's announcement of proceedings against IIML, Questor, and IOOF senior executives, ANZ announced that 'Given the significance of APRA's action, we will assess the various options available to us while we seek urgent information from both IOOF and APRA.'[840]

4.6 What the case study showed

4.6.1 Did Questor mislead TPS members in breach of section 12DA of the ASIC Act?

Counsel Assisting submitted that Questor may have engaged in misleading and deceptive conduct, in breach of section 12DA of the ASIC Act, by sending the letter to TPS members saying that they would receive compensation for a 'historical distribution error'.[841] IOOF submitted that such a finding was not open.[842] It submitted that the 'historical distribution error' in the letter meant the over-distribution, and on that basis everything else in the letter was true.[843]

There are a number of reasons that I cannot accept this submission.

First, the letter said that the problem had been detected 'following a periodic review'.[844] In fact, the problem was detected when the new custodian took over from NCS. The statement in the letter was not true. Questor did not submit that it was.

---

839 Transcript, Victoria Weekes, 15 August 2018, 5034.

840 ANZ, 'Update on Sale of Wealth Businesses' (Media Release, 7 December 2018).

841 Counsel Assisting, Module 5 Closing Submission, 65 [228.3].

842 IOOF, Module 5 Case Study Submission, 11 [45].

843 IOOF, Module 5 Case Study Submission, 11 [46].

844 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

Second, the letter said that a ‘historical distribution error’ had ‘resulted in’ a lower rate of return.[845] As IOOF submitted, the expression ‘historical distribution error’ means the over-distribution. But the over-distribution did not ‘result in’ a reduced rate of return. Questor’s decision to claw back the over-distribution caused the reduced rate of return. The clawback was not inevitable. Questor chose to recoup the loss to the CMT in this manner.

Third, the letter did not explain that the compensation was being paid out of an asset held on trust for those members. Nor did it explain the choices Questor had made that led to the need for compensation.

Taken as a whole, the letter created the impression that an unexplained ‘error’ had reduced members’ payments, and Questor was now paying them back. In fact, Questor had chosen to reduce their payments to make up a loss in a different fund it controlled. It was using money it held on trust for them to pay compensation to them. In this way, the letter may have been misleading.

There is no evidence that this possible contravention of the ASIC Act is presently under investigation. The authority responsible for such a contravention is ASIC. I refer the matter to ASIC, pursuant to paragraph (a) of the Commission’s Terms of Reference for ASIC to consider what course it should take.

4.6.2 Pricing changes

Counsel Assisting submitted that IIML may have breached section 52(2)(c) of the SIS Act, and prioritised its own interests over the interests of members of the fund in breach of section 52(2)(d) of the Act, by not applying the new IES pricing to members who would be better off.[846]

IOOF rejected that suggestion. It submitted that the repricing decision was part of a broader strategy to benefit all members,[847] that there was no

845 Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 12) [IFL.0029.0001.1164].

846 Counsel Assisting, Module 5 Closing Submission, 65 [229.1].

847 IOOF, Module 5 Case Study Submission, 13 [56].

evidence that retaining revenue was an important consideration for IIML,[848] and that in any case IIML was not able to identify which members would be better off.[849] IOOF emphasised that IIML made the new pricing available to existing members.[850]

There were three troubling aspects of IOOF's approach to the pricing changes.

The first is that IIML appeared to assume that financial advisers will not act in members' best interests. Mr Oliver's evidence was that members paying a grandfathered trail commission are generally slower to move to new pricing, even when it is in their interests to do so. That can only happen if members are not receiving appropriate advice.

The second is that IIML management may not have given priority to members' best interests. Management knew that members would be better off if they moved, but assumed that they would not. Management relied on that assumption when setting the new pricing. In fact, it set the pricing such that if all new members took it up immediately the product would become 'unviable'. That is, IIML's management were proposing a pricing scheme under which either some members would be worse off because their financial advisers failed to act in their interests, or the product would be unviable. Despite apparently believing that some financial advisers would be slow to move clients to lower pricing, IIML's communication plan relied on those same advisers to advise members about the lower pricing.

Third, IIML management did not explain this to the board. None of the board papers explain IIML's experience with grandfathering. None of the papers explain how many members were paying trail commission. In those circumstances, the board could not make an informed decision about the proposal or the communication plan.

Having regard to these matters, I am satisfied that IIML may have failed to act in the best interests of members and thereby contravened section 52(2)(c) of the SIS Act. The matter not having been drawn to the

848 IOOF, Module 5 Case Study Submission, 13 [59].

849 IOOF, Module 5 Case Study Submission, 14 [62].

850 IOOF, Module 5 Case Study Submission, 15 [63].

attention of the regulator, I refer the conduct to APRA in accordance with paragraph (a) of the Commission's Terms of Reference, for its consideration.

4.6.3 ANZ transaction

Finally, it is as well to say something about the conduct of the OPC Board. OPC is a trustee within a large retail group. The sale of OPC and Oasis was one part of a larger transaction, arranged by and for the benefit of the trustee's parent group. The trustee's approval of the SFT was a condition precedent to that transaction.

The tenor of Ms Weekes' evidence was that the OPC Board was focused on the interests of its members. Her evidence was that the board actively considered the various matters involved, sought more information when necessary, was prepared to challenge management, and tried to think strategically about both the substantive decision and the board's decision-making processes. That focus on OPC's members, despite significant and potentially conflicting interests of the parent group, is to be commended.

5 ANZ branch selling program

5.1 Background

OnePath Custodians Pty Ltd (OPC) is a wholly owned subsidiary of ANZ and an RSE licensee. OPC offers a superannuation product that it refers to as Retail Smart Choice Super. OPC says this is a basic, low fee superannuation product[851] that is 'designed to be used by a broad range of people irrespective of their age and income'.[852] This case study considered the distribution of the Retail Smart Choice Super product through ANZ branches.

851 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [290]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221.

852 Exhibit 5.310, Witness statement of Timothy Mullaly, 8 March 2018, Exhibit TM-3 [ASIC.0041.0006.0051 at .0076].

Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, gave evidence about this case study.

5.2 Evidence

From 2012 until August 2018, OPC engaged ANZ to distribute the Retail Smart Choice Super product through ANZ branches.[853] The distribution process followed a 'scripted general advice model'.[854] It was designed to 'leverage' a regulatory exemption that allowed branch staff, who were not financial planners, to provide general advice and sell certain financial products by following a script.[855] Branch staff were not allowed to make a recommendation, provide advice, or take into account any information about the customer. If they knew that Retail Smart Choice Super was not suitable for the customer, they could not say so.[856]

The distribution process was as follows. When a customer came into an ANZ branch for help – about any matter, not just superannuation – branch staff could conduct an 'A–Z Review'. An A–Z Review involved the staff member asking the customer questions about their financial situation, and discussing the customer's 'goals and needs'.[857] At the end of the A–Z Review, the staff member could recommend retail banking products to the customer.[858] This was a general discussion about the customer's finances and ANZ's banking products. It had nothing to do with superannuation.

After the A–Z Review, the staff member read the customer a 'delinking statement'.[859] In full, that statement was:[860]

---

853 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [290]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221.

854 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291].

855 Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 6.

856 Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 5.

857 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 104 [289].

858 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 104 [289].

859 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(b)].

860 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-215 [ANZ.800.873.0025].

> Now that we've completed the A–Z Review, would you like me to provide you with some general information on ANZ Smart Choice Super, which is designed to be a simple low cost way for customers to manage their superannuation.
>
> Please be aware that I won't be able to use or reference any of the information you've already provided me when discussing this product with you.
>
> Would you like to know more about this product?

If the customer wanted more information, the staff member would offer to refer the customer to an ANZ financial planner.[861] From June 2015, a referral was only offered to customers with funds under management or whose gross yearly salary was over $50,000.[862] If the customer declined, or no referral was offered, the process would continue.

The staff member would then give the customer a pack of documents that included a product diclosure statement (PDS) and a brochure. The staff member would read aloud the first two pages of the brochure.[863] Those two pages included a 'general advice disclosure', which said that the staff member could 'only provide general advice' and that the customer should consider if the product was 'right for you'.[864] From 2014, it also said that the information given by the staff member did not take into account the customer's 'personal circumstances, objectives or needs'.[865] The staff member also read out from the brochure a statement of 'things you need to know'. These were that the customer should consider exit fees or additional costs, changes in investment risk exposure, and loss of any insurance they

861 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(d)].

862 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(d)].

863 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(e)], [291(b)].

864 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-216 [ANZ.800.873.0001].

865 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-217 [ANZ.800.873.0009]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-218 [ANZ.800.873.0017]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-219 [ANZ.800.891.0038]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-220 [ANZ.800.875.0001].

had through their current superannuation.[866] At this point, if requested, the staff member would help the customer open a Retail Smart Choice Super account.[867]

Mr Pankhurst said that ANZ thought that this process meant customers only received general advice, not personal financial advice (which branch staff were not allowed to provide).[868] ANZ monitored compliance with the process through a 'mystery shopping' program, customer surveys and tests of branch staff members. ANZ found that the process was complied with in the large majority of cases.[869]

Between 1 June 2016 and 30 June 2018, 60,466 customers opened a Retail Smart Choice Super account on the same day that they had an A–Z Review. Of those customers, 23,967 made a contribution or rollover into their account.[870] In total, 400,988 Retail Smart Choice Super accounts were opened between 2012 and 30 June 2018.[871] When Mr Pankhurst gave evidence, the value of funds under management in Retail Smart Choice Super products was approximately $3.6 billion.[872]

866 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-217 [ANZ.800.873.0009]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-218 [ANZ.800.873.0017]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-219 [ANZ.800.891.0038]; Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-220 [ANZ.800.875.0001].

867 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 105 [291(f)].

868 Transcript, Mark Pankhurst, 16 August 2018, 5055.

869 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 107 [306]; Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 3 [9].

870 Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 4 [10]. Due to data limitations, ANZ does not know how many A–Z Reviews were conducted before June 2016: Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 2 [8].

871 Exhibit 5.257, Witness statement of Mark Pankhurst, 14 August 2018, 2 [6].

872 Transcript, Mark Pankhurst, 16 August 2018, 5060.

5.2.1 The Services Deed

OPC engaged ANZ to perform the distribution process through a services deed executed in August 2012.[873] OPC did not pay ANZ for providing the distribution service.[874] Mr Pankhurst said that OPC would distribute revenue from Retail Smart Choice Super as part of its ordinary arrangements with ANZ.[875]

In 2012 the Deed referred to branch staff providing information 'within' the A–Z Review process.[876] In September 2016, well after ASIC started investigating the matter, the Deed was amended to refer to providing information 'after' the A–Z Review process.[877] Mr Pankhurst was 'surprised' by the wording of the earlier version, because he had always understood that the information was to be provided after the A–Z Review.[878] ANZ submitted that the earlier wording was an error or 'infelicity of expression' that did not reflect the actual arrangements.[879] I accept that, in practice, the process operated in the way described above. The earlier version of the Deed simply highlights, perhaps inadvertently, that the sales process was seen within ANZ as inextricably entwined with the A–Z Review.

5.2.2 ANZ's consideration of risks

In September 2011, ANZ's Managing Director of Distribution for Australia Division made a presentation to ANZ's Chief Risk Officer identifying a number of risks with the 'scripted general advice' model. Those risks included a failure to ensure the correct process was followed, failure to provide the general advice warning, and failure to ensure that only general

---

873 Exhibit 5.260, 3 August 2012, Deed of Amendment to the Services Deed between ANZ and OnePath Custodians.

874 Transcript, Mark Pankhurst, 16 August 2018, 5059–60.

875 Transcript, Mark Pankhurst, 16 August 2018, 5060.

876 Exhibit 5.260, 3 August 2012, Deed of Amendment to the Services Deed between ANZ and OnePath Custodians, 22.

877 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-153 [ANZ.800.778.0254 at .0283].

878 Transcript, Mark Pankhurst, 16 August 2018, 5059.

879 ANZ, Module 5 Case Study Submission, 6 [19].

advice was provided.[880] It also included a risk that regular breaches 'would be seen by the regulator as "systemic"[,] putting ANZ's licence at risk'.[881] The presentation described the 'inherent risk rating' of the process as 'extreme', but that with controls the 'residual risk rating' was 'medium'.[882] The presentation said that distribution of Tier 1 products (such as Retail Smart Choice Super) through branches was a 'key component' of ANZ's strategy to 'improve its wealth penetration'.[883] It recommended that the Chief Risk Officer accept the risks.[884]

Two years later, in 2013, ANZ identified a number of specific risks in the distribution process. One was that discussing Retail Smart Choice Super directly after the A–Z Review might 'imply to the customer that the staff member believes Retail Smart Choice Super is suitable for them'.[885] The 'delinking statement' and 'general advice warning' were intended to address this risk by separating the A–Z Review from the provision of information about Retail Smart Choice Super. Another risk, which one paper described as the 'key risk', was that customers would switch their superannuation without understanding the consequences, and end up with a less suitable product.[886] The 'things you need to know' statement was intended to address this risk.

880 Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

881 Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 3.

882 Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 3.

883 Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

884 Exhibit 5.262, 30 September 2011, Retail Distribution Advisory Risk, Australia Division, 2.

885 Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution.

886 Exhibit 5.261, September 2013, Sale of Wealth Products by Retail Distribution, 4.

5.2.3 ASIC investigation

In September 2014, ASIC started investigating ANZ's distribution process.[887] In December 2016, ASIC gave ANZ a 'position paper' that said that ASIC suspected that the distribution process breached the law.[888] In May 2017, ASIC sent ANZ a draft court pleading that alleged that the distribution process breached the law.[889] Between May 2017 and July 2018 the parties negotiated. On 5 July 2018, ASIC accepted an enforceable undertaking (EU) from ANZ.[890]

The EU recorded that ASIC held several concerns. One of those concerns was that the distribution process may not have allowed for informed decision-making, because customers may not have realised that branch staff were not considering their personal circumstances.[891] Another was that branch staff had provided personal advice.[892] The EU said that ASIC was concerned that ANZ may have breached sections 912A, 964A and 961K of the Corporations Act. ANZ acknowledged in the EU that ASIC's concerns were reasonably held.[893]

Under the EU, ANZ agreed to stop using the distribution process, or any similar process, within 45 days of the EU.[894] In submissions, ANZ said it had stopped the practice 'from 18 August 2018'.[895]

887 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 107 [300].

888 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-2 [ASIC.0041.0003.2761].

889 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-6 [ASIC.0041.0001.7093].

890 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001].

891 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

892 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

893 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0004].

894 Exhibit 5.256, Witness statement of Mark Pankhurst, 105 [290].

895 ANZ, Module 5 Case Study Submission, 6 [20].

5.3 What the case study showed

5.3.1 Distribution process

Superannuation is a complex financial product that, for many people, is one of their biggest assets. It is different in both character and importance from retail products like a bank account. However, ANZ's distribution process effectively added Retail Smart Choice Super to its normal sales process for retail products. As ANZ identified, this process gave rise to two significant risks: first, that the customer would conclude from it being offered immediately after the A–Z review that the staff member thought the product suitable for the customer; and second, that the customer would switch superannuation accounts when it was not wise to do so. ANZ submitted to the Commission that both risks were mitigated by the 'delinking statement', the 'general advice disclosure', the statements made to the customer that they should consider their existing superannuation product, and the fact that the statements were read verbatim.[896] I do not agree.

Information about Retail Smart Choice Super was provided to customers immediately after they were asked about their financial situation and had discussed their 'goals and needs'. As ANZ recognised, the very structure of that process could imply that staff were suggesting the product because it was right for them. If customers believed that the product was suitable for them, they would be more likely to switch. Yet, in fact, the product might not be suitable. Indeed, branch staff might know (from the A–Z Review) that Smart Choice Super was *not* suitable, but could not tell the customer. In other words, ANZ's process required its staff to stand by while customers made decisions that were not in their interests. Reading out two short scripted statements could not overcome this risk.

The second risk was that customers would switch their superannuation without proper consideration, and be worse off as a result. The considerations involved in switching superannuation – such as exit fees, investment risk, and insurance – are important and often complex. Every customer should carefully consider them before making a decision. ANZ's own risk assessments and scripts acknowledged this. Yet the distribution process ultimately led to the staff member offering to help the customer

---

896 ANZ, Module 5 Case Study Submission, 8 [33], [35].

apply for an account on the spot. Few customers could appropriately consider those complex issues and make an informed decision to open a new account right away, particularly if they had not come to the branch to talk about superannuation. Again, this problem could not be overcome by short scripted statements.

5.3.2 Misconduct

Despite its acknowledgment in the EU that ASIC's concerns were reasonably held, ANZ submitted to the Commission that its conduct did not breach section 912A of the Corporations Act or fall below community standards and expectations.

Effective controls?

ANZ submitted that it had behaved prudently by identifying the risks in the process and putting in place appropriate controls.[897] It submitted that its control framework was effective, pointing to the results of the mystery shopping program.[898] But those results showed only that in most (but not all) cases, branch staff were complying with the process. They did not show that the process was effective. In particular, they did not show whether customers understood that the discussion about Retail Smart Choice Super was entirely separate from the A–Z Review.[899] And even if that was understood, ANZ's controls did not show whether customers would be harmed by switching to the offered product.

To Mr Pankhurst's knowledge, ANZ has never considered whether customers were worse off as a result of switching to Retail Smart Choice Super.[900] In its submissions, ANZ submitted that ASIC had not 'definitively' identified any customer who was worse off.[901] The suggestion appeared to be that I should not make any of the adverse findings invited by Counsel Assisting without definitive evidence that customers were worse off.

---

[897] ANZ, Module 5 Case Study Submission, 7 [32].

[898] ANZ, Module 5 Case Study Submission, 9 [37].

[899] Transcript, Mark Pankhurst, 16 August 2018, 5065–6.

[900] Transcript, Mark Pankhurst, 16 August 2018, 5067.

[901] ANZ, Module 5 Case Study Submission, 6 [23], 9 [37].

I do not find this submission convincing. ASIC had only conducted 'a preliminary analysis' of 'a small number of customers'.[902] At the least, some of those customers had given up Total and Permanent Disability (TPD) Insurance coverage as a result of switching to Retail Smart Choice Super.[903] ANZ further observed that of the customers ASIC reviewed, all but one were paying lower fees in Retail Smart Choice Super than in their old superannuation fund. However, as ANZ's own scripts acknowledged, there are important matters other than fees that are relevant. The distribution process did not allow for proper consideration of those matters.

ASIC's guidance

Underlying a number of ANZ's submissions was the proposition that ANZ's practices were consistent with ASIC's published guidance, and with ASIC's views (as ANZ understood them). In particular, ANZ referred to a risk paper dated July 2011. That paper recorded that in 2009, ANZ had sought ASIC's view about branch distribution of a different product. According to the paper, ASIC had indicated to ANZ that:[904]

> The ability to provide general advice was not compromised by prior awareness or concurrent completion of a customer fact find process. The crucial factor was the absence of a personal recommendation as to the suitability of, or, [recommendation] to acquire a product.'

ANZ referred to ASIC's Regulatory Guide 244, which states that ASIC will 'not consider general advice to be personal advice' where the customer is told that they are not being given personal advice and their relevant circumstances are not considered.[905] ANZ also submitted that its training of branch staff exceeded the minimum requirements set by ASIC's Regulatory Guide 146.[906]

I do not doubt that at the time ANZ began to sell Retail Smart Choice Super in branches, it believed that its conduct was lawful. In particular,

---

902 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 16 [76].

903 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 16 [76].

904 Exhibit 5.263, July 2011, Wealth Risk Mass Market Wealth Australian Distribution Advice and Distribution Risk, 18.

905 ASIC, Regulatory Guide 244, 13 December 2012, reg 244.23.

906 ANZ, Module 5 Case Study Submission, 9 [36].

I accept that it thought it possible to sell superannuation under a 'general advice model' and that this view of the matter was discouraged neither by ASIC's response when ANZ raised the question with it nor by the requirements set out in the above-mentioned regulatory guides. It would have been better if ASIC had made clear that distributing complex financial products in this way was unacceptable. But I do not consider that this excuses ANZ's conduct. First, ANZ knew the risks of the process from its own analyses. Its primary concern should have been whether the distribution process was appropriate for customers, which it was not. Second, ANZ did not respond to the regulator's expressions of concern. By 2014, ANZ knew that ASIC had concerns about the process. By 2016, it knew that ASIC suspected it had breached sections 912A, 961B and 961K of the Corporations Act. By May 2017, it knew that ASIC was threatening to go to court alleging contravention of those provisions. Yet ANZ continued to use the distribution process. It continued using the process while negotiating the EU. It continued using the process after the EU was signed. In fact, it did not stop the process until three days before the absolute deadline imposed by the EU. The only conclusion can be that the profitability of this sales channel was more important than the probability that what was being done was contrary to law.

Breaches

Under section 912A(1)(a), ANZ was required to do all things necessary to ensure that its financial services were provided 'efficiently, honestly and fairly'. As I have explained above, ANZ's process:

- could have led customers to wrongly believe staff thought the product was suitable for their individual needs;
- prevented staff from telling customers if staff thought the product was unsuitable; and
- not only facilitated, but encouraged, customers opening an account without the customer properly considering the consequences.

ANZ recognised those risks. It should not have distributed a superannuation product in this way. In doing so, ANZ may not have ensured that financial services were provided 'efficiently, honestly and fairly' as required under section 912A(1)(a). As ASIC has accepted an EU from ANZ in respect of its concerns, I do not consider it necessary to refer these matters to ASIC.

6 Suncorp Portfolio Services Limited

6.1 Background

Suncorp Portfolio Services Limited (SPSL), a company within the Suncorp group, is the trustee of two superannuation funds, Suncorp Master Trust (the Master Trust) and the Suncorp Pooled Superannuation Trust.[907] At the time of the Commission's inquiries, the Master Trust had funds under administration of around $6.8 billion and approximately 216,000 members.[908] The Master Trust contains a number of different divisions as a result of several successor fund transfers between 2008 and 2011.[909] The assets in at least three of those divisions are invested in life insurance policies issued by Suncorp Life and Superannuation Limited (Suncorp Life), another company within the Suncorp group.

The evidence focused on two issues:

- the payment of amounts by SPSL to Suncorp Life for services, and the disclosure of those payments to members; and
- some aspects of SPSL's responses to the MySuper reforms.

907 Transcript, Maurizio Pinto, 13 August 2018, 4806.

908 Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 3 [12].

909 Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 2 [9]; Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007].

The Commission heard evidence from Mr Maurizio Pinto, the Executive Manager of the Office of the Superannuation Trustee within SPSL.[910]

6.2 Evidence

6.2.1 Payments to Suncorp Life

SPSL and Suncorp Life share the administration of the Master Trust. SPSL currently provides administration services to 75% of its membership, and Suncorp Life provides administration services to the remaining 25%.[911] Before a recent rebalancing between investment through life insurance policies and investments managed through the Suncorp Group Trust, 'Suncorp Life was administering 45 per cent of the membership and SPSL was administering the remaining 55 per cent'.[912]

SPSL does not recover the costs of its administration of the Master Trust directly from the fund. Instead, administration and other fees are determined for each product and charged to members. Once paid, the fees form part of SPSL's general revenue.[913] This differs from the administration reserve model generally adopted by 'not for profit' RSE licensees. Under that model, a trustee charges fees to cover its estimated expenses. The fees are paid into a reserve from which the trustee's expenses can be paid or reimbursed. By contrast, SPSL simply receives fees as general revenue rather than paying them into a reserve.[914] However, as trustee, SPSL still has the usual right to be indemnified for a liability incurred in its capacity as trustee.[915]

910 Transcript, Maurizio Pinto, 13 August 2018, 4804; Exhibit 1.164, Witness statement of Maurizio Pinto, 5 August 2018; Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018.

911 Transcript, Maurizio Pinto, 13 August 2018, 4813.

912 Transcript, Maurizio Pinto, 13 August 2018, 4813.

913 Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 38 [91]. This is expressly authorised by the trust deed: Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007 at 0035].

914 Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 38 [91].

915 Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, Exhibit EAC-1 [SUN.1506.0001.0007 at 0035].

SPSL maintains a reserve in the Master Trust that it applies to meet or to reimburse itself for the liabilities it incurs as trustee. The reserve is mostly made up of surplus contributions tax amounts.[916] This tax surplus arises because SPSL collects 15% of every taxable superannuation contribution.[917] However, in some circumstances SPSL is entitled to tax deductions. As a result, not all of the 15% it collects needs to be remitted to the ATO to pay the tax due on taxable superannuation contributions. SPSL keeps the difference.[918]

The Trustee Reserve Policy provides that SPSL has a right of reimbursement for properly incurred expenses that SPSL has paid from its own funds.[919] The board is required to satisfy itself that expenses are of a reasonable amount.[920]

A services deed made between SPSL and Suncorp Life provides that SPSL will pay any tax surplus to Suncorp Life in consideration for the provision of 'Additional Services'.[921] 'Additional Services' is defined by reference to services listed in various schedules, and include 'Administration Services', 'Fund Accounting Services', 'Investment Services' and 'Compliance Services', as well as any other services agreed by the parties.[922] The expression expressly excludes services provided under the life insurance policies issued by Suncorp Life to SPSL.

[916] Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 33 [77].

[917] Transcript, Maurizio Pinto, 13 August 2018, 4807.

[918] Transcript, Maurizio Pinto, 13 August 2018, 4808.

[919] Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 41–2 [97]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-1 [SUN.1501.0005.6886].

[920] Exhibit 5.320, Witness statement of Edward Cooley, 25 July 2018, 41–2 [97]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-1 [SUN.1501.0005.6886].

[921] Transcript, Maurizio Pinto, 13 August 2018, 4809–10; Exhibit 5.166, 18 April 2018, Board Submission.

[922] Transcript, Maurizio Pinto, 13 August 2018, 4810–11.

Each financial year between 2013 and 2016, management recommended to the SPSL Board that all of the tax surplus should be paid to Suncorp Life.[923] The annual submission by management generally included a breakdown of the cost of services.[924] The management submission referred to a 'four step test' for the board in reaching its decision:[925]

- Understand the quantum of the surplus.
- Understand the quantum of Additional Services.
- Consider the appropriateness of paying Suncorp Life the surplus in consideration of those Additional Services. It was said that the reasonableness of the payment could be determined by: the disparity of the fee payable for a particular year with previous financial years; the services provided by Suncorp Life in the particular year and over the life of the services deed; and the risk sharing nature of the agreement.
- If SPSL determines that the ongoing value of the fee exceeds the ongoing value of the Additional Services, it should initiate negotiations with Suncorp Life to seek a reduction.

On its face, this process required the board to compare the 'value' of the fee with the 'value' of the Additional Services. But there was no evidence that any attempt was made to value the Additional Services. Rather, the evidence suggested that the cost incurred by SPSL was used as a 'proxy' for the value attributed to the Additional Services.[926]

923 Transcript, Maurizio Pinto, 13 August 2018, 4809; Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 [SUN.1501.0005.5563]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1506.0011.0267]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1506.0011.0260].

924 See, eg, Exhibit 5.166, 18 April 2013, Board Submission.

925 See, eg, Exhibit 5.166, 18 April 2013, Board Submission; see also Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1501.0004.6602]; Exhibit 5.320, Witness statement of Edward Cooley, Exhibit EAC-2 [SUN.1501.0005.0948].

926 Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

A 2017 board submission (for the 2016 financial year) acknowledged that a number of Additional Services could not be accurately valued, but asserted that the value of Additional Services would be significantly higher than the fee actually charged if there was a more reliable methodology for their allocation.[927]

Mr Pinto told the Commission that an equivalent submission has not yet been made to the board in 2018 (for the 2017 financial year).[928]

6.2.2 MySuper transition and ADA transfers

The Commission also heard evidence about SPSL's transition to the MySuper regime.[929]

As I have noted elsewhere, in 2013 the law was changed to require all RSE licensees to transfer accrued default amounts (ADAs) to a MySuper default option by 1 July 2017.

SPSL started transferring ADAs to its MySuper default option on 9 June 2017, and finished on 19 June 2017 – 13 days before the five year time limit expired.[930] Mr Pinto told the Commission that the timing of the transition of ADAs was a deliberate strategy to reduce the implementation risk of the transfer of approximately $790 million of members' funds.[931] He said that the transfer happened after SPSL finished a 'Super Simplification Program'.[932] This program ran from 2015 to November 2017 and had a number of components, including information technology outsourcing, business

927 Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

928 Transcript, Maurizio Pinto, 13 August 2018, 4809.

929 Exhibit 5.170, 2013, MySuper Transition Plan.

930 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32]; Transcript, Maurizio Pinto, 14 August 2018, 4838.

931 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

932 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

process outsourcing, and the simplification of SPSL's existing suite of products.[933]

One consequence of not transferring ADAs sooner was that members with ADAs continued to be charged grandfathered commissions until just before the statutory deadline. After the transfer, commissions could not be charged because of the MySuper rules. But if members gave an investment direction and opted out of the transfer, they would remain in a choice product, the MySuper rules would not apply and grandfathered commissions would continue to be paid.

Members were notified of the transfer on 6 March 2017. Yet SPSL had started communicating with advisers much earlier. Suncorp, in one 2013 email, told advisers that commissions would be payable on products that contained ADAs 'until' 2017.[934] It said that, for choice members who had made an investment decision, '[g]randfathered commissions [will still be] paid on insurance and [funds under administration]'.[935]

SPSL also emailed advisers recommending that 'you call or write to your key MySuper customers and encourage them to make an investment decision'.[936] It emailed advisers lists of their clients who would be affected by the MySuper changes. Mr Pinto said that the trustee had provided the lists and files to an 'intermediaries' team, which was set up to 'assist advisers' and 'build relationships with advisers', without knowing what the documents would be used for.[937] Mr Pinto accepted that an effect of making an investment decision was that the member would not transition into a MySuper product and would continue to pay commissions.[938]

933 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 19–20 [21].

934 Transcript, Maurizio Pinto, 14 August 2018, 4837–8; Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 (Tab 3) [SUN.1508.0007.4238].

935 Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 [SUN.1508.0007.4238].

936 Exhibit 5.165, Witness statement of Maurizio Pinto, 6 August 2018, Exhibit MP-4 [SUN.1508.0007.4238]; Transcript, Maurizio Pinto, 14 August 2018, 4839.

937 Transcript, Maurizio Pinto, 14 August 2018, 4840–1.

938 Transcript, Maurizio Pinto, 14 August 2018, 4839.

6.2.3 FoFA and grandfathering of commissions

The FoFA legislation was passed by Parliament on 25 June 2012 and commenced on 1 July 2012. Compliance with the FoFA reforms, including the ban on conflicted remuneration, became mandatory from 1 July 2013. Less than one week before that deadline, amendments were made to the Product Issue and Distribution Agreement between SPSL, Suncorp Life and Suncorp Financial Services Pty Ltd (Suncorp Financial).[939]

Clause 7 of the Agreement as amended provides for payment of commission and other fees by SPSL to Suncorp Financial as consideration for distribution of SPSL and Suncorp Life's products, including superannuation products.

Internal Suncorp emails from June 2013 said (in relation to the amendments): 'It is critical that these are finalised by this date to ensure that commissions can continue to be paid for any new clients into our products for the next 12 months and … can be Grandfathered after 1 July 2014'.[940] SPSL, as trustee of the Master Trust, agreed to these amendments.

The amount of commissions paid to licensees from the Master Trust has decreased somewhat, from $19,570,000 to $14,717,000 between 1 January 2013 and 1 January 2018.[941] But even if that rate of decrease continues, grandfathered commissions will continue to be paid for many years to come.

6.3 What the case study showed

6.3.1 Use of the tax surplus

Counsel Assisting submitted that SPSL, by its conduct in relation to the tax surplus, may have contravened the best interests obligations; the duty to

939 Exhibit 5.375, 24 June 2013, Document Approval Process Form for Distribution Agreement (SFS, SPSL and Suncorp Life), 17.

940 Exhibit 5.375, 24 June 2013, Document Approval Process Form for Distribution Agreement (SFS, SPSL and Suncorp Life), 5.

941 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 32 [33].

exercise the degree of care, skill and diligence a prudent superannuation trustee would exercise; and the applicable prudential standards.

SPSL submitted that the obligation in the services deed to pay Suncorp Life the tax surplus gave rise to an expense incurred by SPSL for which it was entitled to be indemnified.[942] If followed, so the argument went, that the payments to Suncorp Life under the services deed were a proper exercise of SPSL's right of indemnity.[943]

It will be recalled that the trustee may be indemnified for properly incurred expenses. To be properly incurred, the expenses must be reasonable. And it will be recalled that the management submissions to the board of SPSL said that the board should consider matters bearing upon whether the account to be paid for 'Additional Services' was reasonable. It is not clear that SPSL could decide whether payment of the tax surplus amounts to Suncorp Life was (or is) a properly incurred and reasonable expense. While the four step process set out in the management submissions evidently was directed to those issues, I observe that:

- So far as the evidence goes, the surplus has always been paid to the maximum extent.[944]
- Only limited information is provided to the SPSL Board about the *value* of the services provided by Suncorp Life. Instead, the management submission focused on the *cost* to Suncorp Life of providing those services. That is not the same thing.
- There was no evidence before the Commission of any independent valuation of the services having been requested or undertaken.[945]

942 SPSL, Module 5 Case Study Submission, 15–16 [43].

943 SPSL, Module 5 Case Study Submission, 15 [42].

944 Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563].

945 One management submission said that the cost of individual projects is not benchmarked against what they could be delivered for externally. Exhibit 5.166, 18 April 2013, Board Submission, 5.

- It is anything but clear – and I greatly doubt that the trustee could determine – whether services were provided and paid for under the services deed or under some other contractual arrangement.[946]

Prudential Standard SPS 231: Outsourcing requires RSE licensees to be able to demonstrate that outsourcing to an associated entity is conducted on an arm's length basis.[947] Although SPSL's written submissions pointed out that the standard came into effect after the services deed was executed, SPSL did not go so far as to suggest that SPSL need not comply with the standard.[948] The arrangements between SPSL and Suncorp Life by which Suncorp Life is paid for Additional Services are unlikely to meet those requirements.

Whether or not that is so, I consider that the arrangement made between SPSL and Suncorp Life may not have been administered by SPSL in accordance with its obligation to exercise the degree of care, skill and diligence a prudent superannuation trustee would have exercised, in accordance with the covenant set out in section 52(2)(b) of the SIS Act. I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference, for APRA to consider what action it can and should take.

Separate questions about disclosure to members about the use of the tax surplus were canvassed in written submissions. SPSL submitted that it had a right of remuneration and a right of indemnity and that both are explained to members in relevant product disclosure statements (PDSs) –

946 One management submission said there was overlap between the Additional Services and services provided in return for administration fees: Exhibit 5.320, Witness statement of Maurizio Pinto, 27 July 2018, Exhibit MP-2 (Tab 19) [SUN.1501.0005.5563]. Mr Pinto agreed that SPSL could not be certain that the member was not paying twice for the cost of Suncorp Life's calculation of the unit price, for example: Transcript, Maurizio Pinto, 14 August 2018, 4831.

947 APRA, Prudential Standard SPS 231, 15 November 2012, [16].

948 SPSL, Module 5 Case Study Submission, 17 [48].

albeit that the right of remuneration can be precisely quantified in the form of fees whereas the right of indemnity, by its nature, can not.[949]

In its written submissions, Suncorp submitted that there was no basis for finding that the PDS and Product Guide were misleading. It submitted that there was no basis for an assumption that the administration fees expressly payable by members to SPSL should be 'comprehensive and exhaustive of all administration expenses of the Master Trust'.[950] It also submitted that there could be no reasonable expectation that the fact that excess contributions will be paid to Suncorp Life for administration services will be disclosed. Suncorp submitted that 'the fact that excess contributions tax amounts may be used to pay expenses of the Master Trust *is* disclosed in plain terms in the Product Guide'.[951]

I agree with Suncorp's submission that the PDS and Product Guide were not themselves misleading. The PDS and Product Guide revealed to readers that excess contributions tax collected from members would not be refunded to members. The PDS and Product Guide also revealed that the excess contributions tax might be used to cover administrative expenses that were incurred by the fund. What this meant in terms of the effective amounts paid by a member towards administration of the fund was not revealed by the PDS and Product Guide but, as Suncorp submits, SPSL had no stand-alone obligation to include within the PDS a statement of administration fees that is 'comprehensive and exhaustive of all administration expenses of the Master Trust'.

However, this raises a broader question about the adequacy of the disclosures required to be made by trustees as to the amounts paid by members towards administration.

ASIC's Regulatory Guide 97 provides that a trustee must not use any income tax deductions to reduce the administration fee it discloses.[952] That is, if a trustee charges an administration fee of $100 but receives a $15 income tax deduction, it must disclose the fee as $100, not $85.

---

949 SPSL, Module 5 Case Study Submission, 15 [41].

950 SPSL, Module 5 Case Study Submission, 15 [41].

951 SPSL, Module 5 Case Study Submission, 17 [51].

952 ASIC, Regulatory Guide 97, March 2017, reg 97.172.

The benefit of the deduction should be disclosed under a separate heading within the PDS.

Suncorp, of course, did not use the tax surplus to reduce its disclosed fees. Suncorp simply kept it. Mr Pinto acknowledged that the result of retaining the tax surplus in 2016 was that members of the fund effectively paid a 1.05% administration fee.[953] However, as Mr Pinto also acknowledged, that fact would not be obvious to members.[954] If consumers are to be able to make informed comparisons between funds then they need to be able to understand the implications to them, in dollar or percentage terms, of a fund retaining excess contributions tax. Otherwise, it will be effectively impossible to compare a fund that adopts this practice, and therefore charges a lower face administration fee, with a fund that does not adopt this practice and charges a transparent administration fee that covers all administration expenses.

6.3.2 Misconduct in respect of MySuper and ADA transfers

It will be recalled that RSE licensees were obliged to attribute default contributions to a MySuper product *by* 1 July 2017. SPSL submitted that its conduct was reasonable because it completed the transfer within that legislative time limit.[955] As I have noted elsewhere, the legislative deadline for compliance represented an outer limit. It did not mean that RSE licensees were entitled to wait until 30 June 2017 to comply. They were still required to comply with their other obligations, including their covenant to act in the best interests of members.

SPSL also submitted that it was reasonable to complete the transfer after the Super Simplification Program, because of the complexity that existed before that program was completed.[956] There are two difficulties with this submission. The first is that the Program was not implemented until 2015, long after the transition requirement was known. If it was part

953 Transcript, Maurizio Pinto, 14 August 2018, 4823.

954 Transcript, Maurizio Pinto, 14 August 2018, 4823.

955 SPSL, Module 5 Case Study Submission, 18 [53].

956 SPSL, Module 5 Case Study Submission, 18 [53].

of the transition strategy, why did it not start until 2015? The second is that Mr Pinto said that the transfer, which occurred in June 2017, started 'immediately following the completion of the [Program]'.[957] But he also said that the Program was 'implemented from 2015 until November 2017'.[958] If that is right, the Program was not completed until after the transfer had occurred. This apparent contradiction was not explored in evidence. But even accepting that all of the work of the relevant Program was complete at the time of transfer, I am not persuaded that it provides an adequate reason for Suncorp's delay. At best, it was one factor among others.

One of those other factors was that until the transition happened, commission payments would be made to advisers in respect of ADAs. Advisers stood to benefit from a delayed transition. Members did not. Yet rather than writing to members to inform them of this fact (among others), SPSL wrote to advisers to recommend that the adviser encourage the member to make an investment decision. SPSL submitted that an investment decision did not necessarily mean a continued payment of commission, since a client could tell their adviser they desired to be invested in the MySuper product.[959] Strictly speaking, that is true. But taken as a whole, the communications suggest a focus on encouraging members to take action that would stop them from being transferred to a MySuper product.

I consider that Suncorp's delay in transferring ADAs, and its actions encouraging advisers to contact members, each may have breached the covenant to act in the best interests of its members. It might also have been a breach of its covenant to prioritise the interests of members over others (like financial advisers). The conduct not having been drawn to the attention of the regulator, I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference, for APRA to consider what action it can and should take.

---

957 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 30 [32].

958 Exhibit 5.164, Witness statement of Maurizio Pinto, 5 August 2018, 19 [21].

959 SPSL, Module 5 Case Study Submission, 19 [58]–[59].

6.3.3 Grandfathered commissions

As described above, the Distribution Agreement between SPSL, Suncorp Life and Suncorp Financial was apparently amended, at least in part, for the express purpose of maintaining grandfathered commissions. This topic was not explored in Mr Pinto's oral evidence. Nor did Counsel Assisting submit that Suncorp's conduct in this respect constituted misconduct or conduct falling below community standards or expectations.

In the circumstances, I do not make any findings about this conduct. I only observe that, on its face, it is difficult to understand how amending the agreement to allow for grandfathered commissions to be maintained was in members' best interests. Commission payments reduce members' benefits. But it is not clear what benefits, if any, were to flow to members as a result of the amendments. On the limited material available, it is not clear that members' interests were even considered when the decision was made. If it were the case that the amendments would result in continued reduction of members' benefits with no corresponding benefit, Suncorp should not have agreed to them. But, as I say, I make no finding.

7 QSuper

7.1 Background

This case study highlighted the steps taken by QSuper to make its products and services more accessible to its vulnerable members, including Aboriginal and Torres Strait Islander members living in remote communities.

Evidence in this case study was given by Ms Lynette Melcer, the Head of Technical Advice for the QSuper Board.[960] QSuper is a public sector fund and is the default superannuation fund for all employees of Queensland government departments and employees of a number of Queensland government agencies.[961] It has funds under management of more than $104 billion.[962]

960 Transcript, Lynette Melcer, 13 August 2018, 4710.

961 Transcript, Lynette Melcer, 13 August 2018, 4711.

962 Transcript, Lynette Melcer, 13 August 2018, 4711.

7.2 Evidence

During the fourth round of hearings, the Commission had heard that significant issues affecting Aboriginal and Torres Strait Islander people living in remote communities were the barriers to their engagement with and ability to access their superannuation.

The Commission heard that many Aboriginal and Torres Strait Islander people living in such communities were unaware of their superannuation entitlements or experienced difficulty when accessing those entitlements, due to factors including geographical isolation, the ways in which superannuation funds have implemented identification requirements, and complexities associated with Indigenous kinship structures.[963]

During that round of hearings, Mr Nathan Boyle, a Senior Policy Analyst in ASIC's Indigenous Outreach Program, told the Commission that in 2014, he and Ms Melcer visited the Lockhart River community in Far North Queensland.[964] Mr Boyle and Ms Melcer met with a significant number of people who were unable to access their superannuation entitlements, and provided those people with assistance.[965]

In the Commission's fifth round of hearings, Ms Melcer gave evidence about her experience with the Lockhart River community, and about her involvement in QSuper and industry initiatives to assist Aboriginal and Torres Strait Islander people to access their superannuation.[966]

QSuper estimated that 5,648 of its members identified as Aboriginal and/or Torres Strait Islander people.[967] An estimate was necessary because

963 Transcript, Lynda Edwards, 3 July 2018, 3719; Transcript, Nathan Boyle, 3 July 2018, 3720–2.

964 Transcript, Nathan Boyle, 3 July 2018, 3757.

965 Transcript, Nathan Boyle, 3 July 2018, 3757.

966 Transcript, Lynette Melcer, 13 August 2018, 4713–21.

967 Transcript, Lynette Melcer, 13 August 2018, 4712.

QSuper does not ask its members whether they identify as Aboriginal and/or Torres Strait Islander people.[968]

In relation to the trip to the Lockhart River community, Ms Melcer explained that she and Mr Boyle spent three days working with more than 100 Aboriginal and Torres Strait Islander people who were members of QSuper, AMP, Sunsuper and LGIAsuper.[969] Ms Melcer and Mr Boyle assisted those people to complete superannuation-related forms, prepare supporting documentation and get in contact with their superannuation funds.[970]

Ms Melcer said that the people she assisted faced a number of distinct difficulties. Among other things, many people experienced difficulties in satisfying the identification requirements of superannuation funds; some did not have a valid driver's licence, passport or birth certificate.[971] They also faced difficulties interacting with superannuation funds and completing paperwork, due in part to a lack of access to necessary technology, including computers and functioning photocopiers.[972] At least one person experienced difficulties proving his medical condition: it was hard for him to find two medical practitioners who could attest to his condition: his community was only visited by the Royal Flying Doctor Service.[973] In addition, at least one person had faced difficulties obtaining a death certificate for a relative within her kinship group, but outside her immediate family unit.[974] The difficulties were compounded by the fact that this person had to travel a significant distance to make inquiries about obtaining the death certificate.[975]

968 Transcript, Lynette Melcer, 13 August 2018, 4712.

969 Transcript, Lynette Melcer, 13 August 2018, 4714.

970 Transcript, Lynette Melcer, 13 August 2018, 4718.

971 Transcript, Lynette Melcer, 13 August 2018, 4714.

972 Transcript, Lynette Melcer, 13 August 2018, 4715.

973 Transcript, Lynette Melcer, 13 August 2018, 4715–16.

974 Transcript, Lynette Melcer, 13 August 2018, 4717.

975 Transcript, Lynette Melcer, 13 August 2018, 4717.

Ms Melcer told the Commission about steps that QSuper took to assist its Aboriginal and Torres Strait Islander members upon her return from the Lockhart River community. QSuper conducted a search of members living in Far North Queensland with whom it had lost contact, and noticed that there were many duplicate records.[976] QSuper merged these duplicate records.[977] QSuper then conducted further research into its lost superannuation accounts with the assistance of electoral offices and the Registry of Births, Deaths and Marriages.[978] QSuper attempted to obtain contact details for the next of kin of members who had died, and wrote to members who it knew were over the preservation age.[979] The communications were written in a straightforward way, without using jargon.[980] The exercise undertaken by QSuper resulted in it reconnecting 80 people with lost superannuation totalling over $2 million, and paying out 17 estates valued at $1.7 million.[981] Ms Melcer's evidence was that this exercise did not involve any additional cost to QSuper, and did not require any additional resources.[982] Ms Melcer said that she viewed it as an obligation of QSuper to ensure that members can 'get the[ir] money when they need it'.[983]

Ms Melcer said that the steps taken by QSuper had led to members of other superannuation funds contacting QSuper, after which QSuper referred those people to the relevant fund.[984] However, QSuper's ability to assist members of other funds had since been diminished as a result of reforms associated with the MyGov platform.[985] She said that the process of reconnecting people with lost superannuation had been undertaken by QSuper by

976 Transcript, Lynette Melcer, 13 August 2018, 4718.

977 Transcript, Lynette Melcer, 13 August 2018, 4718.

978 Transcript, Lynette Melcer, 13 August 2018, 4718.

979 Transcript, Lynette Melcer, 13 August 2018, 4718–19.

980 Transcript, Lynette Melcer, 13 August 2018, 4721; Exhibit 5.141, 13 August 2018, Draft Letter to Member.

981 Transcript, Lynette Melcer, 13 August 2018, 4719.

982 Transcript, Lynette Melcer, 13 August 2018, 4719.

983 Transcript, Lynette Melcer, 13 August 2018, 4719.

984 Transcript, Lynette Melcer, 13 August 2018, 4719–20.

985 Transcript, Lynette Melcer, 13 August 2018, 4720.

using the ATO website but now can be done only through the MyGov platform and only by the person concerned.[986]

Since Ms Melcer's trip to the Lockhart River community, Ms Melcer has raised awareness within QSuper of issues affecting its vulnerable members, including its Aboriginal and Torres Strait Islander members living in remote communities.[987] Ms Melcer has also engaged in broader advocacy work, including through the Indigenous Superannuation Working Group (ISWG).[988]

Ms Melcer explained that in 2016, following a recommendation discussed at the 2015 ISWG Summit,[989] the Australian Transaction Reports and Analysis Centre (AUSTRAC) released a compliance guidance protocol for the identification of Aboriginal and Torres Strait Islander people (AUSTRAC Guidance).[990] Ms Melcer provided feedback on drafts of the AUSTRAC Guidance.[991] When Ms Melcer was asked about the steps that QSuper had taken to ensure that its front line employees understood and implemented the AUSTRAC Guidance, she said that QSuper was committed to ensuring that it was 'as flexible as possible' in respect of identification requirements for its vulnerable members, including its Aboriginal and Torres Strait Islander members.[992] Ms Melcer provided the Commission with an example of a letter that QSuper had received from a community legal centre on Mornington Island, Queensland, which contained various details about one of its clients, as an alternative form of identification.[993] Ms Melcer said that it was 'not an impost at all' for QSuper to offer these types of alterative verification procedures.[994]

---

986 Transcript, Lynette Melcer, 13 August 2018, 4720.

987 Transcript, Lynette Melcer, 13 August 2018, 4720.

988 Transcript, Lynette Melcer, 13 August 2018, 4721.

989 Exhibit 5.143, 13 August 2018, Report of Indigenous Superannuation Summit July 2015; Transcript, Lynette Melcer, 13 August 2018, 4723.

990 Transcript, Lynette Melcer, 13 August 2018, 4723.

991 Transcript, Lynette Melcer, 13 August 2018, 4723.

992 Transcript, Lynette Melcer, 13 August 2018, 4723.

993 Exhibit 5.144, 13 August 2018, Identity Declaration, Junkuri Laka, Mornington Island.

994 Transcript, Lynette Melcer, 13 August 2018, 4724.

Ms Melcer was asked about ways to improve the experience of vulnerable people, including Aboriginal and Torres Strait Islander people living in remote communities, with superannuation.[995] Ms Melcer provided a number of suggestions.

In the context of binding nominations, Ms Melcer identified that legislation currently only permits a person to nominate their legal personal representative or ‘dependent’ to receive death benefits.[996] Ms Melcer suggested that the definition of ‘dependent’ should be expanded in a way that accommodates the kinship structures operating in Aboriginal and Torres Strait Islander communities.[997]

Ms Melcer also gave evidence that some funds do not permit the early release of superannuation funds on the ground of severe financial hardship.[998] Ms Melcer recognised that these types of claims were the most difficult claims to assess, but said that it was ‘absolutely not an impost’ for QSuper to offer early release on this basis, because the members who make such claims are ‘in a situation where they need [their funds]’.[999]

Ms Melcer was asked whether it would be beneficial to lower the preservation age for Aboriginal and Torres Strait Islander people.[1000] Ms Melcer did not consider that to be desirable, but suggested that lower life expectancy could be taken into account in other ways.[1001] For example, Ms Melcer suggested that it could be used by trustees and medical professionals in the course of assessing TPD claims.[1002]

In response to a question about whether superannuation funds should ask their members whether they consider themselves to be Aboriginal

995 Transcript, Lynette Melcer, 13 August 2018, 4726.

996 Transcript, Lynette Melcer, 13 August 2018, 4726.

997 Transcript, Lynette Melcer, 13 August 2018, 4726.

998 Transcript, Lynette Melcer, 13 August 2018, 4727.

999 Transcript, Lynette Melcer, 13 August 2018, 4727.

1000 Transcript, Lynette Melcer, 13 August 2018, 4727.

1001 Transcript, Lynette Melcer, 13 August 2018, 4727–8.

1002 Transcript, Lynette Melcer, 13 August 2018, 4727.

and Torres Strait Islander people, Ms Melcer said that this should not be mandatory.[1003] Ms Melcer said that QSuper 'strive[s] to really understand the person that we're talking to … and solving [problems] for that member', and as a result of that approach, QSuper did not need to collect information about the background of its members in this way.[1004]

Finally, when asked what measures superannuation funds could take to assist vulnerable members, including Aboriginal and Torres Strait Islander people living in remote and regional communities, Ms Melcer made a number of suggestions, all of which were focused on the need for funds to understand their members.[1005]

7.3 What the case study showed

This case study demonstrated that superannuation funds can take a number of steps– as QSuper has done – to better inform vulnerable members of their entitlements and to remove barriers to access. Further, this can be done at little or no cost. The case study also highlighted a number of areas for potential reform, which are addressed in the chapter of this report dealing with the superannuation sector.

8 Hostplus

8.1 Background

Hostplus Pty Limited (Hostplus) is the trustee for the Hostplus Superannuation Fund.[1006] Hostplus is a profit-for-member industry superannuation fund that was established in 1988 by the Australian Hotels Association and the Liquor, Hospitality and Miscellaneous Workers' Union (now United Voice).[1007] Most of its members work in the hospitality and

---

[1003] Transcript, Lynette Melcer, 13 August 2018, 4728.

[1004] Transcript, Lynette Melcer, 13 August 2018, 4728.

[1005] Transcript, Lynette Melcer, 13 August 2018, 4729.

[1006] 'Hostplus' is used to refer to both the trustee and the fund, unless otherwise indicated.

[1007] Transcript, David Elia, 14 August 2018, 4844; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, 4 [10], [16].

tourism industries.[1008] As at August 2018, Hostplus had approximately $34.5 billion in funds under management and just over 1.1 million members.[1009]

The Commission looked at two aspects of Hostplus' conduct:

- its use of funds on corporate hospitality to attract and retain employers; and
- its retention strategies to retain members in the fund.

The Commission heard evidence from David Elia, who has been the Chief Executive Officer of Hostplus since 2003.[1010]

To put the conduct in its proper context, I should explain three matters.

The first is that Hostplus is a high performing superannuation fund.[1011] Mr Elia said that the Hostplus default option had been the top performing default product in Australia based on return on investment (net of fees and taxes) over the period of 1, 3, 5, 7, 15 and 20 years.[1012]

Second, Hostplus's members tend to be young and disengaged, with low superannuation balances. At the time of Mr Elia's evidence, the average balance was approximately $30,000, less than half the industry mean.[1013] Almost 50% of Hostplus's members had a total balance of less than $6,000.[1014] At 30 June 2017, 296,898 member accounts were 'inactive':

[1008] Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, 4 [10]; Transcript, David Elia, 14 August 2018, 4844.

[1009] Transcript, David Elia, 14 August 2018, 4844.

[1010] Transcript, David Elia, 14 August 2018, 4843; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 3 [1], [10].

[1011] Transcript, David Elia, 14 August 2018, 4845.

[1012] Transcript, David Elia, 14 August 2018, 4845; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 11 [44].

[1013] Transcript, David Elia, 14 August 2018, 4845.

[1014] Transcript, David Elia, 14 August 2018, 4846; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 6 [19].

that is, no contribution had been received in the preceding 12 months.[1015] The fund's members are largely young people who have recently entered the workforce, are employed on a casual or part-time basis, and who regularly change employment.[1016]

The consequences of disengagement and low balances can be significant. For example, the Commission received a half-yearly member statement dated 30 June 2017. The statement showed that the member had not made any contributions to the account during the previous six months. The member had received net investment returns of $83.91, paid administration fees of $39 and insurance premiums of $565.59, and had a closing balance of $1,216.54.[1017] If the member did not act, their account balance would reduce.[1018]

The third point to notice is that Hostplus has two sources of revenue.[1019] The first is administration fees collected from members. The second source is a tax benefit that Hostplus receives on members' insurance premiums.[1020] The benefit arises because Hostplus collects 15% of every taxable superannuation contribution, but in some circumstances is entitled to tax deductions. As a result, not all the 15% it collects needs to be remitted to the ATO. In practice, this benefit yields Hostplus an amount equal to 15% of the insurance premiums paid by members.[1021] Hostplus retains these amounts in an administration reserve. As at May 2018, Hostplus' administration reserve was forecast to hold a balance of approximately $172 million as at 30 June 2018.

[1015] Transcript, David Elia, 14 August 2018, 4846–7; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 6 [20].

[1016] Transcript, David Elia, 14 August 2018, 4845–6, 4855.

[1017] Transcript, David Elia, 14 August 2018, 4862; Exhibit 5.177, 30 June 2017, Member Statement.

[1018] Transcript, David Elia, 14 August 2018, 4862–3.

[1019] Exhibit 5.362, 15 March 2018, Draft Australian Asset Owner Stewardship Code, 106.

[1020] Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

[1021] Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

At the time of the events described below, Hostplus's revenue from the tax benefit was likely to significantly reduce. Proposed legislation would require members with balances of less than $6,000, under the age of 25, or who had not made a contribution in 13 months, to 'opt-in' to insurance. Over 670,739 members (paying 43% of total insurance premiums) would have their insurance cover end if this legislation was introduced,[1022] reducing the benefit to Hostplus by approximately $14.5 million per year.[1023] Further, Hostplus intends to comply with the Insurance in Superannuation Voluntary Code of Practice, which provides that insurance cover must end if no contribution has been made within 13 months.[1024] Even without legislative change, this change would reduce Hostplus's revenue.

8.2 Evidence

8.2.1 Marketing and corporate hospitality

Hostplus spends a significant amount each year on marketing and entertainment. In the year ended 30 June 2017, Hostplus's marketing and entertainment expenses were $21.44 million.[1025] This has increased from $13.12 million in 2013.[1026] Part of this money is spent on corporate entertainment, where Hostplus senior executives 'informally entertain current and prospective employers'.[1027] For example, the Commission heard that Hostplus spent approximately $260,000 on corporate entertainment for employers to attend the Australian Open tennis competition in 2018.[1028]

[1022] Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

[1023] Transcript, David Elia, 14 August 2018, 4859–60; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

[1024] Hostplus, Module 5 Case Study Submission, 1 [5].

[1025] Transcript, David Elia, 14 August 2018, 4865; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, Exhibit DE-2 (Tab 5) [HOS.0014.0001.0257].

[1026] Transcript, David Elia, 14 August 2018, 4865; Exhibit 5.321, Witness statement of David Elmslie, 26 July 2018, Exhibit DE-2 (Tab 5) [HOS.0014.0001.0257].

[1027] Transcript, David Elia, 14 August 2018, 4866; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 8 [27].

[1028] Transcript, David Elia, 14 August 2018, 4867.

Mr Elia agreed that the amount spent on marketing and entertainment expenses was 'not an insignificant sum of money', but said that it was 'done for the right purposes' of retaining the default status of the fund for employers currently with Hostplus[1029] and to build brand awareness.[1030] Mr Elia said that hosting employers at events such as the Australian Open was a way to establish and retain relationships that are 'absolutely critical in terms of retaining the default fund status … and, therefore, retaining members'.[1031] That is, the ultimate purpose of the entertainment spend was to grow and retain funds to take advantage of scale.[1032]

Mr Elia was asked why he thought employers needed to be entertained to select Hostplus as their default fund. He said that the high performance of the fund was not enough to retain default status.[1033] He said that Hostplus loses approximately $500 million a year in rollovers to underperforming, and high cost, funds.[1034] He said that:[1035]

> Relationships are absolutely critical. And where you have – you may have one or two individuals ostensibly making default fund decisions on behalf of their entire workforce. Let me tell you, I don't like it. I don't like the fact that we lose default fund status or lose employers to other competitors, to poorer performing funds, high fee paying funds. It does not make any sense to me. So retention of defaults is absolutely critical. And unashamedly – unashamedly, we utilise, you know, entertainment, corporate hospitality, in order to strengthen the relationships we have with our employers. You need to do that.

