



AUSTRALIAN INSTITUTE of
SUPERANNUATION TRUSTEES

Competition in the Australian Financial System – Draft Productivity Commission Report

20 March 2018

AIST Submission to the Productivity Commission

Competition in the Australian Financial System – Draft Productivity Commission Report

AIST

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

As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

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

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Executive summary

In brief:

AIST agrees with the draft Report’s themes that consumers are losing their market power to shareholders and this causes consumer detriment. A *consumers first approach* is needed through ensuring general advice is **un**conflicted, conflicted advice is renamed to reflect its sales/commissions based purpose, disclosure gaps are addressed, and that the complete chain of product manufacture and distribution is accountable for consumer outcomes.

AIST welcomes the opportunity to provide feedback to the Productivity Commission regarding its *Competition in the Australian Financial System – Draft Productivity Commission Report* (the ‘draft Report’). Our recommendations address two of the Productivity Commission’s key concerns – that consumers’ power to exert competitive pressure is weakening, and that competition does need to be addressed within the regulatory framework (while always putting consumers first).

AIST focusses upon **two key issues** in this submission:

1. What is needed to help consumers exert competitive pressure?

AIST strongly advocates that a lens of requiring market participants to put the consumer first needs to be applied.

2. Where does competition fit within the regulatory framework?

AIST agrees that there is a role for competition within the regulatory framework, but that the consumer first approach should always be the priority.

AIST recommendations

We have set out a number of recommendations in the following. In summary:

| Issue | AIST recommendations |
|--|---|
| <p>1. Unconflicted general advice should not be renamed</p> | <p>Unconflicted general advice should not be renamed.</p> <p>(i) Renaming of all general advice does not address the conflicts and structures which may influence the advice.</p> <p>(ii) Unconflicted advice delivers improved member outcomes and helps build member confidence in advice.</p> |
| <p>2. Conflicted advice should be renamed</p> | <p>There be legislative change to tighten the definition of general advice to exclude advertising and sales activities or that generates commissions.</p> |

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|---|---|
| <p>3. Review disclosure objectives</p> | <p>Objectives of disclosure should include:</p> <ul style="list-style-type: none"> • Transparency. • Comparability. • Enabling benchmarking. |
| <p>4. Close disclosure gaps</p> | <p>AIST strongly advocates that the various disclosure gaps which lessen consumer protection and increase inefficiencies should be removed.</p> |
| <p>5. Develop a taxonomy of key disclosure terms</p> | <p>AIST recommends that a taxonomy of key disclosure terms be developed to aide comparability, transparency, and system analysis.</p> |
| <p>6. Conduct consumer testing</p> | <p>(i) AIST recommends that further consumer testing of key disclosure documents be undertaken. We outline key documents below.</p> <p>(ii) AIST recommends that the consumer testing methodology be the subject of prior public consultation.</p> |
| <p>7. All components of the product manufacture and distribution chain must be accountable</p> | <p>An examination should take place of the current regulatory framework to ensure all components of the chain are accountable for consumer outcomes. AIST notes several examples in this submission where this has not occurred, including the incomplete disclosure of fees, costs and performance by platform-superannuation products at PDS point-of-sale.</p> |
| <p>8. Competition issues need to be taken into account, but consumer protection should be the priority</p> | <p>Consumer protection should be the priority in a compulsory superannuation system.</p> |

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1. Key issue 1 – What is needed to help consumers exert competitive pressure

1.1 Introduction

AIST draws particular attention to two key themes covered within the draft Report:

- **Consumers have lost their market power to shareholders.**

AIST agrees that consumers have lost their market power to shareholders. This is true in the for-profit superannuation sector, the very purpose of which is to benefit members.

In superannuation, the loss of market power is evidenced by Choice investment options in the for-profit sector (mainly run by banks) generally providing lower investment returns than the profit-to-member funds and being between 53% to 280% more expensive.¹

In the advice space, this is evidenced by for-profit entities providing conflicted general advice without any legislative requirement to act in the best interests of consumers. AIST strongly advocates that **unconflicted** general advice is of benefit to members and should remain named as ‘general advice’. Conflicted general advice should be renamed.

