CHAPTER 7

PRUDENTIAL SUPERVISION AND CONSUMER PROTECTION

Introduction

7.1 Choice of fund will inevitably lead superannuation providers to actively compete for the business of employees to improve market share. In this climate, the previous Committee received evidence in 1998 indicating that there was concern in some quarters about whether the consumers of superannuation and other financial services would be adequately protected from practices which were not in the best interests of the consumers or would unnecessarily restrict choice.

7.2 As discussed in Chapter 4, adequate education and full disclosure of fees and charges are the minimum preconditions necessary for consumers to be adequately informed. During the 1999 roundtable, the Committee also heard from witnesses concerned about other consumer protection issues, such as:

- commission based selling;
- twisting, churning, and third line forcing;
- enforcement powers; and
- dispute resolution mechanisms.

7.3 These issues are discussed in turn below.

Commission based selling

7.4 Some witnesses recognised that people are likely to seek advice in relation to their superannuation, as it is viewed as very complicated.

7.5 Although there was not extensive discussion on this issue, a variety of views were expressed by witnesses on commission-based selling versus fee-for-service selling of superannuation products.

7.6 The peak service provider group, the Investment and Financial Services Association (IFSA), suggested that people who provide service have the right to be paid for that service. IFSA said:

> The reason people are paid commission is that they are providing advice and service and, at the end of the day, we think they have a right to be paid for that. Some people are paid for that inside a fund. Many funds these days are setting up free financial planning advice for members of the fund, in which case everyone in the fund is actually paying for that advice. Someone is going to pay for that advice and that service. At the end of the day, a

> whole range of services are provided to funds and to fund members, and we think those people are entitled to be paid for that.[1]

7.7 Using the example of comparison with the retirement incomes market, which currently operates with both commissioned advisers as well as fee-based advisers, IFSA told the Committee that it had not seen evidence of gross mis-selling in that marketplace.[2]

7.8 Confirming this view, the Australian Retirement Income Streams Association (ARISA) advised that 'the mixture of fee based systems and commission based systems has worked in the retirement income stream industry for about the last 12 years and, by and large, I do not think we have had too many mistakes in that industry.' Having said that, ARISA also remarked: 'that is not to say that we should not be looking at even more controls over the practices that happen.'[3]

7.9 This view was not wholly supported by industry, with the Industry Funds Forum advising that 'the fee-for-service model is … a better model than commission based selling because, whichever way you cut it, it is very hard to demonstrate that the advice provided is independent of the gain to be made by the individual.' IFF went on to point out that it had seen evidence of mis-selling occurring.[4]

7.10 Industry funds were also strongly critical of commission selling in a compulsory superannuation environment. The IFF advised the Committee that, in its view, commission selling of compulsory superannuation should be disallowed.[5]

7.11 Jacques Martin Industry Funds Administration also advised the Committee that:

> We have no problems with commissions in areas of voluntary savings, top-ups, private savings and the like, but what we have got here is a very explosive mix of a financially illiterate marketplace, a compulsory system and …. a competitive free-for- all. We think there should be a ban on commission selling of compulsory SG superannuation.[6]

Twisting, churning and third line forcing

7.12 Other practices, such as twisting, churning and third line or full line forcing were also commented on by witnesses at the roundtable. These practices relate to agents receiving commissions by convincing consumers to change products between or within suppliers, and providers offering 'deals' - inducements or products - which

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1 Hansard, pp. 51-52.

2 Hansard, p. 52.

3 Hansard, p. 53.

4 Hansard, p. 52.

5 Submission No. 1, p. 2.

6 Hansard, p. 51.

would lock a consumer into an arrangement which is not necessarily in the best interest of the consumer or would unnecessarily restrict choice.

7.13 Consumer advocates, such as the Australian Consumers Association (ACA), were highly critical of such practices. The ACA advised the Committee that:

> I have seen, both in private practice and through work on one of the industry complaints schemes … examples of churning or twisting. The practice is out there and it needs to be kept under control and kept in line in any choice environment.[7]

7.14 Further, the ACA submitted that there should be strong provisions against 'deals' between employers and product providers that work against the interests of employees or unnecessarily restrict choice; and that it sought assurances that 'third line forcing' provisions in the Trade Practices Act were appropriate for the superannuation system.[8]

7.15 The IFF was also critical of such practices. It submitted that:

- churning should be disallowed;
- there should be a regulatory limit (say $50) on transfer out fees and penalties; and
- legislative measures should prohibit third line forcing and penalties should apply.[9]

7.16 The Australian Bankers' Association pointed out that section 78 of the *Retirement Savings Accounts Act 1997* already contains provisions which prohibit practices such as third line forcing.[10] Although these provisions relate specifically to RSAs, it was suggested that they could be used as a model to prohibit such practices for superannuation products in the choice environment.