[1029] Transcript, David Elia, 14 August 2018, 4869.

[1030] Transcript, David Elia, 14 August 2018, 4870.

[1031] Transcript, David Elia, 14 August 2018, 4867.

[1032] Transcript, David Elia, 14 August 2018, 4866; Exhibit 5.172, Witness statement of David Elia, 1 August 2018, 8 [27].

[1033] Transcript, David Elia, 14 August 2018, 4867–8, 4870.

[1034] Transcript, David Elia, 14 August 2018, 4870.

[1035] Transcript, David Elia, 14 August 2018, 4868.

8.2.2 Retention strategies

Hostplus's member retention strategies were directed at members who were inactive and had a balance of $6,000 or less. Mr Elia agreed that inactive members with low balances were less likely to be engaged with their superannuation, and may have moved on to another employer and, as a result, may have joined another superannuation fund.[1036]

Where an RSE licensee holds funds in an account that becomes a 'lost member account', it must pay those funds to the ATO. An account becomes a 'lost member account' where the balance is less than $6,000 and the member is a 'lost member' (among other things, where the member has not contacted the fund or made a contribution in the last 12 months).[1037]

Hostplus wrote to members who appeared likely to become 'lost members' to encourage them to exclude themselves permanently from the 'lost member' process,[1038] such as by contacting the fund and indicating that they wished to continue to be a member of the fund.[1039] One such letter read:

> We are writing to advise that your account may soon be closed and your money transferred to the Australian Tax Office. Your account has been identified as at risk of becoming inactive and under current legislation we are required to transfer inactive accounts to the ATO.
>
> …
>
> Please note if your money is transferred to the ATO your super may not experience the same level of investment return as it would with Hostplus.

The letters did not explain why the member would be transferred or the precise effect the transfer might have on their retirement savings.

[1036] Transcript, David Elia, 14 August 2018, 4848.

[1037] *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 1.03A(2)(a) and reg 1.03A(2)(b).

[1038] *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 1.03A(2)(a) and reg 1.03A(2)(b).

[1039] Exhibit 5.173, 26 February 2015, Letter to Lost Members at February 2015; Transcript, David Elia, 14 August 2018, 4850.

Hostplus also ran a marketing campaign called ‘Tick the Box Hit the Box Office’.[1040] Members were told that if they permanently opted out of the ATO lost member process, they would go into the draw to win a ‘Hoyts VIP Black card’.[1041] The evidence was that around 18,500 members responded to the campaign.[1042] Approximately 2,000 of those members exited the fund. Of the remainder, 2,000 members had balances of less than $2,000, and approximately 180 members had their balance eroded to $0.[1043]

8.3 What the case study showed

8.3.1 Keeping low balance members in the fund

Hostplus submitted that there was no evidence that it had sought to keep low balance members in the fund, or engaged in any retention strategy, for the purpose of obtaining the tax benefit.[1044] Mr Elia rejected the proposition that Hostplus was reliant on the premiums paid by inactive low balance members.[1045]

The administration reserve was expected to reduce from $172 million, as at 30 June 2018, to $45 million, by 2022 to 2023, if insurance cover ceased because no contribution had been made in 13 months.[1046] And the tax benefit accruing to the administration reserve was expected to reduce by approximately $14.5 million per year.[1047] That amount is not insignificant. In those circumstances, it would not be surprising if Hostplus was, to at least

[1040] Transcript, David Elia, 14 August 2018, 4852; Exhibit 5.175, 2016, Inactive Template Letter Cycle 1.

[1041] Transcript, David Elia, 14 August 2018, 4852; Exhibit 5.175, 2016, Inactive Template Letter Cycle 1.

[1042] Transcript, David Elia, 14 August 2018, 4852.

[1043] Transcript, David Elia, 14 August 2018, 4852.

[1044] Hostplus, Module 5 Case Study Submission, 3 [17].

[1045] Transcript, David Elia, 14 August 2018, 4860.

[1046] Transcript, David Elia, 14 August 2018, 4859; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

[1047] Transcript, David Elia, 14 August 2018, 4859–60; Exhibit 5.176, 27 July 2018, Extract from CEO Report to Board Meeting, 17.

some extent, reliant on the premiums paid by those members to operate the fund.

I accept that, as Hostplus submits, it is an 'all profits to member' superannuation fund, so any tax benefit it obtains accrues to the members as a whole.[1048] Even in those circumstances, retention strategies that seek to preserve this position and that do not have adequate regard to the member's circumstances or interests may be conduct that falls below community standards and expectations.

Mr Elia said that, since providing to the Commission the letters regarding permanent exclusion, Hostplus has developed processes and is undertaking to review those members who have been permanently excluded to ensure that permanent exclusion is in their best interests.[1049] Hostplus also referred to this program of works in its submissions.[1050]

8.3.2 Conduct falling below community standards and expectations in relation to retention strategies

Counsel Assisting submitted that Hostplus's conduct in sending the letters to inactive members fell below community standards and expectations, because the letters gave the impression that the member would lose their account balance to the ATO and did not explain the consequences of their choice.

Hostplus rejected that submission.[1051] It submitted that the confusion said to arise from the letters was inherently improbable, and that there was no evidence that any Hostplus member was in fact confused or misled by the letters.[1052]

In his evidence, Mr Elia said that 'having looked at some of these particular statements [in the letters to members], there is no doubt in my mind that we could be a lot better at articulating the message'.[1053] I agree. The letters sent

1048 Hostplus, Module 5 Case Study Submission, 4 [21].

1049 Transcript, David Elia, 14 August 2018, 4856.

1050 Hostplus, Module 5 Case Study Submission, 3 [14].

1051 Hostplus, Module 5 Case Study Submission, 1 [5].

1052 Hostplus, Module 5 Case Study Submission, 2 [9].

1053 Transcript, David Elia, 14 August 2018, 4851.

by Hostplus did not give the member enough information to assist them to make an informed decision about whether to stay with the fund. This was particularly so in the case of the ‘Tick the Box Hit the Box Office’ marketing campaign, where members were offered the possibility of financial reward for staying with the fund, without any information about the consequence of their choice.

There was no evidence before the Commission about the particular circumstances of the members who received the letters, or who permanently excluded themselves. Considering the fund’s demographics, it is not unlikely some or many were young members who had possibly joined another superannuation fund by that time. I cannot say whether members who received the letters and decided to stay with the fund made an informed choice.

The retention communications in evidence may have departed from community standards and expectations. The community expects trustees to communicate to their members clearly and transparently and to be careful not to mislead. This is particularly so having regard to the high levels of disengagement on the part of members, which Mr Elia acknowledged was a likely trait of Hostplus’s members.[1054]

8.3.3 Consideration of section 68A

Section 68A was inserted into the SIS Act in 2004.[1055] It was modelled on section 78 of the *Retirement Savings Accounts Act 1997* (Cth), which was a provision inserted to ensure that employers were not influencing employees’

[1054] Transcript, David Elia, 14 August 2018, 4848.

[1055] Senate, Hansard, 22 June 2004 at 24,540, 24,551–2. It was introduced by the government as an amendment to the amending Bill, Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2003 (Cth), and described as the ‘so-called kickback amendment’.

superannuation decisions.[1056] Parliament saw the insertion of section 68A as an 'important protection for employees' used to help 'get to a stage where it is employees who are making real decisions [about their superannuation] rather than their employers'.[1057] The mischief Parliament was trying to address was 'to ban payments to employers, which would include the so-called 'soft dollar' arrangements,[1058] in exchange for choosing their fund as the default fund'.[1059]

Mr Elia said that the board had considered section 68A in the context of corporate hospitality expenses.[1060] In general terms, that section prohibits a trustee or its associate from supplying or offering to supply goods or services *on the condition* that the person's employees will be members of the fund.[1061] The board's view was that the offers were not made to employers 'on a conditionality basis'.[1062] Mr Elia did not agree that they could be characterised as 'inducements' to employers to remain with the fund.[1063]

Mr Elia's evidence suggested that, at least to some extent, employers are choosing a default fund based on relationships with executives and employees of superannuation funds and are influenced by inducements

---

1056 Senate, Hansard, 22 June 2004 at 24,540, 24,553. It was concerned with eliminating third-line forcing: see Senate, Hansard, 25 March 1997 at 2439–40; Senate, Hansard, 12 May 1997 at 3080–1. Note the different nature of Retirement Savings Account (defined in *Retirement Savings Account Act 1997* (Cth) s 8 as a superannuation product offered by an RSE licensee), in that they are products offered by banks outside any trustee relationship. See also Senate, Hansard, 24 March 1997 at 2193–209 for debate about the Bill before the amendment inserting the equivalent of SIS Act s 68A.

1057 Senate, Hansard, 22 June 2004 at 24,554.

1058 'Soft dollar' payments were those where inducements were used to incentivise someone: see Senate, Hansard, 22 June 2004 at 24,552. This term was used in the context of ASIC *Report 30: Disclosure of Soft Dollar Benefits*, released June 2004, which concerned inducements to financial advisers.

1059 Senate, Hansard, 22 June 2004 at 24,555.

1060 Transcript, David Elia, 14 August 2018, 4871.

1061 SIS Act s 68A(1).

1062 Transcript, David Elia, 14 August 2018, 4871.

1063 Transcript, David Elia, 14 August 2018, 4871.

or experiences offered to them, including by way of corporate hospitality.[1064] His evidence suggested that these offers were important to employers, and that performance of the fund, net benefits to members, and other product features are subsidiary considerations for employers in selecting a default fund.[1065]

Mr Elia said that Hostplus offers things such as tickets to sporting events to employers to maintain and build its relationship with those employers.[1066] Yet it is difficult to see that the conduct could breach section 68A given the specific wording that the offers be made '*on the condition that*' the employer will ensure their employees remain or become members of the fund.[1067] The hospitality and other benefits provided were not offered or received on that condition.

The prohibition of conduct that may improperly influence decisions is not novel. In the context of elections, the law has long sought to prohibit expenditure on such things as food, drink and entertainment that is intended to influence the vote of an elector.[1068] Provisions of that kind seek to prohibit conduct that is intended to influence or interfere with a decision in circumstances where the decision should be made free of such influence or interference. Legislation of this kind provides a much better model of regulation than the existing provisions of section 68A.

It is not right that an employer should choose a default fund for its employers because of benefits that the employer may personally enjoy, but which have nothing to do with the merits of the fund or what it has to offer their employees.

ASIC is the regulator responsible for the general administration of section 68A.[1069] In its written submissions to the Commission, ASIC said that

---

1064 Transcript, David Elia, 14 August 2018, 4868–70.

1065 Transcript, David Elia, 14 August 2018, 4868–70.

1066 Transcript, David Elia, 14 August 2018, 4868–70.

1067 Transcript, David Elia, 14 August 2018, 4871.

1068 See, eg, *Treating Act 1696* (Imp); *Commonwealth Electoral Act 1902* (Cth) s 176. See also Colin Hughes, 'Electoral Bribery' (1998) 7(2) *Griffith Law Review* 209, 210–11.

1069 SIS Act s 6(1)(c).

the Hostplus case study shows that section 68A as currently framed is ineffective: despite significant expenditure from fund assets for the benefit of employers, there was no breach of that section. ASIC identified the deficiency as the requirement that the inducement be 'on the condition that' the employees joined the fund.[1070] I agree.

Section 68A(1) and (3) should be repealed and provisions made along the lines of the long-established electoral law prohibitions against bribing electors. The redrawn provisions should hinge upon whether the conduct *would* induce, or could reasonably be *expected* to induce, a person's choice of default fund for their employees who have made no choice of fund.

9 Board governance

9.1 Background

United Super Pty Ltd is the trustee of Construction and Building Unions Superannuation, better known as Cbus.

Australian Super Pty Ltd is the trustee of the AustralianSuper Fund.

Sunsuper Pty Ltd is the trustee of the Sunsuper Superannuation Fund.

Cbus, AustralianSuper and Sunsuper are 'profit-for-member' superannuation funds. The shareholders of each RSE licensee are trade unions and employer organisations. Those shareholders are entitled, under the RSE licensees' respective constitutions, to appoint directors to the trustee board. The Commission looked at three issues that can arise as a result of this structure: tenure, in the case of AustralianSuper; size, in the case of Cbus; and dismissal, in the case of Sunsuper.

The Commission heard oral evidence about these issues from AustralianSuper's Chief Executive, Ian Silk. The Commission also received

[1070] ASIC, Module 5 Policy Submission, 3–4 [16]–[17].

written statements from the Chair of United Super, Stephen Bracks,[1071] and the Chair of Sunsuper, Andrew Fraser.[1072]

9.2 Evidence

9.2.1 Director tenure – AustralianSuper

In 2007, AustralianSuper amended its constitution to include term limits for its directors. As amended, the constitution provides that directors are appointed for three years. At the end of one three year term, they may be re-appointed for another three year term. In June 2017, AustralianSuper revised its Board Renewal Policy to introduce a maximum tenure of 12 years (four three-year terms).

The amendment to the constitution operates only prospectively – that is, it only applies to directors who were appointed after December 2007.[1073] As a result, the 12-year maximum in the Board Renewal Policy also operates prospectively. Because four of the board's current directors were appointed before 2007, their appointments are not subject to any tenure limitation.[1074] For those four directors, there is no policy in place at AustralianSuper that provides for their maximum tenure.[1075]

At the time of Mr Silk's evidence, the shareholders were considering whether tenure limits should apply to those four directors. The board, including the four directors, had unanimously asked the shareholders to do this.[1076] This was because to apply those limits, the shareholders would need to agree to a constitutional change. AustralianSuper cannot enforce a tenure limit without their agreement. The shareholders had not made a decision when Mr Silk gave his evidence.

[1071] Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018; Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018.

[1072] Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018.

[1073] Transcript, Ian Silk, 9 August 2018, 4523.

[1074] Transcript, Ian Silk, 9 August 2018, 4523–4.

[1075] Cf APRA, Prudential Standard SPS 510, 31 October 2016, par 23(b).

[1076] Transcript, Ian Silk, 9 August 2018, 4524.

9.2.2 Number of directors – Cbus

Cbus is a large superannuation fund with over 755,000 members and $39 billion in funds under management.[1077] Cbus's shareholder organisations are Master Builders Australia, the Australian Council of Trade Unions (ACTU) and three unions.[1078] Cbus's board ordinarily has 16 directors. Seven directors are appointed by Master Builders Australia and seven by the union shareholders.[1079] There is one independent director, and the chair is appointed by the ACTU after consultations between the stakeholders.[1080]

Since 2013, the board's self-assessments have identified that some directors think the board is too big, and that this affects its functioning. Other directors disagree.[1081] In 2015, an independent consultant considered the effectiveness of the board.[1082] It held interviews with all board members and senior management, and compared Cbus's arrangements against best practice. The consultant recommended that it reduce its board to 12 directors, and said that this was a high priority.[1083] In 2016, APRA did a prudential review of Cbus. APRA said it was concerned that the size of the board limited the effectiveness of the board's decision-making.[1084]

1077 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 6 [14].

1078 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 4 [11].

1079 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 4 [11].

1080 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 12 [32]–[35].

1081 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 24) [CBUS.0001.0023.0071].

1082 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211].

1083 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211 at .0238].

1084 Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-94 [APRA.0007.0002.2728].

Mr Bracks said that Cbus does not think that the size of the board is a problem.[1085] But since 2015 the Chair and CEO have spoken to shareholders about the issue.[1086] In 2017, the Master Builders Association suggested both it and the CFMEU give up a board seat. They suggested that one of their nominated directors, who had been recommended by Cbus's investment team, should move to the independent director position.[1087] However, the shareholders could not agree.[1088] Cbus has not changed its board size.

In recent years, both employer and union shareholders have nominated directors based on their skills or experience.[1089] But Cbus cannot force them to do this. As a result, some directors are still appointed based on their links to shareholder organisations.[1090]

9.2.3 Appointment and dismissal of directors – Sunsuper

The Sunsuper Superannuation Fund is a large profit-for-member fund, with $55 billion in funds under management and more than 1.3 million members. The shareholders of Sunsuper are the Chamber of Commerce and Industry Queensland (CCIQ), an employer organisation, as well as the Queensland Council of Unions and the Australian Workers Union of Employees, Queensland Branch (AWUEQ).[1091] Sunsuper's board has an 'equal representation' structure, with three directors appointed by CCIQ, three appointed by the union bodies, and three independent directors.[1092] In early 2016, the three directors appointed by CCIQ were not affiliated with that organisation.

[1085] Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 8 [27].

[1086] Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 8 [32].

[1087] Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 9 [35].

[1088] Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018, 9 [35].

[1089] Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 21) [CBUS.0002.0001.0352 at .0352]; Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, Exhibit SPB-1 (Tab 27) [CBUS.0001.0023.0211 at .0221].

[1090] See, eg, Exhibit 5.348, 11 August 2017, Letter from D Perkins (President, Master Builders Australia) to Stephen Bracks (Chair, United Super P/L).

[1091] Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018, 16 [65].

[1092] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 44 [155].

In April 2016, CCIQ announced that it would remove all three of its appointed directors and replace them with the President, Vice President and CEO of CCIQ. The first change would take place immediately, with the remaining changes to be complete by September 2016.[1093] One of the existing directors had announced his retirement, but the other two had been appointed in 2014 and 2015.[1094] CCIQ had not told Sunsuper about this plan before announcing it.[1095]

The Chair of Sunsuper told CCIQ that he was very concerned about CCIQ's actions. In particular, he was worried that it could damage Sunsuper's reputation and derail tender negotiations that were at a delicate stage. He said that he was also concerned that APRA might intervene, with potentially serious reputational and commercial effects.[1096] After getting this letter, CCIQ decided not to remove one of the three directors, but said that it still planned to replace the other two.[1097]

Various correspondence, meetings and other communications followed. Sunsuper continued to press CCIQ to reconsider its decision.[1098] The three independent directors on the board, and the AWUEQ, also sent separate letters asking CCIQ to reconsider.[1099] APRA wrote to Sunsuper saying it had 'serious concerns' that the board changes would 'materially impact the

[1093] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-177 [SSU.2001.0001.0628].

[1094] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [210].

[1095] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 55 [201].

[1096] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-179 [SSU.2001.0001.0743].

[1097] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-180 [SSU.2001.0001.0749].

[1098] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56–64 [214]–[265].

[1099] Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-182 [SSU.2001.0001.0752]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-200 [SSU.2001.0001.0612].

stability and continuity of the Board'.[1100] It met with Sunsuper's directors and shareholders, as well as separately with CCIQ.[1101] The tendering party also told Sunsuper it was very concerned about the events.[1102] Ultimately, in July 2016, CCIQ replaced two of its nominated directors with its President and Vice President.

There was no doubt that under the Sunsuper constitution, CCIQ was entitled to act as it did.[1103] Although Sunsuper, the independent directors, and other shareholders sought to persuade it to act differently, there was nothing preventing CCIQ summarily replacing one third of the board. There was no limit on its powers of appointment and dismissal (except that the new directors would need to be 'fit and proper').

In 2017, an independent consultant did a governance review of Sunsuper.[1104] Because of the events that had happened and the recommendations made as a result of the review, Sunsuper introduced a number of governance changes, including a consultation process for selecting directors and minimum notice periods before a shareholder can remove a nominated director.[1105]

The Chair of Sunsuper considered that what had happened was 'not best practice'. However, he said that he thought it had led to some positive governance changes.[1106]

1100 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-186 [SSU.2001.0001.0541].

1101 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 60 [237]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-203 [SSU.2001.0001.0615]; Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, Exhibit APF-211 [SSU.2001.0001.0880].

1102 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 61 [245].

1103 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [207].

1104 Exhibit 5.331, Witness statement of Andrew Fraser, 30 July 2018, Exhibit APF-33 [SSU.1003.0001.0176].

1105 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 69 [308].

1106 Exhibit 5.332, Witness statement of Andrew Fraser, 4 August 2018, 56 [207].

9.3 What the case studies showed

Shareholder control of the appointment of directors is a fundamental feature of company law. A premise for that control is that the directors are responsible for protecting the interests of shareholders in the management of the company. That premise needs amplification and modification in the case of a corporate trustee of a superannuation fund. The directors are to manage the company not only in the interests of shareholders but in the interests of members of the fund.

All superannuation trustees are obliged to prioritise the interests of members. Profit-for-member fund trustees differ from retail fund trustees. Retail fund trustees look to the interests of the members of their funds but also to the interests of their shareholders in, among other things, the trustee making a profit and paying a dividend.

If it could be said that an advantage of profit-for-member fund trustees is that they need only look to the interests of members and not also to the interests of shareholders, then it would seem to follow that one of the premises for unhindered control by shareholders over appointment of directors is reduced in force, if not eliminated. It follows that the rules for the appointment of directors should focus only on achieving governance that will be in the best interests of members.

Each of the case studies illustrated ways in which the rules conferring control over appointment of directors on shareholders might be at odds with that focus. In the case of AustralianSuper and Cbus, the requirement for shareholder approval of constitutional changes meant governance reforms have been slowed. In the case of Sunsuper, the exercise of shareholder power of appointment caused at least a time of instability and it might have led (but did not lead) to more serious consequences.

This is not to say that the conduct described might amount to misconduct. Nor do I think there was conduct of the trustee that might have fallen below community standards and expectations. The appointment of directors is conduct of the shareholders, not the trustee. I do not think it is necessary to reach a view about whether in any of the case studies the conduct of any shareholder might fall below community standards and expectations and Counsel Assisting did not submit that I should consider doing so. But I do note that these case studies, together with the case studies concerning mergers, invite consideration of whether shareholders should be required to exercise their powers in the best interests of members.

10 Mergers

10.1 Background

The Commission looked at two case studies about proposals to merge superannuation funds. In both cases, the merger did not proceed because of disputes over who would sit on the board of the merged entity.

The Electricity Supply Industry Superannuation (Qld) Ltd (Energy Super) is the RSE licensee of Energy Super (the Energy Super Fund), which has over 47,500 members and $7.2 billion in funds under management.[1107] During 2016 there were merger discussions between Energy Super and Equipsuper Pty Ltd (Equipsuper), the RSE licensee of the Equipsuper Superannuation Fund.

The Chair of the Board of Energy Super, Scott Wilson, gave evidence about this case study. Mr Wilson was nominated by the Electrical Trades Union Queensland and Northern Territory (the ETU), and has been on the board since 2011.[1108]

CSF Pty Ltd (CSF) is the RSE licensee for the MyLifeMyMoney Superannuation Fund (the CSF Fund),[1109] which has approximately 75,000 members and $9.3 billion in funds under management.[1110] In 2017, CSF was involved in negotiations with Sydney Catholic Super Pty Ltd (SCS), which is the RSE licensee of the Australian Catholic Superannuation and Retirement Fund (the SCS Fund).

The Commission heard evidence from Mr Peter Haysey, the Deputy Chair of CSF. The Commission also received witness statements from Mr David Hartley, a director of CSF, and Mr Greg Cantor, the Chief

1107 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 3 [24].

1108 Transcript, Scott Wilson, 10 August 2018, 4666.

1109 Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 1 [1].

1110 Transcript, Peter Haysey, 15 August 2018, 4997; see also Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 5 [26].

Executive Officer of SCS.

10.2 Evidence

10.2.1 Energy Super

In 2016, Energy Super was interested in merging with another superannuation fund. It thought that a merger would benefit its members through increasing membership numbers, changing its membership demographic and reducing administration costs.[1111] It had held merger discussions with several superannuation funds since 2011.[1112]

The most advanced discussions were with Equipsuper. Those discussions began in early 2016.[1113] In May 2016, staff from Energy Super and Equipsuper performed an evaluation study that found that there were many benefits of a merger, including increased scale in investments and lower investment fees.[1114]

On 2 June 2016, Energy Super wrote to Equipsuper proposing that the merged board be equally split between directors from each entity, with Energy Super's contribution including two union-nominated directors, two employer-nominated directors, and one independent director.[1115]

1111 Transcript, Scott Wilson, 10 August 2018, 4683–5.

1112 Since 1 January 2012, Energy Super had engaged in merger discussions that had gone to a stage where Energy Super considered that a merger may be possible. Those discussions were with: AUSCOAL Superannuation Pty Ltd as trustee of the Mine Superannuation Fund: Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(a)]; AUST (Queensland) Pty Ltd as trustee of Allied Unions Superannuation Trust (Queensland): Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(b)]; and Maritime Super Pty Ltd as trustee of Maritime Super: Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 43 [211(c)].

1113 Transcript, Scott Wilson, 10 August 2018, 4687.

1114 Transcript, Scott Wilson, 10 August 2018, 4688; Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-60 [EYS.0013.0001.0090 at .0091].

1115 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-80 [EYS.0008.0001.1325].

This reflected the existing board of Energy Super, which had one independent director, four employer-nominated directors, and four directors nominated by either the ETU or the Australian Municipal, Administrative, Clerical and Services Union Queensland (QSU).[1116] The largest employers contributing to the Energy Super Fund were Queensland Government-owned corporations such as Energy Queensland Limited and the Queensland Electricity Transmission Corporation Limited.[1117]

On 15 June 2016, the Chair of Equipsuper Andrew Fairley wrote to the then Chair of Energy Super, Mark Williamson, saying:[1118]

> It is important to the Equip board there be a commitment from Energy to adopt the approach of a skills-based board. This would logically mean that in circumstances where a skills matrix has been established by the merged fund[,] in the event that persons nominated by the unions or employers did not have the necessary skills as measured by an independent third party consultant … then the board would retain a right to not accept the nomination, and to request another nomination of individuals that did have the appropriate skills.
>
> A process would need to be developed, based on objective criteria, using arm's length parties to make judgments about the skill levels of individuals concerned.

The proposal about board appointments differed from Energy Super's existing process. Energy Super did not engage a third party consultant to evaluate nominees to its board.[1119] Rather, when candidates were being considered, it engaged with the nominating organisation to 'talk to them about who we're after'.[1120] Further, under the Energy Super constitution, to be appointed to the board a person must satisfy Energy Super's Fit

1116 Transcript, Scott Wilson, 10 August 2018, 4665–7; Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0001.0001.0005 at .0015].

1117 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 3 [25].

1118 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-81 [EYS.0014.0001.3075].

1119 Transcript, Scott Wilson, 10 August 2018, 4690.

1120 Transcript, Scott Wilson, 10 August 2018, 4676.

and Proper Policy.[1121] The Fit and Proper Policy contains a board skills matrix. Applying that matrix shows the experience and diversity of the board, and identifies gaps the board should fill.[1122] Mr Wilson said that Energy Super has regard to that matrix when considering new board appointments,[1123] and since June 2014 the board's performance (as distinct from proposed appointments) has been analysed by an independent consultant each year.[1124]

Mr Wilson said that he agreed that it was reasonable to have a skills-based board.[1125] He said that Energy Super had not been opposed to Equipsuper's approach, but wanted to see the process and criteria that would be involved.[1126]

By late July 2016, Energy Super and Equipsuper had appointed a joint working committee of directors of their respective boards and had entered into a memorandum of understanding.[1127] The parties aimed to enter into an implementation agreement by the end of October 2016.[1128]

In September 2016, a report by KPMG concluded that a merger of Energy Super and Equipsuper would provide 'members and employers with annual cost benefits of up to $20.5 million'.[1129] The report also concluded that the new fund size would strengthen corporate governance and achieve additional scale.[1130] KPMG thought that superannuation funds the size of

[1121] Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0001.0001.0005 at .0017].

[1122] Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-1 [EYS.0005.0001.0029 at .0049–.0050].

[1123] Transcript, Scott Wilson, 10 August 2018, 4690.

[1124] Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, 16 [83]–[84].

[1125] Transcript, Scott Wilson, 10 August 2018, 4690.

[1126] Transcript, Scott Wilson, 10 August 2018, 4690–1.

[1127] Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-61 [EYS.0013.0001.0002].

[1128] Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-61 [EYS.0013.0001.0002].

[1129] Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 4.

[1130] Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 27.

Equipsuper and Energy Super should consider mergers, to achieve benefits of scale and to combat risks such as low member growth and competition from larger and similar sized funds.[1131]

Following that report, the funds engaged with member and employer stakeholders to get their views about the potential merger.[1132] But it appears that it was at this point that the merger discussions started to collapse.

On 13 September 2016, Mr Wilson emailed a fellow ETU-appointed director of Energy Super, Peter Simpson, saying that he and the Chair of Energy Super were 'trying to pull up the merger' (meaning to stop it going ahead).[1133] Mr Wilson said that from the outset of negotiations in early 2016, Mr Fairley had said that Equipsuper would not accept union-nominated directors on the board of the new fund. At the same time, other directors of Equipsuper told Energy Super 'not to worry' about it.[1134] Mr Wilson said that when he sent the email he believed that the merger would not ultimately proceed. As a result, he wanted to stop it to avoid spending any more money.[1135]

On 23 November 2016, Mr Simpson sent an email to the Chair and CEO of Energy Super, saying he had 'concerns that our position on having a spot on the board has been undermined by the wording' of the draft constitution provided by Equipsuper.[1136] For reasons that were not explained in evidence, Mr Simpson then forwarded this email to Mark Bailey, the then Queensland Minister for Energy, saying:[1137]

> I'm unsure if you're across Energy Super's current discussions with Equip Super in Victoria about a possible merger?

1131 Exhibit 5.133, 6 September 2016, KPMG Project Power High Level Assessment, 3.

1132 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-55 [EYS.0013.0001.0128 at .0130–.0131].

1133 Exhibit 5.134, 13 September 2016, Emails to and from Mr Wilson, September 16.

1134 Transcript, Scott Wilson, 10 August 2018, 4693.

1135 Transcript, Scott Wilson, 10 August 2018, 4693.

1136 Exhibit 5.135, 23 November 2016, Email from Simpson, November 16.

1137 Exhibit 5.136, 23 November 2016, Email from Simpson, November 16, 3.

> … The GOCs [government owned corporations] that are represented on the [Energy Super] board will have a big say in whether or not any merger proceeds … we may need to talk to you about Govt's position on this prior to Xmas.

The next day, on 24 November 2016, Mr Simpson again forwarded Mr Bailey correspondence between him and other board members regarding his proposed amendments to Equipsuper's constitution.[1138] Mr Simpson then forwarded the chain of emails to an organiser for the ETU, stating, 'I will talk to Bailey down the track about Govt knocking this off … my aim is to not have it happen'.[1139]

Despite these events, the merger process continued. At a joint meeting of directors of Energy Super and Equipsuper on 1 December 2016, management of Energy Super was asked to work on a principles paper that would articulate the proposed board appointment process and identify the differences between each of the funds' Fit and Proper policies and board appointment processes. It was proposed that Equipsuper would then review the paper and identify potential amendments to the constitution to circulate.[1140]

At about the same time, Mr Fairley was asking Equipsuper's employer representatives about their views on the merger. On 15 December 2016, Mr Williamson emailed a number of Energy Super board members. He told them Mr Fairley had said that, out of five Equipsuper employers, one was 'indifferent', two were 'passively against' and two 'aggressively against' the merger. [1141] One of those employer representatives said that it would 'aggressively oppose merger plans with Energy Super', based on '1. Dilution of shareholding status [and] 2. Board appointment process'. This employer apparently said that it preferred Equipsuper's Board Skills Policy. Mr Williamson said that Mr Fairley told him Equipsuper would not proceed

1138 Exhibit 5.137, 24 November 2016, Email from Simpson, November 16.

1139 Exhibit 5.137, 24 November 2016, Email from Simpson, November 16.

1140 Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-85 [EYS.0008.0001.0761 at .0762–.0763].

1141 Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-86 [EYS.0008.0003.0019].

with the merger unless Energy Super agreed that there were no automatic rights for the ETU and QSU to nominate board positions, and that all board members had to comply with Equipsuper's Board Skills Policy.[1142]

Mr Wilson said in evidence that this was a problem for Energy Super. He said that Energy Super valued the engagement of the unions as an important feature of the fund and that unions contributed significantly to the fund, including in respect of member engagement[1143] and representation of member's interests.[1144]

At a meeting on 20 December 2016, the board of Energy Super resolved that the merger should proceed, but on the basis that there would ongoing union representation on the merged board.[1145] The same day, Mr Fairley wrote to Mr Williamson terminating the merger discussions. Mr Fairley said that 'the Equip employers' would not agree to 'an entitlement to appoint member directors in the manner proposed'.[1146]

Mr Williamson's response on the next day expressed his disappointment that discussions had been terminated, and said that the board of Energy Super 'unanimously agreed the merger is still in the best interest of our Members'.[1147]

10.2.2 CSF Pty Ltd

Like Energy Super, CSF has been open to merger opportunities for some years.[1148] Mr Haysey said that CSF believes there to be significant benefits of a merger with SCS, particularly the benefits of increased scale, and that

1142 Exhibit 5.131, Witness statement of Scott Wilson, 26 July, Exhibit SW-86 [EYS.0008.0003.0019].

1143 Transcript, Scott Wilson, 10 August 2018, 4670.

1144 Transcript, Scott Wilson, 10 August 2018, 4697.

1145 Transcript, Scott Wilson, 10 August 2018, 4696–8.

1146 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-51 [EYS.0008.0003.0364].

1147 Exhibit 5.131, Witness statement of Scott Wilson, 26 July 2018, Exhibit SW-52 [EYS.0008.0001.0718].

1148 Transcript, Peter Haysey, 15 August 2018, 4998.

any increase in the number of members and funds under management would lead to reduced administration costs for members.[1149]

In December 2016, CSF commissioned Rice Warner to conduct an assessment of the potential benefits of a merger with SCS.[1150] That report said that the CSF and SCS funds would both benefit from increased scale, and faced challenges in growing individually from their current positions. The report concluded that '[t]he potential to merge CSF and [SCS] presents a unique opportunity at a time when the superannuation industry faces a period of rationalisation and change'.[1151]

Mr Haysey said that merger discussions between CSF and SCS started in 2017, and that CSF believed that a merger of the funds was in the best interests of their members.[1152] However, from the outset of negotiations, it became clear that the primary point of contention was the composition of the board of the successor fund.[1153]

Initially, on the basis that CSF regarded its fund as demonstrating superior performance (a point about which I make no finding), CSF propsed that the CEO, CIO and Deputy Chair should come from CSF, and that CSF should be the successor fund.[1154] CSF was content for the Chair to come from SCS.[1155] By contrast, SCS thought that appointments at board and executive level should be determined by an independent process.[1156]

[1149] Transcript, Peter Haysey, 15 August 2018, 4998.

[1150] Exhibit 5.240, December 2016, Merger Assessment Prepared by Rice Warner.

[1151] Exhibit 5.240, December 2016, Merger Assessment Prepared by Rice Warner.

[1152] Transcript, Peter Haysey, 15 August 2018, 5001.

[1153] That is not to say that other issues were not important to one, or other, of the parties. Mr Hartley, for example, said that SCS was concerned about the continued operation by CSF of its banking services: Exhibit 5.248, Witness statement of David Hartley, 13 August 2018, 64–67 [169].

[1154] Transcript, Peter Haysey, 15 August 2018, 5003; Exhibit 5.241, 27 March 2017, Letter CSF to the Chair of SCS.

[1155] Transcript, Peter Haysey, 15 August 2018, 5002–3; Exhibit 5.241, 27 March 2017, Letter CSF to the Chair of SCS.

[1156] Exhibit 5.242, 6 April 2017, Letter ACSRF to CSF.

As negotiations progressed, CSF changed its proposal for the SCS Chair to be the Chair of the merged fund, and asserted that 'a new independent chair is essential'.[1157]

By September 2017, CSF and SCS had agreed on all elements of the proposed merger except who would be in the role of Chair.[1158] By this time, CSF contended that the Chair should be Daniel Casey.[1159] Mr Casey had been employed by CSF as a consultant to assist with the merger process. This became known to SCS 'late in the process'.[1160] SCS did not consider that Mr Casey was an appropriately independent person to chair the merged fund.

On 26 October 2017, the Chair of SCS submitted a 'final proposal' to CSF. He proposed that the merged fund have equal board representation, an independent chair selected through a market search process, and that CSF's CEO be the ongoing CEO.[1161] That is, the only matter appearing to be in dispute between the two funds was who would chair the merged fund.

CSF did not accept the proposal. Negotiations ended.

Mr Haysey told the Commission that the merger discussions failed because CSF thought that its fund, rather than the SCS Fund, should be the successor fund. He said that CSF thought that if its proposal was not accepted, the policies and procedures that (it believed) led to its superior returns might not be guaranteed.[1162] In circumstances where the board of the new fund would set policies and procedures, and both parties agreed to equal representation on the board and an independent chair,[1163] it is not clear why the question of which fund should merge into which would be a matter of any real moment.

1157 Exhibit 5.243, 9 May 2017, Letter CSF to ACSRF.

1158 Exhibit 5.244, 27 September 2017, Email Bugden to Haddock.

1159 Exhibit 5.244, 27 September 2017, Email Bugden to Haddock.

1160 Transcript, Peter Haysey, 15 August 2018, 5008.

1161 Exhibit 5.245, 26 October 2017, Letter ACSRF to CSF.

1162 Transcript, Peter Haysey, 15 August 2018, 5011.

1163 Transcript, Peter Haysey, 15 August 2018, 5011.

In any event, merger discussions began again in early 2018. They continued at the time Mr Haysey gave evidence in August 2018.[1164]

10.3 What the case study showed

In both cases, the trustee considered that the proposed merger was desirable, and had independent advice to that effect. I have no reason to doubt those views were correct. But in both cases, the proposed merger did not proceed because of a dispute about the board composition of the merged entity.

It is not apparent why those disagreements caused negotiations to collapse. In the case of Energy Super, both parties agreed that it was appropriate to have a skills-based board; the dispute was over who would nominate the directors. In the case of CSF, both parties agreed to an equal representation board and an independent chair; the dispute was over who the first chair should be (or, perhaps, which fund should merge into which). These were differences of detail, not substance. It is troubling that such differences of detail should have prevented the mergers proceeding where they were otherwise in the best interests of members. If, as some of the communications may be read as suggesting, there was some difference in principle, what exactly was the principle?

This conduct of Energy Super and CSF suggests that the trustees may have lost sight of their fundamental obligation to act in the best interests of members. In doing so, their conduct fell below community standards and expectations.

11 Trustee money management

11.1 Background

In three case studies, the Commission looked at issues about management and expenditure of superannuation trust moneys.

[1164] Transcript, Peter Haysey, 15 August 2018, 5012.

AustralianSuper Pty Ltd (AustralianSuper) is the RSE licensee for the AustralianSuper Fund. The AustralianSuper Fund has approximately $140 billion in funds under management[1165] and 2.2 million members. It is Australia's largest superannuation fund.[1166]

The Commission examined three different issues concerning AustralianSuper: its approach to one investment it had made, its 'cash' investment option, and two items of its expenditures. The Commission looked at AustralianSuper's spending on a publication called *The New Daily*, and on an advertising campaign known as 'Fox and Henhouse'. The Commission heard evidence from AustralianSuper's Chief Executive, Ian Silk, and its Head of Mid-Risk Portfolios, Jason Peasley.

United Super Pty Ltd is the trustee of Construction and Building Unions Superannuation, better known as Cbus. Cbus has over 755,000 members and $39 billion in funds under management.[1167]

The Commission looked at payments made by Cbus to 'partner' organisations, including union and employer organisations that are its shareholders. The Commission received written statements from Stephen Bracks, the Chair of United Super;[1168] Jarrod Coysh, Group Executive Employers, Corporate Development and Strategy;[1169] Kristian Fok, Chief Investment Officer;[1170] and Robbie Campo, Group Executive of Brand, Advocacy, Marketing and Product.[1171]

1165 Transcript, Jason Peasley, 8 August 2018, 4434.

1166 Transcript, Ian Silk, 9 August 2018, 4522.

1167 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018, 6 [14].

1168 Exhibit 5.336, Witness statement of Stephen Bracks, 25 July 2018; Exhibit 5.337, Witness statement of Stephen Bracks, 3 August 2018.

1169 Exhibit 5.338, Witness statement of Jarrod Coysh, 31 July 2018.

1170 Exhibit 5.339, Witness statement of Kristian Fok, 31 July 2018.

1171 Exhibit 5.340, Witness statement of Robbie Campo, 3 August 2018.

CSF Pty Ltd (CSF) is the RSE licensee for the MyLifeMyMoney Superannuation Fund (the CSF Fund).[1172] The CSF Fund has approximately 75,000 members and $9.3 billion in funds under management.[1173]

The Commission looked at payments made by CSF to a group known as the Australian Family Network,[1174] which had personal links to one of CSF's senior executives. The Commission also looked at the use of corporate credit cards by the same senior executive. The Commission heard evidence from Mr Peter Haysey, the Deputy Chair of CSF.

11.2 Evidence

11.2.1 AustralianSuper

Investments

AustralianSuper invests in the IFM Australian Infrastructure Fund (the Infrastructure Fund), an investment portfolio that provides exposure to infrastructure assets. One of those assets was Pacific Hydro Pty Ltd, a renewables development company.[1175] Other assets include Melbourne Airport, Port of Brisbane and Southern Cross Station in Melbourne's central business district.[1176] Historically, the Infrastructure Fund was the main way that AustralianSuper Fund invested in unlisted Australian infrastructure assets.

IFM Holdings Pty Ltd is the investment manager of the Infrastructure Fund. IFM is a fund manager owned by a company called Industry Super Holdings (ISH). ISH is in turn owned by the trustees of 27 industry super funds,

---

1172 Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 1 [1].

1173 Transcript, Peter Haysey, 15 August 2018, 4997; see also Exhibit 5.237, Witness statement of Peter Haysey, 24 July 2018, 5 [26].

1174 The Australian Family Network consists of Family Pack Services Pty Ltd and Paul Clancy Consulting Pty Ltd (formerly known as Australian Family Magazine Pty Ltd): Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, 20 [103].

1175 Transcript, Jason Peasley, 8 August 2018, 4434.

1176 Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 2 [1.6].

including AustralianSuper.[1177] It has approximately $100 billion in funds under management. IFM, through the Infrastructure Fund, was the sole shareholder in Pacific Hydro until IFM sold Pacific Hydro in 2016.

AustralianSuper is not the only investor in the Infrastructure Fund, although it is a significant one. It regularly engages with IFM regarding the performance of the Infrastructure Fund, and has a representative on the Infrastructure Fund investor advisory committee.[1178]

In 2011, AustralianSuper thought that its investment in Pacific Hydro was underperforming. It conducted an internal review, as it ordinarily did when an investment underperformed. The review sought to understand the reasons for investment underperformance, and to work out what to do about it.[1179] As a result of the review, AustralianSuper told IFM that it wanted to reduce its exposure to Pacific Hydro over time.[1180] AustralianSuper then became more heavily engaged with IFM on the subject of Pacific Hydro's performance, and, from time to time, AustralianSuper received direct presentations from Pacific Hydro's management.[1181]

In mid-2014, Pacific Hydro's performance deteriorated and its value was written down significantly.[1182] IFM initiated a strategic review of its investment in Pacific Hydro. AustralianSuper was significantly involved with that review. It told IFM what it expected would be the nature and scope of that review. In particular, AustralianSuper told IFM that the review should cover the governance of Pacific Hydro and Pacific Hydro's place in the Infrastructure Fund's portfolio.[1183] AustralianSuper remained involved as the

[1177] Transcript, Jason Peasley, 8 August 2018, 4435.

[1178] Transcript, Jason Peasley, 8 August 2018, 4436; Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 5 [5.1].

[1179] Transcript, Jason Peasley, 8 August 2018, 4438–9.

[1180] Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, Exhibit JRP 6.1 [ASU.0018.0001.0028]; Transcript, Jason Peasley, 8 August 2018, 4439.

[1181] Transcript, Jason Peasley, 1 August 2018, 4441.

[1182] Transcript, Jason Peasley, 8 August 2018, 4442.

[1183] Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, Exhibit JRP 6.5 [ASU.0018.0001.0001].

review progressed, and from time to time representatives of AustralianSuper met with the IFM review team.[1184]

The review resulted in a number of changes at Pacific Hydro. Among other things, several directors of Pacific Hydro resigned.[1185] AustralianSuper thought that the review provided 'corrective action' to the business, which improved its operations and allowed the asset to be prepared for sale.[1186] In 2016, the Infrastructure Fund sold Pacific Hydro, generating returns significantly higher than its valuation before the write downs in 2014. Ultimately, the return over the life of the Infrastructure Fund's investment in Pacific Hydro was approximately 7.2%.[1187]

The second investment issue concerned the Fund's 'cash' investment option. Between 2016 and 2018, members invested in this option received an average return between 2.35% and 2.74%. The return of 2.35% and 2.74% was net of a 0.05% investment management fee.[1188]

In 2018, APRA wrote to AustralianSuper and other RSE licensees expressing concern that 'cash' options offered by some superannuation funds included significant proportions of non-cash assets.[1189] APRA was concerned that members who invested in such options would expect the return and volatility of cash, but might, in fact, be invested in non-cash assets with different characteristics. That is, APRA's concern was that members might not be getting the investment they had bargained for. At the time, AustralianSuper's non-cash securities comprised 1.84% of its 'cash' accumulation option.[1190] Although this was a relatively small proportion, having received APRA's letter AustralianSuper instructed its investment

1184 Transcript, Jason Peasley, 8 August 2018, 4446.

1185 Transcript, Jason Peasley, 8 August 2018, 4448.

1186 Transcript, Jason Peasley, 8 August 2018, 4451.

1187 Exhibit 5.62, Witness statement of Jason Peasley, 1 August 2018, 4 [4.2].

1188 Transcript, Ian Silk, 9 August 2018, 4540.

1189 Transcript, Ian Silk, 9 August 2018, 4540.

1190 Exhibit 5.88, Witness statement of Ian Silk, 30 July 2018, 9 [3.15].

manager to divest all non-cash securities. The exposure to non-cash securities within the cash options is now zero.[1191]

Spending

The first spending issue examined related to a publication called *The New Daily*. In the second half of 2012, AustralianSuper received a proposal from Industry Super Australia Pty Ltd (ISA) to participate in the establishment of an online news publication for the benefit of industry super members.[1192] ISA provides, among other things, collective marketing and research services to many industry funds.[1193] AustralianSuper is a shareholder in ISA's parent company, ISH.[1194]

AustralianSuper considered the proposal on the basis that it was a marketing strategy, not an investment. It considered the publication's potential to help AustralianSuper engage its members, provide them with information about superannuation, and, ultimately, retain and grow its membership.[1195] The board decided that the amount to be paid out was a relatively small amount of money, which was worth spending in the context of its multi-pronged marketing approach.[1196]

AustralianSuper bought two million partly paid shares in *The New Daily*, at a total cost of $2 million.[1197] Because the purchase was not an investment by the AustralianSuper Fund intended to generate investment returns for members, but a tool to enhance the fund's engagement with members,[1198] the subscription price was paid out of the administration fee paid by members. That fee pays for all non-investment costs of the AustralianSuper

---

[1191] Exhibit 5.89, Witness statement of Ian Silk, 31 July 2018, 26–7 [19.3], noting that the divestment was made by an instruction to the relevant investment manager, IFM, on 12 July 2018 and was completed on 20 July 2018.

[1192] Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 2 [7.1].

[1193] Transcript, Ian Silk, 9 August 2018, 4541.

[1194] Transcript, Ian Silk, 9 August 2018, 4535–6.

[1195] Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 3 [7.6].

[1196] Transcript, Ian Silk, 9 August 2018, 4534.

[1197] Transcript, Ian Silk, 9 August 2018, 4529.

[1198] Transcript, Ian Silk, 9 August 2018, 4528.

Fund, including marketing.[1199] The shares were held as an asset separate from the fund, owned by AustralianSuper in its personal capacity.

In the latter half of 2015, The New Daily Pty Ltd asked its shareholders to make further funding contributions so that *The New Daily* could continue its operations.[1200] AustralianSuper thought that *The New Daily* was not operating as successfully as it had hoped, and decided not to make any further contribution.[1201] Some other shareholders did not contribute.[1202] As a result, ISH offered to acquire all the shares in *The New Daily* from AustralianSuper and the other shareholders for nothing. The offer was made on the basis that IFM would continue operating the publication and shareholders could continue to use its services.[1203] Because AustralianSuper had accounted for the share purchase as part of its administration expenses, the shares carried no continuing value for it.[1204] And because the shares were not acquired as an asset of the superannuation fund, this disposal was at no cost to members. Accordingly, AustralianSuper thought that transferring the shares for free was fair and reasonable,[1205] particularly as *The New Daily* would keep operating and AustralianSuper would still have access to its services.[1206] *The New Daily* continues to be published by ISH.[1207]

The second spending issue concerned the 'Fox and Henhouse' advertising campaign. The campaign was developed by ISA, in conjunction with a number of its members (including AustralianSuper), and broadcast on television in 2017.[1208] The 'Fox and Henhouse' advertisement was the

---

[1199] Transcript, Ian Silk, 9 August 2018, 4528.

[1200] Transcript, Ian Silk, 9 August 2018, 4535.

[1201] Transcript, Ian Silk, 9 August 2018, 4535.

[1202] Transcript, Ian Silk, 9 August 2018, 4535.

[1203] Transcript, Ian Silk, 9 August 2018, 4535; Exhibit 5.90, Witness statement of Paul Schroder, 9 [9.3].

[1204] Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 9 [9.3].

[1205] Exhibit 5.90, Witness statement of Paul Schroder, 1 August 2018, 9 [9.3].

[1206] Transcript, Ian Silk, 9 August 2018, 4535.

[1207] Transcript, Ian Silk, 9 August 2018, 4535.

[1208] Transcript, Ian Silk, 9 August 2018, 4541.

third in a series of advertisements about banks offering superannuation products.[1209] Mr Silk said the advertisement was a response to lobbying by retail wealth management businesses, including banks, to change the superannuation default system. AustralianSuper thought such changes would expose workers to 'significant risks of mis-selling, cross-selling and conflicts of interest that would have done them significant damage'.[1210] Mr Silk said the campaign was an important part of the strategy to maintain industry funds as the most common default superannuation funds in Australia.[1211]

ISA initially proposed to air the advertisement in 2016. However, AustralianSuper decided not to participate because it thought the Australian federal election was too close.[1212] The decision was based on the timing of the election, not the substance of the advertisement.[1213] The advertisement was not broadcast in 2016.

In February 2017, after the election campaign, ISA was finalising the advertisement.[1214] At the time, there was no legislative proposal or Bill about the default superannuation system being considered by the Federal Parliament. Mr Silk said that the advertisement was run in anticipation of legislation that ISA, and AustralianSuper thought would disrupt the default fund system.[1215] Mr Silk said that AustralianSuper's main concern was that the anticipated changes would disadvantage members because of the risk that employers may nominate lower performing funds as default

---

1209 Transcript, Ian Silk, 9 August 2018, 4542.

1210 Transcript, Ian Silk, 9 August 2018, 4543. Mr Silk referred to surveys and reports that demonstrated that small and medium business enterprises in particular were vulnerable to approaches from their business bank to transfer default superannuation to a fund associated with the bank: Transcript, Ian Silk, 9 August 2018, 4548–9; Exhibit 5.351, February 2015, Bank Cross-selling to Employers: A Threat to Australia's Super Safety Net, Briefing Notice; Exhibit 5.352, September 2016, Default Funds and the Banks; Exhibit 5.353, February 2015, SME Employer Attitudes to Superannuation.

1211 Transcript, Ian Silk, 9 August 2018, 4544.

1212 Transcript, Ian Silk, 9 August 2018, 4544.

1213 Transcript, Ian Silk, 9 August 2018, 4544.

1214 Exhibit 5.94, 3 January 2017, AustralianSuper CEO Report.

1215 Transcript, Ian Silk, 9 August 2018, 4548.

funds, as well as the impacts on the scale of the fund if it lost members.[1216] The advertisement eventually aired in June 2017, with the approval of AustralianSuper.[1217]

For AustralianSuper, the success of the campaign depended on the likelihood that federal politicians, including cross-bench senators, would not support legislative reform to the default system. According to Mr Silk, the campaign was successful because ‘the objective that it was seeking to achieve has been achieved’.[1218] However, he added that ‘[f]orces continue to seek to pursue that legislative change’.[1219]

11.2.2 Cbus

Cbus has ‘partnership agreements’ with many organisations. Its ‘partners’ include its shareholders who comprise both trade unions and employer organisations. Cbus pays its partners for marketing opportunities like attending conferences, putting its logo on merchandise, or advertising in trade publications.[1220]

In 2015, a KPMG report found that Cbus had paid over $7 million to its shareholder organisations in five years.[1221] But it also found that Cbus did not have any formal way to determine whether it was getting value out of what it paid for.[1222] After receiving this report, Cbus introduced a number of process changes. It also hired an independent consultant to review the benefits of its industry partnerships program. Cbus ended up introducing a revised ‘Industry Partnership Strategy and Evaluation Model’. This model measured different variables and tried to assess the overall value of each

1216 Transcript, Ian Silk, 9 August 2018, 4549–50.

1217 Transcript, Ian Silk, 9 August 2018, 4549, 4551; Exhibit 5.95, 17 July 2017, Email from Silk to APRA.

1218 Transcript, Ian Silk, 9 August 2018, 4554.

1219 Transcript, Ian Silk, 9 August 2018, 4554.

1220 Exhibit 5.340, Witness statement of Robbie Campo, 3 August 2018, 8–9 [21].

1221 Exhibit 5.368, 20 May 2015, Cbus-United Super Pty Ltd, Audit & Risk Management Committee Agenda, 178.

1222 Exhibit 5.368, 20 May 2015, Cbus-United Super Pty Ltd, Audit & Risk Management Committee Agenda, 173.

partnership to Cbus.[1223] The model was put into practice in 2016/2017, and is applied to both shareholders and non-shareholder partners.[1224]

11.2.3 CSF

The CSF Fund is an industry fund, with most of its members drawn from the education, health and social welfare sectors. Since 2011, CSF has had a particular strategy to attract members from the childcare and early education industries.[1225] Australian Family is a marketing and communications network organisation that operates in the early education and care sector.[1226] It has provided services to CSF since 2010.

Since 1 January 2013, CSF has paid over $2 million to Australian Family for marketing, consulting and other services. Of that amount, over $500,000 related to sponsorship expenses for the Early Education and Child Care Awards.[1227]

Australian Family is constituted by Family Pack Services Pty Ltd and Paul Clancy Consulting Pty Ltd (formerly known as Australian Family Magazine Pty Ltd).[1228] Paul Clancy is the Managing Director of Australian Family. Jennifer Kernahan is the editor of the Australian Family Magazine and a shareholder in Family Pack Services Pty Ltd.[1229]

Robert Clancy was the Head of Institutional Relations at CSF.[1230] Ms Kernahan is his wife, and Paul Clancy is his brother.

[1223] Exhibit 5.369, 16 June 2016, United Super Pty Ltd, ATFT Construction and Building Industry Superannuation Fund, Member and Employer Services Committee Agenda.

[1224] Exhibit 5.347, Undated Spreadsheet, Agreement Master List – FY19.

[1225] Exhibit 5.328, Witness statement of Peter Haysey, 3 August 2018, 7 [19].

[1226] Transcript, Peter Haysey, 15 August 2018, 5014.

[1227] Transcript, Peter Haysey, 15 August 2018, 5016.

[1228] Transcript, Peter Haysey, 15 August 2018, 5014.

[1229] Transcript, Peter Haysey, 15 August 2018, 5014–15.

[1230] Transcript, Peter Haysey, 15 August 2018, 4997.

Robert Clancy did not disclose to CSF the conflict raised by his wife's position until 2015.[1231] He did not disclose the conflict raised by his brother's connection with Australian Family until July 2018, when the issue was raised in preparation for Mr Haysey's appearance at the Commission.[1232]

After Mr Clancy disclosed the position with his wife, CSF sought to manage the conflict by requiring only the CEO of CSF, Frank Pegan, to manage the relationship between CSF and Australian Family. After an employee raised a concern, Mr Pegan told them that there was no potential for conflict as 'all negotiations with Australian Family are only with me'.[1233]

But based on his review of CSF material, Mr Haysey told the Commission that he was not satisfied that the relationship between Australian Family and CSF had been entirely managed by Mr Pegan.[1234] Robert Clancy had had business meetings with Paul Clancy and other CSF employees, including Mr Pegan,[1235] and Robert Clancy purported to approve payments to Australian Family without authority.[1236] Robert Clancy also sent his brother and wife confidential CSF communications, and engaged in 'continuous' email communications with his brother about CSF tasks.[1237]

At the time of Mr Haysey's evidence, the CSF Board had started a review of the relationship and Robert Clancy had been placed on leave.[1238] Robert Clancy's employment with CSF was eventually terminated, after CSF had conducted further investigations after the relevant hearings of the Commission.

1231 Transcript, Peter Haysey, 15 August 2018, 5015.

1232 Transcript, Peter Haysey, 15 August 2018, 5015.

1233 Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-57 [CSF.0010.0001.0944].

1234 Transcript, Peter Haysey, 15 August 2018, 5016.

1235 Transcript, Peter Haysey, 15 August 2018, 5019.

1236 Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, 22 [122].

1237 Transcript, Peter Haysey, 15 August 2018, 5020.

1238 Transcript, Peter Haysey, 15 August 2018, 5017.

Use of corporate credit cards

The second issue concerning CSF's use of trust moneys arose out of Robert Clancy's use of his corporate credit card and the monitoring of his expenditure by CSF.

Between 2013 and 2016, Mr Clancy incurred over $46,000 of unauthorised expenses in breach of the CSF Corporate Credit Card policy.[1239] An undated note – which Mr Haysey believed was given to Mr Clancy by the CSF's finance team in early 2016 – said that the expenditure on his corporate credit card had to be 'urgently' reviewed.[1240] After that review, Mr Clancy paid back the unauthorised expenses to CSF.[1241] However, he continued to accrue new unauthorised expenses on his card.[1242]

The board was not told about the 2016 review.[1243] The note was only found in Mr Clancy's drawer after he had been placed on leave shortly before Mr Haysey gave evidence.[1244] In evidence, Mr Haysey said he thought that after the 2016 review into Mr Clancy's credit card expenses, Mr Clancy's expenditure was reviewed and approved by more senior executives.[1245] Yet it appeared that in February 2017, Mr Clancy approved his own credit card expenditure.[1246]

Mr Clancy's credit card use took place in the context of an undocumented but 'longstanding' practice at CSF, where senior executive staff used their corporate credit cards to pay for personal travel and other minor expenditure. This was contrary to internal policies, but provided it was reimbursed it appears to have been overlooked. Mr Haysey said that

[1239] Transcript, Peter Haysey, 15 August 2018, 5020; Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-62 [CSF.0010.0001.0593].

[1240] Exhibit 5.238, Witness statement of Peter Haysey, 3 August 2018, Exhibit PJH-61 [CSF.0010.0001.0839].

