AUSTRALIAN INSTITUTE of SUPERANNUATION TRUSTEES

External Dispute Resolution: Compensation and Redress

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AIST Submission

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AIST

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

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

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

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Executive summary

The Australian Institute of Superannuation Trustees welcomes the opportunity to comment on the issues raised in the Supplementary Issues Paper released in May 2017.

AIST represents the profit-to-member superannuation system, and as such our comments will primarily focus on the appropriateness of a compensation scheme of last resort, and whether the provision of redress for past disputes is warranted.

This submission will only address selected consultation questions. Our position can be summarised as follows:

- A compensation scheme of last resort is not required for superannuation related complaints because uncompensated losses are not an issue within the sector because:
    - Extensive prudential regulation supports the financial stability of Australian Prudential Regulation Authority regulated superannuation funds and reduces the likelihood of trustees failing to comply with a determination of a dispute resolution body.
    - Legislative provisions effectively prohibit non-compliance with determinations.
    - Existing arrangements within the *Superannuation Industry (Supervision) Act 1993* (SIS Act) protect members' financial interests.
- However, unpaid compensation can be an issue in other parts of the financial sector. These issues can, in part, be addressed by exploring Australian Financial Service Licencing obligations, including the adequacy of professional indemnity insurance.
- If a compensation scheme is deemed to be appropriate for non-superannuation complaints moral hazard risks would need to be addressed.
- Profit-to-member superannuation funds should not be made to contribute to any compensation scheme.
- It is inappropriate to allow complainants access to redress for past disputes, a redress scheme should not be established because:
    - There is no evidence of redress problems within the superannuation sector.
    - The scheme would potentially jeopardise members' interests as the trustee would be required to use trust monies to address old complaints that were not bought before the trustee or the dispute resolution body.
    - It ignores the policy rationale of placing time limits on actions.
    - There is no evidence that allowing redress to past disputes would be beneficial.

Compensation scheme of last resort

Uncompensated losses and superannuation

AIST understands that the main issue sought to be addressed by the establishment of a compensation scheme of last resort is to allow claimants to access compensation when an external dispute resolution (EDR) body determines that they be paid, but the compensation is ultimately unpaid.

A compensation scheme of last resort is not required for superannuation related complaints. The scheme is unnecessary as uncompensated losses are not a material issue because of prudential regulation, legislative provisions prohibiting non-compliance with determinations and existing arrangements within the SIS Act.

Uncompensated losses are unlikely become an issue under the proposed reforms, however we stress the importance of addressing the concerns raised in our submission to Treasury on 14 June 2017 titled *EDR and complaints framework.*[1]

As uncompensated losses are not an issue and are unlikely to become an issue within the superannuation sector, as detailed below, a compensation scheme is not required. If the panel forms the view that a compensation scheme is necessary for other parts of the financial sector, we strongly believe that it would be inequitable to require the superannuation industry to fund the compensation scheme of last resort.

AIST submits that a compensation scheme should not be established for superannuation disputes and funds should not be required to fund any compensation scheme of last resort if a scheme is established.

Prudential regulation

A compensation scheme for super complaints is not required because the prudential regulation of superannuation funds supports their financial stability and thus ability to comply with a determination of a dispute resolution body.

The vast majority of profit-to-member superannuation funds are regulated superannuation funds, which means they are governed by the SIS Act and regulated by APRA. By virtue of being subject to

[1] Australian Institute of Superannuation Trustees, *EDR and Complaints Framework* (14 June 2017) <https://tinyurl.com/ybw2rayc>

the SIS Act and APRA regulation, the risk of fund insolvency, and thus the inability to comply with a determination is small. The mix of legislation, prudential standards, practice guides, and oversight by APRA have the cumulative effect of ensuring funds' financial stability, which in turn means that funds do not collapse, phoenix, or become unable to comply with a determination requiring the payment of money to a claimant.

It is clear that the prudential regulation of funds will continue under the proposed EDR model, therefore a compensation scheme of last resort is unnecessary.

Legislative protections

The SIS Act compels trustees to comply with determinations of the Superannuation Complaints Tribunal (SCT), which effectively reduces the likelihood of fund non-compliance.[2] This legislative provision has likely had a positive effect on trustee behavior, as there have only been approximately five referrals to APRA for non-compliance within the last twenty three years. Furthermore, as at 2 May 2017 the SCT had no outstanding unpaid determinations related to superannuation disputes.

While under the proposed model the SCT's operations will be wound up, proposed section 1065(1)(d) of the *Corporations Act 2001* states that if a party to a complaint (such as a trustee) refuses, or fails to give effect to a determination, then the matter will be referred to APRA or ASIC or both. This referral power will likely will deter a trustee from failing to adhere to a determination of the EDR body.

In light of these legislative provisions, a compensation scheme of last resort is not required for superannuation disputes.

Financial assistance under the SIS Act

Part 23 of the SIS Act allows superannuation funds to receive financial assistance to cover loss as a result of fraudulent conduct or theft that leads to a difficulty regarding the payment of benefits.[3] If an EDR body makes a determination that a complainant be paid a benefit, and the trustee cannot pay due to fraud or theft, the trustee can receive financial assistance under the SIS Act to ensure the benefit is paid.