7.17 A representative of Westscheme Superannuation Fund advised the Committee that the experience in Western Australia was that third line forcing and churning were problems, and that it was necessary to have in place mechanisms to make sure that invitations and offers made in the context of negotiating business opportunities are responsible and fair.[11]

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7 Hansard, pp. 53-54.

8 Submission No. 12, p. 3.

9 Submission No. 1, p. 2.

10 Hansard, p. 51.

11 Hansard, p. 83.

Enforcement powers

7.18 Witnesses raised concerns about enforcement of the Superannuation Guarantee (SG) obligations from the perspectives both of the adverse effect on individuals' retirement savings and the possible interruption in insurance cover where contributions are paid late or not at all.

7.19 The role of the Australian Taxation Office (ATO) in enforcement of the Superannuation Guarantee attracted some comment during the roundtable.

7.20 ASFA commented that the enforcement strategies as they relate to individuals needed 'to be thought through,' because with 90 per cent compliance, 'that means that there is 10 per cent non-compliance.' ASFA's view was that the ATO saw its role as 'more of one of education of the employer.'[12] ASFA went on to say that:

> The difficulty is that the ATO are the only ones with the statutory powers of enforcement in so far as the individual is concerned, so they really do have to take responsibility for those individual remedies. As a matter of practicality, they prefer to see the infringements amount to 40,000-plus, which might mean the numbers of individuals mounting before it becomes cost-effective for them to take it through the courts. But that is not really dealing with the individuals' concerns about their enforcement nor with the confidence of the system overall. So it really does need to be addressed.[13]

7.21 The Australian Consumers' Association drew attention to difficulties it perceived with the ATO's collection of payments from 'recalcitrant employers.' The ACA told the Committee:

> I think there are problems with that at the moment in the collection mechanism through the Australian Taxation Office – the identification of employers who are not paying and then chasing them up and collecting the money.[14]

7.22 The Australian Society of Certified Practising Accountants, drew the Committee's attention to the recent Australian National Audit Office (ANAO) audit report on Superannuation Guarantee enforcement by the ATO.[15] Overall the ANAO found that the ATO's administration of the SG was sound. However, in its report, the ANAO made a number of recommendations to improve the ATO's administration of the SG, including exploring options that may be available to reduce the number and value of unredeemed vouchers, and developing an effective prosecution strategy for SG avoidance.

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12 Hansard, p. 57.

13 Hansard, p. 57.

14 Hansard, p. 54.

15 Australian National Audit Office, Audit Report No. 16, 1999-2000, *Superannuation Guarantee, Australian Taxation Office*, Canberra, 1999, referred to at Hansard, p. 55.

7.23 Although its submission to the Committee's main terms of reference was not discussed at the roundtable, in it the ATO pointed out that results from the annual SG Compliance Research Survey completed in 1999 indicate that 71 per cent of capital city businesses and 70 per cent of reginal businesses were fully complying with their SG obligations. Of the remaining 29 – 30 per cent, only minor non-compliance was found. According to the ATO, less than one percent of both the capital city and regional businesses were found to be fully non-compliant.[16]

Dispute resolution

7.24 In Western Australia the state choice of fund legislation contains no provisions for a dispute resolution mechanism for problems arising from superannuation choice. In the absence of such a provision, the only recourse for dispute resolution is the industrial relations system.

7.25 Witnesses appearing before the Committee were generally agreed that an effective independent and accessible complaints mechanism is required to ensure a fair resolution of any disputes and overall confidence in the system.

7.26 However, there were a number of views expressed about the current dispute resolution mechanisms. The major current mechanisms for dispute resolution involve:

- the Superannuation Complaints Tribunal (SCT) – The SCT provides a mechanism for superannuation fund members to resolve complaints about decisions or conduct of trustees, insurers, Retirement Savings Accounts (RSA) providers, superannuation providers and certain other decision makers in relation to regulated superannuation funds, approved deposit funds, life policy funds, annuity policies and RSAs.
- the Award system, which currently provides a mechanism through the Australian Industrial Relations Commission (AIRC) to resolve some disputes between employer and employee, including disputes over superannuation.
- the Financial Industry Complaints Service (FICS). IFSA advised that FICS is authorised under its constitution, and by ASIC, to conduct alternative dispute resolutions between companies, which are its members, and consumers of superannuation products. FICS's jurisdiction in relation to superannuation complaints intends to extend to all matters involving members and consumers which do not fall within the jurisdiction of the SCT.