[1241] Transcript, Peter Haysey, 15 August 2018, 5021.

[1242] Transcript, Peter Haysey, 15 August 2018, 5021.

[1243] Transcript, Peter Haysey, 15 August 2018, 5021.

[1244] Transcript, Peter Haysey, 15 August 2018, 5020.

[1245] Transcript, Peter Haysey, 15 August 2018, 5022.

[1246] Transcript, Peter Haysey, 15 August 2018, 5022; Exhibit 5.247, 14 August 2018, Credit Card Expenditures, Clancy.

the practice had ended, and previous payments were part of the ongoing review.[1247]

CSF told the Commission in its submission that Mr Clancy's employment had been terminated and that it intended to seek restitution in respect of the personal expenditure incurred by Mr Clancy that had not been repaid.[1248]

11.3 What the case studies showed

11.3.1 AustralianSuper

Not all investments will perform well. Nor can a superannuation trustee guarantee the performance of investments. However, the trustee does promise its members that it will act in their best interests and exercise the same degree of care, skill and diligence as a prudent trustee. These are not impossible standards to satisfy even when an investment's performance is less than is desired. AustralianSuper's monitoring and management of its indirect investment in Pacific Hydro illustrates that this is so. Similarly, its prompt response to concerns raised by APRA as to the investments underlying cash products was consistent with a trustee discharging its duties.

AustralianSuper's spending on *The New Daily* and the 'Fox and Henhouse' campaign is undoubtedly more controversial. Spending on advertising, insofar as it seeks to maintain or increase scale by retaining existing members or attracting new ones or both, may be consistent with the sole purpose test. And just as not every investment will perform well, not every expenditure by a trustee on promotion will achieve the desired result.

AustralianSuper did not seek to defend the 'Fox and Henhouse' campaign solely on the basis that it was a conventional form of advertising that promoted the merits of industry funds to consumers. Mr Silk characterised the advertisement as being directed at protecting the existing default system and thereby maintaining industry funds as the most common default superannuation funds in Australia.

[1247] Transcript, Peter Haysey, 15 August 2018, 5021.

[1248] CSF, Module 5 Case Study Submission, 2 [10].

Not every form of political advertising by a superannuation fund will satisfy the trustee's obligations. Conversely, not every form of political advertising by a superannuation fund constitutes a failure to act in the best interests of members or a use of members' funds other than in satisfaction of the sole purpose test. Nice questions of judgment are required. The particular advertisement was not directed to AustralianSuper's particular position. It was, as Mr Silk said, directed to the interests of industry superannuation funds more generally. But AustralianSuper was only one of several contributors to the cost of the advertisement.

I am not persuaded that it was not open to AustralianSuper, as trustee, to conclude that legislative changes were possible and that, if made, those changes would adversely affect its members. This being so, I do not consider that it was shown that the expenditure may have contravened either the best interests or the sole purpose obligations.

I should add that while I have no doubt at all that judging what is and is not an appropriate use of members' funds for advertising will in many cases be difficult, I am not persuaded that some more prescriptive law should be made to provide some 'bright line' test. It is better that the tests be those that are now to be applied: best interests and sole purpose. And as a general rule I would expect that most trustees would rightly err on the side of caution. Especially will that be so if regulators properly monitor compliance with the obligations.

11.3.2 Cbus

As I have emphasised many times in this report, a superannuation trustee promises its members that it will act in their best interests and exercise the same degree of care, skill and diligence as a prudent trustee. Just as it must carefully choose how to spend members' money, it must also take reasonable steps to make sure that its spending achieves the desired results.

On the limited information available, the changes Cbus made to its 'partnership' arrangements after the 2015 report are an example of such steps. Having identified that it could not tell whether it was getting what it paid for, Cbus introduced process changes and initiated a review of the relevant program more broadly. That review appears to have led to a more rigorous approach to its commercial relationships, not just with its shareholders but with other organisations as well.

11.3.3 CSF

Paragraph 8 of Prudential Standard SPS 521: Conflicts of Interest required CSF to have a conflicts management framework that ensured that the RSE licensee identified all potential and actual conflicts in the RSE licensee's business operations, and took all reasonably practicable actions to ensure that potential and actual conflicts were avoided or prudently managed.

CSF purported to manage the conflict raised by Ms Kernahan's positions at Australian Family by having only the CEO, Mr Pegan, manage the relationship. Robert Clancy's continued involvement in the relationship between Australian Family and CSF shows that the strategy was not effective. Further, CSF apparently did not even identify the conflict raised by Paul Clancy's position at Australian Family until asked about it by the Commission.

Both matters suggest that CSF may not have complied with the Prudential Standard. The matter not having been so far drawn to the attention of the regulator, I refer the relevant conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference for APRA to consider what action it should take.

Separately, the evidence suggested that Robert Clancy incurred significant personal expenses on his corporate credit card. Mr Haysey said that the CSF Board only became aware of a review of his expenses because a note was found in a drawer when responding to the Commission's enquiries. At least during one period, Mr Clancy approved his own expenses, and there was a 'longstanding practice' at CSF of using corporate cards for personal use in breach of internal policies.

CSF's corporate credit cards are funded from money ultimately received from members. Their use should be carefully monitored and controlled. CSF did not, or could not, ensure that was the case. Its failure to do so fell below community standards and expectations.

12 Payments from third party managed investment schemes

12.1 Background

Both IOOF and ANZ have subsidiaries that are RSE licensees. These RSE licensees operate ‘platforms’ for members of their superannuation funds. These ‘platforms’ let members choose where to invest their superannuation funds from a menu provided by the RSE licensee. Some of the options on that menu are managed investment schemes. A company that runs a registered managed investment scheme is known as a ‘responsible entity’ (RE). When an RSE licensee includes a managed investment scheme on its platform’s menu, the RE may pay a fee to the RSE Licensee or an entity related to the RSE licensee.

Under the **Future of Financial Advice** (FoFA) reforms, ‘volume-based shelf-space fees’ are banned in most circumstances.[1249] This is a fee paid by a fund manager (such as an RE) to a platform operator that is calculated on the basis of the number or value of the fund manager’s financial products included on the menu. Two exceptions to the ban are relevant. First, a reasonable fee for a service provided to the fund manager by the platform operator is not presumed to be a volume-based shelf-space fee. Second, volume-based shelf-space fees that existed before 1 July 2013 were grandfathered.

The Commission heard evidence from each of IOOF and ANZ about payments made by the REs of managed investment schemes to trustees within each of their respective groups. Mark Oliver, General Manager, Distribution, for IOOF Holdings gave evidence about IOOF. Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, gave evidence about ANZ.

[1249] Corporations Act s 964A.

12.2 Evidence

12.2.1 IOOF Investment Management

IOOF Investment Management Limited (IIML) is RSE licensee of the IOOF Portfolio Service superannuation fund (the Portfolio Service). Through the 'platform' provided by IIML, superannuation members can invest in particular managed investment schemes run by IIML or by third parties.[1250] IOOF Holdings Ltd, IIML's parent company, has 'platform services agreements' with some of these third party REs. Under those agreements, IOOF Holdings promises that its related entities (IIML, Questor, or Australian Executor Trustees) will provide 'administration and investment related services' to the RE.[1251] In return, the RE makes payments to IOOF Holdings.[1252]

The payments are calculated in two different ways, depending on when the contract was made. For contracts made before 1 July 2013, the payments are calculated according to the percentage of funds under management.[1253] For contracts made after that time, the payment is $10 per member.[1254] The services to be provided under each type of contract are the same. Mr Oliver agreed that the fixed fee was introduced because FoFA banned most volume-based shelf space fees.[1255] He understood that the $10 fee was a recovery of IOOF's process costs.[1256]

The Commission asked IOOF to identify the amount of fees it received that was generated from investments of superannuation members' money. In the quarter ending March 2018, REs had paid total fees of $2.317 million

1250 Transcript, Mark Oliver, 10 August 2018, 4572.

1251 Exhibit 5.100, Fund Manager Deed IOOF Holdings and Aberdeen Asset Management Limited, 29 April 2010.

1252 Exhibit 5.100, Fund Manager Deed IOOF Holdings and Aberdeen Asset Management Limited, 29 April 2010, 5.

1253 Transcript, Mark Oliver, 10 August 2018, 4573.

1254 Transcript, Mark Oliver, 10 August 2018, 4573.

1255 Transcript, Mark Oliver, 10 August 2018, 4573.

1256 Transcript, Mark Oliver, 10 August 2018, 4574.

based on Portfolio Service members' investments.[1257] The amounts paid by individual external entities ranged from $419 to $186,034.[1258]

The Commission asked IOOF whether it considered that the superannuation fund should receive the benefit of these payments. Mr Oliver answered a slightly different question. In his written statement, he gave evidence that IIML, the trustee of the fund, believed it should only receive these payments if it provides services to the REs of the managed investment schemes.[1259] In his oral evidence, Mr Oliver said that this was what IOOF's legal counsel had told him.[1260] He did not know 'directly' if the IIML Board had ever considered the issue.[1261]

It was not clear what actually happened to these payments. Mr Oliver gave evidence that IOOF Holdings passed on the payments to IIML as the 'platform operator'.[1262] His only basis for this evidence was that his 'governance service colleagues' had told him.[1263] Yet this was not consistent with IIML's financial reports, which in the 2017 financial year showed payments from related entities of only $154,498.[1264] Mr Oliver said he was not familiar with those reports, and could not explain the difference.[1265]

12.2.2 OPC and Oasis

OnePath Custodians Pty Ltd (OPC) and Oasis also provide platforms that allow superannuation members to invest in managed investment schemes operated by third parties. In some cases, the REs of those managed

1257 Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, Annexure D.

1258 Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, Annexure D. Note that IIML was recorded as having paid $667,290 during the period.

1259 Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, 17 [40].

1260 Transcript, Mark Oliver, 10 August 2018, 4579.

1261 Transcript, Mark Oliver, 10 August 2018, 4578.

1262 Transcript, Mark Oliver, 10 August 2018, 4579, 4582; Exhibit 5.99, Witness statement of Mark Oliver, 26 July 2018, 17 [44].

1263 Transcript, Mark Oliver, 10 August 2018, 4582.

1264 Exhibit 5.102, IIML Financial Report, 30 June 2017, 28.

1265 Transcript, Mark Oliver, 10 August 2018, 4580–2.

investment schemes make payments back to OPC, Oasis, OnePath Life or OnePath Funds Management (OPFM).[1266]

Those payments are made under contracts that fit either a 'pre-FoFA' or 'post-FoFA' test.[1267] Under a 'pre-FoFA' contract, the payment is calculated as a percentage of funds under management.[1268] That is, the RE pays ANZ a rebate for each dollar invested in the managed investment scheme. The payment is described as a 'shelf space fee'.[1269] No ANZ company has to provide any service in return for the fee.[1270]

The Commission also asked ANZ to identify the amount of fees it received that was generated from investments of superannuation members' money. For the year ending 30 September 2017, REs had paid OPC and Oasis more than $13.7 million based on superannuation fund members' investments.[1271] The amounts paid by individual entities ranged from $489 to $2,228,031.

Under 'pre-FoFA' contracts, none of the payments are given back to members.[1272] The money is kept by ANZ. Mr Pankhurst's evidence was that the rebate payments are one of the things ANZ considers when setting the fees it charges to superannuation members.[1273] That is, investment management fees were one of the costs that formed part of the pricing model, and the rebates from REs reduced that cost.[1274] Mr Pankhurst did

---

1266 At least in the case of OPFM, it was not clear which company received the payments: Transcript, Mark Pankhurst, 15 August 2018, 5039–40; Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007].

1267 Transcript, Mark Pankhurst, 15 August 2018, 5042.

1268 Transcript, Mark Pankhurst, 15 August 2018, 5043.

1269 Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007 at .0025].

1270 Exhibit 2.95, Witness statement of Mark Pankhurst, 13 April 2018, Exhibit MJP-18 [ANZ.800.467.0007].

1271 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, [158]. This amount excluded fixed payments and fee rebates that were passed back to the member.

1272 Transcript, Mark Pankhurst, 15 August 2018, 5045.

1273 Transcript, Mark Pankhurst, 15 August 2018, 5044.

1274 Transcript, Mark Pankhurst, 15 August 2018, 5044.

not suggest there was a direct correlation between the rebates received and the price charged. However, he also said that this type of arrangement was ‘antiquated’. Now, in many cases ANZ simply fixes a price and ‘there are no payments’.[1275] In the case of the new Oasis Wrap platform, the rebates are returned to members.[1276]

Mr Pankhurst gave evidence that OPC and Oasis had not formally considered whether the relevant fund should receive the benefits of these payments.[1277] However, at its meeting in July 2018, the combined OPC and Oasis Board received a presentation about these payments.[1278] The board asked for further information, and commented that it will ‘need to clarify how it views these arrangements [under] the current and future structure’.[1279]

12.3 What the case study showed

Four things should be observed about these arrangements.

The first is that the payments described above add up to significant amounts. If IOOF’s income for the March 2018 quarter were repeated for the rest of the year, the payments would be worth more than $9 million annually. ANZ earned more than $13.7 million from these payments in 2017. It is important to remember that these amounts are not total payments across the group. They are only the payments generated from superannuation investments.

The second is that, on the material available, it is not possible to say whether the amounts received from the RE are properly seen as either a fee for service or as cost recovery. In the case of IOOF, the payments were calculated as either a proportion of funds under management or a flat $10 fee per member, depending on when the relevant agreement was made. Mr Oliver said that the $10 amount represented IIML’s processing cost. If the payments made under the earlier contracts were in return for the same services, they would represent a significant windfall for IOOF.

1275 Transcript, Mark Pankhurst, 15 August 2018, 5044.

1276 Transcript, Mark Pankhurst, 15 August 2018, 5045.

1277 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 73 [157].

1278 Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

1279 Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

In the case of ANZ, no entity in the ANZ group was even required to perform a service in return.

The third is that although this income is derived directly from members' money, there appeared to be no direct benefit to members. Mr Oliver could not explain, and the evidence did not reveal with any real clarity, where the money received by IOOF Holdings went. Mr Pankhurst said that ANZ considers those payments when setting its fees. But the payments appear to be merely one input among many into ANZ's pricing model.

The fourth is that the trustee has ultimate responsibility for this income. In the case of IOOF, I accept that IOOF Holdings (rather than IIML) is the contracting entity. But IIML is the trustee of the fund and decides where to invest its members' money. The evidence was that IIML was aware of the payments but had taken no steps in relation to them. In the case of ANZ, the trustee is itself a party to the agreements under which the payments are made.

Arrangements of this kind may raise two issues.

First, I do not accept that an independent trustee acting in the best interests of its members would allow other parties to receive large amounts of money directly generated from members' funds with nothing in return. I cannot say whether that is a proper description of what happened in these cases. If it is, it may well follow that the trustee has not complied with the covenant to act in the best interests of members.

The matter not having been so far drawn to the attention of the regulators, I refer the conduct of OPC, Oasis and IIML to APRA for its consideration of whether to take action.

The second issue relates to the duty to give priority to the interests of beneficiaries over the interests of others. Both APRA and ASIC told the Commission that payments of this kind could cause a conflict.[1280] They said the conflict could arise because it would be in the trustee's interest to invest funds to maximise payments, rather than maximise benefits to members.

1280 ASIC, Module 5 Policy Submission, 6–7 [33]–[41]; APRA, Module 5 Policy Submission, 28–9 [85].

As a result, they said, a trustee should not receive such payments unless the payments were then passed on to members.

This risk may be less significant than it initially appears. Under 'platform' arrangements, the individual superannuation member selects which managed investment scheme to invest in. That is, to the extent that the payments relate to investments through a platform, the trustee has limited scope to direct investments to obtain larger payments. However, the trustee still has control over what schemes are available to members. A risk remains that these payments could inappropriately influence those selections. On the material available, I cannot say whether this has occurred. But the risk would be avoided if the payments were passed on to members.

I make one further observation. It is troubling that in both organisations, the trustee appeared to have little awareness or understanding of these payments. The Commission heard that after the Commission enquired about this topic, the boards of OPC and Oasis asked for a briefing.[1281] Yet the information provided to the board in response was, according to Mr Pankhurst, inaccurate. Similarly, it seems that the board of IIML may not have considered the issue. What is more, even after the Commission's enquiries it remains unclear what happens to the payments made to IOOF Holdings. It should not be the case that trustees of large superannuation funds, forming part of large and sophisticated financial groups, have so little knowledge of what happens to income generated from members' investments.

13 Fees for no service

13.1 Background

Each of the case studies concerning Colonial First State (CFS), NAB and AMP included consideration of trustees charging fees for services that were not provided.

[1281] Transcript, Mark Pankhurst, 15 August 2018, 5039; Exhibit 5.254, Draft Minutes OnePath Custodians Meeting 26 July 2018, 13 August 2018.

The Commission received evidence in three other case studies that raised similar issues. The three cases were:

- State Super Financial Services Australia Limited (StatePlus), now a subsidiary of FSS Trustee Corporation (FTC).[1282] The Commission received a written statement from Mark Lennon, a director of FTC and StatePlus, in relation to this case study.
- Asgard Capital Management Limited (Asgard) and BT Funds Management Limited (BT), both part of the Westpac Group. The Commission received a written statement from Melinda Howes, Executive Director, Superannuation Boards and General Manager – Superannuation, BT Financial Group in relation to this case study.
- OnePath Custodians Pty Ltd (OPC), a subsidiary of ANZ. The Commission received written statements from Mark Pankhurst, Head of Superannuation, Pensions and Investments for ANZ Wealth, and Peter Mullin, a director of OPC, in relation to this case study.

13.2 Evidence

13.2.1 StatePlus

StatePlus is the RSE licensee for the StatePlus Fixed Term Pension Plan and the StatePlus Retirement Fund.[1283] As at 30 June 2017, the funds had, respectively, $7.6 million under management in respect of 632 members and $17.228 billion under management in respect of 74,739 members.[1284]

In June 2016, StatePlus was purchased by a subsidiary of FTC. After the purchase, FTC performed a review of StatePlus's business practices and its provision of service to members.[1285]

[1282] Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 6 [38], 10 [54].

[1283] Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 5 [29]–[30].

[1284] Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 17–18 [92].

[1285] Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 135 [527].

That review found that from April 2013, StatePlus told some members who had received written advice from a financial adviser that StatePlus would invite them to an annual review with a financial planner.[1286] However, StatePlus's advice procedures were not updated to ensure that all relevant members received the invitation. Some members with balances under $150,000 did not receive an invitation to receive an annual review. Others received an invitation, but only on a 14 month cycle (instead of a 12 month one). The cost of the annual review was included in the management fee paid by the member.[1287]

StatePlus reported the breach to ASIC in May 2017.[1288] Since then, in consultation with ASIC, StatePlus has started to compensate affected members.[1289] At the time of Mr Lennon's statement in August 2018, 12,269 members had been paid compensation.[1290] StatePlus forecast that the total cost of project expenses and fee repayments will not exceed $92 million.[1291]

13.2.2 OPC

OPC is the RSE licensee of the OnePath Master Fund, which has over $36 billion in funds under management and over 949,000 member accounts.[1292]

In October 2014, an internal team noticed that money was accumulating in a 'dummy' account within OPC. ANZ logged an incident report and began an investigation.[1293]

1286 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 135–6 [530]–[531].

1287 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, Exhibit ML-193 [STS.5003.0001.1284].

1288 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 136 [532]; Exhibit ML-193 [STS.003.0001.1284].

1289 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 156 [553], 157 [557].

1290 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 155 [550].

1291 Exhibit 5.344, Witness statement of Mark Lennon, 17 August 2018, 157 [557].

1292 Exhibit 5.330, Witness statement of Peter Mullin, 25 July 2018, 10 [29].

1293 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [279].

The investigation found that adviser service fees (ASFs) were being deducted from some members' accounts after those accounts were no longer allocated to an adviser. This happened when staff did not properly follow a two-step process to stop adviser payments.[1294] OPC eventually established that this problem had been occurring since 2003, and that 2,640 members were affected. It found that it had wrongly deducted $1,018,448 from those members' accounts.[1295]

In February 2015, OPC reported the breaches to ASIC and APRA.[1296] Between March and September 2015, OPC communicated with ASIC and developed a remediation program.[1297] In November 2015, ANZ engaged an independent consultant to review its proposed remediation program.[1298] ANZ finished compensating all customers in August 2016.[1299]

OPC engaged Ernst and Young to assess its processes, business rules and controls in respect of ASFs across OPC and ANZ's Pensions & Investments operations more broadly.[1300] With the exception of recommendations relating to the integration of the control environment of the ANZ Financial Planning and aligned dealer group businesses, which are being separated from ANZ's systems as part of the IOOF transaction, all recommendations have been implemented.[1301]

13.2.3 Westpac

This case study concerned some 'investor-directed portfolio service' products, and similar products, administered by Asgard, and some superannuation products of which BT was the RSE licensee.

1294 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 98–9 [251]–[253].

1295 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 99 [255].

1296 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 101 [267].

1297 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [270].

1298 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [272].

1299 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 102 [277].

1300 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [280].

1301 Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, 103 [282].

After 1 July 2014, the fee structure of these products changed. Under the new structure, an advice fee was collected by Asgard or BT as a separate fee, rather than being included in an administration fee.[1302] After this structure was introduced, some customers were charged advice-related fees even though they were no longer receiving advice. The wrongly charged fees were retained by Asgard or BT.[1303]

In October 2016, a customer complained about being charged an advice fee after having asked to remove their financial adviser from their account. Westpac conducted an investigation into the issue, which finished in February 2017.[1304] It found that the root causes of the error were insufficient procedures and inconsistent processing of the removal or reduction (as applicable) of the relevant fees either by relevant employees or by a third party service provider.[1305]

Westpac notified ASIC of the issue on 17 July 2017.[1306] A remediation process was agreed in December 2017[1307] and completed in March 2018.[1308] 767 customers were affected.[1309] In total, $634,490 was paid to those customers, comprising reimbursement of the fees incorrectly charged and compensatory interest.[1310]

13.3 What the case study showed

In each case, members were charged fees for services that were not provided because of failures in the trustee's systems. StatePlus did not update its procedures. OPC failed to follow its procedures. Asgard and BT

[1302] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [19].

[1303] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [21].

[1304] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 5 [27].

[1305] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 5 [28].

[1306] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 7 [38], Exhibit MSH1-5 [WBC.529.001.0012].

[1307] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 8 [45].

[1308] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 9 [46].

[1309] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [22].

[1310] Exhibit 5.343, Witness statement of Melinda Howes, 18 July 2018, 4 [22].

had both inadequate procedures and inconsistent processing. As a result, each trustee took money from members to which it was not entitled. In each case the conduct continued for several years. In the case of OPC, it continued for over a decade.

As I said in connection with home loans in the *Interim Report*, processing errors are failures by entities to make proper provision in their systems to charge customers only what the customer has agreed to pay. Entities should not sell what they cannot deliver.[1311]

Each of the three entities acknowledged that its actions constituted misconduct.[1312] Westpac specifically acknowledged that its conduct may have breached its obligations under section 912A of the Corporations Act.[1313] I agree. In my view, the conduct of each entity may have breached section 912A(1)(a) of the Act, in that the trustee failed to do all things necessary to ensure that the financial services covered by its Australian financial services licence were provided efficiently, honestly and fairly. Each matter having already been reported to ASIC, it is a matter for it to decide what, if any, further action should be taken.

14 MySuper and other retail groups

14.1 Background

Each of the case studies concerning Colonial First State, IOOF and AMP included consideration of whether the interests of members – having their superannuation invested in a simple, low-cost product – were subjugated to the interests of the relevant retail group or its associated financial advisers – having members remain invested in higher fee-paying products.

Two other case studies raised similar issues.

1311 FSRC, *Interim Report*, September 2018, Vol 1, 67.

1312 FTC, *Submission*, 29 January 2018, 4 [3.7]; ANZ, *ANZ Submission in Response to the Commission's Letters of 15 December 2017*, 29 January 2018, 12 [5.31], 15 [5.41]; Westpac, Module 5 Case Study Submission, 1 [2].

1313 Westpac, Module 5 Case Study Submission, 1 [2].

14.2 Evidence

14.2.1 Aon Hewitt

The first concerned Aon Hewitt Financial Advice Limited (Aon Hewitt), which offers financial advice services. It has 185 financial advisers, 149 of whom are authorised representatives of Aon Hewitt. Aon Hewitt is part of the Aon Group, which provides financial advice, insurance, and other professional services.

Three of Aon Hewitt's advisers switched clients out of their existing default superannuation product, and into a choice product, before 30 June 2017. The timing was significant, because RSE licensees were required to transfer accrued default amounts to a MySuper default option by 1 July 2017. By switching their clients to a choice product, the advisers avoided those funds being transferred. One consequence was that the financial advisers remained entitled to receive trailing commissions. Yet it was not clear that these clients had provided informed consent to the switch. It appeared that many had not been provided with a Statement of Advice (SOA) or Financial Services Guide (FSG), or any advice at all.

The Commission received a statement of evidence from Mr Jayson Walker, the General Manager of Aon Hewitt, about this case study.[1314]

The first financial adviser wrote to 331 clients on 18 August 2016 as follows:[1315]

> [W]e are proposing that your existing super and future contributions be invested in your existing AON Master Trust *Balanced Growth – Active* investment option. This balanced option helps to ensure that your super is not invested too aggressively nor too defensively, and that your super is not exposed to excessive risks.
>
> …

[1314] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018.

[1315] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit 2.2, Appendix A (emphasis in original); see also Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 3 [22]–[24].

> *What do I need to do?*
>
> If you are happy to have your existing MySuper balance and future contributions invested in your AON Master *Balanced Growth – Active* investment option, no further action is required from you. We will do all the work for you to ensure this happens. However, if you wish to leave your Aon MySuper account unchanged, please contact us within *30 days* from the date of this letter.

The adviser did not provide any SOA or FSG to those clients, either with the letter or otherwise. There was no indication on the clients' files that they had been given any advice about whether switching was in their best interests. There was nothing to suggest the clients had given informed consent to switch to the choice product. Nevertheless, the first financial adviser switched all 331 clients to a choice product.[1316]

The second and third financial advisers both worked for the same corporate group. Again, it appears that these advisers switched clients to a choice product without providing an SOA or an FSG. Aon Hewitt's investigation could not find sufficient evidence of informed consent.[1317]

Initially, in its breach report to ASIC on 27 March 2018, Aon Hewitt said that the conduct had affected 500 clients of those financial advisers.[1318] Since then, Aon Hewitt has undertaken further analysis and is still determining the number of clients who may have been affected.[1319] On the state of the evidence, I cannot be satisfied of the precise number of clients of the second and third advisers who may have been affected.

The conduct of each of the three financial advisers only came to Aon Hewitt's attention when it was issued with notices by ASIC pursuant to section 33 of the ASIC Act in late 2017. Aon Hewitt then commenced

[1316] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [133].

[1317] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 5 [34].

[1318] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit JW-2 (Tab 2.2) [AHF.001.001.1373].

[1319] Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [134]–[135].

an investigation. As a result of that investigation, Aon Hewitt lodged a breach report with ASIC in relation to the three advisers.[1320]

Aon Hewitt is now in the process of designing its review and remediation program. It intends to compensate clients for any loss suffered by reason of differences in fees and costs payable and investment returns.[1321] Aon Hewitt acknowledged before the Commission,[1322] and has acknowledged to ASIC,[1323] that it is liable to compensate clients who suffered loss as a result of breaches by the three financial advisers.[1324]

14.2.2 Mercer Superannuation

The second case study involved Mercer Superannuation (Australia) Limited (Mercer Superannuation), the RSE licensee of the Mercer Super Trust (the Mercer Fund) and three other superannuation funds.[1325]

The Mercer Fund is divided into four divisions: the Corporate Superannuation Division, the Personal Superannuation Division, the Mercer Retail Division and the Mercer Allocated Pension Division (the Pension Division).[1326] This case study related to the Pension Division, which in June 2018 had 3,143 members and funds under management of $1.038 billion.[1327]

The case study concerned statements made in an internal email, which suggested that Mercer Superannuation was deliberately making it difficult for its members to access a new, lower fee structure.

Three written statements of Benjamin Walsh, Mercer Superannuation's Executive Director, were tendered in relation to the case study.

1320 Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, Exhibit JW-2 (Tab 2.2) [AHF.001.001.1373].

1321 Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 19 [136]–[137].

1322 Aon Hewitt, Module 5 Case Study Submission, 2 [10].

1323 Exhibit 5.345, Witness statement of Jayson Walker, 26 July 2018, 20 [139]–[142].

1324 Corporations Act ss 917A, 917B and 917F.

1325 Exhibit 5.333, Witness statement of Benjamin Walsh, 30 July 2018, 1 [1], 2 [7].

1326 Exhibit 5.333, Witness statement of Benjamin Walsh, 30 July 2018, 3 [10].

1327 Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 1–2 [4].

In 2013, Mercer Superannuation was preparing for the commencement of FoFA and the Stronger Super reforms. In February, the Mercer Superannuation Board resolved that new fee structures would be introduced in respect of members who joined the Pension Division from 30 June 2013. Trailing commissions would not be paid under these new structures. Existing arrangements, which did allow the payment of trailing commissions, would be grandfathered.[1328]

In June 2013, the board delayed the application of the new fee structures to 1 January 2014 so that the change of fees would align with other changes being made because of the introduction of MySuper.[1329]

As part of the changes, Mercer staff were considering what process to follow where a Pension Division member wanted to access the new fee structure. An internal email chain showed that one staff member thought members should close their existing account and open a new one. Another staff member replied that doing so would be ‘a lot of work and totally unnecessary’.[1330]

Stephen Partridge was the Fund Product Leader at the time. On 12 December 2013, he replied to those emails as follows:[1331]

> Part of the logic here is that we want to protect our existing APD [Pension Division] revenue as much as possible.
>
> Accordingly *we do not intend to advertise the new lower fees to existing APD members and we don’t want to make it easy for them to (a) find out about the new lower fees and (b) access them.*

[1328] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 5 [20]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-116 [MER.501.001.3068 at .3072].

[1329] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 5–6 [22]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-119 [MER.510.001.0835 at .0845].

[1330] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 8–9 [34]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-130 [MER.003.001.0638].

[1331] Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BJCW-130 [MER.003.001.0638] (emphasis added).

> However, anyone who wants can take out a new allocated pension and we cannot stop existing members doing this.
>
> APD members who have a Mercer adviser who is acting in the [members'] best interests will likely initiate this also.
>
> There are some delicate trustee fiduciary issues involved in this decision also.
>
> If we allow existing members to simply apply to have their fees reduced while remaining in the same account with nothing else changing, then Mercer Superannuation is probably obligated to inform existing members of this, which we do not want to do.
>
> *I am aware that operationally this is painful and costly, but it is much less costly for the business than advising all the existing members and have most of them apply to have their fees reduced.*

This email formed part of a story on *Four Corners* broadcast by the ABC on 26 March 2018.[1332] After the story aired, Mercer Superannuation investigated the email and the way it had communicated with Pension Division members after the introduction of the new pricing structure.[1333]

Mercer Superannuation found that while some members would have paid lower fees if the new pricing structure was applied to their accounts, there were other members whose fees would have increased if that new pricing structure had been applied to their accounts.

On 23 July 2018, the board of Mercer Superannuation made an in-principle decision to:[1334]

- Align the pricing of all members of the Pension Division, regardless of whether they joined before or after 1 January 2014. This would be done by introducing a new pricing structure for the Pension Division from a nominated future date (provisionally, 1 January 2019).

[1332] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 10 [40].

[1333] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 11 [43].

[1334] Exhibit 5.335, Witness statement of Benjamin Walsh, 3 August 2018, 11 [43]; Exhibit 5.335, Witness statement of Benjamin Walsh, Exhibit BCJW-136 [MER.547.001.001 at .0030], Exhibit BJCW-137 [MER.300.011.0005].

- Provide a 'goodwill allowance' to members of the Pension Division as at 31 December 2013. This allowance would be the difference between their actual account balance on a nominated date (for example, 31 December 2018) and the amount their account balance would have been if Pension Division fees from 1 January 2014 had been capped at 1.5%.

14.3 What the case study showed

14.3.1 Aon Hewitt

On the limited material I have, it may be that the advisers concerned may have breached each of sections 941B(1), 946A(1) and 961B of the Corporations Act on each occasion a switch was made, if the switch was made without the client's informed consent, by, respectively, failing:

- to provide an SOA;
- to provide an FSG; and
- to act in the best interests of the client.

Not having heard the advisers' side of the story, I cannot, and do not, say whether that is so.

Each of the relevant obligations applies to the 'providing entity' or 'provider'. Insofar as section 961B(1) of the Corporations Act is concerned, not consulting with a client at all, or merely informing a client of a chosen course without consulting with him or her could constitute a breach of the section.[1335] But, as I say, I make no finding.

Instead, the question is whether Aon Hewitt itself may have breached these or other provisions of the financial services laws. In its submissions, it contended, by reference to the wording of each of section 941B(1), 946A(1) and 961B of the Corporations Act, that those provisions only apply to the 'providing entity' or 'provider' of the relevant advice and that it was not the

[1335] Cf Aon Hewitt, Module 5 Case Study Submission, 2 [8].

providing entity or provider that was engaged in the conduct described here. I agree.

Nevertheless Aon Hewitt would be liable under the Corporations Act, sections 917A, 917B and 917F, to compensate the affected clients if the conduct of the three advisers was not lawful. Aon Hewitt was right to acknowledge that this is the case, and it is right to have committed itself to a program of compensation. The supervision of that compensation program is a matter for ASIC.

14.3.2 Mercer Superannuation

Mercer Superannuation conceded that the instructions recorded in the email – that Mercer Superannuation should not make it easy for members to find out about or access lower fees – was conduct that fell below community standards and expectations.[1336] I agree.

Retail trustees often emphasise to regulators, the Commission and others, the importance of managing conflicts. But when it comes to superannuation, conflicts must not just be ‘managed’ – trustees have an overriding obligation to prefer the interests of beneficiaries. In these cases, financial advisers (in the case of Aon Hewitt) and the trustee (in the case of Mercer Superannuation) might not have done so.

15 Regulatory responses

15.1 ASIC

15.1.1 Approach to regulation

Peter Kell, Deputy Chairman of ASIC, told the Commission that ASIC’s regulatory aim is to have a superannuation system that delivers good outcomes for consumers.[1337] He said that ASIC is concerned with the fair

[1336] Mercer, *Royal Commission into the Banking, Superannuation & Financial Services Industry*, 3 August 2018, 1.

[1337] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

treatment of consumers and reducing poor conduct,[1338] and that it takes a risk-based approach, focused on acting where consumers might be harmed.[1339]

Mr Kell said that ASIC believes general deterrence in the superannuation industry is important.[1340] This is because of the large amount of money involved and the importance of superannuation to consumers.[1341] He said that ASIC believes that litigation is a 'critical part' of general deterrence,[1342] though deterrence can also be achieved through other methods, such as administrative orders and licence conditions.[1343]

Under the ASIC Act and Corporations Act, ASIC can bring a range of court proceedings against superannuation trustees or their directors. For example, ASIC can bring civil penalty proceedings against a trustee for making false or misleading statements to its members.[1344] Similarly, it can bring civil penalty proceedings if directors of a trustee fail to act in good faith, or engage in unconscionable conduct.[1345]

Mr Kell conceded that ASIC had not, in fact, brought many court proceedings regarding superannuation.[1346] He said that this was not due to any confusion about the division of regulatory responsibility between ASIC and APRA, but because there were some parts of the SIS Act that ASIC was not responsible for.[1347] ASIC is prepared to take on a greater role as a conduct regulator for RSE licensees, but considers it would need additional

---

[1338] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

[1339] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 7 [22].

[1340] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 43 [154].

[1341] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 43 [154].

[1342] Transcript, Peter Kell, 17 August 2018, 5260.

[1343] Transcript, Peter Kell, 17 August 2018, 5260.

[1344] ASIC Act ss 12DB, 12GBA and 12GBC(1).

[1345] ASIC Act ss 12CA, 12CB, 12GBA and 12GBC(1); Corporations Act ss 181(1), 1317E(1) and 1317J(1); Transcript, Peter Kell, 17 August 2018, 5261.

[1346] Transcript, Peter Kell, 17 August 2018, 5261.

[1347] Transcript, Peter Kell, 17 August 2018, 5262.

powers to do so.[1348] By way of example, Mr Kell said that ASIC might be prepared to take action against a trustee for breach of the sole purpose test under such an expanded role.[1349]

One of ASIC's other enforcement tools is the power to accept enforceable undertakings (EUs). Mr Kell said that ASIC will consider an EU where it can get better or different outcomes as compared to a court proceeding.[1350] However, part of the 'threshold test' for using an EU was whether ASIC was otherwise prepared to go to court.[1351] He said that using EUs without being prepared to go to court would mean the tool would not have 'credibility'.[1352]

15.1.2 Fees for no service

Mr Kell said that the fees for no service project was a significant undertaking. The project involved 27 investigations across 31 licensees, and the collection of more than 2.5 million documents.[1353] ASIC had imposed banning orders, a licence condition, and accepted EUs, though at the time of Mr Kell's evidence it had not commenced any proceedings.[1354] In implementing the project, he said that ASIC had given priority to remediating customers. The estimated compensation bill at the time of Mr Kell's evidence was $850 million, though he said the total compensation amount could be more than $1 billion.[1355]

At that time, Mr Kell said that ASIC had only considered remediation due to consumers. It had not assessed what profits the entities had made by charging fees for no service. Mr Kell's evidence was that ASIC would consider the issue, but so far had been focused on 'the main game, getting money back into the pockets of consumers'. In this context, Mr Kell

---

[1348] Exhibit 5.318, Statement of Peter Kell, 13 August 2018, 56 [203].

[1349] Transcript, Peter Kell, 17 August 2018, 5262.

[1350] Transcript, Peter Kell, 17 August 2018, 5251.

[1351] Transcript, Peter Kell, 17 August 2018, 5250–1.

[1352] Transcript, Peter Kell, 17 August 2018, 5250.

[1353] Transcript, Peter Kell, 17 August 2018, 5254.

[1354] Transcript, Peter Kell, 17 August 2018, 5254.

[1355] Transcript, Peter Kell, 17 August 2018, 5254.

said that ASIC had publicly argued in favour of a disgorgement power, so that it could deal with the money entities make from misconduct.[1356]

Mr Kell agreed that another way of deterring entities from this sort of misconduct was to commence proceedings and obtain large civil penalties that deprived entities of their profit. In respect of the fees for no service conduct, he said that ASIC was 'certainly alert' to the risk of limitation periods expiring, and that 'you will expect to see' ASIC commence proceedings.[1357] In September 2018, three weeks after Mr Kell gave evidence, ASIC filed proceedings against NAB's two superannuation trustees for charging fees for no service. I have said more about the subject of fees for no service in the body of this report.

15.1.3 Grandfathered commissions

In 2016, NULIS wrote to ASIC about grandfathered commissions. It thought that it should be allowed to continue paying grandfathered commissions to advisers, and planned to do so.[1358] Mr Kell said that internally ASIC thought that the law was uncertain and involved complex legal issues.[1359] As a result, ASIC replied noting NULIS's view and that it did not seek a 'no action' letter from ASIC. ASIC did not take any further action.[1360] Mr Kell said that, in hindsight, ASIC should have considered whether continuing grandfathered commissions satisfied a 'best interests test'. At a broader level, his evidence was that 'the entire [grandfathering] provision is not in the interests of consumers'.[1361] It was initially 'depicted as a transition issue', but was 'actually an extremely expansive provision'. He said that grandfathering generated conflicts of interests and unnecessary costs, and while ASIC

[1356] Transcript, Peter Kell, 17 August 2018, 5255.

[1357] Transcript, Peter Kell, 17 August 2018, 5255–6.

[1358] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-151 [ASIC.0800.0011.3312].

[1359] Transcript, Peter Kell, 17 August 2018, 5257; Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-150 [ASIC.0800.0012.1761].

[1360] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, Exhibit PK-151 [ASIC.0800.0011.3312]; Transcript, Peter Kell, 17 August 2018, 5256.

[1361] Transcript, Peter Kell, 17 August 2018, 5258.

can and should look at individual cases, the matter should be dealt with at a policy level.[1362]

15.1.4 Transfer of ADAs

Mr Kell also gave evidence that in ASIC's view, there was no systemic problem with the default transfer process following the introduction of MySuper.[1363] However, he said that ASIC's work around the transition of accrued default amounts (ADAs) to MySuper products had been focussed on a specific project where advisers had tried to avoid transitioning their clients to MySuper. He said that ASIC had not found large numbers of advisers engaging in misconduct, but had not considered the transfer of ADAs through 'the broader prism' of trustees and wealth management firms.[1364] In light of the evidence heard by the Commission, he considered that 'more broadly there is a systemic issue'.[1365]

15.1.5 Branch selling program

As described earlier, between 2012 and 2018 ANZ sold its Retail Smart Choice Super product through its bank branches. Timothy Mullaly, Senior Executive Leader of the ASIC Financial Services Enforcement team, told the Commission that ASIC was concerned that this sales process might involve personal financial advice, which would breach the law.[1366]

In the middle of 2014, ASIC started surveillance of ANZ's distribution practices. Its investigation into the superannuation selling practices of ANZ, as well as those of CBA and Westpac, became part of a broader project within ASIC called the Wealth Management Project.[1367] In May 2015, the Wealth Management Project Board set a target to issue civil penalty

---

[1362] Transcript, Peter Kell, 17 August 2018, 5258.

[1363] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 30 [110].

[1364] Transcript, Peter Kell, 17 August 2018, 5259.

[1365] Transcript, Peter Kell, 17 August 2018, 5259.

[1366] Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 2 [7].

[1367] Transcript, Timothy Mullaly, 17 August 2018, 5225–6.

proceedings against one of the three banks by the end of October 2015.[1368] In July 2015, the target date changed to November 2015.[1369] However, by the end of November 2015, ASIC had still not issued a proceeding. Mr Mullaly said that was because investigations were continuing, and ASIC still needed to get more evidence and advice.[1370]

In December 2016 ASIC sent a 'position paper' to ANZ. That position paper said ASIC suspected that the distribution processes were against the law.[1371] ANZ and ASIC also met to discuss ASIC's concerns.[1372] In February 2017, ANZ sent a position paper in response.[1373] It denied breaching the law. It did not offer to change its conduct, or stop engaging in the conduct. It did not suggest any other way to resolve ASIC's concerns.

On 10 May 2017, ASIC sent ANZ a draft court pleading.[1374] It told ANZ that it would commence proceedings by 15 May 2017, and asked whether ANZ would make any admissions.[1375] Mr Mullaly said that this was intended to show ANZ that ASIC was 'serious' and would go to court if the matter did not resolve.[1376] But despite its stated intention to commence proceedings, ASIC was willing to resolve the matter with an EU. He said that while ASIC was prepared to go to court if it did not get the outcome it wanted,

---

1368 Transcript, Timothy Mullaly, 17 August 2018, 5227; Exhibit 5.312, 20 May 2015, Papers for the Wealth Management Project Board Meeting of 20 May 2015, 43.

1369 Exhibit 5.313, 2 July 2015, Papers for the Wealth Management Project Board Meeting of 2 July 2015, 4.

1370 Transcript, Timothy Mullaly, 17 August 2018, 5227–30.

1371 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 7 [26]; Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-5 [ASIC.0041.0003.2762].

1372 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 8 [27].

1373 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-3 [ASIC.0041.0006.0051].

1374 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-7 [ASIC.0041.0001.7094].

1375 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-6 [ASIC.0041.0001.7093].

1376 Transcript, Timothy Mullaly, 17 August 2018, 5233.

ASIC actually thought an EU would be a better outcome than commencing proceedings.[1377]

On 12 May 2017, ANZ replied and suggested a meeting.[1378] On 15 May 2017, ANZ's Group General Counsel emailed Mr Mullaly asking for 'one final chat' before ASIC commencing proceedings.[1379] Mr Mullaly said this showed that ASIC had 'got their attention'.[1380] As a result, ASIC did not commence proceedings.[1381]

By the end of May 2017, ANZ told ASIC that it was prepared to accept an EU.[1382] In October 2017, ASIC gave ANZ a draft EU.[1383] ANZ and ASIC then negotiated the terms of the EU for 10 months.[1384] As part of those negotiations, ANZ and ASIC had to agree exactly what ANZ would stop doing. Mr Mullaly said that ANZ tried to narrow the conduct that would be prohibited.[1385] ASIC also wanted to include contextual information about how many superannuation accounts had been opened, and how much money had been contributed to those accounts.[1386] ANZ did not want to include that information,[1387] and ASIC agreed to delete it.[1388] The final EU was signed

1377 Transcript, Timothy Mullaly, 17 August 2018, 5232–3.

1378 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, Exhibit TM-8 [ASIC.0041.0001.7107].

1379 Exhibit 5.314, 15 May 2017, Email from Mr Santamaria to Mr Mullaly.

1380 Transcript, Timothy Mullaly, 17 August 2018, 5234.

1381 Transcript, Timothy Mullaly, 17 August 2018, 5234.

1382 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 8 [34]; Transcript, Timothy Mullaly, 17 August 2018, 5238.

1383 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 12–13 [56].

1384 Exhibit 5.310, Witness statement of Timothy Mullaly, 3 August 2018, 12 [54].

1385 Transcript, Timothy Mullaly, 17 August 2018, 5237–9.

1386 Transcript, Timothy Mullaly, 17 August 2018, 5241; Exhibit 5.377, 25 January 2018, ANZ Smart Choice – Terms of draft EU – Comparison, 3 [2.9].

1387 Exhibit 5.379, 28 March 2018, Letter from Allens to ASIC, 2.

1388 Exhibit 5.380, 15 May 2018, Letter from ASIC to Allens, 2.

on 4 July 2018, and accepted by ASIC the next day. ANZ had to stop the distribution process within 45 days of the EU.[1389]

Mr Mullaly said ASIC's main concern was stopping the conduct.[1390] He said the EU process meant the conduct stopped in a 'very timely way'.[1391] He said that if they had gone to court in May 2017, there was 'no guarantee … that we would be anywhere near resolving the matter'.[1392] He said that ASIC had considered seeking a court injunction to stop the conduct, but decided it would be 'futile'.[1393] Mr Mullaly also thought that the EU gave ASIC a better result than they could get from a court order. He said those better results included 'the cessation of the conduct; the precise specification of what ANZ 'could not do'; and the implementation of a monitoring process.'[1394]

15.2 APRA

APRA is Australia's prudential regulator, with responsibility for banking, insurance and superannuation.[1395] Among other things, it regulates RSE licensees and has the general administration of important parts of the SIS Act.[1396] Helen Rowell, Deputy Chairman of APRA, told that Commission that APRA is concerned with making sure that RSE licensees can meet their financial promises to their members 'within a stable, efficient and competitive financial system'.[1397] ASIC also regulates RSE licensees, but is mainly concerned with their relationship with consumers.[1398]

[1389] Exhibit 5.256, Witness statement of Mark Pankhurst, 1 August 2018, Exhibit MP-221 [ANZ.800.870.0001 at .0006, cl 3.6].

[1390] Transcript, Timothy Mullaly, 17 August 2018, 5234, 5242.

[1391] Transcript, Timothy Mullaly, 17 August 2018, 5234.

[1392] Transcript, Timothy Mullaly, 17 August 2018, 5235.

[1393] Transcript, Timothy Mullaly, 17 August 2018, 5235.

[1394] Transcript, Timothy Mullaly, 17 August 2018, 5240.

[1395] Transcript, Helen Rowell, 17 August 2018, 5163.

[1396] SIS Act s 6.

[1397] Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 5 [46].

[1398] Exhibit 5.318, Witness statement of Peter Kell, 13 August 2018, 2 [4].

15.2.1 Approach to regulation

Mrs Rowell said that APRA's approach to regulation is 'principles based' and 'risk based'.[1399] This approach is consistent with the Federal Government's Statement of Expectations, which sets out the Federal Government's view on APRA's roles and responsibilities.[1400] Mrs Rowell said that 'principles based' regulation means that it focuses on outcomes. It allows regulated entities to choose how to comply with high level principles, rather than controlling them with detailed prescription.[1401] 'Risk based' regulation means that APRA focuses on areas of high risk or impact. That means smaller or lower risk entities get less attention than larger or higher risk entities.[1402] Mrs Rowell said that APRA's focus is on making sure superannuation entities can meet their promises and obligations to members.[1403]

As part of its 'principles-based' regulation, APRA issues Prudential Standards. The Prudential Standards set principles-based objectives to support compliance with the law.[1404] As Mrs Rowell put it, the Prudential Standards 'elaborate on the high level requirements' in the legislation.[1405] RSE licensees must comply with these standards. There are five prudential standards specific to superannuation, and six prudential standards that cover superannuation and other APRA-regulated industries.[1406] APRA also publishes non-binding guidance to help entities understand its requirements.[1407]

1399 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 2 [23].

1400 Exhibit 5.443, Undated, Statement of Expectations – Australian Prudential Regulation Authority.

1401 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 2–3 [24].

1402 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [25].

1403 Transcript, Helen Rowell, 17 August 2018, 5174.

1404 Transcript, Helen Rowell, 17 August 2018, 5163.

1405 Transcript, Helen Rowell, 17 August 2018, 5163.

1406 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 7–8 [61]–[62].

1407 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 7 [59].

APRA considers that the assessment of prudent conduct and risk management is 'nuanced and intentionally directed to processes and outcomes' rather than questions of compliance or breach.[1408] As a prudential regulator, APRA tries to improve outcomes for members and standards of practice. It considers this approach to be quite different 'from other regulators with the mandate to enforce compliance with legislation after a violation has occurred'.[1409]

15.2.2 Supervision and enforcement

As part of its regulatory role, APRA supervises RSE licensees. Each RSE licensee has a nominated supervisor within APRA, who is expected to have in-depth knowledge of the entity.[1410] Large entities may have a team of supervisors.[1411] The supervisors do various kinds of supervision activities. These can include 'prudential reviews', which are detailed assessments of selected practices or procedures, as well as regular meetings with senior executives and other staff.[1412]

APRA aims to be 'forward looking and consultative' in its supervision.[1413] If it detects problems, it prefers to work with the entity to resolve those problems.[1414] It is focused on pre-emptive steps, rather than reacting to problems and taking formal enforcement action.[1415] Mrs Rowell's evidence was that in APRA's experience it has 'generally not had to pursue or resort to litigation', given other options such as increased supervision and enforcement action, and the availability of voluntary undertakings.[1416]

1408 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [32].

1409 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 3 [27].

1410 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 10 [78].

1411 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 10 [78].

1412 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 14 [101].

1413 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 6 [53].

1414 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 37–8 [249]–[250].

1415 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 35 [230].

1416 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 4 [39].

However, APRA does have a range of enforcement options. From 2003 to 2008, APRA could disqualify a person from acting as a trustee or responsible officer of a superannuation fund. It disqualified 133 people during that that time.[1417] In 2008 the law changed, and APRA now has to apply to the Federal Court for a disqualification order. When Mrs Rowell gave evidence, APRA had applied to disqualify one person, a director of Trio Capital.[1418] That proceeding resolved with an EU. APRA has accepted 13 EUs from individuals instead of commencing proceedings to disqualify. Each of these individuals was associated with Trio.[1419]

No corporate trustee has given APRA an EU regarding a superannuation matter in the last 10 years.[1420] APRA has never commenced a civil proceeding for breach of the 'sole purpose test' in section 62 of the SIS Act. When Mrs Rowell gave evidence, APRA had never formed the view that an RSE licensee was not acting in the best interests of members. Other than those mentioned above, it had not started any other court proceeding about superannuation in the past 10 years.[1421]

It is important to note, therefore, an event that happened after the Commission received Mrs Rowell's evidence. As I have recorded in the section dealing with the IOOF Holdings Ltd group of companies, and as discussed further below, on 6 December 2018 APRA commenced proceedings in the Federal Court against five individuals, IOOF Investment Management Ltd (IIML) and Questor Financial Services Pty Ltd (Questor).[1422] By those proceedings, APRA seeks seeks disqualification orders under section 126H of the SIS Act. It also seeks declarations that IIML, Questor and certain individuals had breached their duties as trustees and contravened various provisions of the Act.

1417 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 44 [288].

1418 Transcript, Helen Rowell, 17 August 2018, 5167.

1419 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 45 [297].

1420 Transcript, Helen Rowell, 17 August 2018, 5178.

1421 Transcript, Helen Rowell, 17 August 2018, 5169.

1422 *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

APRA does not publicly identify entities who have engaged in particular conduct, except through EUs.[1423] However, it does not think that public disclosure is needed to achieve general deterrence.[1424] APRA believes it is more important to make sure RSE licensees are aware of issues and practices of concern to it.[1425] Therefore it communicates with the industry generally, including through reports, letters and speeches, and with entities individually, through its regular supervision activities.[1426] APRA considers that its approach to general deterrence is effective, and 'regulated entities know that APRA will take action to enforce its standards if it must'.[1427]

In dealing with individual cases, Mrs Rowell said that APRA prefers to take a 'behind the scenes' approach.[1428] This is because APRA is concerned that negative publicity about a fund can harm members.[1429] Where public concerns are raised, members or employers might seek to withdraw their funds, which in turn could create liquidity and asset valuation issues that could reduce the value members get from their superannuation investments. APRA considers this issue when deciding whether or not to take enforcement action.[1430]

15.2.3 Fees for no service

Mrs Rowell said that APRA was aware of ASIC's investigation into the fees for no service issue.[1431] APRA had not decided whether to take any action against trustees for breach of the sole purpose test. It did not want to 'intervene in ASIC's process', even though APRA, not ASIC, is responsible

1423 Transcript, Helen Rowell, 17 August 2018, 5178.

1424 Transcript, Helen Rowell, 17 August 2018, 5178.

1425 Transcript, Helen Rowell, 17 August 2018, 5178.

1426 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 33–4 [220]; Transcript, Helen Rowell, 17 August 2018, 5178.

1427 Exhibit 5.298, Witness statement of Helen Rowell, 14 August 2018, 34 [221].

1428 Transcript, Helen Rowell, 17 August 2018, 5179.

1429 Transcript, Helen Rowell, 17 August 2018, 5179.

1430 Transcript, Helen Rowell, 17 August 2018, 5179.

1431 Transcript, Helen Rowell, 17 August 2018, 5180.

for addressing contraventions of the sole purpose test under the SIS Act.[1432] Mrs Rowell said that APRA would consider 'at an appropriate point' whether to take further action.[1433] APRA had not decided when that point would be. Mrs Rowell was not sure whether there was a limitation period for prosecuting a breach of the sole purpose test.[1434]

Mrs Rowell did say that, as a general proposition, APRA would be concerned if an RSE licensee did not have appropriate monitoring systems in place, including monitoring whether advice had been provided in exchange for fees paid out of superannuation.[1435] She said that APRA supervisors had been engaging with individual entities to understand those issues.[1436]

Something more should be said about two particular cases: Colonial First State (CFS) and the transfer of members to MySuper, and IOOF.

15.2.4 CFS and the transition of members to MySuper products by retail fund trustees

From 1 January 2014, superannuation trustees had to pay new default contributions into a MySuper account. Before the change came into effect, APRA reminded RSE licensees of their obligations, and that failing to comply was an offence under section 29WA(3) of the SIS Act.[1437] APRA's expectation was that RSE licensees would have systems in place to comply with the provision from 1 January 2014.[1438]

As I have explained earlier, in February 2014, CBA's subsidiary Colonial First State Investments Limited (CFSIL) told APRA that it may have breached section 29WA. This was because some members of its FirstChoice Personal Super product had received contributions into

[1432] Transcript, Helen Rowell, 17 August 2018, 5181.

[1433] Transcript, Helen Rowell, 17 August 2018, 5181–2.

[1434] Transcript, Helen Rowell, 17 August 2018, 5181.

[1435] Transcript, Helen Rowell, 17 August 2018, 5182.

[1436] Transcript, Helen Rowell, 17 August 2018, 5183.

[1437] Transcript, Helen Rowell, 17 August 2018, 5186.

[1438] Transcript, Helen Rowell, 17 August 2018, 5186.

a non-MySuper product. APRA told CFS that it needed to fix the problem 'in the short term', or else APRA might take enforcement action.[1439] CFS's breach notification to APRA said approximately 13,000 members were affected.[1440]

As part of engaging with APRA, CFSIL provided its proposal to address the breaches. It told APRA that it had started calling affected members to get an investment direction. One call script it used said that CFS was 'required to confirm the investment options into which you would like your superannuation contributions paid'.[1441] That statement was not accurate. CFS was not 'required' to make any such confirmation. Rather, if CFS did not receive an investment direction it had to pay contributions into a MySuper account. In evidence, Ms Elkins of CBA said that the script was misleading,[1442] although in submissions CFS did not agree.[1443] Ms Elkins also said that the script was not balanced, because it was focused on keeping members in their investment option.[1444] When asked about the script, Mrs Rowell said that it 'did not provide complete information to the member'. When asked if that was acceptable, Mrs Rowell said that it was 'not desirable'. She said it would be 'preferable if there was complete disclosure to members'.[1445]

After receiving the proposal, APRA asked for some further information but otherwise told CFS that it was acceptable.[1446] CFSIL continued to receive contributions in breach of section 29WA for more than two years. Every few months, CFS would provide an update to APRA. In its update number 24, on 13 September 2017, CFSIL told APRA that it had resolved the final

[1439] Exhibit 5.299, 14 March 2014, Letter APRA to CFSIL.

[1440] Exhibit 5.184, 19 March 2014, Breach Notice Colonial First State Investment to APRA.

[1441] Exhibit 5.187, 26 March 2014, Email CBA to APRA and Attached Call Script.

[1442] Transcript, Linda Elkins, 14 August 2018, 4888.

[1443] CBA, Module 5 Case Study Submission, 22 [58].

[1444] Transcript, Helen Rowell, 17 August 2018, 4888.

[1445] Transcript, Helen Rowell, 17 August 2018, 5196.

[1446] Exhibit 5.190, 29 April 2014, Letter, APRA to Elkins.

tranche of contributions it had received in breach of section 29WA.[1447] APRA subsequently considered the matter closed.[1448]

APRA did not take any formal enforcement action. This was because CFS had agreed to a process in consultation with APRA to address the issues, and APRA was satisfied that the process had been followed.[1449]

More generally, Mrs Rowell agreed that it was typically in the interests of retail trustees to keep members in choice products rather than moving them into MySuper, due to the higher fees and commissions attached to choice products.[1450] However, she said that did not necessarily mean that it was not in members' best interests. Her evidence was that the payment of commission, for example, could not be 'looked at in isolation'. More analysis was required to assess whether there was a member interest issue.[1451] APRA had not done a general project to evaluate whether retail trustees had acted in their own financial interests at the expense of members' interests when transferring ADAs to MySuper.[1452] She was not aware of APRA giving that issue any internal consideration.