- **Product proliferation is poorly aligned with consumer interests.**

AIST agrees that product proliferation is poorly aligned with consumer interests. In superannuation, there are over 40,000 investment choices.

We deal with these issues in more detail below.

1.2 Put consumers first

Members in defined contribution schemes bear investment and operational risks. As the OECD notes², a combination of being in defined contribution funds and having member choice can lead to, for example, hidden commissions and insider trading. The OECD notes this is a problem exaggerated when the pension providers are commercial financial institutions and that members rarely make retirement decisions.

¹ SuperRatings (2017). *Fee and Performance Analysis 1 March 2017*. [online] AIST. Available at: <https://tinyurl.com/y9lywg53> [Accessed 8 Mar. 2018].

² John Ashcroft and Fiona Stewart, *Managing and Supervising Risks in Defined Contribution Pension Systems*, Working Paper no. 12 October 2010 International Organisation of Pension Supervisors, <http://www.oecd.org/site/iops/principlesandguidelines/46126017.pdf> [Accessed 8 Mar. 2018].

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AIST strongly disagrees with the notion mentioned in the draft Report (in referencing the Financial System Inquiry) that where members are disengaged, the effectiveness of disclosure is limited. Consumers deserve a robust regulatory framework. A robust regulatory framework both sends clear signals to providers as well as enabling regulators to step in.

The Financial Stability Board (FSB) issued a Report examining consumer finance protection with particular focus on credit post the GFC which found:³

Disclosure laws in Australia may have acted as a deterrent for the marketing arms of global investment banks (many of which have extensive operations in Australia) to bring riskier products to consumers in Australia.

AIST records its firm support for the regulatory framework, but believes that further is needed to assist its ongoing strength and resilience. We outline our proposals below. We turn first to the area of advice.

1.3 Advice - *unconflicted* general advice is helping members General advice should remain but only as *unconflicted* advice

Members have the right to expect high quality, *unconflicted* advice. Any review of advice, including general advice, should take into account what type of information and advice members want, how they wish to access it, and ensure that the regulatory framework provides members with sufficient protection.

AIST strongly advocates:

- **Unconflicted** general advice is of benefit to members.
- **Unconflicted** general advice should not be renamed.
- **Conflicted** general advice should be renamed.
- **A purposeful and much stronger and focussed solution** to the issues raised in the draft Report would be the Productivity Commission recommending that legislation be amended:
 - Tighten the definition of general advice to exclude advertising and sales activities.
 - Tighten the definition of general advice to exclude all activities that generate commissions as a result of grandfathering or exemptions from the ban on conflicted remuneration under FOFA (eg. insurance and life insurance).

³ Financial Stability Board, Consumer Finance Protection with particular focus on credit, 26 October 2011 https://www.financialstabilityboard.org/publications/r_111026a.pdf [Accessed 8 Mar. 2018].

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- Addressing the regulatory gap which enables for-profit superannuation funds to switch members from a MySuper product to an inferior choice product under the general advice or no-advice business model.

The examples in the draft Report all relate to the impact of sales and marketing on consumer decisions. The draft Report cites ASIC's comment that representatives are under no obligation to sell a product that meets the needs of the consumer.

AIST contends that these systemic instances of poor behaviour will not be properly dealt with by holistically renaming general advice. Unconflicted general advice is of benefit to members, and is being used to good effect. AIST urges the Productivity Commission to recognise the benefits of **unconflicted** general advice.

Holistic renaming of general advice does not address the conflicts and structures which may influence the advice.

Unconflicted general advice is of benefit to members

Unconflicted general advice is an efficient way for superannuation funds to deliver simple advice to a high volume of members facing similar issues. Profit-to-member funds have never paid commissions for general advice. If all general advice was renamed as product sales information, this would imply that all general advice was conflicted (which it is not).

