

REVIEW OF AUSTRALIA'S CONSUMER POLICY FRAMEWORK

INTRODUCTORY REMARKS

The Commission's draft report proposing a reformed consumer policy framework -- the 'golden rule report' -- is a hopeful contribution and one duly hopes it strikes an empathetic chord in the heart of the Australian business community.

A consumer-policy framework promoting kind and true ideals, and making market players accountable for observing them, would set a new benchmark for consumer protection. As I read it, the spirit of the proposal would readily find wide acceptance in the community. In summary:

'competing suppliers would cooperate to ensure consumers are well informed before individually offering, in good faith, products that are fit for purpose but, if necessary, allowing complaints to be resolved independently'

As is, breaches of the golden rule are usually conscious decisions taken by suppliers (and sometimes customers) -- people knowingly doing the 'wrong thing', because they can and know they won't be stopped. Black-letter regulation to protect particular dealings often becomes a game of contrived frustration: prospectively, exposing breaches of golden-rule principles might change the game. It will be interesting to see what support there is for a golden-rule approach in the business sector including industry associations and other peak industry bodies.

Regulators also can be mightily at fault. Whatever golden-rule arrangements might be agreed, success will often depend on front-line regulatory agencies applying them with a suitable commitment to their own accountability. Some major national regulatory agencies apparently have scant regard for their charges observing anything akin to the golden rule, misbehaviour in markets is often condoned with alacrity and some regulators simply choose not to pursue with proper purpose what otherwise would seem to be their clear legislative responsibilities. Regulatory agencies that are seen to be compromised or underpowered would ideally be made subject to an extended freedom-of-information obligation to explain apparent shortcomings.

I suspect that proposal, for regulators with consumer protection roles to be made more openly accountable, is the main point I would want to add to the framework proposed by the Commission. The commission knows well from its previous inclination to allow independent reviews of regulators, that there is resistance to external review from regulatory agencies and their political patrons, even so, it may be worth putting that proposal on the table again—adopted, it would be a powerful force for good.

RETAIL FINANCIAL SERVICES [AND AN ILLUSTRATIVE CASE STUDY]

The contrast between golden-rule principles and observable market misbehaviour is routinely stark in markets for retail financial services. It is, for example, common to refer to the ‘banking cartel’ which operates largely unchecked in blatant abuses of its substantial, collective market power largely underwritten by regulatory shortcomings. Similarly it is simply accepted that, for superannuation products, the prevailing commission-sales culture typically entails licensed financial advisers newly giving advice that is very clearly not in their customers’ best interests and continuing to draw financial advantage from similarly corrupted advice given previously. More generally superannuation fund managers (misnamed trustees?) administering one-sided contracts are apparently at liberty to set and vary fees and charges sometimes unfairly with no avenue yet available for independent review.

The prevailing culture in retail financial services is more jungle rule than golden rule and, given the acquiescence of appointed regulators, few would see any real prospect of a much needed turnaround. It would be some welcome revolution if the retail financial services industry were to genuinely accept the spirit of the consumer-protection framework suggested by the Commission.

The case study that follows in the context of superannuation illustrates a particular ‘we can and we will’ departure from the golden rule for which there has been, and remains, no prospect of an independent review of the related complaint. The (mis)behaviour, not checked, and now being copied by other players is apparently beyond the reach of a regulatory framework that is silent on matters of fees and charges and a fund structure that denies members a voice in decisions of mutual concern.

The retail superannuation industry comprises mainly for-profit funds, predominantly subsidiaries of banks, while not-for-profit funds, cooperative mutual organizations known as industry funds, provide the most effective competition. The main practical difference was that, for similar products, members of for-profit funds typically paid fees and charges about double those paid by members of industry funds. The cost differential, mainly ongoing levies to pay never-ending entitlements to commissions of various kinds, was typically some 1% p.a. of the member’s investment account balance – a de facto reduction in the annual investment earnings which, compounded over a working life, could mean an eventual total payout some 25% less for members of for-profit funds.

Such a marked difference in the cost of essentially the same thing in the same market is indicative of both market and regulatory failure. A third, inevitable, consequence now underway is a fees-down/fees-up convergence towards some sustainable middle ground where any continuing differences in fees and member returns would perhaps not be as marked although particular high-profile scheme operators might continue to fleece vulnerable customers. Even so the community generally is worse off by reason of a competitive balance being struck at a price level well above the best possible outcome.