15.2.5 IOOF

Throughout 2015, APRA was communicating with IOOF about various issues. In September 2015, it told IOOF that '[g]iven the size and complexity of IOOF, the number and range of prudential matters raises concerns for APRA'.[1453] In late 2015 and early 2016, it made a number of recommendations to IOOF including that IOOF restructure its APRA-

1447 Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

1448 Exhibit 5.195, 21 September 2017, Email, APRA to Colonial First State Concerning Section 29WA Update Number 24.

1449 Transcript, Helen Rowell, 17 August 2018, 5188–90; APRA, Module 5 Case Study Submission,14 [62].

1450 Transcript, Helen Rowell, 17 August 2018, 5193–4.

1451 Transcript, Helen Rowell, 17 August 2018, 5194–5.

1452 Transcript, Helen Rowell, 17 August 2018, 5195.

1453 Exhibit 5.104, 15 September 2015, Letter APRA to IOOF Holdings, 4.

regulated entities to reduce the number of common directors,[1454] and consider establishing an 'Office of the Trustee' to improve oversight.[1455] IOOF told APRA it would review its governance frameworks 'as a priority'.[1456]

Stephen Glenfield, General Manager, Specialised Institutions Division of APRA, told that Commission that despite this, APRA's supervision team continued to have concerns. In March, after a meeting with the board, an internal file note again commented that IOOF appeared to favour its shareholders above its members. The note also said that IOOF often took a legalistic approach to 'shield IOOF from obligations which may be in members' best interests'.[1457] In July, IOOF told APRA it would appoint two new independent directors to the boards of its APRA regulated entities. APRA's supervision team told Mr Glenfield this had been done to 'appease' APRA, and that IOOF 'did not intend to engage in genuine and critical consideration' about its governance.[1458]

In December 2016, APRA wrote to Questor about the CMT over-distribution discussed above. It said that Questor's use of the general reserve to compensate members was inappropriate, and that Questor had not effectively identified and managed conflicts of interest and duty.[1459] APRA said that Questor should immediately replenish the general reserve, and that a failure to do so would 'escalate APRA's concerns'.[1460] IOOF replied in April 2017. It said that Questor's behaviour had been appropriate, and that the 'so-called pub test, which in these circumstances is a proxy for

[1454] Exhibit 5.106, 21 December 2015, Letter APRA to IOOF Holdings, 5.

[1455] Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-26 [APRA.0002.0004.1315].

[1456] Exhibit 5.367, 21 July 2016, Memorandum, IOOF Group Status of Governance Review.

[1457] Transcript, Stephen Glenfield, 17 August 2018, 5206; Exhibit 5.303, 24 March 2016, File Note of Meeting between APRA and IOOF.

[1458] Exhibit 5.376, 21 July 2016, APRA Memorandum Regarding IOOF Group, 2.

[1459] Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 18) [IFL.0006.0003.4087].

[1460] Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 19) [IFL.0006.0003.4093].

members' best interests' had been passed.[1461] In evidence, Mr Glenfield agreed that the 'pub test' was not a way of explaining the best interests duty.[1462]

Despite this, APRA decided not to take any further action. This was partly because APRA's internal legal advice said the likelihood of success in a proceeding was 'less than clear cut'. It was also partly because APRA could not direct IOOF to replenish the reserve.[1463] Mr Glenfield thought Questor's behaviour was a symptom of IOOF's structural issues, and the most important thing was to get the structure right.[1464] When deciding whether or not to start a court proceeding, Mr Glenfield thought about the effect of any action on IOOF. He did not think about issues of general deterrence across the industry.[1465]

In June 2017, the supervision team gave Mr Glenfield another memorandum. It said that the IOOF Board 'fundamentally misunderstood' the duty to prioritise the interests of superannuation members.[1466] It also said that IOOF directors had difficulty identifying conflicts with related parties and were 'resistant to detailed documentation' about conflict management.[1467] The supervision team was concerned that the IOOF Board might not be fit and proper to be superannuation trustees. They recommended that APRA consider this issue further.[1468]

[1461] Exhibit 5.116, Witness statement of Christopher Kelaher, 26 July 2018, Exhibit CK-2 (Tab 19) [IFL.0006.0003.4093].

[1462] Transcript, Stephen Glenfield, 17 August 2018, 5210.

[1463] Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, 24–5 [109].

[1464] Transcript, Stephen Glenfield, 17 August 2018, 5220.

[1465] Transcript, Stephen Glenfield, 17 August 2018, 5220.

[1466] Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

[1467] Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

[1468] Exhibit 5.307, 13 August 2018, Memorandum to Mr Glenfield of 14 June 2017 Concerning IOOF Prudential Review.

After meeting with the board, APRA sent IOOF another letter. That letter said that IOOF's understanding of its obligations under the SIS Act was wrong. It said APRA 'required' IOOF to comply with those obligations.[1469] It took no other formal action.

In October 2017, IOOF announced that it was buying some of ANZ's business, including its superannuation funds.[1470] In March 2018, APRA wrote to IOOF. It had 'continued concerns' about conflicts.[1471] It thought IOOF's management of conflicts was 'inadequate'. It also thought the boards were inherently conflicted because of IOOF's structure.[1472] On 19 June 2018, APRA told IOOF that four 'minimum changes' were necessary. Those were to:

- split the RSE licensee and responsible entity (RE) functions;
- appoint an independent chair to lead a majority independent board;
- establish a dedicated support function; and
- consolidate the RSE licensees and REs after the ANZ acquisition.[1473]

On 1 August 2018, the IOOF Holdings Board decided to accept three of the four changes. It would appoint an independent chair to the IIML Board and replace Mr Kelaher with an independent director.[1474] It would also investigate separating the RSE licensee and the RE, potentially as a result of the acquisition of the ANZ wealth entities by IOOF.[1475] However,

1469 Exhibit 5.124, 15 August 2017, Letter APRA to IOOF.

1470 Transcript, Stephen Glenfield, 17 August 2018, 5218.

1471 Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-23 [APRA.0002.0007.2874].

1472 Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-23 [APRA.0002.0007.2874].

1473 Transcript, Christopher Kelaher, 10 August 2018, 4604; Exhibit 5.302, Witness statement of Stephen Glenfield, 14 August 2018, Exhibit SG-1-16 [APRA.0002.0007.3219].

1474 Transcript, Christopher Kelaher, 10 August 2018, 4606.

1475 Transcript, Christopher Kelaher, 10 August 2018, 4606.

at that time, IOOF did not agree to establish a dedicated support function. IOOF formally told APRA of its decision on 14 August 2018.[1476]

In evidence, Mr Glenfield agreed that Mr Kelaher, the Managing Director of IOOF, did not think there were legitimate concerns about IOOF's governance. Mr Glenfield said APRA's intervention with IOOF was an 'ongoing matter'. He said that a successful intervention from his perspective would involve splitting the RSE licensee and RE functions, with a fully independent board of the RSE licensee acting in the best interests of the members.[1477]

On 4 September 2018, after the Commission's hearings into superannuation had concluded, APRA wrote to IOOF. Among other things, it asked the IIML Board to reconsider the decision not to replenish the CMT general reserve. On 27 September 2018, the IIML Board resolved to replenish the IPS Fund's general reserve by the same amount that was used to compensate members of the CMT.[1478]

On 20 September 2018, IOOF agreed to implement a 'managed action plan' set out by APRA, 'subject to some comments on timing and approach'.[1479] Among other things, that plan included a number of further governance changes and the establishment of a dedicated support function.[1480]

As I have recorded in the section dealing with IOOF, on 6 December 2018 APRA commenced proceedings in the Federal Court against IIML, Questor, Mr Kelaher, and four other individuals holding senior positions at IOOF.[1481]

1476 Exhibit 5.308, 14 August 2018, Letter IOOF to APRA.

1477 Transcript, Stephen Glenfield, 17 August 2018, 5220.

1478 Exhibit 5.440, 30 October 2018, EF 27.9.18 signed.

1479 Letter APRA to King & Wood Mallesons, 6 December 2018, 7 <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

1480 Letter APRA to King & Wood Mallesons, 6 December 2018, 6–7 <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

1481 *APRA v Christopher Francis Kelaher & Ors*, NSD 2274/2018.

It also sent IOOF a ‘show cause’ letter setting out its intention to direct IIML to comply with its RSE licence, and to impose additional conditions on the licences of IIML and two other IOOF subsidiaries.[1482]

As I have also explained in the section dealing with IOOF, I make no comment or findings about the matters referred to in the documents filed by APRA. For that same reason, I make no comment on APRA’s response to those matters over a period of more than three years.

In general, I would observe that the conduct that a regulator tolerates crystallises the meaning and effect of the standards it sets.

[1482] Letter APRA to King & Wood Mallesons, 6 December 2018, 1 <www.apra.gov.au/sites/default/files/show_cause_notice.pdf>.

Case studies: Insurance

Introduction

In its sixth round of hearings, the Commission examined the insurance industry. It did so by reference to case studies involving all stages of the insurance process:

- the design of insurance products was considered in the CommInsure and IAG case studies;
- the sale of life insurance products was considered in the ClearView and Freedom case studies;
- the sale of general insurance products was considered in the Allianz, IAG and AAI (AAMI's Complete Replacement Cover policy) case studies;
- the handling of life insurance claims was considered in the CommInsure and TAL case studies; and
- the handling of general insurance claims made by policyholders affected by natural disasters was considered in the Youi case study, and in both AAI case studies.

Issues connected with **group life insurance** policies taken out through superannuation were also considered through two case studies. Product design, particularly key definitions and exclusions, and claims handling issues were considered in the REST case study. The AMP case study considered the appropriateness of default settings, the availability of insurance in MySuper products, premium deduction practices and supervisory issues arising from **vertical integration**.

The case studies also raised broader questions about a number of themes, including the appropriateness of the current regulatory regime and the adequacy of insurers' compliance frameworks.

1 ClearView

1.1 Background

This case study concerned the direct sale of life insurance by ClearView Life Assurance Limited (ClearView), and ClearView's engagement with the Australian Securities and Investments Commission (ASIC) in respect of its sales practices. The Commission heard evidence from Mr Gregory Martin, the Chief Actuary and Chief Risk Officer of ClearView Wealth Limited, the ultimate holding company of ClearView.[1]

1.2 Evidence

Prior to 2011, ClearView operated as a 'captive insurer', selling life insurance products to customers of the corporate group of which it formed part – most recently, Bupa.[2] By 2013, ClearView had expanded into a 'more substantial and professional direct life insurance business', and was selling policies to non-Bupa sourced customers.[3] At that time, ClearView established a sales centre in Parramatta.[4] In 2014, ClearView expanded its direct life insurance operations by investing in an outsourced Melbourne-based sales centre called YourInsure.[5] ClearView closed this business in late 2015.[6]

For the period that ClearView was directly selling life insurance, ClearView sold a range of life insurance products through outbound telephone sales, including life cover, trauma cover, funeral cover and accidental death

1 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 1 [1].

2 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 2 [12].

3 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 3–4 [24].

4 Transcript, Gregory Martin, 10 September 2018, 5308–9.

5 Transcript, Gregory Martin, 10 September 2018, 5309.

6 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [25].

cover.[7] At the time of the sixth round of hearings, ClearView was continuing to sell a number of similar products through its retail channel.[8]

During 2015 and 2016, ClearView had made changes to its business to target more affluent customers.[9] By mid-2016, ClearView had decided to revise its operating model by moving from a 'high volume, low value' model involving emotional sales pitches and above-market pricing, to a 'lower volume, higher value' model, in which products were pitched using both emotional and rational arguments and sold at market price.[10] Mr Martin accepted that, for the period that ClearView was operating under the former model, the life insurance products that ClearView sold in its outbound telephone sales were more expensive and of lower value than the products they were selling to more affluent people through other channels.[11] ClearView ceased direct sales of life insurance in mid-2017, for reasons that are discussed below.[12]

1.2.1 Accidental death policies

One of the products that ClearView sold through its direct life insurance business, and which it continued to sell through its retail channel at the time of the hearings, is accidental death cover.[13] Accidental death policies pay out upon a person's death where that death is due to an accident.[14] At least at the time of the hearings, ClearView's practice in its adviser sales channel had been to always offer an accidental death policy to a customer whose application for life cover was declined for medical reasons.[15]

---

7 Transcript, Gregory Martin, 10 September 2018, 5319–20.

8 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [28]–[29].

9 Transcript, Gregory Martin, 10 September 2018, 5311.

10 Transcript, Gregory Martin, 10 September 2018, 5314–17.

11 Transcript, Gregory Martin, 10 September 2018, 5318.

12 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [27].

13 Transcript, Gregory Martin, 10 September 2018, 5320–1; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 4 [28].

14 Transcript, Gregory Martin, 10 September 2018, 5320.

15 Transcript, Gregory Martin, 10 September 2018, 5322–4.

Mr Martin said that he was aware of ASIC's view that accidental death policies offer a very limited benefit to consumers.[16] He accepted that the number of claims made under ClearView accidental death policies was low compared to the number of policies sold.[17] He also accepted that the claims ratio for accidental death policies was low:[18] the ratio of claims paid out to premiums collected over the last five years was 26%,[19] and in 2014, the ratio was 1%.[20] Asked whether ClearView would continue to sell such products in light of ASIC's views,[21] Mr Martin said that ClearView had not yet reached a position on this, but that if ASIC and society would like ClearView to stop offering the product, it would do so.[22]

1.2.2 ASIC engagement – anti-hawking

In April 2016, ASIC raised concerns with ClearView about unsolicited telephone sales conducted in breach of the requirements of the *Corporations Act 2001* (Cth) (the Corporations Act).[23] ASIC's concerns related to whether ClearView's sales were properly characterised as either 'solicited' or 'unsolicited' sales, and, if the latter, whether they met the requirements in section 992A(3) of the Corporations Act, the '**anti-hawking provision**'.[24] In December 2016, ASIC and ClearView participated in a conference call in which ASIC raised multiple concerns about possible contraventions of the anti-hawking provision, a criminal offence provision.[25]

16 Transcript, Gregory Martin, 10 September 2018, 5325.

17 Transcript, Gregory Martin, 10 September 2018, 5322.

18 Transcript, Gregory Martin, 10 September 2018, 5321–2.

19 Transcript, Gregory Martin, 10 September 2018, 5322.

20 Transcript, Gregory Martin, 10 September 2018, 5322.

21 Transcript, Gregory Martin, 10 September 2018, 5325–6.

22 Transcript, Gregory Martin, 10 September 2018, 5326.

23 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [362]; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-51 [CVW.6000.0001.0843].

24 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [362]; Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-51 [CVW.6000.0001.0843].

25 Transcript, Gregory Martin, 10 September 2018, 5335.

These included concerns that ClearView did not always provide a product disclosure statement (PDS) to customers before they became bound to acquire the product, that customers were not always offered the opportunity to have information contained in the PDS read to them, and that customers were not always offered an opportunity to be placed on the Do Not Call Register.[26] Later that month, ClearView lodged a breach notification with ASIC in relation to likely non-compliance with the anti-hawking provision over a period of about two years.[27] The breach notification did not specify the number of calls estimated to have been affected.[28]

Following this, ASIC and ClearView exchanged correspondence about the number of calls affected, and about the ways in which those calls were affected.[29] Most significantly for present purposes, in January 2017, ClearView acknowledged to ASIC that some calls that it made in respect of particular campaigns were properly characterised as ‘unsolicited’.[30] In April 2017, ASIC told ClearView that it regarded further categories of calls to be ‘unsolicited’.[31] After receiving this indication, ClearView told ASIC that it estimated that over 260,000 customers had received calls in circumstances where ClearView could not verify that it had met the requirements of the anti-hawking provision.[32] Following further investigation, by early May 2017, ClearView estimated that it may have breached the anti-hawking provision up to 303,000 times.[33]

Mr Martin accepted that by February 2017 there were concerns within the ClearView Direct business about breaches of the anti-hawking provisions, and about the way that those breaches were being escalated

26 Transcript, Gregory Martin, 10 September 2018, 5335–6.

27 Transcript, Gregory Martin, 10 September 2018, 5336.

28 Transcript, Gregory Martin, 10 September 2018, 5336.

29 Transcript, Gregory Martin, 10 September 2018, 5337–42.

30 Transcript, Gregory Martin, 10 September 2018, 5337–8.

31 Transcript, Gregory Martin, 10 September 2018, 5340.

32 Transcript, Gregory Martin, 10 September 2018, 5341.

33 Transcript, Gregory Martin, 10 September 2018, 5343; cf ClearView, Module 6 Case Study Submission, 4 [11].

and responded to within the organisation:[34] the breaches were not being treated as material matters that required escalation and consideration.[35]

1.2.3 ASIC engagement – pressure selling

In March 2017, ASIC raised additional concerns with ClearView about pressure selling and mis-selling conduct.[36] After reviewing the transcripts of 42 sales calls from the second half of 2015, ASIC formed the view that ClearView's sales practices may be unfair or manipulative, and may pressure consumers to purchase a policy.[37] Mr Martin accepted that these calls involved highly problematic sales practices,[38] and that some involved misleading or deceptive conduct and unconscionable conduct.[39]

The problematic sales practices identified by ASIC and Mr Martin included, but were not limited to:

- First, misrepresentations about what customers were committing to purchase. ASIC was concerned that ClearView sales agents used language that made it unclear that customers were committing to purchase a policy.[40]
- Second, misrepresentations or omissions about payment arrangements, including not explaining to customers precisely when their first premium would be due,[41] and failing to quote prices aligned with the frequency

34 Transcript, Gregory Martin, 10 September 2018, 5345.

35 Transcript, Gregory Martin, 10 September 2018, 5345.

36 Transcript, Gregory Martin, 10 September 2018, 5346.

37 Transcript, Gregory Martin, 10 September 2018, 5346.

38 Transcript, Gregory Martin, 10 September 2018, 5349.

39 Transcript, Gregory Martin, 10 September 2018, 5354.

40 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, Exhibit GCM-53 [CVW.6000.0001.0848 at .0852]; Transcript, Gregory Martin, 10 September 2018, 5346.

41 Transcript, Gregory Martin, 10 September 2018, 5348.

with which premiums would be deducted, so as to underemphasise the extent of the customer's financial liability.[42]

- Third, other forms of misrepresentation, including that a customer's premiums would never go up with age, despite ClearView retaining the right to unilaterally vary premiums,[43] and about the terms or application of the policies.[44]
- Fourth, sales agents continued to attempt to sell policies, despite a customer indicating that they wished to read over ClearView's documentation or consult with a partner or friend.[45] Mr Martin accepted that this was done because ClearView Direct did not want to give people time to reflect upon their purchase,[46] because they might then decide that they did not want or need the product.[47]
- Fifth, and in a similar vein, sales agents collected customers' personal information, including bank details, before the customer had confirmed their agreement to proceed with the purchase.[48]

Mr Martin accepted that the issues identified in the 42 calls were representative of what he termed 'almost endemic' compliance issues within ClearView Direct for a number of years.[49] ClearView struggled with such systemic issues in 2016 and in 2017 during the period of its engagement with ASIC.[50] As at February 2017, one quarter of all monitored calls by

42 Transcript, Gregory Martin, 10 September 2018, 5348.

43 Transcript, Gregory Martin, 10 September 2018, 5348–9.

44 Transcript, Gregory Martin, 10 September 2018, 5349.

45 Transcript, Gregory Martin, 10 September 2018, 5349.

46 Transcript, Gregory Martin, 11 September 2018, 5387.

47 Transcript, Gregory Martin, 11 September 2018, 5387.

48 Transcript, Gregory Martin, 10 September 2018, 5349.

49 Transcript, Gregory Martin, 10 September 2018, 5358.

50 Transcript, Gregory Martin, 10 September 2018, 5358.

ClearView sales agents involved a breach of ClearView's quality assurance requirements.[51] Mr Martin agreed that this was completely unacceptable.[52]

Mr Martin accepted that there were at least three causes of these systemic compliance issues:

- The first was ClearView's remuneration structure.[53] Mr Martin accepted that ClearView's commission structure was a contributor to inappropriate behaviour,[54] as it incentivised aggressive sales tactics with the aim of making as many sales as possible at whatever cost.[55]

- The second was a culture within ClearView Direct that tolerated aggressive sales tactics at the cost of compliance.[56] This was apparent in ClearView's training practices. Sales agents were trained to engage in unfair sales practices,[57] including through aggressive objection handling approaches.[58] The overarching approach was 'sell at all costs', which Mr Martin accepted was reflective of ClearView Direct's broader culture.[59] The prioritisation of sales over compliance was also evident in communications relating to at least one proposed incentives program, which the Head of Direct Sales considered was necessary to stimulate the team and revive the 'cultural pulse',[60] and which he proposed badging as a 'training [and] educational trip' in order to circumvent the **conflicted remuneration** provisions in the Corporations Act.[61]

51 Transcript, Gregory Martin, 10 September 2018, 5357; Exhibit 6.46, February 2017, Risk and Compliance Committee February 2017 Results, 3.

52 Transcript, Gregory Martin, 10 September 2018, 5357.

53 Transcript, Gregory Martin, 10 September 2018, 5358.

54 Transcript, Gregory Martin, 10 September 2018, 5359.

55 Transcript, Gregory Martin, 10 September 2018, 5359.

56 Transcript, Gregory Martin, 10 September 2018, 5358–9.

57 Transcript, Gregory Martin, 10 September 2018, 5373.

58 Transcript, Gregory Martin, 10 September 2018, 5373.

59 Transcript, Gregory Martin, 11 September 2018, 5387.

60 Transcript, Gregory Martin, 11 September 2018, 5388.

61 Transcript, Gregory Martin, 11 September 2018, 5388–90.

- The third was that there were large deficiencies in ClearView Direct's quality assurance and compliance program.[62] As just one example, only 10 of the 42 calls provided to ASIC had been previously reviewed by ClearView's Quality Assurance team, and only a small number of those had failed that process.[63] Mr Martin accepted that when the legal team had subsequently reviewed those calls, they had taken a different view as to the number of calls that involved problematic behaviour.[64] More broadly, Mr Martin accepted that there was insufficient division between ClearView's sales team and its quality assurance function,[65] and that there was a lack of specific legal and compliance experience, particularly in the Direct business.[66]

1.2.4 Resolution and closure of the Direct business

ClearView and ASIC negotiated to resolve ASIC's investigation into the anti-hawking and mis-selling issues.[67] Those terms required ClearView to undertake a remediation program in respect of over 32,000 policies sold by ClearView between 2014 and mid-2017.[68] Excluding 6,000 policies that were cancelled from inception, ClearView anticipated providing a full or partial refund of premiums, bank fees and interest to approximately 8,200 customers, and a 'Review Offer' to approximately 16,000 customers.[69] If customers opt into the 'Review Offer', ClearView is to review the call in which the customer was sold their policy, and assess whether a refund

---

62 Transcript, Gregory Martin, 10 September 2018, 5358.

63 Transcript, Gregory Martin, 10 September 2018, 5349–50.

64 Transcript, Gregory Martin, 10 September 2018, 5353.

65 Transcript, Gregory Martin, 11 September 2018, 5393–4.

66 Transcript, Gregory Martin, 11 September 2018, 5396.

67 Transcript, Gregory Martin, 11 September 2018, 5398.

68 Transcript, Gregory Martin, 11 September 2018, 5398–9.

69 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 63 [358]; see also Transcript, Gregory Martin, 11 September 2018, 5400–1; cf ClearView, Module 6 Case Study Submission, 8–9 [29].

of premiums or an adjustment of policy terms is appropriate.[70] ClearView also agreed to inform ASIC if it decided to recommence selling through the Direct channel.[71] Mr Martin said that ClearView had no present intention of doing so.[72] Indeed, he went so far as to say that it was difficult to understand how an insurer could sell life insurance in outbound sales calls in a way that was both financially viable and legally compliant.[73]

Mr Martin told the Commission that ASIC had not indicated whether it would take any further action in respect of ClearView's many breaches of the anti-hawking provisions, or what may have been unconscionable conduct or misleading or deceptive conduct engaged in by its sales agents.[74]

1.3 What the case study showed

Mr Martin accepted that Clearview may have engaged in misconduct in a number of respects. Those concessions were properly made.

In respect of the anti-hawking issues, Mr Martin accepted that ClearView may have breached the prohibition on the hawking of **financial products** contained in section 992A of the Corporations Act up to 303,000 times between early 2014 and mid-2017.[75] This flowed from ClearView's acknowledgments, to both ASIC and the Commission, that there were 303,000 calls in respect of which ClearView could not positively verify that there had been no breach of that provision.[76] With that said, I recognise, consistently with ClearView's submissions, that it is unlikely that each and every call involved a breach.[77]

70 Exhibit 6.28, Witness statement of Gregory Martin, 21 August 2018, 62 [351(c)]; see also Transcript, Gregory Martin, 11 September 2018, 5400–1; cf ClearView, Module 6 Case Study Submission, 8 [29].

71 Transcript, Gregory Martin, 11 September 2018, 5402.

72 Transcript, Gregory Martin, 11 September 2018, 5402.

73 Transcript, Gregory Martin, 11 September 2018, 5402.

74 Transcript, Gregory Martin, 11 September 2018, 5402–3.

75 Transcript, Gregory Martin, 10 September 2018, 5343.

76 ClearView, Module 6 Case Study Submission, 4 [11].

77 ClearView, Module 6 Case Study Submission, 4 [13].

In respect of the mis-selling issues, Mr Martin accepted that in the calls in which ClearView representatives mis-sold insurance policies between 2013 and 2016, ClearView may have, on occasion, breached the prohibition on unconscionable conduct contained in sections 12CA and 12CB of the *Australian Securities and Investments Commission Act 2001* (Cth) (the ASIC Act) by pressuring individuals to purchase policies.[78] Mr Martin also accepted that in these calls, ClearView representatives may have breached the prohibition on misleading or deceptive conduct contained in section 12DA of the ASIC Act, by misrepresenting matters such as whether customers were committing to purchase an insurance policy, and the terms of those policies.[79]

Mr Martin also accepted that ClearView may have failed to discharge its general obligations as an **Australian financial services licensee** in four respects:

- First, ClearView may have contravened the obligation contained in section 912A(1)(a) of the Corporations Act to do all things necessary to ensure that the financial services covered by its **Australian financial services licence** were provided efficiently, honestly and fairly.[80] ClearView's systemic failures in its sales processes meant that policyholders were frequently being sold policies in circumstances where ClearView was not behaving honestly or fairly.
- Second, ClearView may have failed to ensure that its representatives were adequately trained to provide the financial services covered by its Australian financial services licence, in contravention of section 912A(1)(f) of the Corporations Act.[81] ClearView sales agents were encouraged to sell aggressively, sign up customers immediately, and use other inappropriate methods of obtaining sales.[82]

78 Transcript, Gregory Martin, 11 September 2018, 5401.

79 Transcript, Gregory Martin, 11 September 2018, 5401.

80 Transcript, Gregory Martin, 11 September 2018, 5401.

81 Transcript, Gregory Martin, 11 September 2018, 5401.

82 Transcript, Gregory Martin, 11 September 2018, 5387, 5389.

- Third, ClearView may have failed to take reasonable steps to ensure that its representatives complied with financial services laws, in contravention of section 912A(1)(ca) of the Corporations Act.[83] ClearView had inadequate training, quality assurance and compliance processes to ensure that its representatives complied with financial services laws.
- Fourth, ClearView may have failed to have in place adequate arrangements for the management of the conflict of interest that it created between the interests of its representatives and the interests of its customers, in contravention of section 912A(1)(aa) of the Corporations Act.[84] The remuneration and incentive structures that ClearView had in place encouraged sales agents to make as many sales as possible, sometimes to the detriment of customers' best interests.[85]

The matter having been drawn to ASIC's attention, it is for ASIC to determine what further action it can and should take.

ClearView did not take speedy or effective action to address substantial compliance issues when they became apparent. As I noted earlier, Mr Martin's evidence was that the compliance issues that were identified in the 42 calls provided to ASIC were 'almost endemic' within ClearView Direct's sales process for a number of years.[86]

Further, ClearView did not take meaningful steps to address defects in its quality assurance processes after becoming aware that they were ineffective.[87] Despite having decided to address the deficiencies in the quality assurance processes by moving towards monitoring 100% of sales calls, ClearView did not execute that decision, because it decided

83 Transcript, Gregory Martin, 11 September 2018, 5401.

84 Transcript, Gregory Martin, 11 September 2018, 5402.

85 Transcript, Gregory Martin, 11 September 2018, 5402.

86 Transcript, Gregory Martin, 10 September 2018, 5358.

87 Transcript, Gregory Martin, 11 September 2018, 5392–3.

to commence shutting down its Direct sales business.[88] As a consequence, problematic sales practices appear to have continued for almost a year.[89]

I would attribute ClearView's conduct to its culture and governance practices, its risk management practices, and its remuneration practices.

There was a culture within Clearview Direct that tolerated aggressive sales tactics at the cost of compliance,[90] and the management of ClearView Direct did not treat compliance issues, such as the breaches of the anti-hawking provisions, as matters that required escalation and consideration.[91]

The quality assurance program within ClearView Direct was seriously inadequate.[92] Its staff lacked qualifications, experience, supervision and resources.[93]

Finally, the remuneration and incentive structures within ClearView Direct encouraged sales agents to make as many sales as possible. This they did, sometimes at the expense of the customers' best interests.[94]

The most telling general point to emerge from the case study was Mr Martin's frank acknowledgment that he found it difficult to see how it would be possible to sell life insurance in outbound sales calls in a way that is both financially viable and legally compliant.[95] As he rightly said, it is difficult to see how a customer can come to a view in a phone call that lasts 20 minutes about 'a fairly complex sort of area of financial services'.[96]

88 Transcript, Gregory Martin, 11 September 2018, 5393.

89 Transcript, Gregory Martin, 11 September 2018, 5392–3.

90 Transcript, Gregory Martin, 10 September 2018, 5359.

91 Transcript, Gregory Martin, 10 September 2018, 5345.

92 Transcript, Gregory Martin, 10 September 2018, 5358.

93 Transcript, Gregory Martin, 11 September 2018, 5396–7.

94 Transcript, Gregory Martin, 11 September 2018, 5402.

95 Transcript, Gregory Martin, 11 September 2018, 5402.

96 Transcript, Gregory Martin, 11 September 2018, 5402.

2 Freedom

2.1 Background

At the time of the sixth round of hearings, Freedom Insurance Group Limited (Freedom) marketed and distributed life insurance products directly to consumers by telephone. The case study examined Freedom's sales and retention practices, both generally and in relation to an individual consumer. The Commission heard evidence from Mr Craig Orton, Freedom's Chief Operating Officer.[97] The Commission also heard evidence from Mr Bruce Stewart, whose son was sold an insurance policy by Freedom in June 2016.[98]

At 3pm on 10 September 2018 – the first day of the sixth round of hearings and the day before Mr Orton was due to give evidence – Freedom notified the Commission of substantial changes to its business model.[99] Freedom told the Commission that it intended to cease selling all insurance products, except funeral insurance and loan protection cover, through outbound sales calls.[100] While Mr Orton accepted that this was a significant change to Freedom's business model, Freedom was not able to produce any documents that directly recorded this decision.[101] I mention this not for the purpose of suggesting that Mr Orton's evidence should be disbelieved,[102] but because I consider it remarkable that a decision of this kind would not be documented by a publicly listed company. Publicly available documents indicate that, after the Commission took evidence from Mr Orton, Freedom

97 Exhibit 6.67, Witness statement of Craig Orton, 27 August 2018, 1 [1].

98 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 2–3 [9]–[12]; Transcript, Craig Orton, 11 September 2018, 5408.

99 Transcript, Craig Orton, 11 September 2018, 5423.

100 Transcript, Craig Orton, 11 September 2018, 5423.

101 Transcript, Craig Orton, 11 September 2018, 5423, 5425; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2–3 [11].

102 Cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2 [7].

determined to suspend all direct sales of life insurance through outbound telephone calls.[103]

2.2 Evidence

2.2.1 Mr Stewart's son

Mr Stewart's son was born with Down syndrome.[104] While Mr Stewart's son has a degree of independence,[105] he has difficulties understanding whether a product is 'expensive or cheap', and whether he has enough money to make purchases.[106] As a result, Mr Stewart and his wife assist their son to manage his finances.[107] In 2016, when Freedom sold Mr Stewart's son an insurance policy, his only source of income was the Disability Support Pension.[108]

Mr Stewart learnt that his son had taken out insurance after his son received a letter from Freedom.[109] The letter said that Mr Stewart's son had taken out a Freedom Protection Plan, which comprised three types of cover: funeral, accidental death and accidental injury.[110] The letter said that premiums for the funeral cover would not be due for 12 months, but that premiums for the accidental death and accidental injury cover would be due 12 days later.[111]

---

103 See, eg, Freedom Insurance, 'ASX/Media Release: Freedom Announces Business Restructure' (Media Release, 2 October 2018) 1.

104 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 1–2 [5]; Transcript, Bruce Stewart, 11 September 2018, 5406.

105 Transcript, Bruce Stewart, 11 September 2018, 5407.

106 Transcript, Bruce Stewart, 11 September 2018, 5407.

107 Transcript, Bruce Stewart, 11 September 2018, 5407.

108 Transcript, Bruce Stewart, 11 September 2018, 5407.

109 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 2 [9]–[10]; Transcript, Bruce Stewart, 11 September 2018, 5408.

110 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-1 [FIG.0001.0001.0057 at .0059]; Transcript, Bruce Stewart, 11 September 2018, 5408.

111 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-1 [FIG.0001.0001.0057 at .0057]; Transcript, Bruce Stewart, 11 September 2018, 5408.

Mr Stewart was ‘flummoxed’ by the letter.[112] He did not understand how or why his son had been signed up, so he asked his son what had happened.[113] Mr Stewart’s son remembered speaking to someone on the phone, and providing that person with his debit card details, but could not explain why he had done so.[114] Mr Stewart did not think that his son understood that he had provided those details in order to purchase an insurance policy.[115]

The following day, Mr Stewart telephoned Freedom and attempted to cancel the policy on his son’s behalf.[116] Mr Stewart was not able to do this. Instead, a Freedom representative told Mr Stewart that they would listen to a recording of the call in which Mr Stewart’s son was sold the policy and then call Mr Stewart back.[117] The representative also told Mr Stewart that the sales agent who sold his son the policy probably did not know that his son had a disability.[118]

Mr Stewart did not receive a call back from Freedom, and did not receive any response to an email that he sent to Freedom’s Head of Operations lodging a formal complaint.[119] Two days later, Mr Stewart telephoned Freedom again.[120]

112 Transcript, Bruce Stewart, 11 September 2018, 5408.

113 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 3 [14]; Transcript, Bruce Stewart, 11 September 2018, 5408.

114 Transcript, Bruce Stewart, 11 September 2018, 5408–9.

115 Transcript, Bruce Stewart, 11 September 2018, 5408–9.

116 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 4 [15]; Transcript, Bruce Stewart, 11 September 2018, 5409.

117 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 4 [17]; Transcript, Bruce Stewart, 11 September 2018, 5409.

118 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-2 [FIG.0001.0001.0060]; Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-3 [FIG.0001.0001.0258 at .0259]; Transcript, Craig Orton, 12 September 2018, 5512.

119 Transcript, Bruce Stewart, 11 September 2018, 5410–11.

120 Transcript, Bruce Stewart, 11 September 2018, 5411.

During this second phone call to Freedom, Mr Stewart and his son were transferred to Freedom's Retention team, a group within Freedom whose chief task was to dissuade customers from cancelling their policies.[121] A Freedom retention agent that they spoke with tried to explain the potential benefits of the policy for Mr Stewart's son, and emphasised several times that the policy was free for the first 12 months.[122] The retention agent also said that there was no reason for Freedom to have known that Mr Stewart's son had a disability.[123] However, the retention agent ultimately agreed to cancel the policy.[124] Mr Stewart's son was asked to confirm that he wished to 'terminate the policy'.[125] Mr Stewart's son had difficulty articulating those words.[126]

After the phone call, the retention agent engaged in an instant messenger conversation with another Freedom representative, in which disparaging remarks were made about Mr Stewart and his son.[127] Mr Orton accepted that this conduct was 'totally inappropriate'.[128]

During the call in which the policy was cancelled, Mr Stewart asked Freedom to provide him with copies of the recordings of the sales calls

121 Transcript, Bruce Stewart, 11 September 2018, 5412; Transcript, Craig Orton, 11 September 2018, 5435.

122 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 5 [24]; Transcript, Bruce Stewart, 11 September 2018, 5412.

123 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0264].

124 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 5 [22].

125 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0266].

126 Transcript, Craig Orton, 11 September 2018, 5413.

127 Transcript, Bruce Stewart, 11 September 2018, 5415–16; Transcript, Craig Orton, 12 September 2018, 5517.

128 Transcript, Craig Orton, 12 September 2018, 5517.

with his son.[129] Mr Stewart did not receive these recordings until August 2018, shortly before the Commission was to take evidence about the matter.[130]

Excerpts of two of these calls were played in the course of Mr Stewart's evidence. In the first call, which lasted for just over two minutes, a Freedom sales agent asked Mr Stewart's son whether his mother was at home, and discontinued the call when he determined that she was not.[131] In the second call, which took place two days later and which lasted for eighteen and a half minutes, the same sales agent sold the policy to Mr Stewart's son.[132] Mr Stewart told the Commission that, having listened to that call, he did not think that his son had any understanding of what he was signing up for.[133] I agree. Mr Orton accepted that the sales agent's actions were inappropriate, and that he should have known that Mr Stewart's son was not capable of understanding what was occurring during the call.[134] Mr Orton agreed that the sales agent who sold the policy to Mr Stewart's son had engaged in 'deeply troubling conduct'.[135] Again, I agree.

2.2.2 Selling to vulnerable consumers

In a submission provided to the Commission in August, Freedom acknowledged that it had engaged in misconduct and conduct that fell below community standards and expectations in respect of its treatment of at least six other vulnerable consumers.[136] These instances related to conduct both before and after the introduction of Freedom's vulnerable customer training

---

129 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-6 [FIG.0001.0001.0261 at .0265].

130 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, 6–7 [30]–[35].

131 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-15 [FIG.0001.0001.0002].

132 Exhibit 6.64, Witness statement of Bruce Stewart, 4 September 2018, Exhibit BGS-17 [FIG.0001.0001.0003].

133 Transcript, Bruce Stewart, 11 September 2018, 5417.

134 Transcript, Craig Orton, 11 September 2018, 5446.

135 Transcript, Craig Orton, 11 September 2018, 5446.

136 Transcript, Craig Orton, 11 September 2018, 5448–50; see also Exhibit 6.72, Freedom's Response to Commission Request of 3 August 2018.

in February 2017.[137] The most recent complaint was received by Freedom in late April 2018.[138]

On 7 September 2018, in the week before Mr Orton was due to give evidence, Freedom filed a breach report with ASIC that related, in part, to the complaints that Freedom had received in relation to its treatment of vulnerable consumers.[139] Freedom told ASIC that when taken together, the conduct of its sales agents in connection with these sales may have breached sections 912A(1)(a), 912A(1)(ca) or 912A(1)(f) of the Corporations Act, which require Freedom to do all things necessary to ensure that the financial services covered by its Australian financial services licence are provided efficiently, honestly and fairly, to take reasonable steps to ensure that its representatives comply with financial services laws, and to ensure that its representatives are adequately trained, and are competent, to provide financial services.[140]

When asked about the causes of these problems, Mr Orton referred to a history of insufficient quality assurance coverage for calls made by Freedom Insurance representatives.[141] The breach report filed by ASIC also linked Freedom's remuneration structures with its mis-selling to vulnerable consumers, a topic to which I will return.[142]

2.2.3 Accidental death and accidental injury policies

Before turning to those matters, I make some observations about Freedom's sale of accidental death and accidental injury products. As I previously indicated, on the day before Mr Orton gave evidence, Freedom told the Commission that it had ceased the outbound sale of those products.[143]

---

137 Transcript, Craig Orton, 11 September 2018, 5449–50.

138 Transcript, Craig Orton, 11 September 2018, 5450.

139 Exhibit 6.74, 7 September 2018, Freedom Breach Notice.

140 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3–4.

141 Transcript, Craig Orton, 11 September 2018, 5451.

142 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 5; Transcript, Craig Orton, 11 September 2018, 5453.

143 Transcript, Craig Orton, 11 September 2018, 5423.

However, the products will still be sold on Freedom's website, and will still be offered to customers if they request them.[144]

In the statement that he provided to the Commission, Mr Orton suggested that 'accidental death cover, combined with an accidental injury rider, provides a relatively low cost alternative insurance benefit to full life cover'.[145] However, in his oral evidence, Mr Orton conceded that those types of cover were not a 'true alternative' to life cover,[146] because the circumstances in which a person could make a claim on those policies were much more limited than under a life insurance policy.[147]

Despite this, Freedom engaged in 'downgrading' sales practices in relation to accidental death policies, by offering the product to customers who failed to qualify for life cover.[148] Mr Orton accepted this practice should not occur.[149] Freedom also offered an accidental death policy to policyholders who attempted to cancel their existing life insurance policy.[150] Mr Orton accepted that the instructions given to its retention agents in this regard were not 'appropriate', and that selling the product in this context carried with it a risk that customers would be confused about the type of policy that they were getting.[151]

Mr Orton also conceded that Freedom's sales processes for accidental death policies were deficient, because the sales scripts failed to notify customers of the narrow definition of 'accident' or the key exclusions

144 Transcript, Craig Orton, 11 September 2018, 5431–2.

145 Exhibit 6.67, Witness statement of Craig Orton, 27 August 2018, 20 [57].

146 Transcript, Craig Orton, 11 September 2018, 5432.

147 Transcript, Craig Orton, 11 September 2018, 5432.

148 Transcript, Craig Orton, 11 September 2018, 5434–6.

149 Transcript, Craig Orton, 11 September 2018, 5434–5.

150 Transcript, Craig Orton, 11 September 2018, 5435–6.

151 Transcript, Craig Orton, 11 September 2018, 5436; see also Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [12].

from these policies.[152] Mr Orton accepted that as a result, policyholders could be confused about what their policies covered.[153]

Until it stopped outbound sales of its accidental death product, Freedom sold significant numbers of accidental death policies – around 19,000 policies in 2016 and around 21,000 in 2017.[154] Despite this, at the time of the hearings, Freedom had consistently received only a very small number of claims – no more than 22 in any of the last three years.[155]

2.2.4 Remuneration and incentives

Between 2013 and 2015, Freedom used a volume-based commission structure.[156] In about 2015, Freedom began introducing variants to this model.[157] Amongst other things, Freedom introduced requirements that sales agents cover their 'seat cost', and the cost of their leads, before they would be eligible to earn commission.[158] Mr Orton conceded that this increased the possibility that sales agents would engage in aggressive sales tactics.[159] More broadly, Mr Orton recognised that Freedom's commission structure over recent years had created a situation in which sales agents had been incentivised to pursue sales aggressively.[160]

In the breach notification that it provided to ASIC on 7 September 2018, Freedom notified ASIC that between 1 January 2018 and May 2018, the variable component of its sales agent remuneration arrangements may have breached section 963E of the Corporations Act, which prohibits Australian financial services licence holders accepting conflicted remuneration.[161]

152 Transcript, Craig Orton, 11 September 2018, 5443–4.

153 Transcript, Craig Orton, 11 September 2018, 5444.

154 Transcript, Craig Orton, 11 September 2018, 5439.

155 Transcript, Craig Orton, 11 September 2018, 5440.

156 Transcript, Craig Orton, 11 September 2018, 5454.

157 Transcript, Craig Orton, 11 September 2018, 5455.

158 Transcript, Craig Orton, 11 September 2018, 5456.

159 Transcript, Craig Orton, 11 September 2018, 5457.

160 Transcript, Craig Orton, 11 September 2018, 5463.

161 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2–3.

Freedom informed ASIC that from 1 October 2018, no commission-based incentives would be paid to Freedom's sales teams.[162] Mr Orton told the Commission that this was because of concerns that commissions may inappropriately influence the conduct of sales agents:[163] in Mr Orton's words, 'any commission payable [to] a sales agent has the potential to be conflicted'.[164]

Mr Orton also gave evidence about various incentive programs for sales agents, including non-monetary incentive programs, which had been run by Freedom over recent years. A number of these incentive programs were based solely on sales made by a sales agent, without any qualifying quality assurance requirement.[165] Mr Orton accepted that these incentive programs, particularly the higher value incentive programs, encouraged conflicted conduct by sales agents, and that this risk was heightened where no quality assurance qualifications were placed upon participation.[166] In its September 2018 breach notification to ASIC, Freedom also told ASIC that it considered that certain incentive programs run between January and April 2018 constituted 'conflicted remuneration', in breach of section 963E of the Corporations Act.[167]

2.2.5 Quality assurance and disciplinary processes

Mr Orton acknowledged that Freedom's quality assurance monitoring processes had been inadequate.[168] The evidence indicated that Freedom's guidelines for 'marking' a sales call for quality assurance purposes were insufficiently robust.[169] For example, at the time Mr Stewart's son was

162 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3.

163 Transcript, Craig Orton, 11 September 2018, 5464–5.

164 Transcript, Craig Orton, 11 September 2018, 5454.

165 Transcript, Craig Orton, 11 September 2018, 5467; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [33].

166 Transcript, Craig Orton, 11 September 2018, 5471.

167 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2.

168 Transcript, Craig Orton, 11 September 2018, 5473.

169 See, eg, Transcript, Craig Orton, 11 September 2018, 5474–6; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [13].

sold his insurance, a sales call would not be marked as a 'fail' even if the representative demonstrated many instances of misleading, deceptive, false or incomplete information.[170] Many similar deficiencies persisted in the call marking guidelines until July 2018. Mr Orton conceded that the marking guidelines should have been strengthened earlier.[171]

The Commission also heard evidence about Freedom's ineffective disciplinary practices, including the actions taken in respect of the sales agent who sold the policy to Mr Stewart's son. The sales agent had received an initial written warning in January 2016, and a 'final written warning' in February 2016.[172] In the following months, additional concerns were raised about the sales agent's practices.[173] For the most part, these warnings and concerns were not referred to in the fortnightly feedback that Freedom provided to the sales agent: rather, the sales agent's supervisor continued to encourage him to 'aim big' and sell more policies.[174] Mr Orton conceded that the disciplinary processes in place at this time did not adequately respond to misconduct by representatives,[175] and that there were broad problems in the feedback loop used by Freedom Insurance to monitor and address such instances of misconduct.[176]

2.2.6 Retention strategies

In its submission to the Commission, Freedom acknowledged approximately 27 instances of conduct in relation to Freedom's retention processes that fell below community standards and expectations.[177] The vast majority

170 Transcript, Craig Orton, 11 September 2018, 5475.

171 Transcript, Craig Orton, 11 September 2018, 5479.

172 Exhibit 6.86, 28 January 2016, First Written Warning; Exhibit 6.87, 16 February 2016, Final Warning.

173 Exhibit 6.89, 2 March 2016, Email Concerning Call Converted; Exhibit 6.91, 6 April 2016, Email from Bryan Reilly; Transcript, Craig Orton, 11 September 2018, 5489.

174 Exhibit 6.88, 16 February 2016, Freedom Insurance Fortnightly 121.

175 Transcript, Craig Orton, 11 September 2018, 5481.

176 Transcript, Craig Orton, 11 September 2018, 5493.

177 Transcript, Craig Orton, 12 September 2018, 5508.

of instances related to complaints received since the start of February 2018.[178] Mr Orton accepted that Freedom's retention processes had been too strong,[179] and that Freedom had at times made it 'too difficult to cancel [policies]'.[180] Information provided by Freedom to ASIC indicated that over a 12-month period, Freedom had received an average of 72 cancellation requests a day,[181] and that policyholders had only succeeded in cancelling their policies in 28.5% of calls made to Freedom.[182]

The Commission also heard about various retention marketing campaigns run by Freedom, including as recently as July 2018.[183] The retention campaigns were directed to dissuading policyholders from cancelling their policies, or getting them to reinstate cancelled policies.[184] Mr Orton conceded that these campaigns were designed to make it as difficult as possible for people to cancel their policies, and to win policyholders back after they had cancelled.[185] Mr Orton said that these campaigns should not have been initiated, and that Freedom would stop running campaigns of this nature.[186]

2.3 What the case study showed

2.3.1 Misconduct

In its submissions to the Commission, Freedom suggested that in circumstances where ASIC was reviewing Freedom's practices, 'ASIC might be considered the more appropriate body to review and make final determinations regarding the past conduct of Freedom Insurance

178 Transcript, Craig Orton, 12 September 2018, 5508.

179 Transcript, Craig Orton, 12 September 2018, 5508–9.

180 Transcript, Craig Orton, 12 September 2018, 5505.

181 Transcript, Craig Orton, 12 September 2018, 5501.

182 Transcript, Craig Orton, 12 September 2018, 5502.

183 Exhibit 6.100, 3 July 2018, Retention Marketing Campaign; Transcript, Craig Orton, 12 September 2018, 5520–2.

184 Transcript, Craig Orton, 12 September 2018, 5518–19.

185 Transcript, Craig Orton, 12 September 2018, 5522–3.

186 Transcript, Craig Orton, 12 September 2018, 5522–3.

[than the Commission is]'.[187] As I have previously explained, I am not empowered to and do not make 'final determinations': I am authorised only to consider whether conduct '*might* have amounted to misconduct'.[188] I do not consider that ASIC's current investigation into aspects of Freedom's practices relieves me of that duty.[189]

Freedom's actions may have amounted to misconduct in a number of respects.

In respect of Freedom's sales to vulnerable customers, I consider that by selling insurance to Mr Stewart's son, in circumstances where the sales agent knew, or ought to have known, that Mr Stewart's son did not understand what he was agreeing to, Freedom may have engaged in unconscionable conduct within the meaning of sections 12CA or 12CB of the ASIC Act.[190] Freedom accepted that the sales agent 'knew or ought to have known that Mr Stewart's son did not understand what he was agreeing to',[191] but said that his inappropriate conduct 'should not be characterised as conduct of Freedom Insurance itself'.[192] In circumstances where the sales agent was acting as a representative of Freedom, within the sales structures put in place by Freedom, I do not accept this submission.[193] Freedom also submitted that this was an 'isolated incident' that 'should not be used to characterise the general conduct of the organisation'.[194] Putting to one side the question of whether the incident was isolated, I do not consider that there is any justification for reading sections 12CA or 12CB as only applying to systemic issues.

For similar reasons, I consider that Freedom may have also engaged in unconscionable conduct in respect of the other three instances where

---

187 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 2 [9].

188 *Letters Patent*, 14 December 2017, (a) (emphasis added).

189 Cf *Letters Patent*, 14 December 2017, 3.

190 Transcript, Craig Orton, 12 September 2018, 5446.

191 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [16].

192 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [17].

193 See also Corporations Act s 917B.

194 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [18].

insurance was sold to vulnerable consumers that were the subject of Freedom's recent breach notification to ASIC.[195]

In addition, Freedom acknowledged both in its breach notification to ASIC and in its submissions to the Commission that the conduct of its sales agents in connection with those four vulnerable customers may have constituted a breach of sections 912A(1)(a), 912A(1)(ca) or 912A(1)(f) of the Corporations Act.[196] I have no reason to doubt that that acknowledgment was properly made.

In respect of Freedom's quality assurance practices, Freedom failed, until July 2018, to appropriately frame its call marking guidelines to ensure that most or all types of serious misconduct, including legislative breaches, constituted a 'QA fail'.[197] I accept that Freedom's call marking guidelines were only one aspect of its quality assurance and risk management regime.[198] However, in my view, they were a significant aspect of that regime, because they set out the criteria by which the performance of Freedom's representatives would be assessed. In my view, the defects evident in the guidelines prior to July 2018 suggest that Freedom historically failed to have in place sufficient processes to deter legislative breaches in the sales process. As a result, I consider that Freedom may have failed to take reasonable steps to ensure that its representatives complied with financial services laws for the purposes of section 912A(1)(ca) of the Corporations Act, or to have in place adequate risk management systems, as required by section 912A(1)(h) of the Act.

In respect of Freedom's remuneration and incentive practices, Freedom acknowledged in its breach notification to ASIC that until May 2018, it may have breached section 963E of the Corporations Act in respect of the

195 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3–4; cf Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4 [19]–[20].

196 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 4; Freedom Insurance Group Ltd, Module 6 Case Study Submission, 3 [22].

197 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4 [24].

198 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 4–5 [25]–[27].

variable component of its sales agent remuneration structure.[199] Freedom reiterated that acknowledgment in its submissions to the Commission.[200] I have no reason to doubt the appropriateness of that acknowledgment.

Similarly, Freedom also acknowledged to both ASIC and the Commission that it may have breached section 963 of the Corporations Act in respect of the non-monetary benefits that it provided to its representatives between January and April 2018.[201] In its submissions to the Commission, Freedom accepted that it may therefore have historically failed to have in place adequate arrangements for the management of conflicts of interest that arose between its representatives and its policyholders, in breach of section 912A(1)(aa) of the Corporations Act.[202] Again, I have no reason to doubt the appropriateness of those acknowledgments.

Finally, in respect of compliance with the anti-hawking regime, Freedom acknowledged certain breaches of the anti-hawking provisions in the Corporations Act to both the Commission and ASIC.[203] I consider that the acknowledgment was properly made.

These matters having been reported to ASIC, it is for ASIC to decide what further steps it should take.

2.3.2 Conduct falling below community standards and expectations

Freedom's submissions to the Commission only addressed one of the findings identified by Senior Counsel Assisting as being open on the evidence.[204] That matter related to three instances of conduct that fell below community standards and expectations relating to Freedom's treatment of

---

199 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 3.

200 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 5 [28].

201 Exhibit 6.74, 7 September 2018, Freedom Breach Notice, 2; Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [32].

202 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [32].

203 Transcript, Craig Orton, 12 September 2018, 5526; Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [35].

204 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6–7 [36]–[37].

vulnerable consumers, which were acknowledged to the Commission, but which were not included in Freedom's breach notification to ASIC. In its submissions to the Commission, Freedom accepted that those instances were properly characterised as conduct that fell below community standards and expectations.[205]

Freedom did not address the other four matters identified by Senior Counsel Assisting as being open on the evidence. In my view, each of those matters is capable of being characterised as conduct that fell below community standards and expectations:

- The first related to the 27 instances of retention- and cancellation-related conduct that Freedom previously identified to the Commission as falling below community standards and expectations.[206]
- The second related to the heavy-handed retention strategies employed by Freedom, which may result in policyholders finding it difficult to cancel policies that they no longer want or need.[207] In my view, the community would not expect that an insurance company would make it so difficult to cancel a policy that was no longer deemed necessary or desirable.
- The third related to Freedom's disciplinary procedures, which were inadequate to address problematic conduct by its sales agents. One stark example is Freedom's conduct towards the sales agent who sold the policy to Mr Stewart's son: he was encouraged to sell aggressively, even in circumstances where Freedom held serious concerns about his sales practices.[208]
- The fourth related to Freedom's failure to appropriately recognise and respond to the harm suffered by Mr Stewart's son. This was demonstrated in a number of respects, including by Freedom's failure to call back Mr Stewart when it had promised to do so,[209] Freedom's

205 Freedom Insurance Group Ltd, Module 6 Case Study Submission, 6 [36].

206 Transcript, Craig Orton, 12 September 2018, 5508.

207 Transcript, Craig Orton, 12 September 2018, 5522–3.

208 Transcript, Craig Orton, 11 September 2018, 5481–9, see specifically at 5485.

209 Transcript, Bruce Stewart, 11 September 2018, 5409.

failure to ensure that Mr Stewart received the call recordings in a timely manner,[210] and the belittling tone of Freedom's internal communications about Mr Stewart and his son.[211] Taken together, these matters indicated a lack of regard for the harm suffered by Mr Stewart's son, and a lack of interest in providing effective or timely redress.

2.3.3 Causes of the conduct

In my view, the conduct of Freedom is to be attributed to its culture and governance practices and its remuneration practices. As Mr Orton accepted, Freedom's remuneration and incentives structure encouraged highly aggressive and inappropriate sales practices.[212] Freedom's quality assurance and disciplinary processes were insufficient to deter and detect these inappropriate practices. These difficulties were compounded by Freedom's failure to provide training to its staff about dealing with vulnerable consumers until February 2017.[213] Overall, these matters contributed to a culture in which sales agents were encouraged to sell aggressively, without regard for the needs of consumers (including vulnerable consumers), and with few, if any, constraints on their conduct.

3 CommInsure

3.1 Background

At the relevant time, CBA conducted its insurance business under the name CommInsure. The Commission examined CommInsure's handling of claims made under life insurance policies that provided trauma cover. The case study examined the way that CommInsure handled two particular claims – one by an insured person who had a heart attack, and the other by an insured person who had breast cancer – as well as a number of issues relating to the definition of 'heart attack' in CommInsure's policies.

210 Transcript, Craig Orton, 11 September 2018, 5412–14.

211 Transcript, Craig Orton, 12 September 2018, 5517.

212 Transcript, Craig Orton, 11 September 2018, 5466; see also Exhibit 6.74, 7 September 2018, Freedom Breach Notice.

213 Transcript, Craig Orton, 11 September 2018, 5449.

The Commission heard evidence from Ms Helen Troup, the Executive General Manager of CommInsure.