Profit-to-member funds provide a wide variety of services which are 'general advice': superannuation seminars, retirement planning seminars, induction seminars, workplace seminars, online calculators, newsletters and advice to individuals. General advice delivered to individuals is delivered through a variety of channels including face to face, over the phone and online. AIST's member funds have found that members who receive general advice leads to members being more engaged with their superannuation and can lead to members seeking more comprehensive personal advice. As evidence of this, many of our larger superannuation fund members would see more than 10,000 members a year through various seminars⁴.

Unconflicted general advice continues to play an important role in engaging with members. This is particularly needed in these times when members are wary of financial planners, a wariness which has arisen from the many scandals arising from conflicted advice by planners employed by or associated with for profit superannuation funds and by bank tellers and other staff.

⁴ AIST and ISA (2015). *Meeting Members' Advice Needs - the provision of advice by not-for-profit super funds*. [online] AIST and ISA. Available at: <https://tinyurl.com/y8uzdtnu> [Accessed 8 Mar. 2018].

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1.4 Information - how can consumers be better protected?

Set clearer disclosure objectives

AIST strongly supports the objectives of comparability and transparency, and that disclosures must be clear, concise and effective.

We also believe that fees, costs, benefits, performance should be capable of being analysed and benchmarked.

The current state of disclosure and reporting in the superannuation system does not enable the benchmarking of fees and costs. For example, surveys from the UK can quantify the cost of both platform products and legacy products within the UK pension system – this currently cannot be done in Australia owing to a lack of disclosure and reporting in some areas.

Close the disclosure gaps

AIST urges the Productivity Commission to recommend that the various disclosure gaps be removed.

The current regulatory framework does not meet basic consumer protection principles. A number of exemptions, gaps and carveouts have been introduced which fundamentally erode consumer protections.

One key example is the regulatory differences between MySuper and Choice products. So-called “Choice” products are frequently recommended under advcet. ASIC recently found that conflicted advice resulting in 68% of client funds being invested in in-house products. Yet there is no requirement for superannuation funds to produce a product dashboard for choice investment options.

Use the regulatory framework to help reduce product proliferation

AIST supports the Productivity Commission’s comments in the draft Report that a proliferation of products is confusing consumers and enabling price discrimination.

This causes confusion to members as well as rendering the superannuation system less efficient than it otherwise could be.

Taxonomy of key disclosure terms must be developed

AIST recommends that a taxonomy of key disclosure terms be developed to aide comparability and transparency, and enable proper system analysis. An example is what is meant by ‘growth’ or ‘defensive’.

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Centralise publishing of information

AIST supports the draft Report's recommendation that APRA publish home loan pricing information on a monthly basis. In the superannuation space, the equivalent would be for APRA to publish product dashboards – something which is not currently happening. AIST notes that currently there are requirements for MySuper product dashboards, but there aren't equivalent requirements for Choice product dashboards.

Test whether consumers have been 'informed'

AIST strongly agrees with the draft Report's comments that disclosure should first be consumer tested.

AIST recommends that the following should be consumer tested:

- Product dashboards.
- PDSs with a particular emphasis on fee and cost templates.
- Periodic statements.
- How consumers would compare superannuation products (such testing could happen without consumers being given prior notice so that the testing could find out how consumers would actually commence their comparisons).

1.5 Integration - impacts of integration must be transparent

In ASIC's recent review⁵ of how financial services institutions manage conflicts arising from both providing advice to retail clients and manufacturing financial products, ASIC found that while there was a high proportion of external products on approved product lists, a high proportion of client funds was invested in in-house products. ASIC also found that in some cases, in being switched to a new platform superannuation product, the consumer had inferior insurance arrangements and/or a significant increase in fees.

AIST repeats that closing the legislative gaps is the starting point to helping consumers:

- Tighten the legislative definition of general advice so that it excludes sales and marketing activities and activities underpinned by commissions.
- Bring Choice product disclosure and reporting into line with that for MySuper.