Observing the golden rule, as industry funds once did, does not return the same handsome salaries as paid to those taking financial advantage of their customers: managers doing the same job can be paid very differently depending on who they work for. The penalty on virtue and the wages of ‘sin’ being correspondingly high, the temptation to sin is eventually irresistible.

It is a most unfortunate development that some industry-funds are now loading their fees and charges with % asset-levies on members account balances over and above appropriate fixed fees for account keeping and recovering the fees paid to the external investment managers responsible for actually investing the money.

Looking ahead, one risk is that these industry funds will, as with other major national mutual organizations, come to embody such substantial unrealized goodwill that they will be privatized and the competitive discipline they now bring to the market lost.

Potential defences against the further erosion of such critical competitive disciplines include reformed arrangements to protect the 'choice of fund' regime which, so far, is not working effectively because the policy, being incomplete, is defective; more resolute proscription of licensed advisers' inclination to give 'bad advice' and simply ignore industry funds offering a better deal for their clients, because they do not pay sales commissions to advisers; the formal allocation of voting rights to the members of industry funds, as a check on the operational discretion of 'trustees', and, ideally, the establishment of a government-owned superannuation fund to bring the benefit of a public interest player to the market for retail super services, a market still in its formative stages (and grossly malformed).

Put more sharply from the perspective of the customers, public policy oversight of the retail superannuation industry has been so lax for so long it is well beyond time to precipitate its wholesale reform.

One question for the Commission is how confident it and the community might be about a new 'golden rule' framework making a prompt and effective contribution to reorientating retail superannuation. On experience to date, with attendant ingrained misbehaviour already clearly identified, could one be confident?

For my money, given the present genetic flaws in the retail super models taking root in Australia, simply asking these people to behave properly in relation to others has little prospect of success. To my mind, the single most useful and effective public policy response would see the establishment of a national super scheme operated in conjunction with the Future Fund. A response along those lines has the hallmarks of a proud Australian tradition, especially in the retail financial services sector where a credible national operator following golden-rule precepts would soon have a salutary influence on the behaviour of others.

THE CASE STUDY

The following case study makes much the same points in the context of a reasonable summary of the way a complaint, fairly put, was dismissed and then let lie unresolved without any prospect of effective regulatory intervention: I am more than happy for my assessment, and my telling of the story, to be corrected on the public record – an outcome which has been the primary objective all along.

In 2002 the industry fund, UniSuper, introduced a marked distinction between its employed, contributing members and its retired members drawing an allocated pension. Up to this point UniSuper treated its pension members essentially the same as its other members – paying modest annual account keeping fees of some \$100 and modest investment management fees of some 0.4%. The marked distinction, affecting pension members only, entailed an additional levy on their account balances of some 0.2% p.a. which, after considering a complaint internally was

capped at \$750 indexed to the CPI. Subsequently, in 2006, the levy on pension members was increased to 0.25% p.a. and the cap doubled to some \$1500.

UniSuper's decision to draw this distinction and penalize its pension members was not reasonably explained either in 2002 or since, notwithstanding a renewed complaint when the levy and the cap was increased in 2006.

From the perspective of a pension member of UniSuper who has continued to object to this discriminatory levy, I can see no sound basis for making such a marked distinction between members of the fund. Whatever nominal difference there may be between its pension members and other members there is no reason to expect UniSuper's cost of servicing pension members to be substantially different and certainly not substantially higher to the tune of one third or one half more than the cost of servicing its other members.

What is interesting in the context of the Commission's proposed consumer policy framework is that, for this matter, there was no objective avenue of complaint available to have the decision reviewed independently.

-- UniSuper reviews itself

Practically the only course open for complaint was UniSuper itself and that arrangement is plainly unsatisfactory. The management of UniSuper and the Trustees of the fund along with various administrative sub-committees are comprised of essentially the same people. UniSuper has continually resisted the suggestion that it cooperate with the appointment of an independent arbitrator to review the decision to impose a levy on pension members only. For an organization proclaiming its no-profit, mutual status and claiming dedication to its members' interests it is no defence of its decision to say that its total pension-member costs are still comparable with or lower than other funds: some members are more equal than others in their entitlements to the benefits of membership of UniSuper.

Adding insult to the injury, UniSuper advised that the complaint could be taken to the Superannuation Complaints Tribunal (SCT) while knowing full well that the SCT was precluded from reviewing 'fees and charges' matters.

-- complaints bodies that do not hear complaints

On the face of it one would expect the SCT and its private counterpart, Financial Industry Complaints Service, to at least be receptive to hearing complaints about discriminatory fees and charges – but 'no' the operating charters of these bodies preclude them hearing 'discriminatory fees and charges' matters among others.