3.2 Evidence

3.2.1 First insured – heart attack

In the first case examined, the insured took out a life insurance policy in 2000.[214] The policy included cover for 'heart attacks', as defined in the policy.[215] The insured suffered a heart attack in January 2014, and made a claim under the policy later that month.[216]

The medical definitions in the insured's policy were updated from time to time.[217] At the time the insured suffered his heart attack, however, CommInsure had not made any substantive changes to the definition of 'heart attack' since July 2005 but, in 2013, had changed the title of the relevant definition from 'Heart attack' to 'Heart attack of specified severity'.[218]

In accordance with the medical opinion of one of CommInsure's medical officers, Dr Carless, CommInsure denied the insured's claim for a full trauma benefit on the basis of his heart attack, because he did not meet the relevant policy definition.[219] Among other things, the definition required elevation in levels of troponin I above 2.0 mcg/L, but the insured's levels of troponin I did not rise to that level.[220]

---

214 Transcript, Helen Troup, 12 September 2018, 5548.

215 Transcript, Helen Troup, 12 September 2018, 5550.

216 Transcript, Helen Troup, 12 September 2018, 5552.

217 Transcript, Helen Troup, 12 September 2018, 5550.

218 Transcript, Helen Troup, 12 September 2018, 5551.

219 Transcript, Helen Troup, 12 September 2018, 5555.

220 Transcript, Helen Troup, 12 September 2018, 5554, 5560–1.

The insured made a complaint to CommInsure in June 2014,[221] but CommInsure did not change its decision.[222]

In March 2016, the ABC's *Four Corners* program and Fairfax Media reported on concerns about CommInsure's life insurance business.[223] Among other things, the reporting raised concerns that the definition of 'heart attack' in CommInsure's trauma policies was out of date, and did not reflect developments in medical science.[224]

As a result of these reports, CommInsure decided to bring forward a planned update to its 'heart attack' definition to March 2016.[225] It decided to backdate the application of the new definition to 11 May 2014.[226]

Shortly after the March 2016 media reports, the insured made a complaint to the Financial Ombudsman Service (FOS) about his claim with CommInsure.[227] At that time, a representative of CBA told the insured that the updated 'heart attack' definition did not apply to his claim, which was made in January 2014, because the updated definition only applied from 11 May 2014.[228] Despite this, the representative asked the insured for information to allow his claim to be assessed against the updated definition.[229] Ms Troup acknowledged that this communication was likely to confuse the insured,[230] and raise his hopes about the potential outcome of his claim.[231]

221 Transcript, Helen Troup, 12 September 2018, 5555.

222 Transcript, Helen Troup, 12 September 2018, 5555.

223 Transcript, Helen Troup, 12 September 2018, 5556.

224 Transcript, Helen Troup, 12 September 2018, 5556.

225 Transcript, Helen Troup, 12 September 2018, 5557.

226 Transcript, Helen Troup, 12 September 2018, 5557.

227 Transcript, Helen Troup, 12 September 2018, 5557.

228 Transcript, Helen Troup, 12 September 2018, 5559.

229 Transcript, Helen Troup, 12 September 2018, 5558–9.

230 Transcript, Helen Troup, 12 September 2018, 5559.

231 Transcript, Helen Troup, 12 September 2018, 5559.

At about this time, CBA asked Dr Carless to provide a further medical opinion about the claim, assessing the claim against both the previous (2013) definition and the new (2016) definition of 'heart attack'.[232] Dr Carless again concluded that the insured did not meet the 2013 definition, but said that he did satisfy the 2016 definition.[233]

On the basis of this opinion, CBA told FOS that it was still CommInsure's position that the insured did not meet the 2013 definition of 'heart attack', and that it was the 2013 definition that applied to the insured's claim.[234] CBA also challenged FOS's jurisdiction to deal with the dispute, on the basis that the dispute related to a matter of commercial judgment for CommInsure.[235] FOS rejected CommInsure's challenge to its jurisdiction, an action Ms Troup later said was 'appropriate'.[236]

Despite FOS having considered and rejected the jurisdictional argument, CBA continued to maintain that the dispute was outside FOS's jurisdiction,[237] and twice challenged that jurisdiction again.[238] Ms Troup acknowledged that this should not have happened, and that CBA should have accepted FOS's determination as to its jurisdiction.[239] Ms Troup attributed this conduct to a failure to log the decision about FOS's jurisdiction in CBA's case management system.[240]

Having rejected CBA's challenge to its jurisdiction, FOS asked CBA to provide the medical opinion on which it relied to say that the insured did not meet the 2013 definition, and asked CBA to obtain and provide a medical opinion about whether the insured met the 2016 definition. In response to

232 Transcript, Helen Troup, 12 September 2018, 5559–60.

233 Transcript, Helen Troup, 12 September 2018, 5559–60.

234 Transcript, Helen Troup, 12 September 2018, 5561; Exhibit 6.138, Witness statement of Helen Troup, 28 August 2018, Exhibit HT-27 [CBA.0001.0508.0118 at .0118]

235 Transcript, Helen Troup, 12 September 2018, 5561.

236 Transcript, Helen Troup, 12 September 2018, 5561.

237 Transcript, Helen Troup, 12 September 2018, 5565, 5567.

238 Transcript, Helen Troup, 12 September 2018, 5561, 5565, 5567.

239 Transcript, Helen Troup, 12 September 2018, 5565.

240 Transcript, Helen Troup, 12 September 2018, 5565.

this request, CBA provided the opinion of Dr Carless referred to earlier, but redacted the section of the opinion dealing with the 2016 definition.[241] In its covering email, CBA said that it 'decline[d] [FOS's] request to obtain or provide a medical report to assess whether the Applicant would satisfy the upgraded definition of Heart Attack'.[242] Ms Troup accepted that it was 'misleading' for CBA to convey to FOS that CommInsure did not already have a medical opinion about whether the insured met the 2016 definition.[243] Ms Troup acknowledged that CBA acted inconsistently with FOS's Terms of Reference and ASIC Regulatory Guide 139 in refusing to provide this information to FOS.[244] She said that this conduct was misguided, and was not a decision that she would have made.[245]

In July 2016, FOS wrote to CBA requesting further information, including information about the decision to backdate the 2016 definition to May 2014.[246] CBA did not provide information about this decision to FOS, because it did not consider it relevant to the dispute.[247] Ms Troup acknowledged that the failure to respond to FOS's request was a breach of FOS's Terms of Reference; she accepted that it was not 'open or transparent'.[248]

In August 2016, more than three months after FOS's first request, CBA provided Dr Carless's opinion to FOS in unredacted form.[249] In October 2016, FOS made a recommendation in favour of the insured.[250] CBA rejected that recommendation,[251] but settled the matter with the insured

241 Transcript, Helen Troup, 12 September 2018, 5563–4.

242 Transcript, Helen Troup, 12 September 2018, 5563.

243 Transcript, Helen Troup, 12 September 2018, 5564.

244 Transcript, Helen Troup, 12 September 2018, 5570.

245 Transcript, Helen Troup, 12 September 2018, 5571.

246 Transcript, Helen Troup, 12 September 2018, 5566.

247 Transcript, Helen Troup, 12 September 2018, 5568, 5570.

248 Transcript, Helen Troup, 12 September 2018, 5570.

249 Transcript, Helen Troup, 12 September 2018, 5568.

250 Transcript, Helen Troup, 12 September 2018, 5571.

251 Transcript, Helen Troup, 12 September 2018, 5571.

on an ex gratia basis.[252] Ms Troup acknowledged that CommInsure's handling of the dispute contributed to the delay in resolving the dispute with the insured and affected CBA's relationship with FOS.[253]

3.2.2 Second insured – breast cancer

In the second case examined, the Commission heard that the insured took out a life insurance policy in 1996.[254] In March 2016, the insured was diagnosed with breast cancer, and underwent two surgeries to have the cancer removed.[255] Following this, in August 2016, she made a claim under her policy.[256]

At the time the insured made her claim, the definition of 'cancer' that applied to her policy had not been updated since November 1998.[257] One of the exclusions from that definition was 'carcinoma in situ unless leading to radical breast surgery'.[258]

In August 2016, CommInsure denied the insured's claim[259] on the basis that she had a carcinoma in situ and her treatment did not involve 'radical breast surgery'.[260] CommInsure formed the view that the treatment did not constitute 'radical breast surgery' because the insured had not undergone a mastectomy.[261] CommInsure did not explain this in the letter it sent to the insured,[262] and Ms Troup acknowledged that the letter did not provide the insured with an adequate explanation of why her claim had been declined.[263]

---

252 Transcript, Helen Troup, 12 September 2018, 5572.

253 Transcript, Helen Troup, 12 September 2018, 5575.

254 Transcript, Helen Troup, 13 September 2018, 5638.

255 Transcript, Helen Troup, 13 September 2018, 5640.

256 Transcript, Helen Troup, 13 September 2018, 5640.

257 Transcript, Helen Troup, 13 September 2018, 5639.

258 Transcript, Helen Troup, 13 September 2018, 5640.

259 Transcript, Helen Troup, 13 September 2018, 5641.

260 Transcript, Helen Troup, 13 September 2018, 5641.

261 Transcript, Helen Troup, 13 September 2018, 5642.

262 Transcript, Helen Troup, 13 September 2018, 5642.

263 Transcript, Helen Troup, 13 September 2018, 5642.

The term ‘radical breast surgery’ was not defined in the policy.[264] Similarly, the policy did not specify that a mastectomy was required to meet the definition of ‘radical breast surgery’.[265] Ms Troup accepted that the lack of definition of ‘radical breast surgery’ in the policy resulted in confusion for the insured.[266]

The insured and her husband told CommInsure they were not happy with its decision to decline the claim, and in February 2017 they provided CommInsure with further information from the insured’s GP and surgeon. Both medical practitioners said that the treatment the insured had for her breast cancer constituted ‘radical breast surgery’.[267] Despite the views of these two medical practitioners, CommInsure maintained its decision to decline the claim, again on the basis that the insured had not had a mastectomy.[268]

Ms Troup accepted that CommInsure’s decision to decline the claim was unacceptable in circumstances where CommInsure:[269]

- was relying on a definition of cancer that, at the time, was about 18 years old;
- imposed limitations on that definition that were not expressed in the policy documents; and
- did not account for the way in which the insured had been treated by her doctors and the opinion expressed by those doctors.

264 Transcript, Helen Troup, 13 September 2018, 5642.

265 Transcript, Helen Troup, 13 September 2018, 5642–3.

266 Transcript, Helen Troup, 13 September 2018, 5642.

267 Transcript, Helen Troup, 13 September 2018, 5644.

268 Transcript, Helen Troup, 13 September 2018, 5645.

269 Transcript, Helen Troup, 13 September 2018, 5645–6.

Ms Troup also acknowledged that CommInsure had breached its duty to act towards the insured with the utmost good faith, by denying her claim in these circumstances.[270]

The insured made a complaint to FOS in April 2017.[271] Ms Troup accepted that CBA's engagement with FOS in relation to the complaint fell below what the community would expect of it.[272] Specifically, CBA chose not to respond to FOS's request for information or to seek an extension of time to respond to that request.[273]

Ultimately, FOS made a recommendation in favour of the insured.[274] The insured and CommInsure accepted the recommendation, and CommInsure paid the insured $169,305 plus interest of just under $5,000.[275] Ms Troup acknowledged that FOS made the right decision[276] and that CommInsure's handling of the claim caused distress to the insured.[277]

3.2.3 The decision not to update the 'heart attack' definition

Ms Troup also gave evidence about the decisions that CommInsure made in relation to the 'heart attack' definition, including decisions about whether to update the definition, and about the date from which the updated definition would be applied.

Ms Troup told the Commission that, between July 2005 and March 2016, CommInsure had considered updating its 'heart attack' definition,

270 Transcript, Helen Troup, 13 September 2018, 5646.

271 Transcript, Helen Troup, 13 September 2018, 5646.

272 Transcript, Helen Troup, 13 September 2018, 5649.

273 Transcript, Helen Troup, 13 September 2018, 5649.

274 Transcript, Helen Troup, 13 September 2018, 5650.

275 Transcript, Helen Troup, 13 September 2018, 5650.

276 Transcript, Helen Troup, 13 September 2018, 5650.

277 Transcript, Helen Troup, 13 September 2018, 5650.

but decided not to.[278] Ms Troup accepted that, from at least early 2012, CommInsure knew that its definition of 'heart attack':

- first, did not reflect the definition of 'heart attack' adopted by an international taskforce of medical practitioners as a generally accepted and universally applicable definition. Among other things that description required reference to whether the insured person's cardiac biomarkers were elevated above the 99th percentile of a normal reference population, rather than above some absolute level;[279]
- second, depending on the laboratory equipment used, might have required troponin I levels 20 times higher than those required under the universal definition of 'heart attack';[280] and
- third, could discriminate against CommInsure's female customers, as it was less common for women to reach the troponin I level specified in the definition.[281]

Ms Troup also told the Commission that in 2012, CommInsure's Chief Medical Officer had expressed the view that he would 'personally move to the universal definition' of 'heart attack'.[282]

Ms Troup accepted that CommInsure should have updated its definition of 'heart attack' in 2012 to reflect the universal definition.[283] Ms Troup acknowledged that the decision by CommInsure not to update the definition of 'heart attack' in 2012 fell below community standards and expectations.[284]

In 2013, CommInsure amended the title of its 'heart attack' definition to read 'Heart attack of a specified severity'.[285] Ms Troup accepted that, prior to that

278 Transcript, Helen Troup, 12 September 2018, 5595.

279 Transcript, Helen Troup, 12 September 2018, 5596.

280 Transcript, Helen Troup, 12 September 2018, 5602.

281 Transcript, Helen Troup, 12 September 2018, 5602.

282 Transcript, Helen Troup, 12 September 2018, 5602.

283 Transcript, Helen Troup, 12 September 2018, 5603.

284 Transcript, Helen Troup, 12 September 2018, 5593.

285 Transcript, Helen Troup, 12 September 2018, 5604.

change, people reading the policy would have assumed that the policy was intended to apply to all heart attacks.[286]

By May 2014, a number of other insurers had updated their 'heart attack' definitions to reflect the universal definition.[287] Ms Troup acknowledged that CommInsure's failure to update its definition in May 2014 was a commercial misjudgment that had adverse consequences for its policyholders.[288] Ms Troup accepted that this misjudgment was at least in part the result of CommInsure focusing on commercial considerations at the expense of the interests of its customers, or the potential reputational risks to CommInsure.[289] Ms Troup also accepted that the decision not to update the definition in 2014 fell below community standards and expectations.[290]

3.2.4 The decision not to backdate the updated 'heart attack' definition to 2012

As mentioned above, when CommInsure decided to update its 'heart attack' definition in March 2016, it decided to backdate the application of that definition to 11 May 2014.[291]

Ms Troup told the Commission that this decision was based upon the date of the last relevant PDS.[292] Ms Troup acknowledged that another reason for choosing this date was that it was in the middle of the period in which CommInsure's competitors had updated their definitions.[293]

After receiving a letter from ASIC in March 2017, CommInsure decided to backdate the updated definition of 'heart attack' even further, to October 2012.[294] In October 2012, the international taskforce of medical practitioners

---

286 Transcript, Helen Troup, 12 September 2018, 5609.

287 Transcript, Helen Troup, 12 September 2018, 5605.

288 Transcript, Helen Troup, 12 September 2018, 5605.

289 Transcript, Helen Troup, 12 September 2018, 5605, 5609.

290 Transcript, Helen Troup, 12 September 2018, 5594.

291 Transcript, Helen Troup, 12 September 2018, 5583.

292 Transcript, Helen Troup, 12 September 2018, 5583.

293 Transcript, Helen Troup, 12 September 2018, 5584.

294 Transcript, Helen Troup, 12 September 2018, 5587.

referred to above had published a paper endorsing a universally accepted medical definition of 'heart attack' that was different to the definition used by CommInsure.[295] Ms Troup acknowledged that October 2012 was a more appropriate date to which to backdate the definition, and that CommInsure should have settled on this date at the point that it decided that backdating was necessary.[296]

3.2.5 ASIC's investigation and misleading advertising

Ms Troup was asked about the way that CommInsure advertised its trauma policies between December 2012 and March 2016.

In connection with its investigation into CommInsure in 2016, ASIC raised concerns with CommInsure about its advertising of its trauma policies.[297] In particular, ASIC raised concerns that certain web pages and brochures made available by CBA were misleading or deceptive.[298] In essence, ASIC's concern was that the material was not sufficiently qualified or limited to convey the specific criteria that consumers would need to meet to satisfy the 'heart attack' definition.[299]

Ms Troup was asked about two web pages and two brochures made available by CommInsure concerning its trauma policies.[300] She accepted, rightly in my view, that a person reading the documents would have been likely to believe that CommInsure's trauma policy covered *all* heart attacks and, of course, as has been seen, that was not the case.[301] Ms Troup accepted that the documents were misleading.[302] CommInsure had not made this acknowledgment prior to the Commission's hearings.[303]

---

295 Transcript, Helen Troup, 12 September 2018, 5596.

296 Transcript, Helen Troup, 12 September 2018, 5589, 5593.

297 Transcript, Helen Troup, 13 September 2018, 5618.

298 Transcript, Helen Troup, 13 September 2018, 5618.

299 Transcript, Helen Troup, 13 September 2018, 5618.

300 Transcript, Helen Troup, 13 September 2018, 5619–24.

301 Transcript, Helen Troup, 13 September 2018, 5620–4.

302 Transcript, Helen Troup, 13 September 2018, 5621–4.

303 Transcript, Helen Troup, 13 September 2018, 5631.

ASIC did not take any enforcement action against CommInsure for these misleading advertisements. Rather, ASIC and CommInsure reached an agreement under which, among other things, CommInsure would make a voluntary community benefit payment of $300,000, and would commission a compliance review of its advertising sign-off processes and procedures.[304]

3.3 What the case study showed

3.3.1 'Heart attack' definition and advertising

Both CBA and Ms Troup rightly acknowledged that, by failing to update its 'heart attack' definition in 2012 and in 2014 to accord with the medical definition that was accepted at that time, CommInsure engaged in conduct that fell below community standards and expectations.[305]

The evidence demonstrated that this conduct was attributable, at least in part, to CommInsure not adequately taking into account the interests of customers in making those decisions, and instead being motivated by commercial considerations. Ms Troup acknowledged this to be the case.[306]

As noted above, Ms Troup accepted that the two web pages and two brochures made available by CommInsure concerning its trauma policies were misleading.[307] In its submissions, CBA rightly accepted that, by publishing these documents without any prominent qualification that only heart attacks of specified severity were covered by CommInsure's trauma policies, CommInsure contravened section 12DA of the ASIC Act, and therefore engaged in misconduct.[308] CBA also rightly accepted that, by publishing the web pages and brochures, it may have contravened section 12DB of the ASIC Act.[309]

---

304 Transcript, Helen Troup, 13 September 2018, 5630.

305 CBA, Module 6 Case Study Submission, 10 [36]; Transcript, Helen Troup, 12 September 2018, 5593–4.

306 Transcript, Helen Troup, 12 September 2018, 5605, 5609.

307 Transcript, Helen Troup, 13 September 2018, 5621–4.

308 CBA, Module 6 Case Study Submission, 6 [20].

309 CBA, Module 6 Case Study Submission, 7 [23].

The matter having already been investigated by ASIC, it is not necessary for me to make any referral.

3.3.2 Individual cases

In relation to the insured who suffered a heart attack, both Ms Troup and CBA rightly accepted that CBA's conduct in withholding part of Dr Carless's medical opinion from FOS, and saying that it declined to obtain or provide such an opinion, misled FOS.[310] CBA acknowledged that this constituted misconduct.[311] Ms Troup conceded that, by engaging in this conduct, CBA had failed to be open and transparent in its dealings with FOS and had acted inconsistently both with ASIC Regulatory Guide 139 and with FOS's terms of reference.[312]

Both Ms Troup and CBA also rightly accepted that CBA contravened clause 7.2 of FOS's Terms of Reference by declining to provide information to FOS about CBA's decision to backdate the updated 'heart attack' definition to May 2014.[313] CBA acknowledged that this constituted misconduct.[314]

These matters having already been investigated by FOS and ASIC, it is not necessary for me to make any referral.

In relation to the insured who suffered from breast cancer, CBA accepted that, in failing to give adequate consideration to the differences in medical opinions concerning the nature of the insured's surgery, and failing to escalate her claim for review, CBA's conduct fell below community standards and expectations.[315]

---

310 CBA, Module 6 Case Study Submission, 5 [13]; Transcript, Helen Troup, 12 September 2018, 5564–5.

311 CBA, Module 6 Case Study Submission, 5 [13].

312 Transcript, Helen Troup, 12 September 2018, 5570.

313 CBA, Module 6 Case Study Submission, 5 [16]; Transcript, Helen Troup, 12 September 2018, 5575.

314 CBA, Module 6 Case Study Submission, 5 [16].

315 CBA, Module 6 Case Study Submission, 9 [31].

In her evidence, Ms Troup went further, and – as noted above – acknowledged that CommInsure had breached its duty to act towards the insured with the utmost good faith, by denying her claim in circumstances where CommInsure:[316]

- relied on a definition of cancer that was, at the relevant time, about 18 years old;
- imposed limitations on that definition that were not expressed in the policy documents; and
- did not account for the way in which the insured had been treated by her doctors and the opinion expressed by those doctors.

Despite Ms Troup's acknowledgment, CBA did not accept in its submissions that CommInsure had breached its duty of utmost good faith in handling the insured's claim.[317] CBA contended that, to establish a breach of that duty, it was necessary to demonstrate that CommInsure had engaged in conduct that was capricious or unreasonable.[318] It went on to say that there was no evidence that CommInsure acted capriciously, unreasonably, or less than honestly towards the insured.[319]

It has been said that the touchstone of the duty of utmost good faith is to act, consistently with commercial standards of fairness and decency, with due regard to the interests of the insured.[320] By declining the insured's claim in the circumstances referred to above, it is arguable that CommInsure failed to act with due regard to the interests of the insured. It is also arguable that CommInsure failed to act reasonably. Accordingly, I consider that CommInsure may have breached its obligation under section 13 of the

316 Transcript, Helen Troup, 13 September 2018, 5645–6.

317 CBA, Module 6 Case Study Submission, 9 [32]–[33].

318 CBA, Module 6 Case Study Submission, 9 [32]. See *TAL Life Ltd v Shuetrim* (2016) 91 NSWLR 439, 452 [49] (Leeming JA).

319 CBA, Module 6 Case Study Submission, 9 [33].

320 See *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1, 12 [15] (Gleeson CJ and Crennan J).

Insurance Contracts Act 1984 (Cth) (the Insurance Contracts Act) to act towards the insured with the utmost good faith.

I refer CommInsure's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

In relation to this insured, CBA also rightly accepted that its failure to respond to FOS within the required time or request an extension of time in connection with the dispute was conduct that fell below community standards and expectations.[321]

3.3.3 Effectiveness of mechanisms for redress

In both of the specific cases considered in this case study, there were aspects of CBA's dealings with FOS that were concerning.

In the case of the first insured, who suffered from a heart attack, Ms Troup accepted that CBA misled FOS, made inappropriate challenges to its jurisdiction, and failed to provide information requested by FOS in breach of FOS's Terms of Reference. In the case of the second insured, who suffered from breast cancer, CBA failed to respond to FOS within the required time, without providing an explanation or requesting an extension of time.

External dispute resolution (EDR) schemes like FOS are an important mechanism for redress for consumers in their dealings with insurance companies. When insurance companies fail to be open, transparent and responsive in their dealings with FOS, it undermines the effectiveness of EDR mechanisms as a mechanism for redress.

4 TAL

4.1 Background

The Commission examined how TAL Life Limited (TAL) handled claims made by three people under income protection policies. The Commission

[321] CBA, Module 6 Case Study Submission, 11 [43].

heard evidence from Ms Loraine van Eeden, the General Manager of Claims. Ms van Eeden made three statements to the Commission. Only two of those statements were tendered; the person to whom the third statement related did not wish to have their circumstances examined by the Commission.[322]

4.2 Evidence

4.2.1 The first insured

The first insured applied for an income protection policy from TAL in February 2009.[323] In the online application form that she completed, she was asked a number of questions about her personal history. One of those questions asked whether she had, or had ever had, ‘depression, anxiety, panic attacks, stress, psychosis, schizophrenia, bipolar disorder, attempted suicide, chronic fatigue, postnatal depression or any other mental or nervous disorder’.[324] She answered ‘no’.[325] TAL offered the insured income protection cover, which she accepted.[326]

In May 2010, the insured made a claim under her policy for stress-induced depression and anxiety, which was tied to circumstances at her workplace.[327] Along with her claim form, the insured provided TAL with a letter from her GP, which explained that she had a generalised anxiety disorder that prevented her from working, and indicated that her condition was a ‘new onset illness’.[328]

Pursuant to an authority provided by the insured, TAL began bringing in her medical records, and records about a related workers’ compensation claim.[329] Ms van Eeden accepted that until 2013, it was TAL’s practice to

322 Transcript, Loraine van Eeden, 13 September 2018, 5661.

323 Transcript, Loraine van Eeden, 13 September 2018, 5672.

324 Transcript, Loraine van Eeden, 13 September 2018, 5673.

325 Transcript, Loraine van Eeden, 13 September 2018, 5673.

326 Transcript, Loraine van Eeden, 13 September 2018, 5675.

327 Transcript, Loraine van Eeden, 13 September 2018, 5675.

328 Transcript, Loraine van Eeden, 13 September 2018, 5677.

329 Transcript, Loraine van Eeden, 13 September 2018, 5677.

bring in extensive medical information about a claimant for the purpose of determining whether the policy could be avoided on the basis of non-disclosure.[330] She agreed that this practice was not acceptable.[331] In September 2016, TAL had introduced a formal guideline relating to investigations. Under this guideline, TAL authorised case managers to undertake a 'general review' even where there were 'no inconsistencies identified' between the underwriting disclosures and the claim information, 'to ensure there [was] no adverse non-disclosure'.[332] Ms van Eeden conceded that these reviews amounted to 'fishing expeditions' by case managers,[333] and that TAL had engaged in a 'fishing expedition' in relation to this insured's claim.[334]

Based on the information obtained by the case manager, the case manager formed the view that the insured may have failed to disclose a pre-existing history of 'work-related stress' when applying for her policy, and answered the 'mental health' question inaccurately.[335] Ms van Eeden did not agree with this assessment.[336] Despite the insured's attempts to address TAL's concerns,[337] TAL relied on section 29(3) of the Insurance Contracts Act to avoid the policy, on the basis that the insured had breached her duty of disclosure and had made a misrepresentation.[338]

The insured applied to TAL for internal review of the decision.[339] In November 2010, TAL's internal dispute resolution (IDR) team confirmed the initial decision.[340] Upon reviewing the letter that TAL's IDR team sent to the

330 Transcript, Loraine van Eeden, 13 September 2018, 5667.

331 Transcript, Loraine van Eeden, 13 September 2018, 5668.

332 Transcript, Loraine van Eeden, 13 September 2018, 5680.

333 Transcript, Loraine van Eeden, 13 September 2018, 5681; cf TAL, Module 6 Case Study Submission, 5–7 [14]–[20].

334 Transcript, Loraine van Eeden, 13 September 2018, 5682.

335 Transcript, Loraine van Eeden, 13 September 2018, 5682, 5688.

336 Transcript, Loraine van Eeden, 13 September 2018, 5688.

337 Transcript, Loraine van Eeden, 13 September 2018, 5685–6.

338 Transcript, Loraine van Eeden, 13 September 2018, 5689.

339 Transcript, Loraine van Eeden, 13 September 2018, 5690.

340 Transcript, Loraine van Eeden, 13 September 2018, 5690.

insured, Ms van Eeden agreed that the IDR team had not seriously engaged with the insured's request for internal review, and that the letter merely reiterated the claims team's decision.[341]

In February 2011, the insured lodged a complaint with FOS about the avoidance of her policy.[342] As part of this process, the insured provided extensive medical material to TAL.[343] Ms van Eeden accepted that this material provided a comprehensive response to the allegations being put by TAL against the insured.[344] Despite this, TAL continued to defend the FOS dispute.[345]

On 5 October 2012, more than two years after the insured had made her claim to TAL, FOS delivered a recommendation in favour of the insured, finding that TAL was not entitled to avoid her policy.[346] TAL rejected the Recommendation.[347] Ms van Eeden conceded that this decision was inappropriate.[348] FOS later delivered a determination in favour of the insured,[349] directing TAL to reinstate her policy and to pay her benefits, with interest.[350]

Following this, TAL did a number of things that were inconsistent with the determination, including:

- requesting that the insured repay premiums that TAL had previously refunded in order for her claim to be assessed;[351]

341 Transcript, Loraine van Eeden, 13 September 2018, 5690.

342 Transcript, Loraine van Eeden, 13 September 2018, 5691.

343 Transcript, Loraine van Eeden, 13 September 2018, 5692–3.

344 Transcript, Loraine van Eeden, 13 September 2018, 5693.

345 Transcript, Loraine van Eeden, 13 September 2018, 5693.

346 Transcript, Loraine van Eeden, 13 September 2018, 5695–6.

347 Transcript, Loraine van Eeden, 13 September 2018, 5697.

348 Transcript, Loraine van Eeden, 13 September 2018, 5698.

349 Transcript, Loraine van Eeden, 13 September 2018, 5698.

350 Transcript, Loraine van Eeden, 13 September 2018, 5698.

351 Transcript, Loraine van Eeden, 13 September 2018, 5699.

- failing to promptly assess all aspects of her claim;[352] and
- failing to pay interest in the correct sum and for the full period.[353]

Ms van Eeden agreed that TAL should have moved more quickly to put the insured in the position that she would have been in had TAL assessed her claim correctly three years earlier.[354]

In November 2013, about eight months after the FOS determination, TAL began to conduct surveillance of the insured. The surveillance lasted for at least four months,[355] and included both 'desktop' and physical surveillance.[356] Ms van Eeden accepted that the surveillance authorised by TAL in this case was 'deeply inappropriate',[357] and that the material reported to TAL was 'very personal and highly intrusive' on the insured's privacy.[358]

In December 2013, while the surveillance was continuing, TAL asked the insured to complete a daily activity diary, commencing from 4 November 2013.[359] Ms van Eeden accepted that this was another attempt by TAL to disprove the insured's entitlement to benefits.[360] Despite the insured having provided TAL with medical evidence that the daily diary was exacerbating her state of anxiety and was probably having a negative impact on her health,[361] TAL continued to insist on completion of the diary.[362]

352 Transcript, Loraine van Eeden, 13 September 2018, 5701.

353 Transcript, Loraine van Eeden, 13 September 2018, 5702.

354 Transcript, Loraine van Eeden, 13 September 2018, 5703.

355 Transcript, Loraine van Eeden, 13 September 2018, 5707.

356 Transcript, Loraine van Eeden, 13 September 2018, 5708–11.

357 Transcript, Loraine van Eeden, 13 September 2018, 5711.

358 Transcript, Loraine van Eeden, 13 September 2018, 5710.

359 Transcript, Loraine van Eeden, 13 September 2018, 5711.

360 Transcript, Loraine van Eeden, 13 September 2018, 5714.

361 Transcript, Loraine van Eeden, 13 September 2018, 5714.

362 Transcript, Loraine van Eeden, 13 September 2018, 5717.

Ms van Eeden accepted that this resulted in harm to the insured,[363] and accepted that some of the case manager's communications with the insured about the diary amounted to bullying.[364] Ms van Eeden also accepted that the case manager misrepresented to the insured that completion of the diary was a term of her policy.[365]

The insured made a further complaint to FOS about TAL's insistence that she complete a daily diary.[366] TAL told FOS that it was standard practice in the industry to require the completion of a diary.[367] Ms van Eeden accepted that it was not, and was unable to say why TAL had misrepresented the position to FOS.[368]

In March 2014, while the second FOS dispute was continuing, TAL informed the insured that she no longer met the definition of 'total disablement', that it would cease paying benefits to her, and that she would be required to repay $69,000 in benefits that she had been paid to date.[369] In support of its decision, TAL relied upon section 56(1) of the Insurance Contracts Act, which applies to fraudulent claims.[370]

Ms van Eeden accepted that the insured's claim had not been made fraudulently,[371] and that the communication of these matters would have caused 'considerable distress' to the insured.[372] Ms van Eeden also agreed that by this time, the case manager managing the insured's case had no regard for the wellbeing of the insured, and was on a mission to stop her from receiving benefits under the policy.[373]

363 Transcript, Loraine van Eeden, 13 September 2018, 5719.

364 Transcript, Loraine van Eeden, 13 September 2018, 5717.

365 Transcript, Loraine van Eeden, 13 September 2018, 5718.

366 Transcript, Loraine van Eeden, 13 September 2018, 5717.

367 Transcript, Loraine van Eeden, 13 September 2018, 5721.

368 Transcript, Loraine van Eeden, 13 September 2018, 5721.

369 Transcript, Loraine van Eeden, 14 September 2018, 5732.

370 Transcript, Loraine van Eeden, 13 September 2018, 5724.

371 Transcript, Loraine van Eeden, 13 September 2018, 5724.

372 Transcript, Loraine van Eeden, 13 September 2018, 5726.

373 Transcript, Loraine van Eeden, 14 September 2018, 5734–5.

In April 2014, TAL declined an invitation from FOS to participate in a conciliation conference with a view to resolving the insured's claim.[374] In November 2014, FOS delivered its Recommendation in the second dispute. FOS found that the insured had not made a fraudulent claim, that it was not fair and reasonable to require her to complete the diary, and that she remained entitled to benefits.[375] TAL challenged the Recommendation insofar as it related to the diary.[376] The matter proceeded to a determination, where FOS again found in favour of the insured.[377] After the determination, TAL again failed to calculate the payment of interest correctly.[378]

Since the determination, TAL has continued to engage in heavy-handed tactics in relation to the insured's claim,[379] and has continued to make several mis-steps in relation to the insured that it attributes to systems or administrative issues.[380] These have included failing to provide the insured with monthly statements, failing to pay the insured her benefits in a timely manner, and informing the insured that she was required to pay her premiums, despite being on claim.[381] Perhaps most worryingly, shortly after Ms van Eeden gave evidence, TAL wrote to the insured, advising her that she had failed to pay her quarterly premium by the due date, and saying that if she did not remedy this by 23 November 2018, she would 'no longer be covered' under her policy, and '[a]ny claims made after this date *cannot* be paid'.[382]

---

374 Transcript, Loraine van Eeden, 14 September 2018, 5741.

375 Transcript, Loraine van Eeden, 14 September 2018, 5742.

376 Transcript, Loraine van Eeden, 14 September 2018, 5745.

377 Transcript, Loraine van Eeden, 14 September 2018, 5747.

378 Transcript, Loraine van Eeden, 14 September 2018, 5749.

379 Cf Transcript, Loraine van Eeden, 14 September 2018, 5751.

380 Transcript, Loraine van Eeden, 14 September 2018, 5757.

381 Transcript, Loraine van Eeden, 14 September 2018, 5757.

382 Exhibit 6.483, 23 October 2018, Letter TAL Missed Premium Payments 19092018.pdf.

Overall, Ms van Eeden accepted that TAL's conduct was a 'deeply troubling response to a legitimate mental health claim', and that it involved 'a series of wrong decisions' and 'very troubling breaches of the insured's privacy'.[383] Ms van Eeden accepted that the poor conduct extended 'over a significant number of years' and involved 'numerous TAL employees'.[384] She also accepted that TAL did not impose disciplinary consequences on the case manager who had authorised and overseen the surveillance of the insured, misrepresented terms of the insured's policy, insisted upon use of the daily diary and used bullying tactics against the insured,[385] nor on a subsequent case manager who had managed the file and other files in a way that was of concern to her superiors.[386]

4.2.2 The second insured

The second insured took out a TAL income protection policy in October 2013.[387] At the time that she obtained the policy, she was asked whether she had 'ever had or received medical advice or treatment' for a significant number of health conditions, including 'depression, anxiety, panic attacks … or any other mental or nervous condition'.[388] She answered 'no'.[389]

In mid-December 2013, the insured was diagnosed with cervical cancer.[390] She made a claim on her policy in January 2014.[391] From January to May 2014, TAL paid the claim.[392] Throughout this period, TAL brought in and

383 Transcript, Loraine van Eeden, 14 September 2018, 5758.

384 Transcript, Loraine van Eeden, 14 September 2018, 5758.

385 Transcript, Loraine van Eeden, 14 September 2018, 5746, 5754; see also Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [189(a)], 30 [193].

386 Transcript, Loraine van Eeden, 14 September 2018, 5752–4.

387 Transcript, Loraine van Eeden, 14 September 2018, 5763.

388 Transcript, Loraine van Eeden, 14 September 2018, 5764.

389 Transcript, Loraine van Eeden, 14 September 2018, 5764.

390 Transcript, Loraine van Eeden, 14 September 2018, 5763.

391 Transcript, Loraine van Eeden, 14 September 2018, 5763.

392 Transcript, Loraine van Eeden, 14 September 2018, 5763.

reviewed information about the insured's medical history.[393] TAL ostensibly did this because the insured's claim was made in close proximity to the risk commencement date.[394] However, Ms van Eeden accepted that this was another general review, or 'fishing expedition', conducted by the case manager.[395] That this is the proper characterisation of what was done was reinforced by the fact that the medical information brought in was not confined to information relevant to the claimed condition.[396] TAL did not tell the insured that it was conducting these investigations.[397]

At the end of June 2014, without giving the insured notice, TAL avoided her contract of insurance on the basis that she had failed to disclose a prior history of depression.[398] Ms van Eeden accepted that at this time, TAL generally did not give policyholders an opportunity to provide information prior to their policy being avoided for non-disclosure, and that this was a systemic deficiency within TAL.[399]

TAL first communicated this decision to the insured by phone.[400] After listening to a recording of the call, Ms van Eeden acknowledged that:

- TAL had not informed the insured of its decision in an appropriate way;[401]
- there had been a lack of empathy and lack of sensitivity towards the insured's situation;[402]

---

393 Transcript, Loraine van Eeden, 14 September 2018, 5766.

394 Transcript, Loraine van Eeden, 14 September 2018, 5766.

395 Transcript, Loraine van Eeden, 14 September 2018, 5766.

396 Transcript, Loraine van Eeden, 14 September 2018, 5766.

397 Transcript, Loraine van Eeden, 14 September 2018, 5766.

398 Transcript, Loraine van Eeden, 14 September 2018, 5763.

399 Transcript, Loraine van Eeden, 14 September 2018, 5770.

400 Transcript, Loraine van Eeden, 14 September 2018, 5769.

401 Transcript, Loraine van Eeden, 14 September 2018, 5769.

402 Transcript, Loraine van Eeden, 14 September 2018, 5770.

- the situation was compounded by the insured's case manager having left her with the impression that she might need to pay back the benefits that she had received from TAL under the policy;[403] and
- overall, the way in which the phone call was handled fell below community standards and expectations.[404]

TAL subsequently sent a letter to the insured confirming that her policy would be avoided.[405] In that letter, TAL asserted that the insured had breached her duty of good faith under section 13 of the Insurance Contracts Act.[406]

Ms van Eeden acknowledged that this assertion was itself a breach by TAL of its duty of utmost good faith.[407] Ms van Eeden also acknowledged that until recently, if TAL declined a claim for non-disclosure, its communications to the policyholder would generally allege that they had breached their duty of good faith.[408] Ms van Eeden conceded that there would have been many cases of innocent non-disclosure in which this allegation was made, and which would have been very unfair to the policyholder.[409]

The letter to the insured emphasised that TAL reserved its right to recover the payments it had made to her.[410] Until about 2017, it had been TAL's practice to reserve its right to repayment of benefits where it avoided a policy for non-disclosure.[411]

The insured challenged TAL's decision to avoid the policy in FOS.[412] While the FOS dispute was continuing, TAL undertook further investigations into

403 Transcript, Loraine van Eeden, 14 September 2018, 5770.

404 Transcript, Loraine van Eeden, 14 September 2018, 5770.

405 Transcript, Loraine van Eeden, 14 September 2018, 5771.

406 Transcript, Loraine van Eeden, 14 September 2018, 5771.

407 Transcript, Loraine van Eeden, 14 September 2018, 5772.

408 Transcript, Loraine van Eeden, 14 September 2018, 5772.

409 Transcript, Loraine van Eeden, 14 September 2018, 5772.

410 Transcript, Loraine van Eeden, 14 September 2018, 5772.

411 Transcript, Loraine van Eeden, 14 September 2018, 5773.

412 Transcript, Loraine van Eeden, 14 September 2018, 5763.

the insured's disclosures.[413] Ms van Eeden accepted that TAL did so to try to find a basis for avoidance that was directly related to the claimed condition.[414]

In particular, TAL sought a further retrospective underwriting opinion in relation to some symptoms experienced by the insured prior to entering into the policy, which TAL considered may have been indicative of cervical cancer.[415] The underwriter advised that if those symptoms had been disclosed, the insured's application for a policy would have been refused on that basis,[416] potentially providing TAL with an alternative basis for avoiding the contract of insurance.[417] Upon receiving the opinion, TAL's General Manager of Claims expressed some concern about TAL 'trying to make retrospective decisions when the facts at the time were different'.[418]

In April 2015, TAL and the insured attended a FOS conciliation conference.[419] Despite having known of the proposed additional basis for avoidance for at least two weeks, TAL only told the insured of it on the day before the conference.[420] Ms van Eeden did not know whether this was a strategic decision by TAL, but accepted that it was part of a broader pattern of delay in TAL's dealings with FOS in this matter.[421] Following the conciliation conference, TAL and the insured settled the dispute by TAL waiving its right to recover the $25,000 paid to the insured, and paying her a further $25,000.[422]

---

413 Transcript, Loraine van Eeden, 14 September 2018, 5776.

414 Transcript, Loraine van Eeden, 14 September 2018, 5776.

415 Transcript, Loraine van Eeden, 14 September 2018, 5777.

416 Transcript, Loraine van Eeden, 14 September 2018, 5777.

417 Transcript, Loraine van Eeden, 14 September 2018, 5777.

418 Transcript, Loraine van Eeden, 14 September 2018, 5777.

419 Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 26 [96].

420 Transcript, Loraine van Eeden, 14 September 2018, 5778.

421 Transcript, Loraine van Eeden, 14 September 2018, 5778.

422 Transcript, Loraine van Eeden, 14 September 2018, 5778.

4.2.3 The third insured

As I have already mentioned, no statement was tendered in respect of the third insured's case. Accordingly, the cross-examination in this part of the case study focused upon a number of acknowledgments made by TAL in a signed, but untendered, statement.

First, TAL's Claims Decision Committee had determined to avoid the insured's policy, but before that decision was communicated to the insured, the case manager added some additional grounds for avoidance, namely an alleged non-disclosure of a mental health condition.[423] This additional information was derived from the contents of an underwriting opinion obtained by the case manager, which was inconsistent with the Committee's decision.[424] The case manager then communicated that revised position to the insured.[425]

Ms van Eeden accepted that the case manager should not have communicated the content of the underwriting decision, rather than the decision of the Committee, to the insured, and that this fell below what the community would expect.[426] Ms van Eeden attributed this to a lack of oversight of, and rigour in, the case manager's decision-making process.[427]

Second, following TAL's decision to avoid the insured's policy, the insured applied for internal review of that decision.[428] Following that internal review, the file was returned to the original case manager.[429] That case manager undertook a review of the file that extended beyond the recommendation made by TAL's IDR team.[430] Ms van Eeden accepted that the case manager's failure to conduct a review in accordance with the IDR team's

423 Transcript, Loraine van Eeden, 14 September 2018, 5780.

424 Transcript, Loraine van Eeden, 14 September 2018, 5780.

425 Transcript, Loraine van Eeden, 14 September 2018, 5781.

426 Transcript, Loraine van Eeden, 14 September 2018, 5780–1.

427 Transcript, Loraine van Eeden, 14 September 2018, 5780.

428 Transcript, Loraine van Eeden, 14 September 2018, 5781.

429 Transcript, Loraine van Eeden, 14 September 2018, 5781.

430 Transcript, Loraine van Eeden, 14 September 2018, 5781.

recommendation fell below what the community would expect.[431] She said that TAL was revising its processes to ensure that claims are no longer remitted from its IDR team back to the original case manager, to improve independence in the decision-making process.[432]

Third, Ms van Eeden acknowledged that, in light of both of these matters, TAL's decision to defend the insured's matter in FOS fell below community standards and expectations.[433]

Fourth, similarly to the case of the first insured, Ms van Eeden accepted that TAL knew about, but did nothing to stop, the inappropriate approach that had been adopted by TAL in response to the insured's claim.[434]

Fifth, similarly to the case of the second insured, Ms van Eeden accepted that TAL should have handled the insured's claim with greater sensitivity and empathy.[435]

4.2.4 The audit of declined mental health claims

As a result of the issues raised in these case studies, Ms van Eeden said that she will review all mental health claims that TAL declined for non-disclosure between 2013 and 2016 to ensure that appropriate processes were followed.[436]

4.3 What the case study showed

This case study showed how TAL had dealt with separate claims under three income protection policies. The claimants had different medical conditions. The case study raised several broader questions about TAL's policies and procedures.

---

431 Transcript, Loraine van Eeden, 14 September 2018, 5781.

432 Transcript, Loraine van Eeden, 14 September 2018, 5781–2.

433 Transcript, Loraine van Eeden, 14 September 2018, 5783.

434 Transcript, Loraine van Eeden, 14 September 2018, 5783.

435 Transcript, Loraine van Eeden, 14 September 2018, 5784.

436 Transcript, Loraine van Eeden, 14 September 2018, 5783.

Much of TAL's conduct was rightly acknowledged as problematic by TAL in the statements that it provided to the Commission, in the course of cross-examination, or in TAL's subsequent submissions to the Commission.

4.3.1 Misconduct

In relation to the first insured, TAL acknowledged on numerous occasions that it had breached its duty of utmost good faith towards the insured, breached professional standards, and engaged in conduct that was misleading.[437] These breaches all stemmed from TAL's 'approach of seeking to avoid the claim, rather than to support the insured'.[438] TAL accepted that this was evidenced by numerous types of inappropriate conduct, including:[439]

- the engagement of, and inappropriate use of, and instructions to, external investigators;
- the excessive use of surveillance;
- bullying tactics and offensive communications;[440]
- misrepresentation of policy terms; and
- misuse of the daily activities diary.

All these acknowledgments were properly made.

In relation to the second insured, TAL accepted that it may have breached its duty of utmost good faith by telling the second insured, when it avoided her contract of insurance, that she had breached her duty of utmost good

437 Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [188]–[189(a)]; Transcript, Loraine van Eeden, 14 September 2018, 5747–8; TAL, Module 6 Case Study Submission, 1–3 [4]–[5].

438 TAL, Module 6 Case Study Submission, 1 [4].

439 TAL, Module 6 Case Study Submission, 1–2 [4]; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–8 [188]–[189(a)].

440 See also Transcript, Loraine van Eeden, 13 September 2018, 5718, Transcript, Loraine van Eeden, 14 September 2018, 5748.

faith.[441] At most, the second insured had innocently failed to disclose certain information about her medical history.[442] TAL accepted that this constituted a breach of its obligation of utmost good faith.[443] Again, the concession was properly made.

I also consider TAL's broader concession about such communications to have been appropriately made. Until early 2017, TAL's standard practice was to tell policyholders whose contracts were being avoided under section 29 of the Insurance Contracts Act that they had breached their duty of good faith.[444] TAL accepted that when it made this allegation against a policyholder in respect of an innocent non-disclosure, TAL breached its duty of utmost good faith to that policyholder.[445] In its written submissions, TAL said that there were 'something less than 497 [cases] over a four year period' in which such allegations were made.[446]

In the course of Senior Counsel Assisting's closing address, I raised for consideration whether TAL's misleading and incorrect statement to FOS in relation to the first insured – namely, that the use of a daily activities diary was standard practice in the industry – was capable of constituting a breach of the contract between FOS and TAL, and therefore, misconduct.[447] As TAL has conceded, 'there is no doubt an implied term of the contract between TAL and FOS that TAL would not knowingly make misrepresentations calculated to lead FOS into error'.[448] Despite this, TAL submitted that it did not breach that term because the misleading statement was accompanied

441 Transcript, Loraine van Eeden, 14 September 2018, 5772.

442 Transcript, Loraine van Eeden, 14 September 2018, 5771–2.

443 Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [6].

444 Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [7].

445 Transcript, Loraine van Eeden, 14 September 2018, 5772; TAL, Module 6 Case Study Submission, 3 [7].

446 TAL, Module 6 Case Study Submission, 4 [8]; see also Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 2–3 [11].

447 Transcript, Commissioner, 21 September 2018, 6483; see also Transcript, Loraine van Eeden, 13 September 2018, 5721.

448 TAL, Module 6 Case Study Submission, 12 [40(a)].

by a concession that TAL would no longer require the first insured to complete the diary.[449] I am not persuaded by this argument. The fact that TAL told FOS that it had decided not to press the first insured to complete the diary (a decision it later reversed),[450] does not alter the misleading character of its statement about standard practice in the industry. In any event, irrespective of the contractual position, the statement about industry practice may well have been 'misleading' or 'deceptive' in the sense described in the Commission's Terms of Reference, and if that was so, it would have been misconduct on this basis alone.

I refer TAL's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

I also raised for consideration whether TAL's actions may have worsened the medical condition of the first insured, and whether this may constitute misconduct or conduct that fell below community standards and expectations.[451] TAL submitted that no such finding was open, because the most recent psychiatric report in evidence did not attribute to TAL any 'responsibility for the observed decline in the First Insured's mental health'.[452] This is unsurprising: the focus of the report was not on identifying causes of the first insured's condition.[453] However, the report did make clear that there was a marked deterioration in the first insured's condition over the period of her engagement with TAL, and that the first insured had expressed 'fearfulness and anger which was directed towards the insurance process'.[454]

449 TAL, Module 6 Case Study Submission, 12–13 [40(a)].

450 TAL, Module 6 Case Study Submission, 11 [35].

451 Transcript, Commissioner Hayne, 21 September 2018, 6484.

452 TAL, Module 6 Case Study Submission, 7 [22].

453 Exhibit 6.202, 13 July 2017, Report of Dr Anthony Dinnen.

454 Transcript, Loraine van Eeden, 14 September 2018, 5755–6; Exhibit 6.202, 13 July 2017, Report of Dr Anthony Dinnen.

Ms van Eeden accepted that TAL's actions towards the first insured were capable of causing her considerable distress,[455] and that TAL failed to properly acknowledge her distress in some significant respects.[456] I doubt that all of TAL's conduct towards the insured is properly characterised – as TAL would have it –[457] as no more than TAL exercising rights it had under the insurance contract. Even if the conduct can be connected to TAL's contractual rights, the manner in which TAL exercised those rights may have exacerbated the first insured's condition. I consider that TAL's conduct fell below community standards and expectations.

4.3.2 Conduct falling below community standards and expectations

TAL's conduct fell below community standards and expectations in a number of other respects.

First, until 2017, TAL did not have adequate systems to train its case managers, or to oversee the actions of its case managers. In its statements and its submissions to the Commission, TAL accepted that this finding was open.[458] In the case of the first and third insureds, this resulted in a number of inappropriate actions being taken, and a failure by TAL to correct those decisions in a timely manner.[459]

Second, at least until 2016, TAL did not have robust systems to avoid potential conflicts of interest. This is demonstrated by reference to two specific examples.

In the case of the first insured, TAL permitted a case manager to sit on the Claims Decision Committee when the Committee was reviewing that

455 Transcript, Loraine van Eeden, 13 September 2018, 5687, 5726; Transcript, Loraine van Eeden, 14 September 2018, 5756.

456 Transcript, Loraine van Eeden, 14 September 2018, 5761.

457 TAL, Module 6 Case Study Submission, 8 [23].

458 Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 30 [193]–[194]; TAL, Module 6 Case Study Submission, 8 [25].

459 Transcript, Loraine van Eeden, 14 September 2018, 5785; TAL, Module 6 Case Study Submission, 8–9 [25].

manager's recommendation. In its written submissions to the Commission, TAL accepted that this fell below community standards and expectations, because the Committee's 'decision-making should have been independent from the case manager'.[460] I agree.

In the case of the third insured, TAL remitted claims to case managers after TAL's IDR team had essentially indicated that the case manager had taken the wrong approach.[461] In the course of cross-examination, Ms van Eeden accepted that it was inappropriate to 'remit[ ] a decision of the internal dispute resolution body to the person who has been found by them to have engaged in poor conduct'.[462] Despite this acceptance, TAL submitted that the practice did not fall below community standards and expectations, because it would not have been readily foreseeable during the period that the practice was employed that it was 'prejudicing the independence of the process'.[463] To my mind, Ms van Eeden's concession was appropriate, and TAL's submission does not convince me to the contrary.

The third way in which TAL's conduct fell below community standards and expectations was its failure to have adequate systems in place to ensure that its IDR team conducted a robust analysis of declined claims, in a way that was independent of the claims team.[464] In its written submissions, TAL accepted that its IDR team did not undertake a robust review of the decision to avoid the first insured's policy, but said that the evidence did not 'support a finding that there existed a systemic failure by the IDR team to conduct robust review of declined claims'.[465] However, in Ms van Eeden's statements to the Commission, and under cross-examination, Ms van Eeden recognised that the IDR team had been 'embedded within the operational functions of TAL', that the team was 'not located in a way that enhanced any independence', and that the team was 'not sufficiently independent of

460 TAL, Module 6 Case Study Submission, 9 [27].

461 Transcript, Loraine van Eeden, 14 September 2018, 5782.

462 Transcript, Loraine van Eeden, 14 September 2018, 5782.

463 TAL, Module 6 Case Study Submission, 10 [29].

464 Transcript, Loraine van Eeden, 13 September 2018, 5690–1; Transcript, Loraine van Eeden, 14 September 2018, 5760.

465 TAL, Module 6 Case Study Submission, 11 [33].

the business' at the time that the first insured made her claim.[466] In my view, these acknowledgments show that TAL's IDR team was not set up in a way that promoted robust analysis of declined claims, independent of the claims team.[467] And the fact is that TAL's IDR team did not make a robust analysis of the first insured's declined claim.

The fourth way in which TAL's conduct fell below community standards and expectations concerned its engagement with FOS. In its submissions, TAL accepted that it failed to engage with FOS in a frank and cooperative way in a number of respects, and that this was conduct that fell below community standards and expectations.[468] As noted above, TAL made a misleading and incorrect statement to FOS in relation to the first insured, namely that the use of a daily activities diary was standard practice in the industry;[469] TAL delayed in communicating to FOS the additional basis on which it was relying to avoid the second insured's policy;[470] TAL refused to participate in a conciliation conference with the first insured;[471] and TAL in some respects failed to comply with FOS's decisions in respect of the first insured in a timely manner, or in some instances, until pushed by FOS to do so.[472]
In my view, TAL was right to accept that each of these instances involved conduct that fell below community standards and expectations.

466 Transcript, Loraine van Eeden, 14 September 2018, 5760; see also Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 29 [190(a)], 30 [195].

467 Transcript, Loraine van Eeden, 13 September 2018, 5690–1; Transcript, Loraine van Eeden, 14 September 2018, 5760.

468 TAL, Module 6 Case Study Submission, 11 [34].

469 TAL, Module 6 Case Study Submission, 11 [35]; see also Transcript, Loraine van Eeden, 14 September 2018, 5758.

470 TAL, Module 6 Case Study Submission, 11 [36]; see also Transcript, Loraine van Eeden, 14 September 2018, 5778.

471 TAL, Module 6 Case Study Submission, 11 [37]; see also Transcript, Loraine van Eeden, 14 September 2018, 5741.

472 TAL, Module 6 Case Study Submission, 11 [38]; Transcript, Loraine van Eeden, 13 September 2018, 5697–8, 5700, 5702; Transcript, Loraine van Eeden, 14 September 2018, 5745, 5761.

Fifth, historically, TAL failed to afford policyholders an opportunity to address TAL before it avoided their policies.[473] Until mid-2017, TAL generally failed to afford policyholders – including the second and third insureds – an opportunity to address TAL, and the material that TAL was relying upon, prior to TAL deciding to avoid their policy.[474] Both in Ms van Eeden's statement and in TAL's submission to the Commission, it was accepted that this conduct fell below community standards and expectations.[475]

The sixth way in which TAL's conduct fell below community standards and expectations concerned TAL's communications with its policyholders. As acknowledged by TAL, several aspects of TAL's communications with the first, second and third insureds fell below community standards and expectations. In relation to the first insured, TAL accepted that it communicated in a way that was inappropriate, bullying, threatening and misleading.[476] In respect of the second and third insureds, TAL accepted that it failed to communicate in a sensitive and empathetic way that recognised the difficult circumstances that they were facing[477] (for example by telling the second insured that she may have to repay the benefits that she had obtained under the policy).[478]

The seventh way in which TAL's conduct fell below community standards and expectations concerned TAL's systems and processes. TAL made

473 Transcript, Loraine van Eeden, 14 September 2018, 5770–1, 5784.

474 TAL, Module 6 Case Study Submission, 13 [41].

475 Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 27–8 [106], 29 [113(c)]; TAL, Module 6 Case Study Submission, 13 [41].

476 Transcript, Loraine van Eeden, 13 September 2018, 5717–18; Transcript, Loraine van Eeden, 14 September 2018, 5748; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 27–9 [188]–[189]; see also TAL, Module 6 Case Study Submission, 14 [42].

477 Exhibit 6.179, Witness statement of Loraine van Eeden, 31 August 2018, 27 [103]; Transcript, Loraine van Eeden, 14 September 2018, 5784.

478 Transcript, Loraine van Eeden, 14 September 2018, 5770; see also TAL, Module 6 Case Study Submission, 14 [43(b)]. TAL made a similar statement to the first insured: see Transcript, Loraine van Eeden, 13 September 2018, 5726 and Transcript, Loraine van Eeden, 14 September 2018, 5732–4.

a number of administrative errors in respect of the first insured's case, including erroneously notifying her that her policy would be cancelled for non-payment of premiums.[479] As is apparent from what I have said, these errors continued after Ms van Eeden gave evidence.[480] Ms van Eeden acknowledged that these types of errors could have been a significant stressor for someone in the first insured's position, and could have impacted on her health.[481] TAL accepted, and I agree, that these errors constituted conduct that fell below community standards and expectations.[482]

4.3.3 Causes of the conduct

TAL accepted that a cause of much of the conduct referred to above was inadequate training and oversight of TAL case managers.[483] Ms van Eeden accepted that at the time when the three claims were made – 2010, 2014 and 2015 – there was minimal oversight within TAL of its senior case managers.[484] In addition, there were no structured ongoing training programs, nor any mandatory induction, at least in relation to TAL's claims philosophy.[485] Ms van Eeden acknowledged that this was a serious flaw in TAL's systems.[486]

Another likely cause was the culture of TAL at the time that the claims were made. Ms van Eeden said that she was unable to speak to TAL's general culture during that period, as she was not employed by TAL at the time.[487] However, Ms van Eeden accepted that that there were multiple employees of TAL 'involved in extremely poor conduct across [the] three files over

479 Transcript, Loraine van Eeden, 14 September 2018, 5757.

480 Exhibit 6.483, 23 October 2018, Letter TAL Missed Premium Payments 19092018.pdf.

481 Transcript, Loraine van Eeden, 14 September 2018, 5761.

482 TAL, Module 6 Case Study Submission, 14–15 [44].

483 TAL, Module 6 Case Study Submission, 15 [46].

484 Transcript, Loraine van Eeden, 14 September 2018, 5759; see also TAL, Module 6 Case Study Submission, 15 [46(c)].

485 Transcript, Loraine van Eeden, 14 September 2018, 5759; Exhibit 6.180, Witness statement of Loraine van Eeden, 5 September 2018, 30 [194]; TAL, Module 6 Case Study Submission, 15 [46(a)–(b)].