⁵ ASIC (2018). Report 562 - *Financial advice: Vertically integrated institutions and conflicts of interest, January 2018*. [online] ASIC. Available at: <https://tinyurl.com/y8na5dfd> [Accessed 8 Mar. 2018].

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- Require platform superannuation products to provide aggregate fee, cost and investment performance information at the point-of-sale (ie. PDS disclosure).

1.6 All components of the product manufacture and distribution chain must be accountable to consumers

All components of a product's manufacture and distribution chain should be accountable for ensuring they are in the members' best interests and are 'fit for purpose'.

AIST strongly recommends all components of the product manufacture and distribution chain are accountable and are fit for purpose.

While about product design (an important component of putting consumers first), AIST notes that the complete chain is not covered in the case of the proposals contained in the *Design and Distribution Obligations and Product Intervention Power – draft Legislation*. The manufacturers of the products would not be placed under an obligation to determine the 'target markets' and suitability of the product for those 'target markets'. AIST notes that the Markets in Financial Instrument Directive ('MiFIDII') which, while not applying in Australia, impacts entities in Australia which operate in Europe. MiFIDII requires that all 'manufacturers' of financial services products will be captured by target market and distribution obligations for financial services products.

The Transparency Taskforce has developed a paper⁶ examining ideas to help prevent the next Global Financial Crisis. One of these ideas is that a whole of system approach should be taken to systems governance and stewardship, ensuring that system ownership and responsibility are correctly allocated. AIST advocates that inclusion of the concept of 'ownership' of product manufacture and distribution is essential.

The continued lack of including the full chain of all involved in the design and distribution of products will lose an opportunity to better protect consumers as well encouraging the continuation of an overwhelming and obfuscating proliferation of choice. AIST welcomes further consultations on these issues.

⁶ Transparency Task Force (2018). *Transparency Task Force White Paper - Ideas to help reduce the chance of another Global Financial Crisis*. [online] London: Transparency Task Force. Available at: <https://tinyurl.com/yarqeyjm> [Accessed 9 Feb. 2018].

2. Key issue 2 – Where does competition fit within the regulatory framework?

Competition issues needing to be taken into account – but stability and consumer protection are the priority

AIST believes that regulation and competition are separate and complementary issues – both needing oversight. Competition policy should address market structure failings, while the consumer protection oversight should ensure issues such as addressing particular misconduct.

AIST recommends that the matter of which regulatory body should examine competition issues within financial services needs to be the matter of a specific consultation. In the meantime, AIST believes that the following matters would need to be taken into account:

- The best interests of consumers is paramount.
- The goals of stability and consumer protection should accordingly take priority.
- Regulation is a powerful tool in shaping markets⁷.
- As the OECD⁷ says, ‘Going forward, the key element to improving the functioning of financial markets is to improve the quality of the regulatory oversight in the sector.’ AIST repeats its earlier comments that the various gaps in the regulatory environment need fixing to ensure consumers are adequately protected. AIST acknowledges that this is a longer-term project.
- Within the financial sector, there is a need to balance the policy goals of stability and consumer protection with competition.
- Effective markets also rely on competition, and that this is, in essence, the ability of consumers to exercise choice in a way that promotes their best interests and how organisations respond to consumers switching. In this regard, the exercise of choice must be supported by a suitable regulatory environment.
- Disclosure should deliver a level playing field both to help protect consumers and to aide competitiveness.
- Financial services regulation needs to respond to financial innovation.
- All components of the financial services product manufacture and distribution chain should be accountable.
- The notion that some financial services institutions are ‘too big to fail’ undermines both stability and competition.

⁷ *Competition and innovation in financial services: the regulator’s perspective* (FCA, 2017) Available at: <https://tinyurl.com/yaw38de7>

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3. Conclusions

AIST greatly appreciates the opportunity to comment about the draft Report. We have made a number of recommendations which we believe would render the next iteration of the Report more efficacious. We look forward to participating in ongoing consultations.

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