The Australian Securities and Investments Commission is similarly not inclined to get involved in such disputes on the basis that aggrieved members can 'go somewhere else': a regulatory attitude which plays into the hands of both industry funds and for-profit funds which, collectively, can all charge more as a result of the regulators apparent acquiescence.

The role of the Australian Prudential Regulatory Authority (APRA) is similarly confused. Regulations administered by APRA make provision for it to require super fund trustees 'to determine costs and ensure they are distributed between members in a fair and reasonable manner'. Unfortunately 'no' was the answer again -- APRA saying that 'the complaint did not

raise prudential concerns' and, presumably, it also had the discretion to not consider the issues irrespective of what the regulations might appear to say it has the authority to do.

Having drawn blanks with requests to the UniSuper trustees to protect the interests of its pension members, along with the raft of Commonwealth regulatory agencies apparently unable or unwilling to get involved, an application was made in 2007 for the NSW Consumer Complaints Tribunal to hear the matter and the related unfolding of events was revealing.

-- application to the NSW Consumer Tribunal

At the outset counsel for UniSuper put the view that the Tribunal had no jurisdiction to hear the matter or make any decision. Told that the Tribunal was prepared to hear the matter, and it being listed, the scheduled hearing was adjourned. The application for adjournment followed advice from the presiding tribunal member warning that UniSuper had indicated its intention to appeal any decision he might make in the NSW Supreme Court and the potential (personal) costs of defending any such appeal would likely be prohibitive for an applicant simply looking to the Tribunal for an inexpensive avenue of dispute resolution. Subsequently having put the view that the barrier posed by the threatened appeal was an unintended and a practically unreasonable hurdle limiting the effectiveness of the Tribunal, no relief was forthcoming from either the Tribunal or the Minister for Fair Trading in NSW

At a subsequent directions hearing at the Tribunal, UniSuper was directed to 'set out the contractual basis for the (levy) decision and why it is not discriminatory'. The response filed with the Tribunal was, to a layman's eyes, illustrative of the circular reasoning that has -- *the administration of the super fund, in line with the trust deed, being overseen by trustees who in turn propose amendments to the trust deed, as they did in relation to the levy 'in a fair and reasonable manner' 'exercising the powers and discretions properly' and in good faith, responsibly and reasonably' and 'giving proper regard to the member's interests'.*

This response, to the applicant's eyes, frankly made no impression on the prospect of an independent assessment of the matter coming to a directly contradictory conclusion – that *the decision was not made in a fair and reasonable manner having proper regard to the essentially similar, funds management, interests of all the members of UniSuper.*

A renewed request, in the wake of this exchange, for UniSuper to agree to the appointment of an independent arbitrator to review the decision has apparently again fallen on deaf ears.

As a possible alternative response, UniSuper could have released the material underpinning its levy decisions that was presented to its various internal and consultative committees prior to amending the trust deed and assuming the powers to set and vary the levy. It seems unusual that an organization publicly claiming the cooperative status of a 'mutual' with 'members' feels no obligation to adopt an open and transparent attitude in dealings with its members. Those policy papers could be persuasive.

In the circumstances the application to have the matter heard in the NSW Consumer Tribunal has been withdrawn, not for any accepted lack of merit but rather because the applicant does not have resources to defend a decision of the Tribunal appealed in the Supreme Court:.

-- a situation plainly unsatisfactory

For a host of reasons one would like to think that there would be wide agreement that access to independent review of operational management decisions and discretions of super fund administrators is presently inadequate and in need of reform.

In the normal course supplementary arrangements would already be in place, not least an industry code of conduct supported by an ombudsman administering a dispute resolution scheme alternative to the courts and the other agencies rendered ineffective with inappropriately limited jurisdiction. It is worth reflecting on the likely (political) explanation for such supplementary arrangements not already being in place.

Short of that formality one might, in the particular case, have expected UniSuper to accept the general sense of an objection to a levy that discriminates between its members and agree to have an independent arbitrator hear the dispute and resolve the issues. Resolute resistance to any external review may not be conclusive but it is suggestive.

In the Commission's prospective future there would seem to be a strong case for a nationally consistent consumer tribunal arrangement, preferably one where appeals against its decisions would be defended by the Tribunal itself as an appropriate body of case-law was established. Nonetheless industries, like retail superannuation, still in their establishment phase are likely to generate more complaints than mature businesses and may need the expertise, at least temporarily, of a dedicated division of a general consumer tribunal.

Peter Mair
15 January 2008