486 Transcript, Loraine van Eeden, 14 September 2018, 5760.

487 Transcript, Loraine van Eeden, 14 September 2018, 5736.

different periods of time'.[488] These included people at a number of levels of the business, from the claims team, the IDR team and the EDR team.[489] Ms van Eeden accepted that the fact that there were 'so many problems with so many people involved over such a lengthy period of time [was] quite telling [in terms of] TAL's culture'.[490] To my mind, the matters raised by TAL in its written submissions do not detract from this.[491]

A further cause of the conduct was a lack of independence in some parts of TAL's decision-making processes.[492] This was illustrated by TAL permitting a case manager to sit on the Claims Decision Committee when the Committee was reviewing that case manager's recommendation,[493] TAL's willingness to remit claims to case managers after its IDR team had essentially indicated that the case manager had taken the wrong approach,[494] and TAL historically having structured its IDR team and EDR team in a way that did not enhance their independence from TAL's business.[495]

Finally, TAL's conduct towards FOS indicates a culture within at least some parts of TAL that, at least at that time, had inadequate respect for FOS.[496]

---

488 Transcript, Loraine van Eeden, 14 September 2018, 5737.

489 Transcript, Loraine van Eeden, 14 September 2018, 5737, 5758, 5773–4, 5785–6.

490 Transcript, Loraine van Eeden, 14 September 2018, 5785.

491 TAL, Module 6 Case Study Submission, 16–18 [47]–[54].

492 TAL, Module 6 Case Study Submission, 18–19 [56]–[58].

493 TAL, Module 6 Case Study Submission, 9 [27].

494 Transcript, Loraine van Eeden, 14 September 2018, 5782.

495 Transcript, Loraine van Eeden, 14 September 2018, 5760.

496 Cf TAL, Module 6 Case Study Submission, 18 [55].

5 REST

5.1 Background

This case study concerned the conduct of the Retail Employees Superannuation Pty Limited, a registerable superannuation entity licensee and the trustee of Retail Employees Superannuation Trust (REST). The focus of the case study was the provision of life insurance, total and permanent disability (TPD), and income protection policies to REST members.

Lachlan Ross, Project Specialist in the REST Operations Team, gave evidence on REST's behalf.[497] Additional statements of Natalie Binns, Paul Howard and Joseph de Bruyn were also tendered.[498]

REST is a large fund, with about two million members.[499] Between 1.4 and 1.5 million of those members have group life insurance with REST.[500] REST offers its members default life, TPD and income protection cover, through the fund.[501]

Since 2004, AIA has been REST's group life insurer.[502] Mr Ross estimated that REST will pay AIA annual premiums of between $750 million and $800 million in the current policy year.[503]

The REST case study focused on particular clauses in the group life policies held by REST and the application of those clauses in particular cases.

497 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 1 [1].

498 Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018; Exhibit 6.230, Witness statement of Paul Howard, 7 September 2018; Exhibit 6.231, Witness statement of Joseph de Bruyn, 12 September 2018.

499 Transcript, Lachlan Ross, 14 September 2018, 5805.

500 Transcript, Lachlan Ross, 14 September 2018, 5805.

501 Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 2–4 [7].

502 Transcript, Lachlan Ross, 14 September 2018, 5806.

503 Transcript, Lachlan Ross, 14 September 2018, 5806.

5.2 Evidence

5.2.1 REST's minimum balance and prescribed employment status clauses

The first type of clause considered was described as a 'prescribed minimum balance clause', being a clause that requires the REST member to maintain a specified balance in their superannuation account in order to obtain or maintain insurance coverage. The second type of clause considered was described as a 'prescribed employment status clause'. That type of clause required a member to have a specified type of employment, or to work a minimum number of hours, in order to obtain or maintain coverage.

Until December 2017, the default policies offered to REST's members contained a prescribed minimum balance clause that operated in conjunction with a prescribed employment status clause.[504] The operation of these clauses combined meant that if a member's balance fell below a certain amount – $3,000 for TPD and $1,200 for life – and a member was not working, or did not receive contributions from their employer, the member would lose default life and TPD cover after 71 days.[505]

Between 2013 and 2018, the operation of the prescribed minimum balance clause led to REST denying the death claims of 11 members and the TPD claims of 36 members.[506]

Once REST became aware that a member had ceased working, and had a balance below the minimum threshold, it ceased charging premiums to that member.[507] However, if REST was not notified that a member had ceased working, it continued to deduct premiums from the member's account regardless of whether they had a balance below the minimum threshold.[508]

504 Transcript, Lachlan Ross, 14 September 2018, 5808, 5816.

505 Transcript, Lachlan Ross, 14 September 2018, 5808, 5815–6.

506 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 3 [7].

507 Transcript, Lachlan Ross, 14 September 2018, 5819.

508 Transcript, Lachlan Ross, 14 September 2018, 5820–2.

The operation of the prescribed minimum balance and prescribed employment status clauses was considered by reference to two examples.

The totally and permanently disabled member

In the first case, a REST member became totally and permanently disabled five days after his cover ceased.[509] Until a claim was made, REST had not been aware that the member had ceased work.[510] REST had continued to deduct premiums up until the time of the member's claim.[511] The claim was denied because of the operation of the prescribed minimum balance and prescribed employment status clauses.[512] All premiums paid by the member after his coverage had ceased were refunded to him.[513]

The paraplegic member

In the second case, the member had joined REST in 2005.[514] She became a paraplegic in May 2012 after falling from the fifth floor of a building.[515]

After the member was injured, she received her 2012 REST annual statement.[516] The statement informed her that she had TPD coverage of $108,000.[517] The statement did not mention the $3,000 minimum

509 Transcript, Lachlan Ross, 14 September 2018, 5820–1.

510 Transcript, Lachlan Ross, 14 September 2018, 5820–1; Exhibit 6.227, 10 November 2017, AIA Procedural Fairness Letter about Declining TPD, 2.

511 Transcript, Lachlan Ross, 14 September 2018, 5822.

512 Transcript, Lachlan Ross, 14 September 2018, 5822.

513 Exhibit 6.227, 10 November 2017, AIA Procedural Fairness Letter about Declining TPD, 3.

514 Transcript, Lachlan Ross, 14 September 2018, 5828.

515 Transcript, Lachlan Ross, 14 September 2018, 5831.

516 Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-21 [RST.0013.0001.0047]; Transcript, Lachlan Ross, 14 September 2018, 5831.

517 Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-21 [RST.0013.0001.0047 at .0052]; Transcript, Lachlan Ross, 14 September 2018, 5832.

balance requirement.[518] Mr Ross gave evidence that this information 'possibly' should have been included in REST annual statements.[519]

In January 2014, with the assistance of her lawyers, the member submitted a TPD claim to REST.[520] It took REST six months to provide the claim to AIA.[521] Mr Ross gave evidence that this was 'too long'[522] and that a delay of this length would now be unusual.[523] After being notified of the claim, AIA had to follow up REST for further information on a number of occasions.[524]

In November 2014, AIA accepted the member's claim, and transferred $108,000 to REST.[525] REST did not immediately notify the member.[526]

In December 2014, REST emailed AIA requesting that it review its decision.[527] REST also refunded the $108,000 to AIA.[528] Mr Ross said that this communication was made because REST had realised that it had made an administrative mistake in relation to the member's last employment date, and had failed to enter that date into its systems.[529] Mr Ross said that he considered it appropriate for REST's administrator to have acted as it did.[530] He did not consider that conduct to be inconsistent with REST's obligation to

518 Transcript, Lachlan Ross, 14 September 2018, 5832–3.

519 Transcript, Lachlan Ross, 14 September 2018, 5832–3.

520 Transcript, Lachlan Ross, 14 September 2018, 5834.

521 Transcript, Lachlan Ross, 14 September 2018, 5834.

522 Transcript, Lachlan Ross, 14 September 2018, 5834.

523 Transcript, Lachlan Ross, 14 September 2018, 5834.

524 Transcript, Lachlan Ross, 14 September 2018, 5834.

525 Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-38 [RST.0010.0003.0099].

526 Transcript, Lachlan Ross, 14 September 2018, 5837.

527 Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-41 [RST.0010.0003.0105].

528 Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, Exhibit LGR-41 [RST.0010.0003.0105].

529 Transcript, Lachlan Ross, 14 September 2018, 5836–7.

530 Transcript, Lachlan Ross, 14 September 2018, 5837.

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.[531]

AIA reviewed its decision and determined that the claim should be denied.[532]

The member later commenced litigation in the Supreme Court of New South Wales.[533] After some time, and various amendments to the member's pleading, AIA settled the claim and paid the member the full amount insured.[534]

Mr Ross did not believe that REST failed to act in the best interests of the member, but said that with hindsight, he wished REST could have done more to get the benefit paid to the member sooner.[535]

A question arose during this case study as to whether REST did everything that is reasonable to pursue the member's claim, as is required by section 52(7)(d) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (the SIS Act). Whether it did would turn on a number of factors, including on whether the claim had a reasonable prospect of success at any particular point. However where, as here, the intent of this part of the case was to explore the operation of particular types of clause and to consider at a more general level the role of the trustee in the handling of group life claims, it is unnecessary for me to form a concluded view on that issue. It is enough to say that the claim was factually difficult and that REST's records were incomplete and inaccurate (at least in some part due to incorrect data entry by REST or its administrator).[536]

531 Transcript, Lachlan Ross, 14 September 2018, 5837.

532 Transcript, Lachlan Ross, 14 September 2018, 5840.

533 Transcript, Lachlan Ross, 14 September 2018, 5843, Transcript, Lachlan Ross, 17 September 2018, 5850.

534 Transcript, Lachlan Ross, 17 September 2018, 5850; Exhibit 6.225, Witness statement of Lachlan Ross, 7 September 2018, 13 [53].

535 Transcript, Lachlan Ross, 17 September 2018, 5850.

536 Transcript, Lachlan Ross, 14 September 2018, 5836.

5.2.2 REST's definition of TPD

Another clause considered in the course of the case study was the clause defining 'totally and permanently disabled'. Mr Ross said that TPD insurance is the most complex type of group life insurance offered because the test is complicated.[537]

REST's definition of 'totally and permanently disabled' has three disjunctive limbs. The first limb has two elements. A person must be absent from work for a period of three consecutive months, and be so disabled that they are unlikely to engage in any occupation for which they are reasonably suited though education, training or experience.[538] The second element of the first limb requires that the member be so disabled that it is unlikely that the member will ever engage in any reasonably suitable occupation. That limb is not unlike the definition of 'permanent incapacity' in the SIS Regulations.[539] The second limb of REST's definition will be met if a member has suffered specific injuries, for example the loss of use of two hands or two feet.[540] The third limb of the definition requires that the member be unable to perform at least two 'activities of daily living' –dressing, bathing, toileting, mobility or feeding – without assistance.[541]

Mr Ross accepted that it was possible for a member to satisfy the first limb of REST's definition, but not the second or the third limbs.[542] However, REST will only assess a member's eligibility against the first limb if the

537 Transcript, Lachlan Ross, 17 September 2018, 5851.

538 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

539 *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 1.03C, which provides that a member is taken to be suffering permanent incapacity if the member's ill-health (whether physical or mental) makes it unlikely that the member will engage in gainful employment for which the member is reasonably qualified by education, training or experience.

540 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

541 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0682].

542 Transcript, Lachlan Ross, 17 September 2018, 5852.

member satisfies REST that they have been in 'Gainful Employment' in the 13 months before the incident.[543] REST defines 'Gainful Employment' as:[544]

> Being employed for gain or reward in any business, trade, profession or employment for at least ten (10) hours per week. If a member does *not* meet the 'Gainful Employment' requirement, REST will assess their eligibility for TPD benefits under the second and third limb of REST's definition, but not the first limb.[545]

In the last five years, REST has denied the death or TPD claims of 224 of its members based on the operation of its prescribed employment status clause, including the 'Gainful Employment' requirement.[546]

5.2.3 Income protection

REST provides default income protection cover to its members. [547] Mr Ross considered that this form of insurance cover was particularly valuable to REST's membership.[548]

A member may not claim the income protection benefit if that member is unemployed.[549] Despite this, absent explicit notification that a member had ceased working, Mr Ross was not aware of any systems that REST had in place to detect and stop the deduction of income protection premiums for unemployed members.[550] Mr Ross accepted that this meant that those members would be paying a premium for a policy on which they could not claim, but did not accept that income protection insurance would be 'junk

543 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

544 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0679].

545 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, Exhibit LGR-3 [RST.0006.0001.0658 at .0681].

546 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 11 [32].

547 Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 2–4 [7].

548 Transcript, Lachlan Ross, 17 September 2018, 5854.

549 Transcript, Lachlan Ross, 17 September 2018, 5854–5.

550 Transcript, Lachlan Ross, 17 September 2018, 5854–5.

insurance' in those circumstances.[551] In its submissions, REST resisted any finding that it should have systems in place to determine if a member might be unemployed and noted that it included warnings in member statements and on its website.[552]

In the last five years, REST declined 37 income protection claims due to the requirement for the claimant to be employed.[553]

5.2.4 Reasons for decisions – Death benefits

One of the topics addressed in the statement of Paul Howard was REST's process for giving reasons for decisions in response to complaints about the proposed payment of death benefits.[554] After the case study concluded, REST provided a further statement of Mr Howard, which supplemented his earlier statement.[555]

The additional information provided in the supplementary statement included that, on 20 September 2018, REST filed a breach report with ASIC and the Australian Prudential Regulation Authority (APRA) in which REST said that it considered that it had inadvertently breached section 101(1)(c) of the SIS Act – which requires trustees to provide reasons for a decision in response to a complaint about the proposed payment of a death benefit.[556] The statement says that REST considered that it may have breached that section 184 times since 15 March 2017.[557]

In the light of that evidence, I find that REST may have engaged in misconduct by breaching section 101(1)(c) of the SIS Act. Section 29E(1)(a)

---

551 Transcript, Lachlan Ross, 17 September 2018, 5855.

552 REST, Module 6 Case Study Submission, 12–13 [55]–[59].

553 Exhibit 6.224, Witness statement of Lachlan Ross, 31 August 2018, 15 [51].

554 Exhibit 6.230, Witness statement of Paul Howard, 7 September 2018, 3 [6].

555 Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, 4–6 [9]–[13], 5–6 [15].

556 Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, Exhibit PBH-63 [RST.0016.0003.0004].

557 Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, Exhibit PBH-63 [RST.0016.0003.0004 at .0004].

of that Act imposes a condition on the licences of all responsible superannuation entities to comply with various laws, including the SIS Act. It follows that REST may also have breached a condition imposed on its licence. In its submissions, REST accepted that such findings were open.[558]

REST's failure to comply with section 101(1)(c) and the licence condition imposed by section 29E(1)(a) was the direct result of its systems, in particular, the use of a template letter that was inadequately drafted.[559]

5.3 What the case study showed

The case study demonstrated the complexities faced by the administration of a group life insurance scheme within a large superannuation fund. It also demonstrated the profound effects for individual members from policy wording negotiated by superannuation trustees and group life insurers.

A point that emerged strongly from the evidence is that there are benefits to be gained from simplicity in key definitions, terms and exclusions. The simpler the term, the more readily it can be conveyed to members and the greater the prospect of members having an understanding of the extent of the cover.

Because group life insurance is, by definition, provided without advice and because it is attached to a passive and very long-term investment, the need for simplicity in the product and the effective communication of terms is heightened. Multi-limbed definitions that operate in combination with other definitions will always be more difficult for a trustee to explain, and for a member to comprehend, than a unitary definition.

Conversely, a definition of clear application – such as a prescribed minimum balance clause that operates without the engagement of other definitions – will be more readily capable of comprehension, provided the substance of the clause is clearly conveyed to a member in an appropriate way and with appropriate regularity.

It is important to recognise that group life insurance through superannuation – perhaps even more so in the case of large scale funds with a broad range

558 REST, Module 6 Case Study Submission, 15–16 [71]–[72].

559 Exhibit 6.422, Witness statement of Paul Howard, 20 September 2018, 1 [3(a)].

of members – is radically removed from a policy of insurance bought directly by a consumer and even more so than a policy taken out on advice.

None of that is to ignore that product pricing looms large in any negotiation or that changes to policy wording will sometimes have pricing effects. But it should also be remembered that the difficulties borne of complexity are not only a risk to the member. Complexities in policy terms generate complexity in policy administration.

Some of those complexities were demonstrated in the course of the case study. One was the difficulty in communicating accurately with members. Not infrequently REST has communicated with members in a way that did not accurately reflect the terms of the Group Life Policy.[560] REST disclosed 52 separate miscommunication incidents affecting more than 48,500 members.[561]

Mr Ross accepted that the operation of the minimum balance and prescribed employment status clauses made it complicated to communicate with members about their level of cover, and that this was one of the reasons that REST removed the prescribed minimum balance clause in December 2017.[562]

REST's submissions acknowledged both the importance of, and the difficulty in, communicating with members about aspects of group life insurance. REST said that 'there are many provisions of an insurance policy which will potentially be of critical importance to members, and there is no obvious means of communicating all of these provisions in another, easier to understand manner. This is a problem which is easy to identify but a perfect solution is elusive'.[563]

560 Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, 36 [47], Exhibit NSB-37 [RST.0009.0004.3502].

561 Exhibit 6.229, Witness statement of Natalie Binns, 31 August 2018, Exhibit NSB-37 [RST.0009.0004.3502].

562 Transcript, Lachlan Ross, 14 September 2018, 5816.

563 REST, Module 6 Case Study Submission, 12–13 [56].

REST also noted that it could not 'compel members to take an interest in their insurance arrangements'.[564] So much may be accepted. But the circumstances in which group life cover is offered, including the statutory requirements for the provision of some types of cover to MySuper members,[565] mean that it would be wrong for trustees to 'assume that members will appreciate the value of the insurance cover provided to them … and take an active interest in its management', as REST does.[566]

Moreover, because premiums are deducted from member accounts, and because the purpose of those accounts is ultimately to provide an income in retirement, superannuation trustees should be vigilant in ascertaining that the premiums deducted are in fact payable by the member *before* the deduction is made. The standard is not one of perfection, but it is not adequate for trustees to assume that the data provided to them is correct, especially in the face of contrary evidence (for example, the absence of contributions for a period of time).

Continuing to deduct insurance premiums when a person is no longer covered by insurance may constitute a failure to perform the trustee's duties and exercise the trustee's powers in the best interests of the beneficiaries as required under section 52(2)(c) of the SIS Act. It may also constitute conduct falling below community standards and expectations.[567] I make no finding that REST has engaged in misconduct or conduct falling below community standards and expectations of that type here. A more wide-ranging investigation would have been necessary in order for me to be satisfied of the relevant facts. The approach taken in the case study was to interrogate practices by reference to specific cases. That provided a useful lens through which to view the operation of the various clauses and practices, but does not cover sufficient factual ground to permit findings concerning section 52(2)(c).

564 REST, Module 6 Case Study Submission, 13 [57].

565 SIS Act s 68AA.

566 REST, Module 6 Case Study Submission, 13 [57].

567 Such conduct will constitute a breach of cls 4.24, 4.25 and 4.27 of the Insurance in Superannuation Voluntary Code of Practice once it comes into force.

Failing to communicate with members about key exclusions in a way that is likely to be comprehensible by most members, and with reasonable frequency, may also amount to conduct falling below community standards and expectations.[568] Again, I need not make any specific findings about REST's communications here.

6 AMP

6.1 Background

This case study concerned group life insurance offered to members of the superannuation funds of AMP Superannuation Limited (AMP Super) and NM Superannuation Proprietary Limited (NM Super), the AMP Group's superannuation trustees. AMP Life Limited (AMP Life) is the group life insurer for all AMP Super funds and for some of NM Super's funds.[569]

AMP Life, a wholly owned subsidiary of AMP Limited, is the group life insurer for most members of the trustees' funds.[570] It is also the administrator of all of AMP Super's funds, and some of NM Super's funds;[571] an arrangement Mr Paul Sainsbury, Group Executive, Wealth Solutions and Customer, for the AMP Group said had existed for 'a very long time'.[572]

568 This conduct would constitute a breach of cl 5.17 of the Insurance in Superannuation Voluntary Code of Practice once it comes into force.

569 Transcript, Paul Sainsbury, 17 September 2018, 5861.

570 Transcript, Paul Sainsbury, 17 September 2018, 5861.

571 Transcript, Paul Sainsbury, 17 September 2018, 5861.

572 Transcript, Paul Sainsbury, 17 September 2018, 5863–4.

As was seen in previous rounds of hearings, AMP Life is also the trustee's investment manager[573] and members' funds are invested through policies issued through AMP Life.[574]

Mr Sainsbury said that one of AMP Life's responsibilities as administrator of the trustees' funds was to undertake 'assessments of potential insurers', recommend replacement insurance arrangements and assist the trustees to 'negotiate the terms and appointment with the preferred insurer' and to ensure compliance with Prudential Standard SPS 250, Insurance in Superannuation.[575] That Prudential Standard requires, amongst other things, that a trustee be able to satisfy itself, and demonstrate to APRA, that the engagement of the insurer is conducted at arm's length and is in the best interests of beneficiaries.[576]

Mr Sainsbury was asked about the suitability of AMP Life to undertake tasks connected with the selection of the group life insurer and the assessment of the appropriateness of those arrangements as required by Prudential Standard SPS 250. Mr Sainsbury did not accept that a conflict arose by AMP Life undertaking the task of assessing and recommending its potential competitors.[577] He said that there was sufficient separation of roles within AMP Life to satisfy the requirements of Prudential Standard SPS 250.[578]

573 To the extent it has not outsourced that role to another related party within the AMP Group.

574 Exhibit 6.486, 3 October 2017, [SIGNED] ART Financial Report 30 June 2017 Final 20170927.pdf, 15; Exhibit 5.434, 3 October 2017, [SIGNED] SST Financial Report 30 June 2017 Final 20170927.pdf, 21; Exhibit 6.487, 3 October 2017, [SIGNED] NMRF Financial Report 30 June 2017 Final 20170927.pdf, 15; Exhibit 6.488, 3 October 2017, [SIGNED] ProSuper Financial Report 30 June 2017 Final 20170927.PDF, 7; Exhibit 5.435, 3 October 2017, [SIGNED] SDF Financial Report 30 June 2017 Final 20170927.pdf, 16.

575 Exhibit 6.233, Witness statement of Paul Sainsbury, 10 September 2018, 17 [67].

576 Transcript, Paul Sainsbury, 17 September 2018, 5862; Exhibit 6.235, 15 November 2012, APRA, Prudential Standard SPS 250, 15 November 2012, 6 [23].

577 Transcript, Paul Sainsbury, 17 September 2018, 5863.

578 Transcript, Paul Sainsbury, 17 September 2018, 5863.

This issue was not directed at actual or potential misconduct by AMP Super or AMP Life, but rather to the adequacy of the current regulatory regime. It was not immediately clear how the AMP trustees could satisfy APRA that the arrangement with AMP Life was at arm's length. Indeed, Mr Sainsbury said that tenders for the provision of group life insurance to the members of the trustees' funds do not occur.[579]

Counsel Assisting posed a number of policy questions connected with the engagement of associated entities as group life insurers after the hearing. I have considered those questions in the chapter of Volume 1 of this Report that deals with the superannuation sector.

6.2 The case studies

The Commission heard evidence from Mr Sainsbury.[580]

Three issues were examined in the course of Mr Sainsbury's evidence. They were: the charging of higher premiums for delinked members where AMP is not aware of the member's smoker status, AMP's processes for ceasing to charge premiums once notified of a member's death, and the provision of default insurance to MySuper members.

6.2.1 Delinked members and smoker rates

A delinked employee is a fund member who was previously part of an employer superannuation plan, but was transferred to another plan after ceasing employment with the employer.[581]

AMP defaulted delinked employees to a standard insurance rate.[582] Delinked employees were defaulted to this rate, Mr Sainsbury said, because AMP did not have a full understanding of the health of those members.[583]

---

579 Transcript, Paul Sainsbury, 17 September 2018, 5864.

580 Transcript, Paul Sainsbury, 17 September 2018, 5861.

581 Transcript, Paul Sainsbury, 17 September 2018, 5864.

582 Transcript, Paul Sainsbury, 17 September 2018, 5865.

583 Transcript, Paul Sainsbury, 17 September 2018, 5865.

Mr Sainsbury described the standard rate as being different to an 'actual smoker rate', although he accepted that for group life policies there were only two rates: the standard rate and the non-smoker rate.[584] He also accepted that the only criterion applied in order to move a member from the standard rate to the non-smoker rate was the submission by the member of a non-smoker declaration.[585] Mr Sainsbury agreed that what he called 'the nuanced differences' between the rates would be difficult for a member to understand.[586]

The issues in connection with default insurance rates for delinked members were examined, in part, by reference to a particular case. A delinked employee, who was a non-smoker, was informed by his financial adviser that he had been classified as a smoker.[587] Until that point, the member was unaware that he was classified as a smoker.[588] It was not stated on his annual statement.[589] At the time of the discovery, the member was being charged $2,600 in premiums per month.[590] The premium reduced to $1,600 per month on the member's reclassification as a non-smoker.[591]

Until then, the member had been charged almost $77,000 in additional premiums.[592] AMP declined to refund this amount to the member on the basis that its records showed that the member was issued with the non-smoker declaration at the time of his delinking, and that it had 'clearly'

584 Transcript, Paul Sainsbury, 17 September 2018, 5868–70, 5875.

585 Transcript, Paul Sainsbury, 17 September 2018, 5875.

586 Transcript, Paul Sainsbury, 17 September 2018, 5871.

587 Transcript, Paul Sainsbury, 17 September 2018, 5864; Exhibit 6.236, 27 February 2013, Email Financial Planner to Planner Liaison.

588 Transcript, Paul Sainsbury, 17 September 2018, 5864.

589 Transcript, Paul Sainsbury, 17 September 2018, 5864.

590 Transcript, Paul Sainsbury, 17 September 2018, 5864.

591 Transcript, Paul Sainsbury, 17 September 2018, 5864.

592 Transcript, Paul Sainsbury, 17 September 2018, 5866, 5877; Exhibit 6.242, 6 June 2014, AMP Premium Comparison Calculation.

explained what would happen to his insurance once he left his employer.[593] This was the only occasion where the matter was drawn squarely to the member's attention.

Internal AMP documents of 2013 described AMP's failure to include the 'smoker status' in its annual statements as 'unethical'.[594] Mr Sainsbury did not agree that it was unethical to fail to include the smoker status in annual member statements[595] because members received a welcome letter on delinking, and were given an opportunity at that stage to elect non-smoking rates.[596]

The member subsequently lodged a complaint with the Superannuation Complaints Tribunal.[597] AMP's position remained that it had acted appropriately and should not be required to refund the additional premiums.[598] The Tribunal held that AMP had not acted fairly and reasonably in refusing to refund the customer.[599]

Mr Sainsbury accepted that it would have been better if annual statements disclosed the smoker status – particularly in circumstances where there was a very significant difference in the premium.[600] In 2013 member statements were 'enhanced' to show the member whether or not they had been classified as a smoker for the purposes of their insurance policy.[601]

593 Transcript, Paul Sainsbury, 17 September 2018, 5870–3; Exhibit 6.238, 15 March 2013, Letter AMP to Member Concerning 'Your Inquiry'; Exhibit 6.239, 14 October 2013, Internal AMP Emails Concerning SCT Complaint, September 2013.

594 Transcript, Paul Sainsbury, 17 September 2018, 5866; Exhibit 6.237, undated, Request for Reversal of Premium.

595 Transcript, Paul Sainsbury, 17 September 2018, 5866–7.

596 Transcript, Paul Sainsbury, 17 September 2018, 5866.

597 Exhibit 6.244, 6 May 2015, SCT Determination of Complaint; Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint.

598 Exhibit 6.244, 6 May 2015, SCT Determination of Complaint, 8 [46]; Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint.

599 Exhibit 6.244, 6 May 2015, SCT Determination of Complaint, 8–9.

600 Transcript, Paul Sainsbury, 17 September 2018, 5867.

601 Transcript, Paul Sainsbury, 17 September 2018, 5878.

Mr Sainsbury was familiar with ASIC *Report 529*, entitled *Member Experience of Superannuation*, in which ASIC expressed the view that only 14.5% of adults were daily smokers, and that, in these circumstances, it was statistically appropriate to assume a person is not a smoker in the absence of other information about that member or group of members.[602] Mr Sainsbury was not aware of the trustees taking any step to implement that recommendation.[603]

In its written submissions, AMP resisted any finding that premiums were charged to members on a statistically inappropriate basis.[604] In large part it did so by relying on facts and information not in evidence.[605] It did that despite questions being put to AMP regarding smoker default settings on two occasions in the weeks before the sixth round of hearings commenced.[606]

AMP could not have been in doubt that issues connected with default settings and life premiums were of interest to the Commission. The questions put to AMP in Rubric 6-69 directly raised the issue of smoker status and default settings. AMP chose to respond with short answers.[607] Mr Sainsbury's statement explained that hybrid rates usually apply where no non-smoking declaration is made.[608] He explained the hybrid category as reflecting a group of customers where a portion are smokers and a portion are non-smokers.[609] He also explained that premiums for the hybrid category fall between the smoker and non-smoker premium rates.[610]

602 Transcript, Paul Sainsbury, 17 September 2018, 5881–2.

603 Transcript, Paul Sainsbury, 17 September 2018, 5882–3.

604 AMP, Module 6 Case Study Submission, 7–8 [34]–[38].

605 AMP, Module 6 Case Study Submission, 7–8 [34]–[38].

606 The questions were first put to AMP on 16 August 2018 in the form of questions 11 to 15 of Rubric 6-69. See Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 1 [1]. Additional questions 12A to 12C were then included by email dated 5 September 2018, and are answered in Mr Sainsbury's statement (Exhibit 6.234).

607 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9–13 [35(b)], [42], [47], [48], [52], [53].

608 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(c)].

609 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(b)].

610 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, 9 [35(b)].

No further explanation was given of the method of calculation, for example, by demonstrating how the hybrid rate accounted for smoking rates and why that was statistically appropriate.

Having followed the course it did, I cannot form any concluded view about the force of the additional material AMP supplied so late in the day. Regardless of whether there was some arguable basis for charging the rates it did to persons who had not declared themselves not to be smokers, AMP's conduct in not disclosing the bases on which the particular premium was charged to this member merit the criticisms levelled against AMP.

What this part of the case study showed

In the case that proceeded to the Superannuation Complaints Tribunal, AMP did not communicate with the member in an effective way that he was being charged a higher premium because a non-smoking declaration had not been completed. Given the very significant differential in the premiums, it was incumbent on AMP to communicate that fact in a comprehensible way at reasonably regular intervals. It failed to do so. AMP's conduct fell below community standards and expectations.

The state of the evidence does not permit me to make findings that AMP may have engaged in misconduct or conduct falling below community standards and expectations beyond the case of the specific member. What can be said at a more general level is if a trustee did not ensure that the rates charged to members were based on appropriate statistical assumptions, the trustee's conduct would likely amount to a breach of one or more of the grounds set out in sections 52(2)(b) and (c) of the SIS Act. It would also be conduct falling below community standards and expectations.

The case study emphasised the importance of fee-related decisions, and the basis for those decisions, being communicated in an effective way both to staff and to customers. The evidence demonstrated that some staff within AMP thought the rate charged to members who had not completed a non-smoking declaration was a smoker rate.[611] That is unsurprising given that the only step that needed to be taken to be paid a lesser rate was

611 See, eg, Transcript, Paul Sainsbury, 17 September 2018, 5877.

to complete the declaration. And some of AMP's own communications appeared to confuse the issue.[612]

6.2.2 The charging and refunding of premiums to deceased members' accounts

The second issue examined in Mr Sainsbury's evidence concerned group life premiums charged to deceased members.

In April 2018, AMP identified that life insurance premiums were continuing to be deducted from deceased members' accounts, and that after payment of a death benefit, refunds were not being processed to deceased members' accounts.[613] AMP had investigated this issue after evidence given by CBA at the Commission's second round of hearings, concerning fees being charged to deceased customers.[614]

On 26 June 2018, AMP notified ASIC and APRA that it had breached section 912A(1)(c) of the Corporations Act and sections 29VC and 52(2)(b) of the SIS Act because insurance premiums charged after the member's death were either not refunded, or the refunded amount was incorrect.[615] That breach notification identified 3,124 members with a total of $922,902 in premium refunds owing.[616] AMP said that it determined the matter was reportable under section 912D of the Corporations Act (and section 29JA of the SIS Act) on 12 June 2018.[617]

---

612 See, eg, Exhibit 6.239, September 2013, Internal AMP Emails Concerning SCT Complaint; Transcript, Paul Sainsbury, 17 September 2018, 5873–4.

613 Transcript, Paul Sainsbury, 17 September 2018, 5883.

614 Transcript, Paul Sainsbury, 17 September 2018, 5891.

615 Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0046].

616 Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0046].

617 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046 at .0047].

As at 5 September 2018, AMP had identified that 4,645 customers were affected by this issue, with $1.3 million in premium refunds owing.[618]

The potential breaches identified by AMP Super were described as failures to *refund* premiums.[619] The potential breaches were not said to relate to the *charging* of premiums to deceased members.[620] In the course of Mr Sainsbury's evidence, the anterior question of AMP Super's right to deduct premiums from a deceased member's account where AMP had been notified of the death was explored.

As the potential breaches have been reported to ASIC and APRA, it is not necessary for me to make any referral.

In its submissions, AMP accepted that before July 2018, its process for some corporate superannuation products – the submissions do not identify which products or the total number of members across those products – was to stop deducting premiums 'only on finalisation of the claim'.[621] Premiums charged between the date of death and the date of finalisation of the claim were later refunded to the member's account (save for those cases identified in the breach reports).[622]

The issue of continuing to deduct life insurance premiums from deceased members' accounts had been raised within AMP in 2016.

A reversal of premiums was requested in respect of a particular deceased member in an internal email dated 8 June 2016.[623] AMP had been notified of the member's death in February 2015, but was still deducting premiums from the member's account at the date of the email.[624] The reversal request

---

618 Transcript, Paul Sainsbury, 17 September 2018, 5892.

619 Transcript, Paul Sainsbury, 17 September 2018, 5884; Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

620 Transcript, Paul Sainsbury, 17 September 2018, 5889–91.

621 AMP, Module 6 Case Study Submission, 13 [59].

622 AMP, Module 6 Case Study Submission, 13 [60].

623 Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2–4.

624 Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2–4.

prompted another AMP staff member to query why the premiums were still being deducted.[625] That query was met with the response that 'the current process is to charge until the claim is processed, which triggers a refund'.[626]

Mr Sainsbury was asked if he understood AMP to have a continuing entitlement to charge premiums once a member passed away.[627] He answered: 'No. That's not our practice. It's not our policy'.[628] But until recently it was both AMP's practice and policy to continue to deduct premiums until the life insurance claim was finalised.

In July 2018, AMP changed that process.[629] Its current process was explained as follows: 'AMP reverses any premiums, which were paid after the date of death and prior to AMP being notified of the death, to the superannuation account before any amount is made available to the beneficiary'.[630] This process was said to result in the member's account being restored to the position it would have been in had no post-death deductions occurred and to account 'for the time value of money (ie – any investment gains or losses or interest, as applicable)'.[631]

How the time value of money is accounted for, and whether it was accounted for in the previous process, is not entirely clear. There was no evidence directed to that issue and the above explanation raises a number of questions. It is enough to say that any process that failed to restore the member's account to the position that it would have been in but for the post-death deductions would be unarguably unfair to the beneficiary of the funds.

---

625 Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2.

626 Exhibit 6.246, 2016–2018, AMP Emails, April and July 16, 2; see also Transcript, Paul Sainsbury, 17 September 2018, 5886–7.

627 Transcript, Paul Sainsbury, 17 September 2018, 5891.

628 Transcript, Paul Sainsbury, 17 September 2018, 5891.

629 AMP, Module 6 Case Study Submission, 13 [59].

630 AMP, Module 6 Case Study Submission, 12 [57(c)].

631 AMP, Module 6 Case Study Submission, 12 [57(c)].

What this part of the case study showed

In its submissions AMP appeared to acknowledge that it had no entitlement to premium payments from a member's account after the member had died, stating that its 'policy at all times had been that the liability to pay premiums on a life insurance policy ceases on the date of death'.[632] It then submitted that both its current process *and* its previous process are compliant with the Corporations Act and the SIS Act 'and reflect the proper conduct of a prudent trustee'.[633]

That submission is at odds with AMP's earlier statement – reflected in the evidence of Mr Sainsbury – that liability to pay premiums ceases on death. Indeed it appears to assume a continuing right in AMP to deduct premiums after death and how an insurer could be entitled to charge life insurance premiums after the life insured has died was not, and could not be, explained.

Unsurprisingly AMP did not point to any contractual right to continue deducting premiums once it has been notified of a member's death, and AMP accepts that the liability of members to pay premiums on a life insurance policy ceases on the date of death. It follows that the wrongful deduction of funds from member accounts was inherent in AMP's previous process of continuing to deduct premiums for some corporate superannuation plans until the claim was finalised. That the funds were subsequently refunded lessens the harm. But it does not cure the breach.

At a minimum, the previous process meant that one or more of AMP Super and AMP Life may have engaged in misconduct by failing to provide financial services to members efficiently, honestly and fairly as required by section 912A(1)(a) of the Corporations Act.[634] AMP Super may also have engaged in misconduct by breaching the duty imposed by the caveat set out in section 52(2)(b) of the SIS Act to act with the skill and diligence of a prudent trustee.

---

632 AMP, Module 6 Case Study Submission, 12 [56].

633 AMP, Module 6 Case Study Submission, 12 [61].

634 See Corporations Act ss 766A(1)(b), 766C(1)(a) and (b) and 763A(1)(a) and (b).

That leaves the breaches reported to APRA and ASIC concerning the failure to refund premiums charged after the death of a member. In its submissions, AMP explained that the breach notification related to specific conduct and did not raise any issue in respect of AMP's policy or its previous process 'as a whole'.[635] The errors were said to have been caused 'as a consequence of process and human error'.[636]

In the breach report to ASIC, AMP identified that AMP Super had breached sections 29VC and 52(2)(b) of the SIS Act and sections 912A(1)(a) and (c) of the Corporations Act. [637] The breach report also advised that AMP Life had breached section 912A(1)(a) of the Corporations Act.[638] I find that AMP Super and AMP Life may have engaged in misconduct by breaching each of those sections.

6.2.3 Breach of trustee obligation to provide insurance

The third issue explored in this case study concerned the obligation imposed on trustees by section 68AA of the SIS Act to ensure that the fund provides, relevantly, permanent incapacity benefit to each MySuper member of the fund on an opt-out basis.

One of the topics addressed in Mr Sainsbury's second statement was the case of an AMP Super MySuper member, who was not provided with insurance.[639] The member was a delinked employee and lost his

635 AMP, Module 6 Case Study Submission, 13 [60].

636 AMP, Module 6 Case Study Submission, 13 [60].

637 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

638 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

639 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018; Transcript, Paul Sainsbury, 17 September 2018, 5893; Exhibit 6.247, 6 December 2017, Letter to Craig Meller.

insurance coverage when he ceased employment with his employer.[640] At the time of the delinking, the MySuper regime was not in place.[641]

The issue came to the member's attention after he was diagnosed with a very serious illness and sought to claim on the group life policy.[642] After being informed that there was no life insurance attached to the superannuation account, the member's wife wrote to Craig Meller, the then CEO of AMP.[643] Mr Meller referred the matter to AMP's Customer Advocate.[644]

Mr Sainsbury accepted that at the relevant time, the member was a MySuper member.[645] AMP Super had determined that it was not appropriate to provide insurance to the member because, when he was delinked, a welcome call had been made to him that 'talked about him not having insurance cover in place', and on that basis he was deemed to have opted out.[646] The member was then in a category of members who were not offered insurance as part of the transition to MySuper.[647]

That position was repeated in AMP's submissions, which noted that section 68AA of the SIS Act permits the trustee to determine reasonable conditions to which the provision of permanent incapacity or death benefits will be subject.[648] The submissions also relied upon legal advice – said to have been provided to APRA, but not in evidence – that concluded that the conduct was not in contravention of section 68AA.[649]

640 Exhibit 6.247, 6 December 2017, Letter to Mr Meller, CEO.

641 Transcript, Paul Sainsbury, 17 September 2018, 5894.

642 Transcript, Paul Sainsbury, 17 September 2018, 5892–3.

643 Exhibit 6.247, 6 December 2017, Letter to Mr Meller, CEO.

644 Transcript, Paul Sainsbury, 17 September 2018, 5893.

645 Transcript, Paul Sainsbury, 17 September 2018, 5894.

646 Transcript, Paul Sainsbury, 17 September 2018, 5895.

647 Transcript, Paul Sainsbury, 17 September 2018, 5894–5.

648 AMP, Module 6 Case Study Submission, 17 [81].

649 AMP, Module 6 Case Study Submission, 17 [83]–[84].

The AMP Customer Advocate did not agree. The Customer Advocate concluded that the member should have been provided with insurance.[650] The trustee does not agree with the Customer Advocate's conclusion and does not consider that the trustee breached any obligation owed to the member.[651] Notwithstanding that, Mr Sainsbury said that the trustee considered the Customer Advocate's decision to be 'appropriate'.[652]

An ex gratia payment was made to the member on the recommendation of the Customer Advocate.[653] In its submissions, AMP sought to add some additional facts – which it had not led from Mr Sainsbury or otherwise sought to tender into evidence – about the payments made to the member and the timing of those payments.[654] It is not necessary to take that additional information into account in order to form the view that the Customer Advocate's role was central to the member obtaining the result that he did.

AMP subsequently commenced an investigation into whether other MySuper members had not been provided with insurance.[655] AMP Super issued a 'possible' breach notification to APRA and ASIC about the issue on 4 June 2018.[656] APRA rejected that letter and invited a formal breach notification from AMP Super.[657] That notification was provided on 10 August 2018.[658] The notification said that AMP was in the process of satisfying itself that the non-provision of insurance to 1,600 MySuper members was appropriate.[659] Mr Sainsbury said that it would take another month or two until AMP Super would reach a view on this issue.[660]

650 Transcript, Paul Sainsbury, 17 September 2018, 5895.

651 Transcript, Paul Sainsbury, 17 September 2018, 5895.

652 Transcript, Paul Sainsbury, 17 September 2018, 5895.

653 Transcript, Paul Jon Sainsbury, 17 September 2018, 5895–6.

654 AMP, Module 6 Case Study Submission, 18 [93], 18–19 [95].

655 Transcript, Paul Sainsbury, 17 September 2018, 5896.

656 Transcript, Paul Sainsbury, 17 September 2018, 5896.

657 Transcript, Paul Sainsbury, 17 September 2018, 5896.

658 Exhibit 6.249, 10 August 2018, Letter AMP to APRA.

659 Transcript, Paul Sainsbury, 17 September 2018, 5896; Exhibit 6.249, 10 August 2018, Letter AMP to APRA.

660 Transcript, Paul Sainsbury, 17 September 2018, 5897.

As the potential breaches have been reported to ASIC and APRA, it is not necessary for me to make any referral.

What this part of the case study showed

This aspect of the case study drew out two points. The first is the need for trustees to pay close attention to the insurance position of MySuper members, particularly those who transitioned to a MySuper product from a corporate plan or from a plan that did not have insurance attached to it. The second was the benefits of having an internal office dedicated to advocating in the interest of the customer.

Given that the investigation remained ongoing at the time of the hearings, and the complexities inherent in the particular member's case, I need not make any specific findings of misconduct or conduct falling below community standards and expectations in respect of this issue.

6.3 What the case study showed

I have already made findings of misconduct and conduct falling below community standards and expectations above. In summary, I have found that:

- In respect of the member charged a higher premium after delinking, AMP's conduct fell below community standards and expectations by failing to communicate with the member in an effective way that he was being charged a higher premium because a non-smoking declaration had not been completed.
- In respect of the deduction of premiums from the accounts of deceased members after being notified of the death:
  - AMP Super and AMP Life may have engaged in misconduct by breaching section 912A(1)(a) of the Corporations Act.
  - AMP Super may have engaged in misconduct by breaching the duty imposed by section 52(2)(b) of the SIS Act to act with the skill and diligence of a prudent trustee.
- In respect of the failure to refund premiums deducted after the date of death:

- AMP Super may have engaged in misconduct by breaching sections 29VC and 52(2)(b) of the SIS Act and sections 912A(1)(a) and (c) of the Corporations Act. [661]
- AMP Life may have engaged in misconduct by breaching section 912A(1)(a) of the Corporations Act.

All of the misconduct and conduct falling below community standards and expectations was caused, at least in part, by AMP's systems. Some of those systems failed to promote the best interests of members in various ways. The most striking example was provided by the second issue – the continued charging of life insurance premiums to member's accounts after death. AMP's previous process for stopping premiums eschewed the 'obvious' solution of turning the premium deductions off upon notification of death.[662] No reason was given for that choice. Mr Sainsbury accepted that it was 'not the best way' to deal with the issue.[663] That is clear from the complaints received by AMP about the continued deduction of premiums after death. Those complaints were raised, at the latest, by 2016, but no action was taken to adopt the 'obvious' solution until 2018.

7 Allianz

7.1 Background

Allianz Australia Insurance Ltd (Allianz) issues general insurance products, including travel insurance products. [664] The Commission heard evidence about misleading and deceptive content that appeared on the travel insurance pages of Allianz's website between 2012 and 2018, as well as issues relating to Allianz's compliance processes, governance and culture more generally. The Commission heard evidence from Mr Michael Winter,

661 Exhibit 6.234, Witness statement of Paul Sainsbury, 5 September 2018, Exhibit PJS-2 (Tab 3) [AMP.6000.0281.0046].

662 Transcript, Paul Sainsbury, 17 September 2018, 5887.

663 Transcript, Paul Sainsbury, 17 September 2018, 5887.

664 Transcript, Michael Winter, 17 September 2018, 5910.

the Chief General Manager of Retail Distribution, and Ms Lori Callahan, the Chief Risk Officer.

7.2 Evidence

7.2.1 Mr Winter's evidence

Allianz distributes travel insurance through a number of channels, including its own website,[665] and through an underwriting agency, AWP Australia Pty Ltd (AWP).[666] AWP also distributes travel insurance products issued by Allianz through a number of channels, including through its website, and through the websites of third parties, such as airlines or travel businesses, which Allianz refers to as 'partners'.[667]

Allianz is responsible for determining the travel insurance content on its own website, and for checking that the travel insurance content of its own website, and the websites of AWP and AWP's partners, comply with the law.[668] Allianz is also responsible for checking that the content of the 'purchase paths' used by customers who buy Allianz travel insurance products from those websites comply with the law.[669]

In 2015, Allianz decided to update the 'look and feel' of its website.[670] At that time, Allianz had a process for approving new website content called the Document Compliance Sign-Off (DCSO) process.[671] That process was used to review the new content that was added to the website, but was not used to review the updated website as a whole

665 Transcript, Michael Winter, 17 September 2018, 5912.

666 Transcript, Michael Winter, 17 September 2018, 5913.

667 Transcript, Michael Winter, 17 September 2018, 5915.

668 Transcript, Michael Winter, 17 September 2018, 5916.

669 Transcript, Michael Winter, 17 September 2018, 5916.

670 Transcript, Michael Winter, 17 September 2018, 5917.

671 Transcript, Michael Winter, 17 September 2018, 5917.

before it was made accessible to the public on 10 December 2015.[672] Mr Winter described this as a 'failure in the approach'.[673]

Shortly before the updated website was made accessible to the public, an Allianz corporate solicitor identified issues with the updated website, including an absence of certain legally required disclaimers.[674] Despite this, the website was launched. Over the coming weeks, the solicitor identified further issues with the content on the website, including misleading and deceptive statements.[675] Despite these issues, Allianz did not take down any part of the website.[676]

In January 2016, Allianz decided to undertake a review of the website content.[677] The corporate solicitor put together a proposal for an external law firm to review the website content by mid-February 2016, at a cost of $25,000 to $30,000.[678] Mr Winter declined to approve this expense.[679] As a result, the corporate solicitor spent two days a week working on the matter until the review was done.[680] Mr Winter conceded that his decision not to approve this expense was not the right decision, and conceded that this was reflective of a lack of prioritisation within Allianz of fixing the issue.[681]

672 Transcript, Michael Winter, 17 September 2018, 5917.

673 Transcript, Michael Winter, 17 September 2018, 5917.

674 Transcript, Michael Winter, 17 September 2018, 5918–9.

675 Transcript, Michael Winter, 17 September 2018, 5922–5.

676 Transcript, Michael Winter, 17 September 2018, 5926.

677 Transcript, Michael Winter, 17 September 2018, 5926.

678 Transcript, Michael Winter, 17 September 2018, 5941–2; Exhibit 6.270, 5 February 2016, Emails of 5 February 2016 Concerning Allianz Website Review Scope of Review and Cost Estimates, 3–4.

679 Transcript, Michael Winter, 17 September 2018, 5943.

680 Transcript, Michael Winter, 17 September 2018, 5943.

681 Transcript, Michael Winter, 17 September 2018, 5943–4.

The review ultimately took about 10 months to complete.[682] Because of the limited resources available, the corporate solicitor prioritised the review of the home, motor, life and business insurance content.[683]

By April 2016, the review had identified a number of misleading and deceptive statements in relation to the home, motor, life and boat insurance pages of the website. These included 14 such statements in relation to home insurance, four in relation to car insurance, three in relation to life insurance, and one in relation to boat insurance.[684] Mr Winter accepted that these statements may have misled consumers, and were contrary to financial services laws.[685]

In May 2016, Allianz decided not to report the incorrect and misleading content to ASIC.[686] Mr Winter was present at the meeting of the committee that made that decision, but could not recall whether the committee considered the number or frequency of similar previous breaches, as required by section 912D of the Corporations Act.[687] He conceded that the decision not to report the matter to ASIC was the wrong decision.[688] He also conceded that there were ‘clear problems known to the committee at the time of this meeting with the way the DCSO process was operating and being applied within Allianz’.[689]

It took until November 2016 for Allianz to complete the review of the travel insurance content and prepare an issues list and proposed rectification plan.[690] Mr Winter told the Commission that the review took so long because Allianz had failed to allocate the appropriate resources and priority to the

682 Transcript, Michael Winter, 17 September 2018, 5944.

683 Transcript, Michael Winter, 17 September 2018, 5943.

684 Transcript, Michael Winter, 17 September 2018, 5926–7.

685 Transcript, Michael Winter, 17 September 2018, 5928.

686 Transcript, Michael Winter, 17 September 2018, 5929.

687 Transcript, Michael Winter, 17 September 2018, 5939.

688 Transcript, Michael Winter, 17 September 2018, 5940.

689 Transcript, Michael Winter, 17 September 2018, 5935.

690 Transcript, Michael Winter, 17 September 2018, 5946, 5948–9.

issue.[691] The issues list identified numerous misleading and deceptive statements about travel insurance products on Allianz's website.[692] Having compiled the issues list, Allianz provided it to AWP for review.[693] Mr Winter conceded that this was an unnecessary step, and told the Commission that Allianz could have just fixed the issues itself.[694]

AWP did not return the issues list to Allianz with its comments until May 2018, about 18 months after Allianz had provided it to AWP.[695] Mr Winter said that the issues list had been the topic of discussion at 14 meetings between Allianz and AWP between July 2017 and May 2018 and conceded that Allianz had been aware of the failure to rectify these issues.[696] He accepted that Allianz had not treated the matter as urgent.[697]

Between December 2015 and May 2018, the misleading and deceptive statements identified in the issues list remained on the website.[698] During that period, Allianz did not report the matter to ASIC, or even consider taking down the relevant parts of the website.[699] Mr Winter conceded that neither Allianz nor AWP acted with any sense of urgency to fix the issue, or appreciated the seriousness of the issue, and that, every day the website was accessible to the public, Allianz was contravening financial services laws.[700] Mr Winter accepted that, in this instance, it was more important to Allianz to protect the bottom line than to stop misleading its customers.[701]

The Commission heard that, in May 2018, given the amount of time that had passed, Allianz decided to engage an external law firm to conduct another review of the web pages and purchase paths. That review identified

691 Transcript, Michael Winter, 17 September 2018, 5926.

692 Transcript, Michael Winter, 17 September 2018, 5948.

693 Transcript, Michael Winter, 17 September 2018, 5946.

694 Transcript, Michael Winter, 17 September 2018, 5950.

695 Transcript, Michael Winter, 17 September 2018, 5951.

696 Transcript, Michael Winter, 17 September 2018, 5953.

697 Transcript, Michael Winter, 17 September 2018, 5954.

698 Transcript, Michael Winter, 17 September 2018, 5954.

699 Transcript, Michael Winter, 17 September 2018, 5954.

700 Transcript, Michael Winter, 17 September 2018, 5954–5.

701 Transcript, Michael Winter, 17 September 2018, 5955.

39 incorrect or misleading statements on the travel insurance pages of the website, and found that many of these statements had been on the website since 2012.[702]

In June 2018, Allianz reported the matter to ASIC.[703] On 12 June 2018, Allianz told ASIC that the misleading and deceptive content had been on the website since December 2015.[704] Although Allianz found out on 21 June 2018 that some of the misleading and deceptive statements had been on the website since July 2012,[705] it did not tell ASIC this until 7 September 2018, and that was in response to a compulsory notice issued by ASIC.[706]

Allianz took down the travel insurance pages of its website on 6 June 2018, and disabled the direct purchase path on 12 June 2018.[707] Although Allianz was aware by 14 June 2018 that there was also misleading and deceptive content in the purchase path for its partner websites, Mr Winter decided not to take down the purchase paths for those websites.[708]

During the period from December 2015 to June 2018, Allianz issued more than two million travel insurance policies.[709] Mr Winter was not able to say how many Allianz customers were affected by the misleading and deceptive content on Allianz's website.[710]

7.2.2 Ms Callahan's evidence

Ms Callahan gave evidence about issues relating to Allianz's compliance processes, governance and culture – both in connection with the misleading

702 Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, 12–18 [86]; Transcript, Michael Winter, 17 September 2018, 5955–6.

703 Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 17) [ALZ.0001.0067.0010]; Transcript, Michael Winter, 17 September 2018, 5960.

704 Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 18) [ALZ.0001.0067.0059]; Transcript, Michael Winter, 17 September 2018, 5960.

705 Transcript, Michael Winter, 17 September 2018, 5975.

706 Transcript, Michael Winter, 17 September 2018, 5975.

707 Transcript, Michael Winter, 17 September 2018, 5957.

708 Transcript, Michael Winter, 17 September 2018, 5967–8.

709 Transcript, Michael Winter, 17 September 2018, 5976.

710 Transcript, Michael Winter, 17 September 2018, 5976–7.

and deceptive content on the website, and more generally. Ms Callahan's evidence is dealt with in more detail below.

7.3 What the case study showed

This case study raised issues not only about the misleading and deceptive content on Allianz's website, but also about Allianz's compliance processes, governance and culture more generally.

It is convenient to begin with the issues relating to the misleading and deceptive content on Allianz's website.

7.3.1 Misleading and deceptive content on the website

In its submissions, Allianz rightly accepted that it may have engaged in conduct that was misleading or deceptive – and therefore amounted to misconduct – in respect of:[711]

- each of the 39 representations in relation to travel insurance described in the table in paragraph 86 of the statement of Michael Winter dated 24 August 2018;
- each of the 14 representations in relation to home insurance described in the table in the Annexure to that statement;
- each of the four representations in relation to motor vehicle insurance described in that Annexure;
- each of the three representations in relation to life insurance described in that Annexure; and
- the representation in relation to boat insurance described in that Annexure.

Allianz noted that the misleading representations in relation to home insurance, motor vehicle insurance, life insurance and boat insurance were remedied in 2016.[712] However, as described above, the misleading

711 Allianz, Module 6 Case Study Submission, 1–2 [3]–[4].

712 Allianz, Module 6 Case Study Submission, 2 [4].

representations in relation to travel insurance were not remedied. They remained on the website until 2018.

The matter having been drawn to ASIC's attention, it is for it to determine what action it should take.

Allianz accepted that, by not taking steps to remove the relevant pages of its website from public view while it investigated the extent of the misleading representations and determined how to fix them, it engaged in conduct that fell below community standards and expectations.[713]

In its submissions, Allianz acknowledged that the number of misrepresentations on the website, and the time it took to remedy them, gave rise to a significant breach that should have been reported to ASIC in accordance with section 912D of the Corporations Act. Allianz rightly conceded that it failed to report this breach within 10 business days, as required by section 912D.[714] As noted above, Mr Winter acknowledged that the decision not to report this matter to ASIC in May 2016 was the wrong decision.[715]

I refer Allianz's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it should take.

In giving evidence about the decision not to report the website issue to ASIC in May 2016, Mr Winter said that he could not recall whether the committee had considered the number or frequency of similar previous breaches, as required by section 912D(1)(b) of the Corporations Act.[716] Mr Winter exhibited notes 'relating to' that meeting to his witness statement,[717] but those notes did not refer to the number or frequency of previous similar

713 Allianz, Module 6 Case Study Submission, 5 [27].

714 Allianz, Module 6 Case Study Submission, 2 [6].

715 Transcript, Michael Winter, 17 September 2018, 5940.

716 Transcript, Michael Winter, 17 September 2018, 5939.

717 Exhibit 6.253, Witness statement of Michael Winter, 24 August 2018, 19 [92].

breaches.[718] In these circumstances, I would infer that Allianz did not take these matters into account in determining whether to report the website issue to ASIC in May 2016.

As noted above, Allianz ultimately reported the website issue to ASIC in June 2018.[719] It is concerning that, although Allianz found out on 21 June 2018 that some of the misleading and deceptive statements had been on the website since July 2012,[720] it did not inform ASIC of this fact until 7 September 2018, and then in response to a compulsory notice.[721] In circumstances where Allianz had previously told ASIC that the misleading and deceptive content had only been on the website since December 2015,[722] I consider that the community would expect Allianz to correct its previous representation to the regulator in a more timely manner.

7.3.2 Breach reporting processes

Allianz's failure to report the website issue to ASIC in May 2016, and the inadequacy of the records of its consideration of whether to report that issue to ASIC, give rise to broader concerns about the adequacy of Allianz's breach reporting systems at that time.

In her witness statement, Ms Callahan described the key features of Allianz's breach reporting procedure since January 2013.[723] She also exhibited copies of the various versions of Allianz's Compliance Incidents

---

718 Exhibit 6.253, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 11) [ALZ.0001.0067.2757].

719 Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 17) [ALZ.0001.0067.0010]; Transcript, Michael Winter, 17 September 2018, 5960.

720 Transcript, Michael Winter, 17 September 2018, 5975.

721 Transcript, Michael Winter, 17 September 2018, 5975. See Allianz, Module 6 Case Study Submission, 7 [41].

722 Exhibit 6.263, Witness statement of Michael Winter, 24 August 2018, Exhibit MW-02 (Tab 18) [ALZ.0001.0067.0059]; Transcript, Michael Winter, 17 September 2018, 5960.