7.27 In the view of IFSA, through the operation of the SCT and FICS, consumers of superannuation products will have access to cost free alternative dispute resolution.[17]

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16 Submission No. 7 by Australian Taxation Office to Committee's main terms of reference, p.3.

17 Submission No. 9a, p. 4.

7.28 In relation to the SCT, ASFA was concerned to ensure that the Tribunal had the jurisdictional authority to deal with claims related to misleading or deceptive selling. In evidence to the Committee ASFA indicated that it may be necessary to broaden the terms of reference of the SCT 'to allow for misleading and deceptive selling'[18] as ASFA's feeling was that the current terms of reference of the SCT may not be broad enough to deal with those types of issues.

7.29 The Australian Securities and Investments Commission (ASIC) advised that the SCT (to which ASIC provides administrative support), was empowered under the *Superannuation (Resolution of Complaints) Act 1993* to deal specifically with mis-selling in relation to life office-sourced superannuation. The Commission also submitted that it was not aware of receiving any notification of alleged misconduct 'either via complaints from employers, employees or superannuation fund competitors or via (its) ongoing compliance/surveillance activities.'[19]

7.30 In addition, ASIC submitted to the Committee that it considered that its existing powers were 'in general sufficient to regulate misleading and deceptive conduct with regard to superannuation products.' Its powers in this area were derived from Parts 18 and 19 of the *Superannuation Industry (Supervision) Act 1993* and Part 2 Division 2 of the *Australian Securities and Investments Commission Act 1989*.[20]

7.31 The Australian Consumers' Association drew the Committee's attention to the need to ensure that, in the event of an increase in disputation arising from choice, the SCT would be adequately funded.[21] ACA also expressed its support for the establishment of a consumer superannuation legal service.[22]

7.32 The Industry Funds Forum submitted that the AIRC was the appropriate dispute resolution vehicle to deal with disputes involving potential or current fund members, employers and funds. However, IFF also pointed out that employees not covered by awards would also need a dispute resolution mechanism.[23]

7.33 Referring to the Government's proposal to remove superannuation from the list of allowable award matters (which would mean that the AIRC could no longer deal with disputes about superannuation by arbitration), the ACTU strongly supported the retention of award superannuation provisions, not least because the AIRC provided a mechanism for dealing with disputes about superannuation. The ACTU advised the Committee that:

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18 Hansard, p. 57.

19 Submission No. 14, pp. 1 and 3.

20 Submission No. 14, p. 2.

21 Hansard, p. 77.

22 Submission No. 12, p. 3.

23 Submission No. 1, p. 2.

> I think the various other bodies which have been established from time to time with jurisdiction over workplace matters have never been able to meet the standards of the Commission in terms of access, speed and general effectiveness in dealing with those issues.[24]

7.34 In supporting the retention of superannuation in the award system, the Australian Institute of Superannuation Trustees also suggested that the AIRC should continue to have the power to settle disputes about superannuation and to insert award provisions in awards which deal with superannuation.[25]

7.35 The union and employer groups were divided about whether award superannuation provisions were consistent with a choice regime.

7.36 The ACTU explained that:

> … it is not correct to say that the maintenance of award superannuation provisions is inconsistent with a choice regime …. (as award provisions) are likely to ….. have a provision that allows for other funds to be used by consent.[26]

7.37 Representing employers, the Australian Chamber of Commerce and Industry, presented an alternative viewpoint. The ACCI told the Committee:

> … if you want to introduce a choice regime federally, you have to either remove choice provisions from awards or do something about them.[27]

Summary

7.38 Overall, the evidence to the Committee suggested that there was support for strong consumer protection measures, in addition to those provided by full disclosure and adequate education.

7.39 Views on commission-based selling varied, with some industry sectors critical of this practice, especially for compulsory components; while other groups, including service providers, considered that a mixture of fee-for-service and commission-based selling was appropriate. There was general agreement that costs associated with selling and marketing will rise.

7.40 All parties appeared to agree that mechanisms are required to address practices such as twisting, churning and third line forcing.

7.41 There was some evidence to suggest that the ATO's role in enforcement of the SG may need to be addressed.

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24 Hansard, p. 55.

25 Submission No. 5, p. 1.

26 Hansard, p. 55.

27 Hansard, p. 56.

7.42 There was general agreement that an effective dispute resolution mechanism is required, and a variety of suggestions were made to address the capability of the SCT. Considerable support was expressed for the retention of superannuation in the awards system, although there were differences in opinion about whether this was inconsistent with a choice regime.