723 Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 2–6 [15]–[20].

and Breaches Handling Procedure that were in force over that time.[724] While there were changes to that procedure over that time, the procedure for reporting breaches to ASIC remained substantially the same between January 2013 and May 2018. Among other things, that procedure required compliance officers to engage relevant senior individual stakeholders separately when determining whether to report a breach to ASIC.[725]

In May 2018, Allianz introduced a new Breach Review Committee.[726] Allianz also began reviewing all open compliance incidents and reassessing them to determine whether they were reportable to ASIC.[727] As a result of that process, in 2018, Allianz had reported seven significant breaches to ASIC by the time of the hearings.[728]

This was more reports than had been made in previous years. Ms Callahan said that there had been one year where Allianz reported four significant breaches but that in other years Allianz had reported either no breaches or only one breach to ASIC.[729] Ms Callahan said that Allianz has now recognised that it needs to look at all historical breaches to determine whether Allianz had an obligation to report them to ASIC.[730] This is because the corporate compliance department at Allianz could not assure itself that the section 912D reportability requirements had been applied to all prior breaches.[731] Ms Callahan said that this task was underway, but she was unable to say how many historical breaches would be assessed.[732]

---

724 Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, Exhibits LMC-02 (Tab 1) [ALZ.0001.0017.3153], LMC-02 (Tab 2) [ALZ.0001.0078.0222], LMC-02 (Tab 3) [ALZ.1000.0002.2921], LMC-02 (Tab 4) [ALZ.0001.0078.0247], LMC-02 (Tab 5) [ALZ.1000.0004.3996], LMC-02 (Tab 6) [ALZ.0001.0017.3135], LMC-02 (Tab 7) [ALZ.0001.0077.0555].

725 Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 13 [73].

726 Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, 13 [73].

727 Transcript, Lori Callahan, 18 September 2018, 6002.

728 Transcript, Lori Callahan, 18 September 2018, 6003.

729 Transcript, Lori Callahan, 18 September 2018, 6002–3.

730 Transcript, Lori Callahan, 18 September 2018, 6002.

731 Transcript, Lori Callahan, 18 September 2018, 6002.

732 Transcript, Lori Callahan, 18 September 2018, 6004.

Ms Callahan did not accept that Allianz's breach reporting procedure prior to May 2018 was inadequate to ensure that Allianz complied with its obligations under section 912D,[733] but she did accept that Allianz had failed to comply with section 912D in the past.[734] She attributed this to a failure to adhere to the documented processes.[735] Ms Callahan also accepted that the breach reporting procedure prior to May 2018 'was not sufficient … with regard to the consideration of the four reporting criteria'.[736] She said that the breach reporting procedure should not have involved individual discussions with the relevant stakeholders.[737]

Given the matters accepted by Ms Callahan, her refusal to accept that the reporting procedure before 2018 was inadequate should be treated with caution. But it is not necessary for me to reach a concluded view about whether Allianz's documented breach reporting procedure was adequate to ensure that Allianz complied with its obligations under section 912D of the Corporations Act. I note that concerns about that process were expressed in an internal audit report prepared in September 2015,[738] not long before the misleading and deceptive content on Allianz's website was discovered. But even if I assume that the documented process was adequate, Ms Callahan's evidence was that:

- the process was not always followed; and
- the failure to follow that process caused Allianz to fail to comply with its obligation under section 912D of the Corporations Act.

The adequacy of a system is not to be judged only by the way it is documented. Whether a system is adequate to fulfil a particular purpose will also depend on the way the system is understood and applied in practice. Here, Allianz's breach reporting process was not always followed,

733 Transcript, Lori Callahan, 18 September 2018, 6072. See Allianz, Module 6 Case Study Submission, 4 [21].

734 Transcript, Lori Callahan, 18 September 2018, 6072.

735 Transcript, Lori Callahan, 18 September 2018, 6072.

736 Transcript, Lori Callahan, 18 September 2018, 6071.

737 Transcript, Lori Callahan, 18 September 2018, 6071.

738 See Exhibit 6.284, Witness statement of Lori Callahan, 24 August 2018, Exhibit LMC-02 (Tab 12) [ALZ.0001.0078.0177 at .0206–.0207].

and Allianz's corporate compliance department could not assure itself that the section 912D reportability requirements had been applied to all prior breaches. After Allianz introduced a new process, the number of significant breaches identified increased from zero or one per year to seven in the first half of 2018. In these circumstances I would infer that, prior to May 2018, Allianz's breach reporting processes were not adequate to ensure that Allianz complied with its obligations under section 912D of the Corporations Act.

I refer Allianz's conduct to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it should take.

7.3.3 Compliance processes

The issues with Allianz's systems and processes that were explored in this case study extended beyond its breach reporting processes.

Ms Callahan accepted that, based on the evidence she and Mr Winter had given, Allianz had failed to comply with the requirement, set out in Prudential Standard CPS 220, that it have a designated compliance function that assists senior management in effectively managing compliance risks, and is adequately staffed by appropriately trained and competent persons who have sufficient authority to perform their role effectively.[739]

This concession was rightly made. The evidence of Mr Winter and Ms Callahan demonstrated that, prior to the recent commencement of the Compliance Transformation Program, Allianz's compliance systems were not adequate to meet the requirements of Prudential Standard CPS 220.

I refer Allianz's conduct to APRA, pursuant to paragraph (a) of the Commission's Terms of Reference, for APRA to consider what action it should take.

The inadequacy of Allianz's compliance systems can be illustrated by reference to four matters that each contributed to Allianz's conduct in relation to the misleading and deceptive content on the travel insurance pages on its website.

---

[739] Transcript, Lori Callahan, 18 September 2018, 6076.

Processes for monitoring website content

First, I consider that Allianz's conduct in relation to the travel insurance pages on its website was attributable, in part, to the fact that, for many years, Allianz had inadequate processes for monitoring the content of its own website, and the websites of other companies that distributed its products.

Ms Callahan accepted that, for many years, Allianz had inadequate processes in this respect.[740] Both Ms Callahan and Mr Winter accepted that these issues contributed to the misleading and deceptive content remaining on the travel insurance pages of the website. In its submissions, Allianz accepted that these issues were one major cause of the misleading content appearing on the relevant websites, and staying there for so long.[741]

Both Mr Winter and Ms Callahan accepted that issues with Allianz's DCSO process were identified in 2015.[742] Despite this, in 2018, Allianz continued to have problems with its DCSO process.[743] This was evidenced by another compliance breach, identified in May 2018, which related to hyperlinks on a number of financial institution partner websites that were linked to the incorrect PDS.[744]

An internal audit report prepared in August 2018 found that the execution of the DCSO process was ineffective in ensuring adherence with legislative and internal requirements.[745] Ms Callahan agreed with the findings of the report.[746] In its submissions, Allianz noted that it had begun to take steps to

740 Transcript, Lori Callahan, 18 September 2018, 5995.

741 Allianz, Module 6 Case Study Submission, 11 [64].

742 Transcript, Michael Winter, 17 September 2018, 5917; Transcript, Lori Callahan, 18 September 2018, 6005.

743 Transcript, Lori Callahan, 18 September 2018, 6007.

744 Transcript, Lori Callahan, 18 September 2018, 6007.

745 Transcript, Lori Callahan, 18 September 2018, 6009.

746 Transcript, Lori Callahan, 18 September 2018, 6009.

address the failings identified in the report, but conceded that it was at the start of that process.[747]

Process for monitoring and closing compliance incidents

Second, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to the fact that, for many years, Allianz has had inadequate processes for monitoring and closing compliance incidents once they had been identified.

In its submissions, Allianz accepted that this was another of the major causes of the misleading content appearing on the relevant websites, and staying there for so long.[748]

Ms Callahan accepted that one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website was that there was insufficient oversight of the incident by corporate compliance.[749] A report to Allianz's risk committee in September 2016 recorded that remediation of the incident was substantially complete, and that all material errors on the website had been corrected – even though, at that time, the review of the travel insurance content on the website was still ongoing.[750]

Ms Callahan accepted that, for many years, Allianz's processes for identifying and monitoring compliance incidents were 'not sufficient … to deliver the compliance results that one would want'.[751]

An internal audit report from September 2015 found, among other things, that significant improvement was required in 'measuring, monitoring and reporting' within Allianz, and that there was no standard process to monitor and confirm that remedial actions had been implemented prior to closing

747 Allianz, Module 6 Case Study Submission, 11 [65].

748 Allianz, Module 6 Case Study Submission, 11 [67].

749 Transcript, Lori Callahan, 18 September 2018, 5993–4.

750 Transcript, Lori Callahan, 18 September 2018, 6017–8.

751 Transcript, Lori Callahan, 18 September 2018, 5995.

reported incidents.[752] Despite the critical findings made in the report, the issue was listed as a low priority.[753] Ms Callahan accepted that the audit report indicated that, at the time, Allianz was not taking its compliance obligations seriously, particularly in relation to remedial action necessary after a compliance incident had been identified.[754]

At the time the Commission heard evidence about his matter, monitoring and supervision remained an issue at Allianz. An internal audit report prepared in August 2018 found that '[t]he compliance plans for laws, legislation and regulation(s) impacting product and related processes are out of date and *compliance monitoring is not taking place*'.[755] Ms Callahan agreed with this finding.[756] She said that Allianz was only 'at the start' of addressing it.[757]

Oversight of AWP

Third, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to inadequate oversight of AWP by Allianz, prior to July 2018.

In its submissions, Allianz accepted that this was a contributing issue.[758] Ms Callahan also accepted that Allianz's past inadequate oversight of AWP was one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website.[759]

Ms Callahan accepted that, under the underwriting agreement between Allianz and AWP that was in force between 2010 and July 2018, Allianz's

---

752 Transcript, Lori Callahan, 18 September 2018, 6020–1.

753 Transcript, Lori Callahan, 18 September 2018, 6020

754 Transcript, Lori Callahan, 18 September 2018, 6023.

755 Transcript, Lori Callahan, 18 September 2018, 6009 (emphasis added).

756 Transcript, Lori Callahan, 18 September 2018, 6009.

757 Transcript, Lori Callahan, 18 September 2018, 6011.

758 Allianz, Module 6 Case Study Submission, 12–13 [71]–[79].

759 Transcript, Lori Callahan, 18 September 2018, 5994–5.

oversight of AWP was inadequate.[760] Allianz's monitoring of AWP did not improve until Allianz and AWP entered into a new underwriting agreement in July 2018.[761]

It is concerning that Allianz did not enter into a new underwriting agreement until July 2018 even though – and as Ms Callahan accepted[762] – during the period while the previous underwriting agreement was in force, Allianz was aware that there were issues with its oversight of AWP, and with AWP's compliance with its legal obligations. She also observed that, in 2016, an internal audit had identified that Allianz's monitoring and control of its underwriting agencies was not sufficient.[763] Although steps were taken in 2017 to address those issues across other underwriting agencies, those steps did not include AWP.[764]

Ms Callahan said that Allianz's systems for monitoring and supervising third party distributors had been a broader problem that extended beyond AWP. She admitted that, as well as underwriting agencies, Allianz also had problems supervising car dealers and the financial institutions selling Allianz products.[765] Ms Callahan gave evidence that Allianz was currently investing more in its compliance systems to improve its supervision and monitoring of third parties.[766]

Giving sufficient priority to compliance

Fourth, I consider that Allianz's conduct in relation to the travel insurance pages on its website was also attributable to Allianz's failure to give enough priority to compliance.

---

760 Transcript, Lori Callahan, 18 September 2018, 6027.

761 Transcript, Lori Callahan, 18 September 2018, 6026.

762 Transcript, Lori Callahan, 18 September 2018, 6026–8.

763 Transcript, Lori Callahan, 18 September 2018, 5996.

764 Transcript, Lori Callahan, 18 September 2018, 5995–6.

765 Transcript, Lori Callahan, 18 September 2018, 6030–1.

766 Transcript, Lori Callahan, 18 September 2018, 6030–1.

Ms Callahan accepted that one of the causes of the misleading and deceptive content remaining on the travel insurance pages of the website was that Allianz had an insufficient appreciation of the consequences for customers of this information being on the website.[767] She said also said that this incident was an example of an instance where Allianz's management had not considered compliance to be a priority.[768]

In its submissions, Allianz conceded that both of these matters contributed to Allianz's conduct in relation to the travel insurance pages on its website.[769]

Ms Callahan said that, prior to her time as Chief Risk Officer, there had been instances where Allianz had focused on technical or legal compliance, rather than encouraging a culture that really looked to improve Allianz's processes.[770] Other than clarifying that Ms Callahan's evidence on this point concerned the past, and did not refer to the current compliance culture at Allianz, Allianz's submissions did not seek to depart from this assessment.[771]

Ms Callahan also accepted that, in the past, Allianz had not devoted adequate resources to compliance.[772] Ms Callahan gave evidence that Allianz only reached the point at which it was fully resourced for its compliance function one week before she gave evidence.[773] Again, other than clarifying that Ms Callahan's evidence on this point concerned the past, Allianz's submissions did not seek to depart from this assessment.[774]

767 Transcript, Lori Callahan, 18 September 2018, 5994.

768 Transcript, Lori Callahan, 18 September 2018, 5996.

769 Allianz, Module 6 Case Study Submission, 13–14 [83]–[84].

770 Transcript, Lori Callahan, 18 September 2018, 5996.

771 Allianz, Module 6 Case Study Submission, 14 [86].

772 Transcript, Lori Callahan, 18 September 2018, 5991; see also Transcript, Lori Callahan, 18 September 2018, 6057.

773 Transcript, Lori Callahan, 18 September 2018, 6069.

774 Allianz, Module 6 Case Study Submission, 14 [87].

7.3.4 Reaction to external reports

It remains to say something about the way that Allianz reacted to the external reports from Ernst & Young (EY) and Deloitte that were considered in this case study.

The Commission heard that Allianz commissioned EY to prepare two reports – a risk report and a compliance report.[775] Allianz commissioned the risk report for the purpose of complying with Prudential Standard CPS 220, and providing the report to APRA.[776] After receiving draft copies of both reports, Allianz staff provided extensive feedback to EY. After receiving this feedback, EY changed the ratings in the compliance report, but did not change the ratings in the risk report.[777]

Ms Callahan accepted that it appeared that there were Allianz staff who did all they could to push for the ratings given by EY in the reports to be improved.[778] Ms Callahan accepted that this was not appropriate.[779] In relation to the risk report, she also accepted that Allianz was trying to influence and alter the content of a report that it was required to produce under CPS 220.[780] Ms Callahan was shown an email from the Head of Risk Management to the Acting Head of Compliance, dated 29 September 2017, in relation to the risk report. In that email, in response to the question ‘How did the meeting with EY go?’ the Head of Risk management said:[781]

> Went ok … they are going to rewrite with a more balanced view … we didn’t get to finish the whole report though :(
>
> [The Chief Risk Officer] tried to ask for a Mature rating for some elements but didn’t think it worked :P

775 Transcript, Lori Callahan, 18 September 2018, 6077.

776 Transcript, Lori Callahan, 18 September 2018, 6078.

777 Transcript, Lori Callahan, 18 September 2018, 6077.

778 Transcript, Lori Callahan, 18 September 2018, 6048.

779 Transcript, Lori Callahan, 18 September 2018, 6078.

780 Transcript, Lori Callahan, 18 September 2018, 6078.

781 Exhibit 6.302, 29 September 2017, Emails Concerning Risk Report.

Ms Callahan accepted that it could be inferred from this email that there was an attempt to manipulate the content of EY's report.[782]

In closing, Counsel Assisting submitted that it was open to me to find that Allianz had engaged in conduct falling below community standards and expectations by 'seeking to manipulate the content of an independent report commissioned by Allianz for the purpose of satisfying the requirements of CPS 220 and which Allianz intended to provide to APRA'.[783]

In response to this submission, Allianz contended that the phrase 'rewrite with a more balanced view' does not suggest 'manipulation'. Allianz said that '[i]t lends itself more towards notions of reconsideration, or even correction'.[784] However, this submission fails to grapple with the reference in the email to the Chief Risk Officer having 'tried to ask for a Mature rating for some elements'. In my view, the clear inference to be drawn from the email is that the Chief Risk Officer attempted to manipulate the content of the risk report. Whether or not she succeeded is beside the point – the attempt to do so was conduct that fell below what the community expects. It demonstrates a concerning attitude to the content of an independent report being prepared for the purpose of provision to the regulator.

For the avoidance of doubt, I emphasise that nothing I have said suggests that EY acted inappropriately in any way. My focus is only upon what Allianz sought to do.

A concerning attitude was also demonstrated by Allianz's reaction to a draft report prepared by Deloitte. In June 2018, Ms Callahan commissioned Deloitte to prepare a report addressing the compliance incidents that Allianz had recently reported to ASIC. On receiving a highly critical draft report, Ms Callahan's reaction was to ask Deloitte to retract the report.[785] She agreed that this was 'not her finest moment',[786] and that this matter would

782 Transcript, Lori Callahan, 18 September 2018, 6078.

783 Transcript, Senior Counsel Assisting, 21 September 2018, 6497.

784 Allianz, Module 6 Case Study Submission, 9 [54].

785 Transcript, Lori Callahan, 18 September 2018, 6064.

786 Transcript, Lori Callahan, 18 September 2018, 6064.

be relevant to the risk governance written assessment that Allianz was then preparing for submission to APRA in November 2018.[787] In its submissions, Allianz acknowledged that this aspect of Ms Callahan's reaction to the Deloitte report may reflect poorly on Allianz's compliance culture as a whole, and characterised it as 'a regrettable human error'.[788] But it is a course of events that does not reflect well on Allianz or its compliance culture.

8 IAG

8.1 Background

Swann Insurance (Aust) Pty Ltd (Swann) is a general insurer and a subsidiary of Insurance Australia Group Limited (IAG).[789] Swann sources and sells add-on insurance products. The Commission heard evidence from Mr Benjamin Bessell, the Executive General Manager Business Distribution and Group Executive within the Australia Division at IAG.[790]

8.2 Evidence

Mr Bessell described the relationship between IAG and Swann as a 'devolved business model',[791] where Swann was effectively a standalone business.[792] However, the person with ultimate responsibility for Swann was the head of the IAG division in which Swann sat,[793] and at all times since 2013, the CEO of IAG has been a director of Swann.[794]

787 Transcript, Lori Callahan, 18 September 2018, 6079–80

788 Allianz, Module 6 Case Study Submission, 15 [94].

789 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 1 [5].

790 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 1 [1]; Transcript, Benjamin Bessell, 18 September 2018, 6082.

791 Transcript, Benjamin Bessell, 18 September 2018, 6082.

792 Transcript, Benjamin Bessell, 19 September 2018, 6137.

793 Transcript, Benjamin Bessell, 19 September 2018, 6137.

794 Transcript, Benjamin Bessell, 19 September 2018, 6138.

The case study focused on add-on sales in the period 2013 to 2017. In that period, Swann manufactured comprehensive motor insurance and eight add-on insurance products, some of which were variations on, or replacements of, others.[795] The products were sold through its authorised representatives, which included car and motorcycle dealers.[796]

Between 2008 and 2018, Swann sold approximately 846,000 policies through car dealerships, received approximately $1.07 billion in premiums, and paid out about 10% of that amount in claims.[797] At its peak, Swann had approximately 3,000 authorised representatives selling its products throughout Australia.[798]

Three of the add-on products were a form of consumer credit insurance, namely Loan Protection Insurance, 'walkaway' insurance and Protection Plus Insurance.[799] Swann also sold 'Guaranteed Asset Protection' or 'GAP' Insurance, Purchase Price Protection Insurance, which was similar to GAP insurance, Mechanical Breakdown Insurance, and Tyre and Rim Insurance.[800]

Swann's add-on insurance products were added on to the purchase of a car or motorcycle.[801] Mr Bessell acknowledged that add-on insurance products were *sold* to customers, rather than *bought* by customers, and that, in many circumstances, the customer's decision about whether or not to buy an add-on insurance product came after a customer had chosen the vehicle and agreed on the terms for finance.[802]

795 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 6–7 [38]; Transcript, Benjamin Bessell, 18 September 2018, 6084–6.

796 Transcript, Benjamin Bessell, 18 September 2018, 6086; Exhibit 6.305, June 2014, Swann Channel Strategy Business Plan FY14–17.

797 See the figures in the tables in Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 20–3; Transcript, Benjamin Bessell, 18 September 2018, 6088–9.

798 Transcript, Benjamin Bessell, 19 September 2018, 6119.

799 Protection Plus Insurance replaced Walkaway Insurance from 1 February 2015.

800 Exhibit 6.304, Witness statement of Benjamin Bessell, 21 August 2018, 6–7 [38].

801 Transcript, Benjamin Bessell, 18 September 2018, 6083.

802 Transcript, Benjamin Bessell, 18 September 2018, 6083.

8.2.1 Authorised representatives and incentives

Swann generally engaged its authorised representatives through authorised representative agreements.[803] Under those agreements, representatives were generally authorised to provide general advice (but never personal advice) and to deal in a financial product.[804]

The agreements required the authorised representatives to, among other things, comply with the applicable laws, including the Corporations Act, and comply with all policies, procedures, guidelines and any reasonable requirements or directions given by Swann.[805] The agreements also provided Swann with the right to inspect the authorised representative's place of business, and to conduct audits.[806] Mr Bessell said he did not know whether Swann had exercised rights under these clauses, but said that Swann regularly obtained information about, and visited premises of, authorised representatives.[807]

Under the authorised representative agreements, representatives were remunerated exclusively by commission, with different rates of commission attaching to different products.[808] The agreement usually provided for more than one commission rate for GAP insurance, because the commission increased when the customer was sold a higher level of cover.[809]

---

803 Transcript, Benjamin Bessell, 18 September 2018, 6089; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement.

804 Transcript, Benjamin Bessell, 18 September 2018, 6090–1; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 1, 5, 25, 28.

805 Transcript, Benjamin Bessell, 18 September 2018, 6092; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 3.

806 Transcript, Benjamin Bessell, 18 September 2018, 6093; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 3–4.

807 Transcript, Benjamin Bessell, 18 September 2018, 6093.

808 Transcript, Benjamin Bessell, 18 September 2018, 6090–1; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 1, 5, 25, 28.

809 Transcript, Benjamin Bessell, 18 September 2018, 6091–2; Exhibit 6.306, 1 August 2015, Corporate Authorised Representative Agreement, 28.

Swann also entered into 'incentive scheme' agreements with some authorised representatives.[810] These agreements were offered to dealers who Swann thought could 'grow' the business.[811] Mr Bessell explained that agreements of this type were not uncommon in the market, and were used to ensure that Swann remained competitive.[812]

The amounts paid under the 'incentive scheme' agreements were paid in addition to amounts paid under the authorised representative agreements.[813] Payments under the 'incentive scheme' agreements were calculated based on the gross written premiums for the financial year, and a factor called 'Group Product Mix', which was calculated by reference to the mix of different add-on products sold.[814] The rationale behind the Group Product Mix factor was that it would incentivise dealers to sell a variety of add-on products.[815]

Under the 'incentive scheme' agreements, authorised representatives could also be paid a 'Performance Bonus Commission', and a 'Product Mix Bonus', which was based on the gross written premiums of consumer credit insurance and Tyre and Rim Insurance.[816] Generally, Tyre and Rim Insurance was difficult to sell.[817]

In a letter to the Commission on 29 June 2018, IAG said that Swann may have breached section 145 of the National Credit Code in the course of making 153 payments to authorised representatives.[818] Section 145 prohibits consumer credit insurance commissions paid by an insurer to

810 Exhibit 6.307, 2 July 2013, Incentive Scheme Agreement; Transcript, Benjamin Bessell, 18 September 2018, 6096.

811 Transcript, Benjamin Bessell, 18 September 2018, 6096.

812 Transcript, Benjamin Bessell, 18 September 2018, 6096.

813 Transcript, Benjamin Bessell, 18 September 2018, 6094; Exhibit 6.307, 2 July 2013, Incentive Scheme Agreement.

814 Transcript, Benjamin Bessell, 18 September 2018, 6094.

815 Transcript, Benjamin Bessell, 18 September 2018, 6094.

816 Transcript, Benjamin Bessell, 18 September 2018, 6094–5.

817 Transcript, Benjamin Bessell, 18 September 2018, 6095.

818 Exhibit 6.311, 29 June 2018, Letter IAG to Commission.

authorised representatives that exceed 20% of the premium (excluding government charges). In his oral evidence, Mr Bessell explained that the possible breaches were caused by the Product Mix Bonus offered to some authorised representatives.[819]

Another way in which Swann incentivised sales was through the Swann 'Ignition Incentive Program'.[820] That program had been running since 2004, and was designed to incentivise *employees* of authorised representatives by providing them with points when they sold add-on insurance products.[821] One point was equal to $1.[822] The points were redeemable online, and could be exchanged for particular products.[823] At least between 2014 and 2016, Swann also ran short-term bonus programs, which allowed employees to accrue more points when they sold a bundle of three or four products in the same transaction.[824] Mr Bessell said that Swann was not the only market participant that provided incentives to employees of dealers.[825]

8.2.2 Swann's dealings with its authorised representatives

Swann was heavily reliant on its dealers to maintain its market share.[826]

A risk report from October 2014 recorded that Swann considered that one of its 'risks' was competitors' 'attacks' to its dealer market, resulting in reduced market share.[827] One 'control' identified to protect against this risk was the

819 Transcript, Benjamin Bessell, 19 September 2018, 6112.

820 Transcript, Benjamin Bessell, 18 September 2018, 6100.

821 Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6100–2.

822 Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6101.

823 Exhibit 6.309, December 2014, Ignition Incentive Program Administrators Manual v4, 6; Transcript, Benjamin Bessell, 18 September 2018, 6101.

824 Exhibit 6.310, February 2014, Ignition Super-Charged Multi-Policy Incentive; Transcript, Benjamin Bessell, 18 September 2018, 6103–4.

825 Transcript, Benjamin Bessell, 18 September 2018, 6102.

826 Transcript, Benjamin Bessell, 18 September 2018, 6097.

827 Transcript, Benjamin Bessell, 18 September 2018, 6097–8.

commission and incentive arrangements between Swann and its authorised representatives.[828] That risk report did not record any explicit consideration of Swann's customers.[829] Mr Bessell agreed that this was, at least in part, because Swann viewed the dealer as its customer.[830]

At all relevant times, Swann was obliged to have in place adequate arrangements for the management of conflicts of interest that may arise from the sale of its products.[831] The 'arrangements' that Swann had in place for that purpose were its training program and electronic questionnaires for authorised representatives, and the ability for employees to notify Swann of issues through a compliance mailbox.[832]

The purpose of Swann's remuneration and incentive arrangements was to incentivise sales – there was no intention to incentivise any other conduct.[833] On occasions, these incentive programs incentivised sales practices that were inappropriate, and Swann's authorised representatives engaged in sales practices where consumers were sold products that were not appropriate.[834]

Between March 2013 and January 2017, Swann maintained a 'light touch' approach to the monitoring of authorised representatives,[835] due in part to the prioritisation of 'scarce resources'.[836]

---

828 Transcript, Benjamin Bessell, 18 September 2018, 6098.

829 Exhibit 6.308, 13 October 2014, Swann Risk Profile, 5; Transcript, Benjamin Bessell, 18 September 2018, 6098.

830 Transcript, Benjamin Bessell, 18 September 2018, 6098.

831 Transcript, Benjamin Bessell, 18 September 2018, 6104.

832 Transcript, Benjamin Bessell, 18 September 2018, 6104.

833 Transcript, Benjamin Bessell, 18 September 2018, 6105.

834 Transcript, Benjamin Bessell, 18 September 2018, 6106.

835 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113.

836 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113–14, 6118.

As at January 2017, Swann had not responded to the changing level of risk that had arisen from the increased scrutiny of add-on products.[837] At that time, Swann had no oversight of any issues that may be occurring, because Swann's authorised representatives were not actively recording potential breaches.[838] In addition, Swann did not undertake any monitoring to ensure that refresher training was completed, nor any face-to-face audits.[839] Swann's electronic questionnaire was limited in the level of detail it captured.[840] Mr Bessell accepted that, at least between 2013 and January 2017, Swann did not have in place adequate risk management systems, particularly in light of the failure of authorised representatives to actively report breaches.[841]

Mr Bessell said that, if he were running the business today, he would not be comfortable with the level of oversight that had been in place as at January 2017.[842] He agreed that this level of oversight would not have been considered appropriate in any year since 2013.[843]

8.2.3 IAG's awareness of issues with add-on insurance

IAG was aware from late 2013 that ASIC had concerns with add-on insurance products,[844] and had understood since 2015 that ASIC's concerns related to product design and sales practices.[845] Despite this, Swann did

837 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 2; Transcript, Benjamin Bessell, 19 September 2018, 6113–14.

838 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 19 September 2018, 6114–15.

839 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

840 Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

841 Transcript, Benjamin Bessell, 19 September 2018, 6121.

842 Transcript, Benjamin Bessell, 19 September 2018, 6120–1.

843 Transcript, Benjamin Bessell, 19 September 2018, 6121.

844 Transcript, Benjamin Bessell, 19 September 2018, 6121.

845 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-019 [IAG.502.002.0719]; Transcript, Benjamin Bessell, 18 September 2018, 6121–2.

not take any active steps to investigate the products or sales techniques of concern.[846]

By June 2015, IAG had begun individually engaging with ASIC about its concerns with the sale of add-on insurance as an industry participant through the Insurance Council of Australia.[847] Mr Bessell said that at that time, the industry had generally acknowledged that commission structures were either inappropriate or not financially competitive for product providers, but that no-one was prepared to move first in reducing commissions.[848] The view was that, unless there was industry reform, one particular insurer reducing commissions would not necessarily improve the customer experience.[849]

By September 2015, IAG was aware that ASIC held serious concerns about add-on insurance products.[850] IAG acknowledged to ASIC at that time that many of IAG's consumer credit insurance products had 'not kept pace with social change [and] technological developments'.[851]

In December 2015, Swann became aware that ASIC considered that the sale of Swann's products through motor dealers may have contravened 'regulatory requirements'.[852] Despite this, internal IAG documents showed that in May 2016, Swann's primary concern about product design risks was still profit-related, and there was no consideration of whether the design of Swann's products adversely affected consumers.[853] Swann continued with

846 Transcript, Benjamin Bessell, 19 September 2018, 6129, 6134.

847 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-001 [IAG.500.100.5078]; Transcript, Benjamin Bessell, 19 September 2018, 6123–7.

848 Transcript, Benjamin Bessell, 19 September 2018, 6126.

849 Transcript, Benjamin Bessell, 19 September 2018, 6126–7.

850 Transcript, Benjamin Bessell, 19 September 2018, 6128.

851 Transcript, Benjamin Bessell, 19 September 2018, 6128; Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-016 [IAG.502.002.0711].

852 Transcript, Benjamin Bessell, 19 September 2018, 6128; Witness statement of Benjamin Bessell, 27 August 2018, 6 [36]–[37].

853 Transcript, Benjamin Bessell, 19 September 2018, 6130–1; Exhibit 6.313, 2 5 May 2016, IAG Risk Profile – Swann.

its remuneration incentive programs until at least June 2016.[854] Mr Bessell accepted that Swann's maintenance of its market share would not have been possible had it unilaterally decreased commissions.[855]

By July 2016, IAG was aware that it had limited oversight of car dealers' sales practices in relation to add-on insurance.[856] IAG had not reviewed Swann's add-on insurance products to assess whether they provided sufficient benefit to customers.[857]

Mr Bessell attributed Swann's failure to take any active steps to investigate issues within its business to Swann's preference for an 'industry-wide approach' to ASIC's concerns.[858] Mr Bessell agreed that Swann could have participated in the industry approach while also reviewing its own products and business practices.[859]

8.2.4 Remediation

From August 2016, IAG commenced negotiations with ASIC in relation to Swann's add-on insurance products.[860] On 19 December 2017, ASIC announced that IAG would compensate just under 68,000 customers by paying approximately $39 million in respect of Swann's add-on insurance products.[861] At the date of Mr Bessell's statement, both estimates had been revised down slightly: it was then estimated that just over 64,000 customers would be remediated $37.1 million.[862] Swann was about half way through

854 Transcript, Benjamin Bessell, 19 September 2018, 6131.

855 Transcript, Benjamin Bessell, 19 September 2018, 6129.

856 Transcript, Benjamin Bessell, 19 September 2018, 6131–4; Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 7.

857 Transcript, Benjamin Bessell, 19 September 2018, 6131–4; Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

858 Transcript, Benjamin Bessell, 19 September 2018, 6129.

859 Transcript, Benjamin Bessell, 19 September 2018, 6129.

860 Transcript, Benjamin Bessell, 19 September 2018, 6134; Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, Exhibit BB-199 [IAG.505.002.4355].

861 Transcript, Benjamin Bessell, 19 September 2018, 6138.

862 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 7 [39], 16 [96].

the remediation program, and was expected to complete the program by 31 January 2019.[863]

The circumstances in which Swann is remediating customers who were sold add-on insurance include where: the customer was unlikely to be able to make a claim under the policy; the GAP cover sold to the customer was unnecessary because it duplicated existing cover; the customer did not receive a rebate under their GAP cover when they paid out their loan; the customer was sold a more expensive level of cover than they needed; the customer was sold Mechanical Breakdown Insurance for longer than they needed; the customer paid twice for roadside assistance; and life insurance was sold to young people who were unlikely to need it.[864]

Other than comprehensive motor vehicle or motorcycle insurance sold by Swann, all products sold by Swann are the subject of the remediation program agreed with ASIC.[865]

8.2.5 Current position

Swann ceased distributing its products through car dealers in August 2016,[866] and through motorcycle dealers in October 2017.[867] Swann no longer sells add-on insurance products, but continues to sell comprehensive motorcycle insurance.[868]

In 2017, Swann developed Product Design Principles applicable to its products.[869] Mr Bessell said that, if Swann add-on insurance products were sold today, they would not meet the standards under those Principles.[870]

863 Transcript, Benjamin Bessell, 19 September 2018, 6140.

864 Transcript, Benjamin Bessell, 19 September 2018, 6138–40.

865 Transcript, Benjamin Bessell, 18 September 2018, 6084.

866 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 17 [99].

867 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 17 [100].

868 Transcript, Benjamin Bessell, 19 September 2018, 6142.

869 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 15 [88].

870 Transcript, Benjamin Bessell, 19 September 2018, 6143.

The matter having been drawn to ASIC's attention, it is for ASIC to determine what further action it can and should take.

8.3 What the case study showed

Mr Bessell accepted that consumers were sold products that were of questionable or little value to them, and that the products could have been better explained by the dealers.[871] Mr Bessell agreed that the number and complexity of the products presented to the consumer, and the various options within the products, made it difficult for consumers to have a proper understanding of the products.[872]

8.3.1 Misconduct

In closing submissions, Counsel Assisting submitted that it was open to me to find that Swann may have engaged in misconduct by breaching the obligation in section 912A(1)(a) of the Corporations Act (in a number of distinct ways), the obligation in section 912A(1)(ca) of the Corporations Act, the obligation in section 912A(1)(aa) and the obligation in section 145 of the National Credit Code. In its written submissions, IAG resisted any finding of misconduct being made.[873]

Section 912A(1)(a)

Section 912A(1)(a) obliges Swann to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly. Counsel Assisting submitted there were four matters that demonstrated that Swann's conduct may have breached that provision. The first was that Swann undertook no meaningful review of its products to determine whether they provided any value to customers.[874] The second was that Swann continued to authorise the sale of those products after becoming aware that ASIC held concerns about their product design and

871 Transcript, Benjamin Bessell, 19 September 2018, 6140–1.

872 Transcript, Benjamin Bessell, 18 September 2018, 6086.

873 IAG, Module 6 Case Study Submission, 2–11 [6]–[55].

874 Transcript, Closing Submissions, 21 September 2018, 6503.

sales practices.[875] The third was that Swann established and maintained arrangements that incentivised dealers to sell as many add-on products to consumers as possible, regardless of the suitability or value to consumers.[876] The final basis was that Swann failed to establish systems to oversee and monitor the sales practices of its authorised representatives.[877]

I deal with each of the four matters in turn.

Swann undertook no meaningful review of its products to determine whether they provided any value to customers.[878] In its submissions, IAG pointed to internal reviews of loan protection insurance and GAP products in July and August 2016. But those reviews came at least eight months after ASIC had raised its concerns with Swann that Swann's products may have contravened regulatory requirements. As at July 2016, Swann had not undertaken a 'deep technical review of all the products distributed by Swann through Motor Dealers'.[879] Indeed, Swann's view was that 'ASIC's review of the [motor dealer] channel and products will highlight any issues in respect of product design negating the need for a further internal review'.[880] Mr Bessell agreed that this was the position.[881]

Swann continued to authorise the sale of those products after becoming aware that ASIC held concerns about their product design and sales practices.[882] IAG noted that after ASIC raised its concerns, Swann participated in an industry approach to the issue through the Insurance Council of Australia.[883] It stated that '[w]hile with the benefit of hindsight,

875 Transcript, Closing Submissions, 21 September 2018, 6503.

876 Transcript, Closing Submissions, 21 September 2018, 6503.

877 Transcript, Closing Submissions, 21 September 2018, 6503–4.

878 Transcript, Closing Submissions, 21 September 2018, 6503.

879 Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

880 Exhibit 6.314, 27 July 2016, Report of IAG Risk Committee Review of CCI and Add-On Insurance, 9.

881 Transcript, Benjamin Bessell, 19 September 2018, 6134.

882 Transcript, Closing Submissions, 21 September 2018, 6503.

883 IAG, Module 6 Case Study Submission, 3 [12].

reasonable minds could differ as to what approach Swann could or should have taken in and after September 2015, it is difficult to see that becoming involved in an industry wide solution through the Insurance Council of Australia was inefficient or unfair (let alone dishonest)'.[884]

There are two problems with this submission.

The first is that, as Mr Bessell recognised in his witness statement, the pursuit of an industry solution through the Insurance Council of Australia delayed Swann dealing directly with the issues in its own business.[885] This approach by Swann, in circumstances where Swann lacked an understanding from (relevantly) September 2015 of the value of its products, does not point toward conduct consistent with the obligation imposed by section 912A(1)(a).

The second is that the submission seeks, impermissibly, to qualify Swann's statutory obligation in section 912A(1)(a). As IAG accepted, Swann continued to sell the products after ASIC raised its concerns in September 2015.[886] Swann possessed all information necessary to ascertain those issues before ASIC's work. Upon becoming aware of ASIC's concerns, there were many options open to Swann to reduce the detriment to consumers. It took only one option, and that option was inadequate to ensure that the sale of the add-on insurance products was efficient, honest and fair.

The third matter referred to by Counsel Assisting was that Swann established and maintained arrangements that incentivised dealers to sell as many add-on products to consumers as possible, regardless of the suitability or value to consumers.[887] In its submissions, IAG again pointed to the Insurance Council of Australia's attempts to develop an industry-wide solution.[888] No doubt the market position made unilateral action difficult.

884 IAG, Module 6 Case Study Submission, 3 [12].

885 Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 18 [105(e)].

886 IAG, Module 6 Case Study Submission, 3 [12].

887 Transcript, Closing Submissions, 21 September 2018, 6503–4.

888 IAG, Module 6 Case Study Submission, 4 [16].

But market-wide misconduct cannot condition the statutory obligation. Compliance with the law will sometimes require entities to sacrifice revenue or profit, if that revenue or profit cannot be generated in a lawful way.

The final matter was that Swann failed to establish systems to oversee and monitor the sales practices of its authorised representatives.[889] IAG pointed to the systems that it did have in place, presumably to suggest that they were adequate.[890] That submission is at odds with Mr Bessell's acceptance that, at least between 2013 and January 2017, Swann did not have in place adequate risk management systems.[891] Given the significance of add-on insurance sales to Swann's total revenue, the sales practices of its authorised representatives was necessarily a significant risk. IAG's own internal report noted that the 'authorised representatives currently are not actively recording potential breaches and, therefore, Swann has no oversight on any issues that may be occurring. Promoting the importance of logging all potential breaches is required'.[892]

In combination, the four matters identified above are sufficient to find that Swann may have engaged in misconduct by breaching its obligation to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly. Selling products through a heavily incentivised dealer network, as an add-on to another sale, creates very significant risk of unfairness for consumers. Doing so in circumstances where the conduct of the authorised representatives is not actively monitored and/or audited heightens the risk that the statutory standard of conduct will not be met. When the products are of low value, the risk of unfairness is compounded. And while industry-wide solutions will often be appropriate, participation through an industry group does not absolve a participating entity of its continuing legal obligations.

[889] Transcript, Closing Submissions, 21 September 2018, 6504.

[890] IAG, Module 6 Case Study Submission, 5–6 [17]–[26].

[891] Transcript, Benjamin Bessell, 19 September 2018, 6121.

[892] Exhibit 6.312, 9 January 2017, Oversight Report of Swann Authorised Representatives.

Section 912A(1)(ca)

IAG also resisted a finding that Swann may have breached its obligation under section 912A(1)(ca) of the Corporations Act – the requirement to take reasonable steps to ensure that its representatives complied with financial services laws – by failing to establish systems to oversee and monitor the sales practices of Swann's authorised representatives.[893] The matters I have mentioned already show that Swann may have breached this obligation.

Section 912A(1)(aa)

IAG did not accept that Swann may have breached section 912A(1)(aa) of the Corporations Act by failing to have in place adequate arrangements for the management of any conflicts of interest that arose through incentivising sales of its add-on insurance products.[894]

IAG sought to rely on the processes that may have been insufficient to prevent Swann from breaching its obligations under section 912A(1)(a) and (ca) to say that its processes for managing conflicts were adequate.[895] The processes relied on operated together with Swann's remuneration and incentive arrangements for its authorised representatives. Those arrangements were, by design, focused solely on sales volumes. The arrangements did not incentivise or promote *appropriate sales*; indeed, they encouraged the inappropriate conduct that has led to the remediation program. Mr Bessell accepted that the point of Swann's remuneration and incentive arrangements was to incentivise sales.[896] He accepted that, on occasion, these incentive programs incentivised inappropriate sales practices, and that Swann's authorised representatives sold products that were not appropriate to the consumer.[897]

---

893 IAG, Module 6 Case Study Submission, 6–7 [27]–[29]; see also Transcript, Closing Submissions, 21 September 2018, 6504.

894 IAG, Module 6 Case Study Submission, 7 [30].

895 IAG, Module 6 Case Study Submission, 7 [31].

896 Transcript, Benjamin Bessell, 18 September 2018, 6105.

897 Transcript, Benjamin Bessell, 18 September 2018, 6106.

IAG did not explain how, in light of these remuneration arrangements, the initial training and electronic compliance questionnaire ensured conflicts would be managed. Indeed, even by January 2017, Swann had no knowledge of what issues may have been occurring. Swann's authorised representatives were not actively recording potential breaches and there was no monitoring in place to ensure that refresher training was completed. No face-to-face audits were being carried out. Swann's electronic questionnaire was limited in the level of detail it captured.[898]

In these circumstances, I find that Swann may not have had in place adequate arrangements for the management of any conflicts of interest.

Exceeding commission cap

Finally, as IAG accepted in its 29 June 2018 letter, Swann may have breached section 145 of the National Credit Code by authorising payments to 34 authorised representatives that may have exceeded the 20% cap on commissions imposed under that section.[899]

8.3.2 Conduct falling below community standards and expectations

Swann also engaged in conduct that fell below community standards and expectations by failing to take meaningful steps to ensure that its authorised representatives only sold add-on insurance products in circumstances where the product would be of value to the customer, by designing and implementing remuneration and incentive systems that promoted unfair sales practices; by failing to promote sales practices that focused on delivering value to customers and that met customer needs and expectations; by failing to investigate the appropriateness of its add-on insurance products or the sales practices of its authorised representatives in a timely manner; and by failing to redesign the add-on insurance products and the remuneration and incentive arrangements after first becoming

[898] Exhibit 6.312, 9 January 2017, Oversight of Swann Authorised Representatives Report, 3; Transcript, Benjamin Bessell, 18 September 2018, 6114–15.

[899] Transcript, Benjamin Bessell, 19 September 2018, 6112.

aware of ASIC's concerns in late 2013. Swann largely accepted that it had failed to meet community standards and expectations in those ways.[900]

8.3.3 Causes of the conduct

Swann's conduct had various causes. One was Swann's remuneration and incentive arrangements for its authorised representatives. As I have noted above, those arrangements were, by design, focused solely on sales volumes.

The conduct was also attributable to Swann's culture in various ways. Swann's focus was profit and the maintenance of market share. Those were the goals pursued in the design of its remuneration and incentive arrangements, the prioritisation of the interests of motor dealers ahead of customers and the failure to design systems that properly supervised the work of the authorised representatives. Mr Bessell acknowledged that Swann viewed the motor dealers – not the ultimate consumer – as its customers.[901] In its initial submission to the Commission, IAG acknowledged that Swann's focus on motor dealers was a 'significant contributor' to the conduct now the subject of the remediation program.[902]

Mr Bessell acknowledged that that there were two important features of the regulatory regime that facilitated the sale of add-on insurance: first, the point of sale exemption in the *National Consumer Credit Protection Regulations 2010* (Cth), relevant to consumer credit insurance products; and second, the ability for Australian financial services licensees to authorise representatives to provide general advice.[903] Mr Bessell acknowledged that some industry participants considered it inappropriate for authorised representatives to determine whether an add-on insurance policy was suitable for the customer, in circumstances where authorised representatives were authorised to provide general advice only.[904]

---

[900] IAG, Module 6 Case Study Submission, 8–9 [37]–[47].

[901] Exhibit 6.304, Witness statement of Benjamin Bessell, 27 August 2018, 18 [105(b)].

[902] IAG, *Initial Submissions*, 29 January 2018, 33 [Item 73].

[903] Transcript, Benjamin Bessell, 18 September 2018, 6083–4.

[904] Transcript, Benjamin Bessell, 19 September 2018, 6144.

9 Youi

9.1 Background

Youi Pty Ltd (Youi) issues general insurance products. The case study examined Youi's conduct in handling claims under home insurance policies following natural disasters. In particular, the Commission heard evidence about Youi's conduct in its handling of two insurance claims:

- a claim made by Ms Sacha Murphy, a Youi policyholder whose home was damaged in a hail storm in Broken Hill in November 2016; and
- a claim made by Mr Glenn Sutton, a Youi policyholder whose home was damaged in Tropical Cyclone Debbie in March 2017.

Both Ms Murphy and Mr Sutton gave evidence about their experiences with Youi. In relation to both claims, the Commission heard evidence from Mr Jason Storey, the Chief Operating Officer, Claims Services at Youi.

At the outset, it should be noted that counsel appearing for Youi did not seek to cross-examine either Ms Murphy or Mr Sutton. While counsel appearing for Youi did re-examine Mr Storey, that re-examination was limited to correcting certain errors in the arrangement of the exhibits to Mr Storey's statements, and tendering certain documents relevant to the handling by Youi of a complaint made by Ms Murphy.

That being so, it is surprising that Youi chose to criticise Counsel Assisting for failing to 'contextualise' particular matters,[905] for '[f]ail[ing] to draw the Commission's attention' to particular matters.[906] Youi had ample opportunity to contextualise or draw the Commission's attention to whatever matters it chose. It did not take that opportunity. Its criticisms were, therefore, not soundly based.

905 Youi, Module 6 Case Study Submission, 2 [10].

906 Youi, Module 6 Case Study Submission, 12 [44].

9.2 Evidence

9.2.1 Sacha Murphy

Ms Murphy took out a home and contents insurance policy with Youi in 2012.[907]

In November 2016, there was a severe hail storm in Broken Hill that caused damage to Ms Murphy's roof.[908] In January 2017, Ms Murphy made a claim under her policy for damage to the roof.[909] Ms Murphy's claim was accepted on 15 February 2017.[910] It took Ms Murphy and her partner several months to save up to pay the excess,[911] which they paid in May 2017. In late May, Ms Murphy and her partner signed a scope of works and agreed for a building company chosen by Youi (Builder A) to complete the repairs.[912]

By that time, Youi was aware of a number of issues in relation to Builder A's performance, specifically in relation to claims in Broken Hill.[913] Youi had formed the view that Builder A had breached the law by not taking out statutory insurance before commencing building jobs, and had suspended new jobs being allocated to Builder A.[914] Despite this, Youi did not reallocate Ms Murphy's claim to another builder, even though work had not yet commenced on her property.[915] Mr Storey acknowledged that, by not informing Ms Murphy about the issues it had identified with Builder A, or reallocating her claim to another builder, Youi failed to handle her claim in a fair and transparent manner, failed to act in an efficient, professional and practical manner, and breached Youi's duty of utmost good faith.[916]

907 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 1 [4].

908 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 1 [5], [7].

909 Transcript, Sacha Murphy, 19 September 2018, 6157.

910 Exhibit 6.334, Witness statement of Jason Storey, 17 September 2018, 32 [70(c)(ii)].

911 Transcript, Sacha Murphy, 19 September 2018, 6159.

912 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 2 [10]; Transcript, Sacha Murphy, 19 September 2018, 6158.

913 Transcript, Jason Storey, 19 September 2018, 6205.

914 Transcript, Jason Storey, 19 September 2018, 6210.

915 Transcript, Jason Storey, 19 September 2018, 6209–10.

916 Transcript, Jason Storey, 19 September 2018, 6210–11.

In around May 2017, Ms Murphy's daughter's lead levels were tested.[917] Lead contamination is a particular issue in the Broken Hill community, and the lead levels of children under five are monitored regularly.[918] Ms Murphy's daughter's lead levels were above the prescribed level, and, as a result of this, the lead levels in Ms Murphy's backyard were tested. The lead level was found to be very high, and Ms Murphy was told that the soil in the backyard would need to be dug up and replaced with loam. However, this remediation work could not take place until her roof was repaired, because otherwise the lead dust in the roof cavity would re-contaminate the backyard.[919] Ms Murphy told the builder that, because of this, she wanted the repairs to the roof to be done quickly.[920]

Despite this, Builder A did not commence repairs until October 2017.[921] Mr Storey acknowledged that Youi did not do enough to address this delay,[922] and that, by not taking steps to ensure that Builder A complied with its obligations to commence repairs in the timeframe set by Youi's contractual agreements, Youi failed to handle Ms Murphy's claim in a timely manner.[923]

On 4 October 2017, Builder A commenced the repairs, and removed most of the roof of Ms Murphy's property, as well as the air-conditioner and solar panels. At the end of that day, however, the builders told Ms Murphy and her partner that they would not do any more work because there were structural issues with the roof that were too much for them, and they needed more money to deal with those issues. The builders left without covering the roof, and asked Ms Murphy and her partner to pay around $1,800 before they

917 Transcript, Sacha Murphy, 19 September 2018, 6159.

918 Transcript, Sacha Murphy, 19 September 2018, 6156.

919 Transcript, Sacha Murphy, 19 September 2018, 6160.

920 Transcript, Sacha Murphy, 19 September 2018, 6160.

921 Transcript, Jason Storey, 19 September 2018, 6216.

922 Transcript, Jason Storey, 19 September 2018, 6216.

923 Transcript, Jason Storey, 19 September 2018, 6216.

would return.[924] Mr Storey acknowledged that it was not acceptable that Ms Murphy and her partner were left in this position.[925]

At this time, Ms Murphy was pregnant. Because the air-conditioner had been removed, it was hot inside the house, and lead dust was able to enter through the open air-conditioning vent. Ms Murphy was concerned about the impact of this on her family and unborn child.[926]

On 6 October 2017, Ms Murphy called Youi and told the representative that she was unhappy with how long it was taking for the roof to be repaired, and that she was pregnant and being exposed to high levels of lead.[927] Youi didn't take any further action to cover the roof until 9 October 2017.[928] On that day, it instructed Builder A to cover the roof, but did not check whether Builder A had done so.[929] Builder A did not cover the roof. Mr Storey accepted that Youi did not do enough when it learned that Builder A had left the roof uncovered,[930] and that Youi's response to the situation of Ms Murphy and her family was inadequate.[931]

On 19 October 2017, just over two weeks after Builder A opened up the roof of Ms Murphy's home, Youi authorised Builder A's variation for the extra work to ensure that the roof complied with the building code.[932] On 20 October 2017, Builder A returned to commence the repair work but then told Youi that it had identified further difficulties with the roof, and that the repair cost would be significant.[933] Ms Murphy called Youi later that day and

924 Transcript, Sacha Murphy, 19 September 2018, 6161, 6163.

925 Transcript, Jason Storey, 19 September 2018, 6217.

926 Transcript, Sacha Murphy, 19 September 2018, 6163–4.

927 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 4 [23]; Transcript, Jason Storey, 19 September 2018, 6219.

928 Transcript, Jason Storey, 19 September 2018, 6219.

929 Transcript, Jason Storey, 19 September 2018, 6220.

930 Transcript, Jason Storey, 19 September 2018, 6220.

931 Transcript, Jason Storey, 19 September 2018, 6220.

932 Transcript, Jason Storey, 19 September 2018, 6220.

933 Transcript, Jason Storey, 19 September 2018, 6221.

told the Youi representative, among other things, that she was very upset about her family being exposed to lead dust.[934]

After this call, Youi agreed to arrange temporary accommodation for Ms Murphy and her family.[935] Youi again requested that Builder A make the property safe for Ms Murphy and her family to live in, by closing the roof.[936] After spending four nights in a caravan park, the family returned to the property.[937]

Ms Murphy told the Commission that it was clear on their first night back in the house that the roof had not been replaced properly as they could hear the noise of the loose metal roofing in the wind.[938] Youi did not take any steps to check that the lead dust could no longer enter the property before the family went home.[939]

Ms Murphy made a formal complaint to Youi on 2 November 2017. Her letter was six pages long and raised a lengthy list of concerns.[940] In response, a representative of Youi spoke to Ms Murphy's partner on the phone, and sent Ms Murphy a system-generated letter.[941] Mr Storey agreed that the letter was not an adequate response to the complaint made by Ms Murphy, and was not an appropriate way to deal with a customer who was clearly distressed by her experience with Youi.[942] He also agreed that the response did not comply with the requirements of the General Insurance Code of Practice.[943]

---

934 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 4 [28].

935 Transcript, Sacha Murphy, 19 September 2018, 6166.

936 Transcript, Jason Storey, 19 September 2018, 6221–2.

937 Transcript, Sacha Murphy, 19 September 2018, 6166.

938 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [31].

939 Transcript, Jason Storey, 19 September 2018, 6222.

940 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [34]; Transcript, Jason Storey, 19 September 2018, 6222.

941 Transcript, Jason Storey, 19 September 2018, 6224.

942 Transcript, Jason Storey, 19 September 2018, 6227.

943 Transcript, Jason Storey, 19 September 2018, 6228.

The Commission heard that Youi's complaints and IDR process more generally is considered by its compliance area to be non-compliant with legal requirements.[944]

On 15 November 2017, it rained in Broken Hill.[945] Ms Murphy told the Commission that water poured into the house through the lounge, kitchen, bathroom and hallway, because the roof had not been replaced properly.[946] The water that got into the house caused internal damage, including cracks in the ceiling and mould.[947] Mr Storey acknowledged that Youi had not checked that Builder A had put the roof on correctly before Ms Murphy and her family returned to the home, despite being responsible for the workmanship of the builder.[948]

The roof was ultimately repaired by a different company in May 2018, 18 months after the hail damage.[949] Mr Storey acknowledged that the delays in dealing with Ms Murphy's claim have prevented the lead remediation works in Ms Murphy's backyard from proceeding.[950]

Mr Storey acknowledged that, in relation to Ms Murphy's claim, Youi failed to conduct its claims in an honest, fair, transparent and timely manner,[951] failed to respond to the catastrophe that was the Broken Hill storm in a way that was efficient, professional, practical and compassionate towards Ms Murphy,[952] and breached its duty of utmost good faith.[953]

944 Transcript, Jason Storey, 19 September 2018, 6230.

945 Transcript, Sacha Murphy, 19 September 2018, 6168.

946 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 6 [39].

947 Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 6 [43].

948 Transcript, Jason Storey, 19 September 2018, 6232.

949 Transcript, Jason Storey, 19 September 2018, 6234.

950 Transcript, Jason Storey, 19 September 2018, 6234.

951 Transcript, Jason Storey, 19 September 2018, 6234.

952 Transcript, Jason Storey, 19 September 2018, 6234.

953 Transcript, Jason Storey, 19 September 2018, 6191.

9.2.2 Glenn Sutton

Like Ms Murphy, Mr Sutton had a home insurance policy with Youi.[954]

In late March 2017, Tropical Cyclone Debbie hit Queensland and caused damage to Mr and Mrs Sutton's home – including causing some of the roof sheeting to come off, leaving a hole in the roof.[955] The damage caused by the storm meant that Mr and Mrs Sutton could not live in the home until it had been repaired.[956]

Mr and Mrs Sutton made a claim under their home insurance policy in March 2017.[957] Mr Sutton told the Commission about three issues in connection with his claim with Youi: inadequate make safe works; delays in repairs; and delays in reimbursement for temporary accommodation.

Inadequate make safe works

In relation to the first of those issues, Mr Sutton said that, a few days after the cyclone, a building company attended his house to perform make safe works.[958] The builder told Mr Sutton that they had only been allocated eight hours to do the job.[959] The builders did not install a tarpaulin to cover the hole in the roof, or conduct any drying work, despite mould being a significant problem when houses in tropical areas like Airlie Beach have been inundated with water.[960] Mr Storey said that Youi does not have any particular procedures for houses at risk of mould, but that this was something Youi was considering introducing.[961] He also said that Youi does not check, as part of its standard claims process, whether make safe work has happened.[962]

954 Transcript, Jason Storey, 19 September 2018, 6234.

955 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 1–2 [5]–[7].

956 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [7].

957 Transcript, Jason Storey, 19 September 2018, 6235.

958 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [12].

959 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [13].

960 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 2 [13]; Transcript, Jason Storey, 19 September 2018, 6238.

961 Transcript, Jason Storey, 19 September 2018, 6238–9.

962 Transcript, Jason Storey, 19 September 2018, 6204.

Mr Sutton told the Commission that, around a month after the cyclone, a tarpaulin was fitted over the hole in the roof.[963] However, within weeks, the tarpaulin was torn by the wind, and water was able to enter the house when it rained.[964] Mr Sutton told Youi several times that the tarpaulin was not sufficient.[965] Despite this, no-one replaced the tarpaulin in the second half of 2017.[966] Over that time, mould continued to grow in the property.[967] Mr Storey agreed that, by May 2017, Youi was on notice that the tarpaulin that had been fitted had become loose and that water would be able to enter the property.[968] Mr Storey agreed that, despite being aware since May 2017 that the tarpaulin on the roof was only a temporary solution, Youi had not taken steps to check the tarpaulin or find a more permanent solution until January 2018.[969]

Mr Storey said that Youi accepted responsibility for failing to ensure that the property was covered and protected from the elements while the claim was being resolved.[970]

Delays in repairs

In relation to the second issue, Mr Sutton told the Commission that, in the weeks following the cyclone, several builders inspected his property to prepare reports.[971] In May 2017, Mr Sutton was sent a scope of works for the repairs. Mr Sutton was concerned that no-one had properly inspected

963 Transcript, Glenn Sutton, 19 September 2018, 6174.

964 Transcript, Glenn Sutton, 19 September 2018, 6174.

965 Transcript, Glenn Sutton, 19 September 2018, 6174–5.

966 Transcript, Glenn Sutton, 19 September 2018, 6175–6.

967 Transcript, Glenn Sutton, 19 September 2018, 6176.

968 Transcript, Jason Storey, 19 September 2018, 6240.

969 Transcript, Jason Storey, 19 September 2018, 6242, 6243.

970 Transcript, Jason Storey, 19 September 2018, 6236.

971 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 3 [20].

the roof for structural damage.[972] He asked Youi to arrange for someone to inspect the roof.[973] Youi arranged for a builder to inspect the roof, and this builder prepared a report. The builder told Mr Sutton that he had not inspected the roof cavity.[974] Mr Sutton raised this with Youi and asked for an engineer to inspect the roof.[975] Youi arranged for this to happen, and the engineer concluded that the roof needed to be replaced.[976]

In August 2017, Mr Sutton signed a building contract with the builder on the basis of an updated scope of works that included the replacement of the roof.[977] Neither Youi nor the builder gave Mr Sutton a start date for the repairs.[978]

By October 2017, repair work still had not started.[979] On 9 October, Mr Sutton sent a complaint to Youi about a number of matters, including the continuing delays.[980] Youi did not provide a written response to that complaint.[981] Mr Storey accepted that Youi did not comply with the General Insurance Code of Practice in responding to this complaint.[982]

By November 2017, repair work still had not started. On 17 November 2017, Youi sent an email to Mr Sutton raising the possibility of cash settling the claim and advising that Mr Sutton would need to organise for an area of the house affected by termites to be repaired before any other repairs could

972 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 3–4 [21]–[22].

973 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [22].

974 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [23].

975 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [24].

976 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [25]. In its submissions, Youi emphasised that the engineer's conclusion that the roof needed to be replaced was based on the use of inadequate fixings in the original roof construction: see Youi, Module 6 Case Study Submission, 12 [43].

977 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 4 [27].

978 Transcript, Glenn Sutton, 19 September 2018, 6179.

979 Transcript, Glenn Sutton, 19 September 2018, 6179.

980 Transcript, Glenn Sutton, 19 September 2018, 6179–80.

981 Transcript, Jason Storey, 19 September 2018, 6245.

982 Transcript, Jason Storey, 19 September 2018, 6245.

proceed.[983] Mr Sutton told the Commission that this was 'out of the blue' and that Youi had not previously discussed a cash settlement with him.[984]

When Mr Sutton gave evidence to the Commission, the house had still not been repaired. Mr Storey acknowledged that it is unacceptable that the Suttons were not yet back in their home, and said that Youi accepted responsibility for the extended delays in dealing with Mr and Mrs Sutton's claim.[985]

Temporary accommodation

In relation to the third issue, Mr Sutton told the Commission that he and his wife have been living in temporary accommodation since the cyclone in March 2017.[986] They have had to move four times,[987] and each time have had to find the accommodation themselves, which has been difficult due to the limited availability of suitable accommodation in the Airlie Beach area since the cyclone.[988]

Mr Sutton told the Commission about his difficulties in getting reimbursement from Youi for temporary accommodation. Youi would regularly take weeks to reimburse costs and Mr Sutton had to follow up Youi when they failed to pay.[989] Mr Storey agreed that Mr and Mrs Sutton were put under financial pressure because Youi delayed in reimbursing them for their temporary accommodation.[990] At various times, Mr and Mrs Sutton were left thousands of dollars out of pocket. Mr Storey agreed that it was not acceptable that Youi repeatedly delayed in reimbursing Mr and Mrs Sutton for the temporary accommodation cost.[991]

983 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [31].

984 Transcript, Glenn Sutton, 19 September 2018, 6181.

985 Transcript, Jason Storey, 19 September 2018, 6235.

986 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [35].

987 Transcript, Glenn Sutton, 19 September 2018, 6182.

988 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 5 [35].

989 Exhibit 6.332, Witness statement of Glenn Sutton, 20 June 2018, 6 [36].

990 Transcript, Jason Storey, 19 September 2018, 6235.

991 Transcript, Jason Storey, 19 September 2018, 6235.

Mr Sutton's 'claims adviser' at Youi, who had primary responsibility for organising the reimbursement of temporary accommodation expenses, was located in South Africa.[992] Mr Storey accepted that this resulted in delays in the handling of Mr Sutton's claim.[993] Mr Storey told the Commission that it had been recognised within Youi in August 2017 that it was not ideal for claims advisers based in South Africa to be trying to manage claims outside of Australian business hours.[994] Despite this, Youi did not transfer Mr Sutton's claim to a claims adviser based in Australia until January 2018.[995]

Mr Storey accepted that, in relation to Mr Sutton's claim, Youi failed to conduct its claims handling process in an honest, fair, transparent and timely manner, failed to respond to Tropical Cyclone Debbie in an efficient, professional and practical way and in a compassionate manner, and failed to comply with its duty of utmost good faith.[996]

9.3 What the case study showed

9.3.1 Ms Murphy's claim

In his evidence in relation to Ms Murphy's claim, Mr Storey accepted that:

- Youi failed to handle Ms Murphy's claim in an honest, fair and transparent manner, as required by clause 7.2 of the General Insurance Code of Practice;[997]

---

992 Transcript, Jason Storey, 20 September 2018, 6257.

993 Transcript, Jason Storey, 20 September 2018, 6262.

994 Transcript, Jason Storey, 20 September 2018, 6261.

995 Transcript, Jason Storey, 20 September 2018, 6262.

996 Transcript, Jason Storey, 19 September 2018, 6236.

997 Transcript, Jason Storey, 19 September 2018, 6234.

- Youi failed to respond to the Broken Hill hail storm in an efficient, professional and practical way and in a compassionate manner, as required by clause 9.2 of the Code;[998] and
- Youi breached its duty of utmost good faith to Ms Murphy.[999]

Despite these acknowledgments, Youi contended in its post-hearing submissions that none of the matters considered by the Commission in relation to Ms Murphy's claim supported a finding that Youi may have engaged in misconduct or conduct falling below community standards and expectations.[1000] That submission is contrary to the evidence, and must be rejected.

The key features of Youi's handling of Ms Murphy's claim may be summarised as follows. Youi selected a builder to undertake repairs at Ms Murphy's property despite being aware of numerous complaints in relation to the builder. When Youi subsequently formed the view that the builder had broken the law, and that no new jobs should be allocated to the builder, Youi did not allocate Ms Murphy's repairs to another builder. Nor did it tell Ms Murphy about these issues. A period of several months elapsed, during which no work was done at Ms Murphy's property. When work commenced, the builders walked off the job, leaving Ms Murphy and her family in a house with no roof and no air-conditioning, which was not protected from lead dust. When Ms Murphy told Youi on 6 October 2017 about her situation, including that she was pregnant and being exposed to lead dust, Youi did nothing until 19 October 2017, when it attempted to arrange make safe works. Those make safe works did not occur. Youi took no steps to check that they had occurred, or that Ms Murphy and her family were safe. It was only on 20 October, after Ms Murphy complained again, that she and her family were placed in temporary accommodation. After that, they were required to return to a home that had not properly been made safe for them. As a result of the builder's poor workmanship, further damage was done to the property when it rained. It was not until May 2018 that Ms Murphy's roof was properly repaired.

---

[998] Transcript, Jason Storey, 19 September 2018, 6234.

[999] Transcript, Jason Storey, 19 September 2018, 6191.

[1000] Youi, Module 6 Case Study Submission, 2–3 [5].

Youi sought to contend that this conduct did not breach clause 7.2 of the General Insurance Code of Practice. Clause 7.2 provides that ‘We will conduct claims handling in an honest, fair, transparent and timely manner, in accordance with this section’. Youi argued that the requirement to conduct claims handling in a ‘timely’ manner requires nothing more than for it to comply with the particular timeframes set out in other provisions of clause 7 of the Code.[1001] I disagree. Consistently with the view taken by the Insurance Council of Australia and the Code Governance Committee,[1002] I consider that the requirement to handle claims in an ‘honest, fair, transparent and timely manner’ has a broader application, and is capable of being breached independently of the other provisions of clause 7 of the Code.

It is clear that Youi may have breached that duty in relation to its handling of Ms Murphy’s claim, and that it therefore may have engaged in misconduct. Among other things, it was not fair or transparent for Youi not to reallocate Ms Murphy’s repairs to another builder in circumstances where it knew about significant issues with Builder A and did not inform Ms Murphy of those issues. When Youi took no steps to enforce the timelines in its agreement with Builder A, despite Builder A’s failure to commence work within those timelines, it failed to handle the claim in a timely manner. When Ms Murphy told Youi on 6 October that she was pregnant and being exposed to lead dust because of Builder A’s failure to complete the repairs, it was not fair for Youi to leave her and her family in their house – without a roof – for another two weeks before moving them into temporary accommodation.

For similar reasons, it is arguable that Youi may have breached its duty of utmost good faith to Ms Murphy, and therefore engaged in misconduct. As noted earlier in this chapter, the duty of utmost good faith may require an insurer to act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured.[1003] Throughout its handling of Ms Murphy’s claim, as summarised above, there were a number

---

1001 Youi, Module 6 Case Study Submission, 6–7 [17]–[18].

1002 Exhibit 6.404, Witness statement of Robert Whelan, 27 August 2018, Exhibit RW-33 [ICA.002.001.0538 at .0606–.0607].

1003 *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1 at 12 [15] (Gleeson CJ and Crennan J).

of instances where Youi could be said to have failed to act with due regard to Ms Murphy's interests.

On the basis of the evidence before the Commission, I am not in a position to draw conclusions about Youi's response to the Broken Hill hail storm as a whole. However, I agree with Mr Storey that, at least in relation to its handling of Ms Murphy's claim, Youi failed to respond to that catastrophe in a way that was efficient, professional, practical and compassionate.

I refer Youi's conduct in connection with the duty of utmost good faith to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

I consider that the matters referred to above that may constitute misconduct were attributable, at least in part, to the way in which Youi remunerated its claims handling staff. At the time of Ms Murphy's claim, claims handling staff at Youi were responsible both for dealing with incoming claims and for managing existing claims. Mr Storey said that about 30% of the performance indicators for these staff related to dealing with new claims, and only 10% related to handling existing claims.[1004] This combination of roles, and the emphasis on dealing with new claims, contributed to claims staff feeling unable to spend time on dealing with their larger, more difficult claims.[1005] In August 2018, Youi introduced changes to address those issues.[1006]

9.3.2 Mr Sutton's claim

In relation to Mr Sutton's claim, Mr Storey accepted that:

- Youi failed to handle Mr Sutton's claim in an honest, fair and transparent manner, as required by clause 7.2 of the Code;[1007]

[1004] Transcript, Jason Storey, 20 September 2018, 6268.

[1005] Transcript, Jason Storey, 20 September 2018, 6269.

[1006] Transcript, Jason Storey, 20 September 2018, 6270.

[1007] Transcript, Jason Storey, 19 September 2018, 6236.

- Youi failed to respond to Tropical Cyclone Debbie in an efficient, professional and practical way and in a compassionate manner, as required by clause 9.2 of the Code;[1008] and
- Youi breached its duty of utmost good faith to Mr Sutton.[1009]

Despite these acknowledgments, Youi contended in its post-hearing submissions that none of the matters considered by the Commission in relation to Mr Sutton's claim supported a finding that Youi may have engaged in misconduct or in conduct falling below community standards and expectations.[1010] Again, that submission is contrary to the evidence, and must be rejected.

Youi's continuing failure to fix the tarpaulin over the hole in Mr Sutton's roof, or find a more permanent way to keep water out of Mr Sutton's house while repairs were taking place, was not professional or practical. Nor was it fair to Mr Sutton, in circumstances where Youi must have been aware that additional water entering Mr Sutton's property was likely to cause damage to that property, and to cause mould to grow. Youi's repeated delays in reimbursing Mr and Mrs Sutton for the cost of their temporary accommodation demonstrated a failure to deal with Mr and Mrs Sutton's claim in a timely manner. They also were not fair to Mr and Mrs Sutton, as those delays in organising reimbursement repeatedly put Mr and Mrs Sutton under financial pressure. As Mr Storey acknowledged, the Code emphasises the importance of not leaving a customer in financial hardship.[1011] While the delays in undertaking repairs to Mr Sutton's property were attributable to a number of factors, they were, at least in part, indicative of a failure by Youi to handle Mr Sutton's claim in an efficient or practical way, or in a timely manner.

Accordingly, I consider that, in relation to Mr Sutton's claim, Youi may have breached its obligation under clause 7.2 of the Code, and therefore may have engaged in misconduct. While I am not in a position to draw conclusions about Youi's response to Tropical Cyclone Debbie as a whole,

[1008] Transcript, Jason Storey, 19 September 2018, 6236.

[1009] Transcript, Jason Storey, 19 September 2018, 6236.

[1010] Youi, Module 6 Case Study Submission, 1–2 [5].

[1011] Transcript, Jason Storey, 19 September 2018, 6188.

I agree with Mr Storey that, at least in relation to its handling of Mr Sutton's claim, Youi failed to respond to that catastrophe in a way that was efficient, professional, practical and compassionate. I also consider that it is arguable that Youi may have breached its duty of utmost good faith to Mr Sutton, and therefore engaged in misconduct. The evidence about Youi's handling of Mr Sutton's claim – particularly in relation to the make safe work and reimbursement for temporary accommodation – indicates that Youi failed in a number of ways to act with due regard to the interests of the insured.

I refer Youi's conduct in connection with the duty of utmost good faith to ASIC, pursuant to paragraph (a) of the Commission's Terms of Reference, for ASIC to consider what action it can and should take.

9.3.3 Effectiveness of mechanisms for response and redress

Youi's handling of both Ms Murphy's and Mr Sutton's claims highlighted issues in relation to Youi's IDR processes.

As noted above, Ms Murphy made a formal complaint to Youi on 2 November 2017, which was six pages long and raised a lengthy list of concerns.[1012] In response to this complaint, a representative of Youi spoke to Ms Murphy's partner on the phone, and then sent Ms Murphy a system-generated letter. This letter did not respond to the matters Ms Murphy had raised in her six-page complaint, did not explain how Youi had resolved that complaint, and did not set out Youi's reasons for any decision that it made in relation to the complaint. The phone call between the Youi representative and Ms Murphy's partner was not recorded, and the only available notes of that call were brief and inadequate.

Mr Storey accepted that Youi had failed to deal with Ms Murphy's complaint in accordance with the requirements of clause 10.13 of the Code.[1013] In its submissions, Youi accepted that its response to Ms Murphy's complaint did not set out the matters required by clause 10.13 of the Code, but sought to argue that this did not constitute misconduct. Under the Commission's Terms of Reference, 'misconduct' includes conduct that breaches a

[1012] Exhibit 6.330, Witness statement of Sacha Murphy, 20 June 2018, 5 [34]; Transcript, Jason Storey, 19 September 2018, 6222.

[1013] Transcript, Jason Storey, 19 September 2018, 6228.

recognised and widely adopted benchmark for conduct. I consider that clause 10.13 represents such a benchmark and that, by breaching it, Youi has engaged in misconduct. Youi's submission to the contrary indicates a concerning failure to accord sufficient importance to the provisions of the Code dealing with the handling of disputes.

Youi's failure to comply with those provisions in this case had the result that, if Ms Murphy had taken her complaint to EDR, there would have been no way of testing any subsequent account given by Youi of what was said in the conversation with Ms Murphy's partner. The brief notes made by Youi of the telephone conversation were not adequate to allow that to occur. This state of affairs has the potential to undermine the effectiveness of EDR mechanisms, and underscores the importance of the requirement in the Code for general insurers to respond to complaints in writing.

In relation to the complaint made by Mr Sutton on 9 October 2017, the issue is presented even more starkly. Youi did not respond in writing to that complaint.[1014] There is no record of how that complaint was resolved, or Youi's reasons for any decision it made in relation to that complaint. In the absence of any record of a decision, it is difficult to see how Mr Sutton could have escalated his complaint to EDR. Mr Storey rightly accepted that Youi failed to deal with Mr Sutton's complaint in accordance with the requirements of clause 10.13 of the Code.[1015] Again, Youi's conduct had the potential to undermine the effectiveness of EDR mechanisms.

9.3.4 Conduct falling below community standards and expectations

Another matter addressed in Mr Storey's evidence was the term in Youi's home insurance policies that excluded from cover any 'additional costs resulting from your buildings or any part thereof not being compliant with the most recent building codes, laws and regulations'.

1014 In its submissions, Youi referred to four brief follow-up emails sent to Mr Sutton after he made this complaint: Youi, Module 6 Case Study Submission, 14 [59]. Those emails were not tendered in evidence at the hearing, and Youi did not seek leave to tender them after the hearing. It is clear on the face of those emails that none of them constituted a written response to Mr Sutton's complaint.

1015 Transcript, Jason Storey, 19 September 2018, 6245.

Mr Storey accepted that it would be impractical and unreasonable for the average person to stay abreast of changes to the building code and upgrade their house accordingly. He said that it would not be economical for any homeowner to do this.[1016] He also accepted that Youi does not enforce this term in practice, but instead determines whether to cover a policyholder for additional costs associated with bringing a property up to code by applying a set of guidelines that are not made available to policyholders.[1017]

Mr Storey accepted that a Youi policyholder has no idea until after they make a claim and the damage is assessed whether or not he or she will be covered for these additional costs.[1018] He accepted that this may not be satisfactory.[1019] He also accepted that it might be possible for Youi to include a narrower exclusion in its home insurance policies, which reflected the circumstances in which the current exclusion is actually applied.[1020] In its submissions, Youi contends that attempting to collate the variables and discretionary matters currently applied by assessors into a simple term within its policies might cause uncertainty and confusion in the minds of customers.[1021] However, I consider that enforcing the current term by reference to criteria in internal guidelines, which are not made available to policyholders, is what is likely to cause uncertainty and confusion in the minds of customers.

No doubt it may be said that Youi's policy of not relying on the strict terms of the policy works to the advantage of the insured. But I consider that the community would expect that the policy terms would explain clearly what is covered and what is not.

[1016] Transcript, Jason Storey, 19 September 2018, 6196.

[1017] Transcript, Jason Storey, 19 September 2018, 6197–200.

[1018] Transcript, Jason Storey, 19 September 2018, 6200.

[1019] Transcript, Jason Storey, 19 September 2018, 6200.

[1020] Transcript, Jason Storey, 19 September 2018, 6197.

[1021] Youi, Module 6 Case Study Submission, 18 [77].

10 AAI Ltd (AAMI'S Complete Replacement Cover policy)

10.1 Background

AAI Limited (AAI) carries out the general insurance activities of Suncorp Group.[1022] The case study focused upon AAI's handling of claims made following the Wye River bushfires on Christmas Day 2015, and the way in which AAI marketed its Complete Replacement Cover (CRC) home insurance product. The Commission heard evidence from Mr Gary Dransfield, Chief Executive Officer, Insurance, at Suncorp Group.[1023]

10.2 Evidence

AAI issues 37 home and contents insurance products through 13 different brands, including AAMI.[1024]

Generally speaking, AAI's home and contents policies are 'sum insured' policies, which require the policyholder to nominate the amount for which their home and contents will be insured.[1025] However, AAMI offers optional CRC on its building insurance and landlord insurance policies.[1026] CRC provides cover for the total amount that it would cost AAI to repair or rebuild a building.[1027] As a result, if a policyholder takes out CRC, there is no need for the policyholder to nominate a particular sum for which a building will be insured.[1028] When a claim is accepted under the CRC policy, AAI can choose

[1022] Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 1 [1].

[1023] Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 1 [1]; Exhibit 6.370, Witness statement of Gary Dransfield, 29 August 2018, 1 [1].

[1024] Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 2 [10].

[1025] Transcript, Gary Dransfield, 20 September 2018, 6281.

[1026] Transcript, Gary Dransfield, 20 September 2018, 6281; see also AAI Ltd, Module 6 Case Study Submission, 2 [5].

[1027] Transcript, Gary Dransfield, 20 September 2018, 6281.

[1028] Transcript, Gary Dransfield, 20 September 2018, 6282.

to either repair or rebuild the property, or to cash settle the claim for the amount that it would cost AAI to do the work.[1029]

AAI introduced CRC in September 2006.[1030] Between 1 January 2015 and 31 May 2018, AAI issued about 1.59 million policies in which customers had CRC, accounting for almost 70% of the policies in which CRC was available.[1031] In the same period, AAI received more than $1.48 billion in premiums in respect of those policies.[1032]

While CRC was introduced to mitigate the risk of underinsurance,[1033] Mr Dransfield accepted that it would only achieve that purpose if the cash settlements offered by AAI represented the true cost of repairing or rebuilding the insured home.[1034]

10.2.1 Wye River bushfires

AAI received 63 claims following the Wye River bushfires, 34 of which related to AAMI products.[1035] In 28 of those 34 claims, the policyholder had opted in to CRC.[1036] AAI settled the majority of contents claims within a few weeks, but the building claims and more complex contents claims took longer to settle. Despite having initially estimated that within a few months, claims would be cash settled or would have their scope of works and cost of repairs confirmed, Mr Dransfield accepted that those timelines were not met for the majority of the claims.[1037] Mr Dransfield did not consider that

---

1029 Transcript, Gary Dransfield, 20 September 2018, 6283.

1030 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 8 [19]; Transcript, Gary Dransfield, 20 September 2018, 6282.

1031 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 11 [31].

1032 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 11 [31].

1033 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 8 [19]; Transcript, Gary Dransfield, 20 September 2018, 6283.

1034 Transcript, Gary Dransfield, 20 September 2018, 6283.

1035 Transcript, Gary Dransfield, 20 September 2018, 6283.

1036 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 27 [76]; Transcript, Gary Dransfield, 20 September 2018, 6284.

1037 Transcript, Gary Dransfield, 20 September 2018, 6284.

AAI's actions were the cause of the delays,[1038] but he said that AAI could nonetheless have communicated better with customers and could have done more to keep them informed of the progress of their claims.[1039]

On 8 November 2016, Ms Sarah Henderson MP gave a radio interview criticising AAMI's handling of the Wye River claims, and its CRC product more broadly.[1040] These criticisms related to a number of matters, including: delay in the resolution of claims; issues with AAI's advertising; and concerns that AAI was underquoting the cost of rebuilding.[1041]

Following these criticisms, Kelly O'Dwyer MP referred Ms Henderson's allegations to ASIC.[1042] ASIC commenced an investigation into AAI's claims handling practices in connection with the Wye River bushfires,[1043] and its marketing of the CRC products.[1044] ASIC was limited in the actions that it could take in respect of the claims handling allegations, because the handling of insurance claims is excluded from the definition of a 'financial service' by regulation 7.1.33 of the *Corporations Regulations 2001* (Cth).[1045]

1038 Transcript, Gary Dransfield, 20 September 2018, 6286; see also AAI Ltd, Module 6 Case Study Submission, 3 [8].

1039 Transcript, Gary Dransfield, 20 September 2018, 6286–7.

1040 Transcript, Gary Dransfield, 20 September 2018, 6285; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 29) [SUN.0760.0300.0464].

1041 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 29) [SUN.0760.0300.0464].

1042 Transcript, Gary Dransfield, 20 September 2018, 6293.

1043 Transcript, Gary Dransfield, 20 September 2018, 6293–4.

1044 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 41) [SUN.0760.0302.0500].

1045 Transcript, Gary Dransfield, 20 September 2018, 6301; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 41) [SUN.0760.0302.0508]; cf Insurance Contracts Act ss 11B and 14A.

10.2.2 Marketing of the CRC product

In May 2015, about six months prior to the Wye River bushfires, AAI ran a direct mail campaign that promoted its CRC to AAMI personal insurance customers.[1046] The mail-out included the following statement:[1047]

> … with our Complete Replacement Cover you can have peace of mind that we cover the repair or rebuilding of your home if it is damaged or destroyed by an insured event, *no matter the cost to us*.

In July 2015, AAI published similar representations on the AAMI website.[1048] The statements on the Home Building Insurance part of the website were:[1049]

> Optional extra: Complete Replacement Cover. Our best protection against underinsurance, *with no set limit. We cover the rebuilding of your home, no matter the cost to us*.

In November 2016, almost a year after the Wye River bushfires, AAI began a mass market radio campaign promoting its CRC option.[1050] The radio advertisement included the statement: 'we'll repair or rebuild your house – *no matter the cost*'.[1051] At around the same time, AAI also introduced search engine marketing with the tagline: 'rebuild your house *regardless of cost* if damaged or destroyed by [an] insured event'.[1052]

Mr Dransfield acknowledged that the clear message of the advertising material, both before and after the Wye River bushfires, was that AAI would *repair or rebuild* homes subject to CRC, *no matter the cost* to AAI.[1053] Mr Dransfield accepted that:[1054]

1046 Transcript, Gary Dransfield, 20 September 2018, 6303.

1047 Transcript, Gary Dransfield, 20 September 2018, 6304 (emphasis added).

1048 Transcript, Gary Dransfield, 20 September 2018, 6305.

1049 Transcript, Gary Dransfield, 20 September 2018, 6305 (emphasis added).

1050 Transcript, Gary Dransfield, 20 September 2018, 6305.

1051 Transcript, Gary Dransfield, 20 September 2018, 6306 (emphasis added).

1052 Transcript, Gary Dransfield, 20 September 2018, 6306 (emphasis added).

1053 Transcript, Gary Dransfield, 20 September 2018, 6306–7 (emphasis added).

1054 Transcript, Gary Dransfield, 20 September 2018, 6307.

- It was not correct that AAI would necessarily repair or rebuild homes covered by the CRC product, because AAI could choose to provide a cash settlement instead.[1055]
- It was not correct that AAI would repair or rebuild, 'no matter the cost' to AAI.[1056] There were cost limits, both 'in terms of the costs that AAI felt was fair and reasonable in relation to the scope of work', and from the requirement that AAI was to repair or rebuild on a 'new for old' basis.[1057]

More broadly, Mr Dransfield accepted that where AAI chose to cash settle a claim, it would generally do so on the basis of the lowest quote to AAI that was 'sufficient and appropriate to complete the scope of works'.[1058] Mr Dransfield also accepted that in some circumstances, it may cost AAI less to perform works than it would cost a policyholder to do so. This could result in a cash settlement being insufficient for customers to repair or rebuild themselves.[1059] Mr Dransfield acknowledged that there were significant differences between the amounts offered by AAI to cash settle some Wye River claims, and the quotes that those policyholders had received from other builders.[1060]

By late November 2016, AAI was aware that ASIC was looking into the way in which it was marketing the CRC product.[1061] After deciding not to launch a new advertisement as planned in January 2017,[1062] AAI sought ASIC's views on its new advertising materials in February 2017.[1063] ASIC sent AAI an email in the following terms:[1064]

1055 Transcript, Gary Dransfield, 20 September 2018, 6307.

1056 Transcript, Gary Dransfield, 20 September 2018, 6307.

1057 Transcript, Gary Dransfield, 20 September 2018, 6307.

1058 Transcript, Gary Dransfield, 20 September 2018, 6288; see also AAI Ltd, Module 6 Case Study Submission, 3 [9].

1059 Transcript, Gary Dransfield, 20 September 2018, 6289.

1060 Transcript, Gary Dransfield, 20 September 2018, 6289–90.

1061 Transcript, Gary Dransfield, 20 September 2018, 6309.

1062 Transcript, Gary Dransfield, 20 September 2018, 6309–12.

1063 Transcript, Gary Dransfield, 20 September 2018, 6312–13.

1064 Transcript, Gary Dransfield, 20 September 2018, 6315; Exhibit 6.378, 20–22 February 2017, Emails Between 20 and 22 February '17 Between AAI and ASIC Concerning Complete Replacement Cover Marketing Materials.

> As you are already aware, we are currently conducting inquiries into the existing promotional and advertising materials relating to AAMI's Complete Replacement Cover feature. These inquiries have been focused on the existing materials, however having viewed the materials sent through yesterday, we note that there are similarities in the messaging of the previous advertising materials and some of the new materials.
>
> Our inquiries relating to your existing promotional and advertising materials are ongoing at this time. As you would be aware, ASIC does not approve advertisements, and we are also unable to provide advice in relation to the proposed advertisements. However, we encourage you to consider the best practice guidelines in ASIC's Regulatory Guide 234, and/or to seek legal advice if you require further guidance.

Despite this, AAI launched its new advertising materials in early March 2017.[1065] Mr Dransfield told the Commission that it did this because there was a strong belief that the advertising material satisfactorily explained the way in which the CRC product worked, and that the material was not misleading.[1066] However, Mr Dransfield accepted that AAI 'could not have had certainty' that the material was not misleading in circumstances where ASIC was conducting an investigation into similar AAI advertising material.[1067] He also acknowledged that AAI launched the new campaign because the 'business imperative [to grow the home insurance portfolio] trumped any desire to ensure that [AAI's] marketing materials were not misleading to … customers'.[1068]

[1065] Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 40 [110].

[1066] Transcript, Gary Dransfield, 20 September 2018, 6315–16.

[1067] Transcript, Gary Dransfield, 20 September 2018, 6316.

[1068] Transcript, Gary Dransfield, 20 September 2018, 6316, and more generally at 6317–18.

Between March and October 2017, ASIC and AAI continued to discuss ASIC's concerns with AAI's advertising.[1069] AAI maintained that its advertising was not misleading or deceptive, and that it did not contain false or misleading representations.[1070]

At a meeting between ASIC and AAI on 30 October 2017, ASIC told AAI that it planned to issue infringement notices in respect of the advertising.[1071] On 6 November 2017, ASIC issued four infringement notices alleging contraventions of section 12DB(1)(e) of the ASIC Act, relating to representations made in radio advertisements and on AAMI's website between late 2016 and mid-2017.[1072] The infringement notices said that ASIC had reasonable grounds to believe that AAMI had contravened section 12DB(1)(e) of the ASIC Act by 'making false or misleading representations that services had particular benefits', namely, that AAMI would repair or rebuild an insured's house no matter the cost.[1073]

The total value of the infringement notices was $43,200,[1074] which AAI paid.[1075] Had the matters been litigated, the maximum penalty that a Court could have awarded in respect of each potential contravention would have been $1.8 million.[1076] The effect of paying the infringement notices was that the Commonwealth and ASIC could not bring proceedings against AAI for the alleged contraventions.[1077]

1069 Transcript, Gary Dransfield, 20 September 2018, 6318.

1070 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 41 [113]; Exhibit GCD-4 (Tab 63) [SUN.0760.0502.0141]; Transcript, Gary Dransfield, 20 September 2018, 6317.

1071 Transcript, Gary Dransfield, 20 September 2018, 6318–19.

1072 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 44 [127]; Exhibit GCD-4 (Tab 58) [SUN.0760.0302.0656], (Tab 58) [SUN.0760.0302.0660], (Tab 58) [SUN.0760.0302.0653], (Tab 58) [SUN.0760.0302.0650].

1073 Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, Exhibit GCD-4 (Tab 58) [SUN.0760.0302.0650].

1074 Transcript, Gary Dransfield, 20 September 2018, 6321.

1075 Transcript, Gary Dransfield, 20 September 2018, 6321.

1076 Transcript, Gary Dransfield, 20 September 2018, 6321.

1077 Transcript, Gary Dransfield, 20 September 2018, 6321.

Mr Dransfield told the Commission that AAI paid the infringement notices despite having maintained throughout the ASIC investigation, and still maintaining, that its advertising was not misleading or deceptive.[1078] The cost of paying the four infringement notices was approximately 0.01% of AAI's premium income from its CRC product in 2017.[1079] Mr Dransfield agreed that it could be concluded that the balancing of commercial risks and rewards paid off for AAI.[1080]

In March 2018, at ASIC's request, AAI introduced a Supplementary PDS to make the features and operation of the CRC product more transparent.[1081] The Supplementary PDS contained three key terms, which were said to reflect AAI's existing claims handling practices.[1082] Mr Dransfield recognised that the Treasury proposals paper on the extension of the Unfair Contracts Terms regime referred to examples of potentially unfair contract terms, including a term that looked very similar to the second term in the Supplementary PDS.[1083] However, Mr Dransfield did not accept that this term was potentially unfair to AAI policyholders.[1084] The third term introduced a definition of 'reasonable cost', which was defined to mean the lesser amount of any quotes obtained by AAI.[1085] Mr Dransfield did not agree it would be confusing to customers to define 'reasonable cost' in this way.[1086]

When asked about his broader views on the extension of unfair contract terms protections, Mr Dransfield said that there was no clear rationale for the extension, and that it would increase the underwriting risk borne by insurers without commensurate enhancement in protection for

1078 Transcript, Gary Dransfield, 20 September 2018, 6321.

1079 AAI Ltd, Module 6 Case Study Submission, 4 [14]; cf Transcript, Gary Dransfield, 20 September 2018, 6322.

1080 Transcript, Gary Dransfield, 20 September 2018, 6323.

1081 Transcript, Gary Dransfield, 20 September 2018, 6323.

1082 Transcript, Gary Dransfield, 20 September 2018, 6323–4.

1083 Transcript, Gary Dransfield, 20 September 2018, 6326.

1084 Transcript, Gary Dransfield, 20 September 2018, 6326.

1085 Transcript, Gary Dransfield, 20 September 2018, 6324.

1086 Transcript, Gary Dransfield, 20 September 2018, 6325.

consumers.[1087] Mr Dransfield also expressed the view that section 13 of the Insurance Contracts Act, coupled with the dispute resolution environment, already afforded strong protections to consumers.[1088]
Mr Dransfield accepted that he placed a heavy reliance on the EDR body in his assessment of customer protection.[1089]

10.3 What the case study showed

The case study raised a number of distinct issues about AAI's marketing of the CRC policies and the operation of those policies in the context of the Wye River bushfires.

10.3.1 Misconduct

I consider that by representing in its CRC advertising materials that AAMI *would repair or rebuild* an insured's house, *no matter the cost*, AAI may have engaged in conduct that was misleading or deceptive in contravention of section 12DA of the ASIC Act, or may have made false or misleading representations in contravention of section 12DB(1)(e) of that Act. Mr Dransfield accepted that:

- it was not correct that AAI would necessarily *repair or rebuild homes* covered by the CRC product, because AAI could choose to provide a cash settlement instead;[1090] and
- it was not correct that AAI would repair or rebuild, 'no matter the cost' to AAI: that proposition was subject to at least two relevant (and significant) qualifications.[1091]

In its submissions, AAI strongly resisted such a finding.[1092]

[1087] Exhibit 6.370, Witness statement of Gary Dransfield, 29 August 2018, 8 [30]; Transcript, Gary Dransfield, 20 September 2018, 6326.

[1088] Transcript, Gary Dransfield, 20 September 2018, 6327.

[1089] Transcript, Gary Dransfield, 20 September 2018, 6327.

[1090] Transcript, Gary Dransfield, 20 September 2018, 6307.

[1091] Transcript, Gary Dransfield, 20 September 2018, 6307.

[1092] AAI Ltd, Module 6 Case Study Submission, 4–6 [15]–[22].

In respect of the ‘repair or rebuild’ representation, AAI submitted that its advertising was not misleading or deceptive because:

- the possibility that claims would be cash settled would have been apparent from the PDS;[1093]
- if customers insisted on AAI managing a rebuild, AAI would do so;[1094] and
- many policyholders prefer their claims to be resolved through a cash settlement.[1095]

Taken together, AAI said that there could ‘have been no real doubt in the market that a cash settlement was a possibility under a CRC policy’.[1096] For my part, I am not so sure of this. The clear and repeated message of AAI’s advertising, as accepted by Mr Dransfield, was that AAI would ‘repair or rebuild’.[1097] That advertising material generally only contained a high-level warning to read the PDS – it did not specifically draw the audience’s attention to the fact that the PDS contained material qualifications to the representation.[1098] In my view, it is not reasonable to expect that persons hearing or seeing AAI’s advertising material would seek out the PDS to understand whether AAI’s central representation was subject to some qualification.

In respect of the ‘no matter the cost’ representation, the central thrust of AAI’s submissions appears to be that the representation ‘would be interpreted to mean that there was no cap by way of a “sum insured” on the repair or rebuild funds’.[1099] In my view, that is not how the representation would have been understood by a reasonable person. Rather, a reasonable person would have likely understood the representation as conveying that

1093 AAI Ltd, Module 6 Case Study Submission, 5 [18].

1094 AAI Ltd, Module 6 Case Study Submission, 5 [19].

1095 AAI Ltd, Module 6 Case Study Submission, 5–6 [20].

1096 AAI Ltd, Module 6 Case Study Submission, 6 [21].

1097 Transcript, Gary Dransfield, 20 September 2018, 6306.

1098 See, eg, Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 44 [127]; Exhibit GCD-4 (Tab 9) [SUN.0760.0302.0540], (Tab 58) [SUN.0760.0302.0656], (Tab 58) [SUN.0760.0302.0660].

1099 AAI Ltd, Module 6 Case Study Submission, 6 [22].

AAI would cover the costs of 'repair[ing] or rebuild[ing]' a property so as to restore it to its 'previous state'.[1100] This would carry with it some natural limitations on the costs that AAI could be expected to bear – AAI would not be expected to 'carry out whatever new and improved building might be desired' by a policyholder[1101] – but it would not have conveyed that AAI would only be liable for *what it would cost AAI* to rebuild or repair. Accordingly, I consider that AAI may have also engaged in conduct that was misleading or deceptive, or have made false or misleading representations, in this respect.

The matter having been drawn to ASIC's attention, it is for ASIC to determine what further action it can and should take.

10.3.2 Conduct falling below community standards and expectations

I consider that AAI's conduct fell below community standards and expectations in three respects.

First, as Mr Dransfield acknowledged, and as AAI accepted in its written submissions,[1102] AAI could have done more to keep policyholders affected by the Wye River bushfires informed as to the progress of their claims,[1103] and could have better explained the delays that it was facing when trying to complete the scope of works.[1104]

Second, AAI sent home and contents policy renewal letters to policyholders whose properties had been destroyed by the Wye River bushfires.[1105] As a result, those policyholders were charged premiums for policies relating to properties that were destroyed or were no longer habitable.[1106]

1100 Cf AAI Ltd, Module 6 Case Study Submission, 6 [22].

1101 Cf AAI Ltd, Module 6 Case Study Submission, 6 [22].

1102 AAI Ltd, Module 6 Case Study Submission, 7 [23].

1103 Transcript, Gary Dransfield, 20 September 2018, 6286–7.

1104 Transcript, Gary Dransfield, 20 September 2018, 6286–7.

1105 Transcript, Gary Dransfield, 20 September 2018, 6299.

1106 Transcript, Gary Dransfield, 20 September 2018, 6299.

As acknowledged by Mr Dransfield, and by AAI in its written submissions, AAI should not have charged premiums on renewed home and/or contents policies for customers whose homes had been destroyed in the Wye River bushfires.[1107]

Third, despite ASIC drawing AAI's attention to similarities between the messaging of advertising materials that it was investigating and advertising materials that AAI was proposing to launch, AAI nonetheless proceeded to launch an advertising campaign featuring those materials in early March 2017.[1108] In its submissions, AAI contended that its conduct did not fall below community standards and expectations, because ASIC had not yet reached a conclusion on the material, and AAI 'genuinely believed that the proposed advertising campaign satisfactorily and appropriately conveyed the way in which the CRC product worked'.[1109] I do not consider that this submission sits comfortably with the concession made by Mr Dransfield that AAI launched its new campaign because the 'business imperative [to grow the home insurance portfolio] trumped any desire to ensure that [AAI's] marketing materials were not misleading to … customers'.[1110] This was conduct that fell below community standards and expectations.

10.3.3 Causes of the conduct

I consider that one cause of the conduct of AAI in relation to its advertising material was an internal culture that favoured growing the business over legal and regulatory compliance. While AAI strongly resisted such a characterisation in its submissions,[1111] Mr Dransfield's evidence was that the business imperative to grow the home insurance portfolio at AAI trumped the desire to ensure the marketing material was not misleading to customers.[1112]

1107 AAI Ltd, Module 6 Case Study Submission, 7 [24]; Transcript, Gary Dransfield, 20 September 2018, 6299.

1108 Transcript, Gary Dransfield, 20 September 2018, 6315; Exhibit 6.369, Witness statement of Gary Dransfield, 24 June 2018, 40 [110].

1109 AAI Ltd, Module 6 Case Study Submission, 10 [27].

1110 Transcript, Gary Dransfield, 20 September 2018, 6316.

1111 AAI Ltd, Module 6 Case Study Submission, 12–13 [33]–[35].

1112 Transcript, Gary Dransfield, 20 September 2018, 6316.

11 AAI Ltd (Hunter Valley storm)

11.1 Background

This case study concerned the handling by AAI of an insurance claim arising out of storm damage. The Commission heard evidence from Ms Bernadette Heald and again from Mr Gary Dransfield, the Chief Executive Officer of Insurance at the AAI Group.[1113]

11.2 Evidence

The Healds held a home and contents policy with AAI.[1114] The policy was branded as a Suncorp product.[1115] On 22 April 2015, they lodged a claim with AAI for damage to their property caused by a major storm in the Hunter Valley region.[1116]

Ms Heald gave evidence about the severity of the storm and the damage caused to her home by the storm.[1117] Immediately after the storm, damage to the balcony railings, laundry and garage was evident.[1118] Over time, more damage became evident. Amongst other things, gyprock and brickwork began cracking and laundry tiles began popping off, exposing the property's slab.[1119] There was also a hairline crack in the slab that grew larger over

1113 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 1 [1].

1114 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, Exhibit GCD-2 (Tab 1) [SUN.0708.0001.0499], (Tab 2) [SUN.0703.0002.0165], (Tab 3) [SUN.0792.0901.0033].

1115 Transcript, Bernadette Heald, 20 September 2018, 6330.

1116 Transcript, Bernadette Heald, 20 September 2018, 6330.

1117 Transcript, Bernadette Heald, 20 September 2018, 6330.

1118 Transcript, Bernadette Heald, 20 September 2018, 6330.

1119 Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

time.[1120] When it rained, dirty storm water would rise up through the slab and flow into the house.[1121]

In about June or July 2015, the western wall of the property started coming away from its supports.[1122] Ms Heald kept AAI updated on the additional damage to her property as it occurred.[1123]

Ms Heald explained that the damage to the property had greatly affected her daughter, who suffers from anxiety.[1124] At times her daughter would become so stressed by the popping and cracking noises made by the house that she would sometimes wake up during the night terrified that the house might collapse.[1125]

The day after Ms Heald lodged her claim, AAI appointed a building inspector to inspect the damage caused by the storm.[1126] It also appointed a builder to undertake a make safe.[1127]

It took until mid-May 2015 before a builder attended at the property to fix the railing.[1128] It took until mid-June for AAI to send a builder to complete a make safe on the railings.[1129]

1120 Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

1121 Transcript, Bernadette Heald, 20 September 2018, 6332; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [23].

1122 Transcript, Bernadette Heald, 20 September 2018, 6333.

1123 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

1124 Transcript, Bernadette Heald, 20 September 2018, 6333; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 1 [2].

1125 Transcript, Bernadette Heald, 20 September 2018, 6333. The Healds' son is also a heart transplant recipient, a fact of which AAI was made aware on 19 May 2015: Transcript, Bernadette Heald, 20 September 2018, 6344–5.

1126 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

1127 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 27 [74] [table entry 2].

1128 Transcript, Bernadette Heald, 20 September 2018, 6332.

1129 Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 5 [25].

There were also delays in having the damage assessed. Ms Heald said that she and her husband were frustrated by AAI's failure to properly assess the damage to their property.[1130] Between May and October 2015, AAI sent a building inspector,[1131] a building assessor,[1132] and two engineers[1133] to assess the damage. Each alluded to some possible structural damage, but no-one could properly explain what was wrong with the house.[1134]

When the first engineer came to the property, he undertook a half hour visual inspection and did no testing.[1135] When the engineer's report was provided, the Healds disagreed with many aspects of it.[1136] The report included a scope of works for the repair of superficial cracking, but recommended that the repairs not be undertaken for six to 12 months so as to allow the soils to dry.[1137] The scope of works did not include any repairs to the foundation of the house.[1138]

The Healds requested that AAI appoint a new engineering firm to assess the property.[1139] AAI rejected that request, but agreed to appoint a

[1130] Transcript, Bernadette Heald, 20 September 2018, 6333.

[1131] Transcript, Bernadette Heald, 20 September 2018, 6331.

[1132] Transcript, Bernadette Heald, 20 September 2018, 6332.

[1133] Transcript, Bernadette Heald, 20 September 2018, 6332, 6334.

[1134] Transcript, Bernadette Heald, 20 September 2018, 6331, 6332–4; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 4 [18]–[19].

[1135] Transcript, Bernadette Heald, 20 September 2018, 6332.

[1136] Transcript, Bernadette Heald, 20 September 2018, 6334.

[1137] Transcript, Bernadette Heald, 20 September 2018, 6333; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, Exhibit GCD-2 (Tab 76) [SUN.0702.0004.1289]

[1138] Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 5 [24].

[1139] Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 6 [29].

second engineer from the same firm to prepare a report.[1140] This second engineer's report contained a revised scope of works, this time including the replacement of the slab in the laundry.[1141] The Healds' concerns were not allayed by the further report.[1142]

Because of the difficulty the Healds encountered in dealing with AAI, they contacted Brenda Staggs, a lawyer from Legal Aid.[1143] Ms Heald said that she did not think they would have been able to deal with the claim without the assistance of a solicitor.[1144] Ms Staggs first wrote to AAI on the Healds' behalf in May 2015, explaining the health problems faced by their children, and noting temporary accommodation may be needed.[1145]

Mr Dransfield gave evidence that upon receiving the email from Ms Staggs in May 2015, AAI should have ensured that the make safe was completed to the satisfaction of the family.[1146] He said that AAI should then have sent an engineer to the property as soon as possible to assess the safety of the home, and that AAI should have been discussing temporary accommodation with the Healds.[1147]

Ms Heald advised AAI on several occasions that she had concerns that the property was not safe to live in,[1148] and requested temporary accommodation on multiple occasions.[1149] AAI agreed to move the Healds

[1140] Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 6 [29].

[1141] Transcript, Bernadette Heald, 20 September 2018, 6335.

[1142] Transcript, Bernadette Heald, 20 September 2018, 6335.

[1143] Transcript, Bernadette Heald, 20 September 2018, 6331.

[1144] Transcript, Bernadette Heald, 20 September 2018, 6341–2.

[1145] Transcript, Bernadette Heald, 20 September 2018, 6331; Transcript, Gary Dransfield, 20 September 2018, 6344–5.

[1146] Transcript, Gary Dransfield, 20 September 2018, 6345.

[1147] Transcript, Gary Dransfield, 20 September 2018, 6345.

[1148] Transcript, Bernadette Heald, 20 September 2018, 6337–8.

[1149] Transcript, Bernadette Heald, 20 September 2018, 6338.

into temporary accommodation in March 2017.[1150] The Healds commenced living in temporary accommodation on 28 April 2017.[1151]

AAI tried to cash settle the Healds' claim in October 2015 for around $30,000.[1152] The Healds rejected that offer and lodged an internal complaint with AAI.[1153] Ms Heald did not recall ever being told by AAI about IDR.[1154] Mr Dransfield did not dispute that the Healds were not informed of AAI's IDR process.[1155]

Ms Staggs emailed AAI again in mid-October 2015, expressing concerns on the part of the Healds with the delay in attending to the repairs to the property.[1156] The Healds were concerned that a wall might collapse and injure them, or their neighbour's children.[1157] Mr Dransfield acknowledged that this concern held by the Healds was a very serious matter, and that at this time, again, AAI should have seriously considered temporary accommodation for the Healds.[1158]

On about 4 December 2015, Mr and Ms Heald lodged a complaint with FOS.[1159]

On 31 December 2015, AAI wrote to the Healds, notifying them that AAI would reimburse them the cost of having a local engineer attend

1150 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 32–3 [83(i)].

1151 Transcript, Bernadette Heald, 20 September 2018, 6340; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 33 [83(l)]; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 10 [52].

1152 Transcript, Bernadette Heald, 20 September 2018, 6335.

1153 Transcript, Bernadette Heald, 20 September 2018, 6336.

1154 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [88] [table entry 10].

1155 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [88] [table entry 10].

1156 Transcript, Gary Dransfield, 20 September 2018, 6345–6.

1157 Transcript, Gary Dransfield, 20 September 2018, 6346.

1158 Transcript, Gary Dransfield, 20 September 2018, 6346.

1159 Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 8 [41].

the property and provide a further report.[1160] Mr and Ms Heald appointed Burke Engineering Services Pty Ltd.[1161]

This letter also made an offer of $3,000 compensation for the frustration and inconvenience AAI had caused.[1162]

Burke Engineering provided a preliminary report on 25 January 2016,[1163] advising that further investigations would be required before a detailed assessment could be provided.[1164] In the meantime, it suggested that temporary fencing be installed.[1165] Burke Engineering subsequently provided two further reports, in which it said that the issues with the foundation (including the footings and slab), coupled with the water inundation, had caused the damage to the property.[1166] It recommended the footings and slab be replaced.[1167]

However, AAI maintained that it was entitled to settle the claim on the basis of its engineer's scope of works, which provided that the cracking could be repaired without needing to replace the foundations and that a complete demolition of the property was not warranted.[1168]

Mr Dransfield accepted that the engineers appointed by AAI to produce reports on the damage to the Heald property failed to produce thorough

1160 Exhibit 6.389, 31 December 2015, Letter Suncorp to Healds.

1161 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 36 [89] [table entry 11].

1162 Exhibit 6.389, 31 December 2015, Letter Suncorp to Healds.

1163 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [92(a)].

1164 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

1165 Exhibit 6.386, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

1166 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

1167 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12].

1168 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 37 [91] [table entry 12], 37 [92(d)].

reports and that the conclusions they reached were ultimately incorrect.[1169] The engineers AAI appointed were 'panel' experts. That is, they were experts drawn from a group of experts used by AAI to provide expert reports and advice. Mr Dransfield acknowledged the potential risk of subconscious bias, on behalf of panel firms, towards particular outcomes because of the panel arrangements.[1170] Mr Dransfield accepted that there was a potential for this subconscious bias to have influenced the work of the panel engineers in the Healds' case, given the significant divergence of views between the panel engineers and the independent engineer, Burke Engineering.[1171] That a panel firm could possibly exhibit subconscious bias as a consequence of an ongoing commercial relationship is entirely plausible. However in this case study, the matter was not explored beyond the hypothetical possibility, and I need not make any express findings about that issue.

In January 2017, FOS informed AAI that it considered that AAI was liable for the damage to the property, including to the foundations.[1172] FOS's determination necessitated the preparation of a revised scope of works. [1173]

By April 2017, AAI had not obtained the fresh scope of works. [1174] Mr Dransfield accepted that this delay was not acceptable. [1175]

AAI and the Healds subsequently made offers to settle the matter between 29 May 2017 and January 2018. [1176]

1169 Transcript, Gary Dransfield, 20 September 2018, 6372.

1170 Transcript, Gary Dransfield, 20 September 2018, 6372.

1171 Transcript, Gary Dransfield, 20 September 2018, 6372–3.

1172 Transcript, Gary Dransfield, 20 September 2018, 6364.

1173 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 32 [83(g)]; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, Exhibit GCD-2 (Tab 92) [SUN.0702.0026.0022].

1174 Transcript, Gary Dransfield, 20 September 2018, 6365.

1175 Transcript, Gary Dransfield, 20 September 2018, 6365–6.

1176 Exhibit 6.328, Witness statement of Bernadette Heald, 30 August 2018, 10–11 [53]–[60]; Transcript, Bernadette Heald, 20 September 2018, 6340–1.

In January 2018, FOS made a determination in favour of Mr and Ms Heald, awarding them more than $744,000.[1177] This amount included interest from 5 August 2015, the date FOS held AAI was in a position to determine its liability under the policy (which, as FOS had found, included replacement of the foundations).[1178]

Mr Dransfield acknowledged that, overall, AAI had failed the Healds in the handling of their claim, and apologised for AAI's failures.[1179] He specifically acknowledged that AAI failed the Healds by having too many people involved in the handling of their claim, and that AAI failed to show compassion to the Healds' situation.[1180]

Mr Dransfield accepted that AAI did not manage the Healds' claim in a satisfactory manner.[1181] In particular, he accepted that the following aspects of the handling of the claim were unsatisfactory: the delay in resolving whether a complete repair or rebuild was required;[1182] AAI's lack of effective and compassionate communication with the Healds regarding the extent of the damage to the property and the possibility of repairs;[1183] the failure to appoint a dedicated claims handler to the Healds' claim;[1184] AAI's processes for dealing with vulnerable customers like the Healds;[1185] and AAI's failure to advise the Healds of its IDR process on 18 June 2015.[1186]

1177 Transcript, Bernadette Heald, 20 September 2018, 6341; Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, 11 [60].

1178 Exhibit 6.382, Witness statement of Bernadette Heald, 30 August 2018, Exhibit BJH-23 [FOS.0031.0001.3557 at .3560].

1179 Transcript, Gary Dransfield, 20 September 2018, 6343–4.

1180 Transcript, Gary Dransfield, 20 September 2018, 6343–4.

1181 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [100].

1182 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [101(a)].

1183 Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40 [101(b)].

1184 Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40–1 [101(c)].

1185 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 40–1 [101(c)].

1186 Exhibit 6.368, Witness statement of Gary Dransfield, 13 June 2018, 41 [101(d)].

Mr Dransfield also acknowledged that in 2016, FOS identified systemic issues within AAI, including:[1187] a failure to comply with its obligation to provide information to policyholders about its IDR process;[1188] delays in assessing damage and conducting repair or rectification works;[1189] and a failure to ensure timely implementation of FOS determinations and negotiated settlement agreements.[1190] Mr Dransfield accepted that the first two of those issues had affected the way in which the Healds' claim was handled.[1191]

11.3 What the case study showed

11.3.1 Misconduct

AAI accepted that it had contravened the General Insurance Code of Practice in four ways in the course of its dealings with the Healds.

First, AAI accepted that it had breached clause 7.2, which required it to conduct claims handling in an honest, fair, transparent and timely manner.[1192] Second, it accepted that it had breached clause 7.13, which required AAI to keep the Healds informed about the progress of their claim at least every 20 business days.[1193] Third, it accepted that it had breached clause 9.2, which required AAI to respond to catastrophes (as defined) in an efficient, professional and practical way.[1194] Finally, it accepted that it had breached clause 10.5, which required it to make information available about

[1187] Transcript, Gary Dransfield, 20 September 2018, 6381; see FOS, Terms of Reference (as amended 1 January 2015), cl 11.2 (definition 'systemic issues').

[1188] Transcript, Gary Dransfield, 20 September 2018, 6375.

[1189] Transcript, Gary Dransfield, 20 September 2018, 6378.

[1190] Transcript, Gary Dransfield, 20 September 2018, 6380.

[1191] Transcript, Gary Dransfield, 20 September 2018, 6382.

[1192] Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 17–18 [47]–[48].

[1193] Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 18 [48].

[1194] Transcript, Gary Dransfield, 20 September 2018, 6372; see also AAI Ltd, Module 6 Case Study Submission, 18 [48].

the customer's right to make an internal complaint and about its processes for handling complaints.[1195]

The General Insurance Code of Practice is a recognised and widely adopted benchmark for conduct. It follows that each breach of the Code of Practice constituted misconduct within the meaning of the Commission's Terms of Reference.

11.3.2 Conduct falling below community standards and expectations

AAI also acknowledged that too many people were involved in the Healds' claim and complaint; that its failure to settle the matter promptly after the FOS determination caused delay and added to the strain on the Healds; that it could and should have moved more quickly to resolve the difference of opinion between the experts; and that it could and should have offered to fund the Healds to engage their own engineer earlier.[1196] However AAI did not accept that those failings, alone or in combination, amounted to conduct that fell below community standards and expectations.[1197]

When the totality of the circumstances is considered, AAI's conduct is revealed to have been insufficiently compassionate – something accepted by Mr Dransfield[1198] – and insufficiently diligent. The failure to act with appropriate compassion made the already difficult circumstances faced by the Healds worse. The lack of diligence prolonged their difficulties. AAI's conduct in handling of the Healds' claim did not meet community standards and expectations for those reasons.

1195 AAI Ltd, Module 6 Case Study Submission, 18 [48].

1196 AAI Ltd, Module 6 Case Study Submission, 18–19 [49]–[50].

1197 AAI Ltd, Module 6 Case Study Submission, 19 [52].

1198 Transcript, Gary Dransfield, 20 September 2018, 6343–4.

11.3.3 Causes of the conduct

AAI's conduct was largely attributable to its internal systems and processes for handling claims and disputes arising from those claims. A particularly significant factor was AAI's team management model, which diffused responsibility for claims across a team of employees.[1199] As a result, no one person had direct responsibility for or deep knowledge of the circumstances of the claim.[1200] The difficulties caused by that system were made worse by the very high volume of claims being handled at that time.[1201] An unusually large number of very significant weather events had occurred within a relatively short period of time and these events had caused many claims.[1202]

Mr Dransfield accepted that AAI's team management model failed the Healds.[1203] Two of the systemic issues identified by FOS – failures to provide information to policyholders about IDR processes and delays in implementing the requirements of determinations and settlement agreements – demonstrated that AAI's systems for handling disputes arising from claims were also inadequate in each of the ways identified by FOS.[1204]

1199 Transcript, Gary Dransfield, 20 September 2018, 6344; Exhibit 6.386, 23 December 2015, Email between Pugliese and Others.

1200 Transcript, Bernadette Heald, 20 September 2018, 6344, 6252; Exhibit 6.386, 23 December 2015, Email between Pugliese and Others.

1201 AAI Ltd, Module 6 Case Study Submission, 19 [53].

1202 AAI Ltd, Module 6 Case Study Submission, 19 [53].

1203 Transcript, Gary Dransfield, 20 September 2018, 6344.

1204 See Exhibit 6.396, 20 December 2016, Letter FOS to AAI Limited; Exhibit 6.398, 6 February 2017, Letter FOS to AAI Limited; Exhibit 6.400, 20 September 2016, Letter FOS to AAI Limited.