The fact that this mechanism exists means that there is little reason for the establishment of compensation scheme of last resort for superannuation disputes.

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[2] *Superannuation Supervision (Industry) Act 1993* s 64A.
[3] *Superannuation Industry (Supervision) Act 1993* s 229(1) and s 227.

Uncompensated losses and non-superannuation complaints

Unpaid compensation can be an issue in other parts of the financial sector, particularly within financial advice. We believe that compensation issues can, in part, be addressed by exploring Australian Financial Services Licencing obligations, including the adequacy of professional indemnity insurance, consistent with the findings in the Richard St. John Report.[4]

Notwithstanding this, if a compensation scheme is deemed to be appropriate for non-superannuation related complaints moral hazards and funding issues must be addressed.

A compensation scheme may give rise to a moral hazard because financial service providers may engage in riskier conduct with the knowledge that someone else will bear the financial cost of those risks. For example, it is possible a financial advisor will provide unsuitable advice to a client because they know that their clients will be compensated for any losses stemming from that advice.

The compensation scheme must be appropriately funded. The superannuation sector should not be required to fund the scheme because unpaid determinations or un-awarded compensation is not an issue within the superannuation context.

Response to consultation questions on the compensation scheme:

Our response to selected consultation questions are below.

4. What are the strengths and weaknesses of the National Guarantee Fund, the Financial Claims Scheme and Part 23 of the Superannuation Industry (Supervision) Act 1993?

Under Part 23 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) the Minister may grant financial assistance to prudentially regulated superannuation funds that suffer loss as a result of fraudulent conduct or theft. Typically the loss must lead to difficulty in the payment of superannuation benefits.[5]

Prudential regulation and the legal framework in which regulated superannuation funds operate provides a high level of safety and stability within the superannuation system, and minimises the risks of superannuation funds collapsing. Within this environment the Part 23 mechanism operates

[4] The Australian Government the Treasury, *Compensation Arrangements for Consumers of Financial Services* (April 2012) <https://tinyurl.com/yakazspg>.
[5] *Superannuation Industry (Supervision) Act 1993* s 227 and 229(1).

as an additional safeguard and ensures that superannuation fund members are not detrimentally impacted as a result of a variety of illegitimate conduct within the trustee.

AIST supports the Part 23 mechanism and acknowledges it provides an additional safeguard to fund members.

6. What are the benefits and costs of establishing a compensation scheme of last resort?

For the explanations provided above, there would be no benefit in establishing a compensation scheme of last resort for superannuation disputes.

There may be merit for a scheme to cover non-superannuation disputes, however issues regarding moral hazards and the funding structure must be addressed.

9. What potential impact would a compensation scheme of last resort have on the operations of financial firms?

There is a risk that a scheme would result in financial service providers and financial firms engaging in riskier conduct with the knowledge that someone else will bear the cost of those risks.

15. What are the arguments for and against extending any compensation scheme of last resort beyond financial advice?

If a compensation scheme is deemed to be appropriate, it should not extend to cover the superannuation sector or superannuation disputes. The reasons are discussed elsewhere in this submission, but can be summarised as:

- Part 23 of the SIS Act provides similar benefits that the proposed scheme would offer.
- The legislative framework means that it is very unlikely that superannuation funds would fail to comply with a determination of the SCT, or the new EDR body.
- Superannuation funds are prudentially regulated, which means that there is a low likelihood that they would be unable to comply with a determination.

24. Who should fund any compensation scheme of last resort?

If a compensation scheme is deemed to be appropriate, it should not extend to cover the superannuation sector or superannuation disputes and as such the superannuation sector should not fund the scheme.

Access to redress for past disputes

Superannuation disputes

The Expert Panel has been asked to explore the merits and issues involved in providing consumers access to redress for past disputes. The panel believes that it is appropriate if the redress mechanism applies to those persons that had a dispute in the past, and could have sought redress through EDR, but, for whatever reason, chose not to pursue their dispute through EDR.

In the context of superannuation disputes and complaints it is inappropriate to establish such a scheme because there is no evidence that a problem exists within the superannuation sector, it would risk jeopardising members' interests, risks ignoring the policy rationale behind placing limits on actions and there is no evidence of the benefit of opening up the old claims.

No evidence base

There is no evidence that the failure to provide access to redress for past disputes within the superannuation context has resulted in poor outcomes for members. Without a clear understanding that a lack of redress is a significant problem, it would be concerning to proceed with the development of a scheme. AIST submits that evidence of the issues must be presented so the extent of the problem can be examined and for a suitable response to be developed if necessary.

Risk to members' financial interests

The establishment of a scheme puts superannuation fund members' financial interests at risk. The profit-to-member superannuation sector is committed to ensuring that they act in the best interests of their members, and only their members. Requiring superannuation funds to provide redress for past disputes would have the effect of eroding retirement savings because the fund, in compliance with an EDR decision, may need to use trust monies to pay a benefit. It is inappropriate to develop a scheme that requires superannuation funds to effectively dip into member retirement savings in order to fund the payment of claims, especially when there is no evidence that this is a real problem. This issue is exacerbated by the fact that it is not known how many old or dormant claims might be raised as a result of the establishment of the scheme.

Ignores purpose of statutory time limits

Allowing access to redress would remove the benefits brought about by having time limits in place that restrict parties from making superannuation complaints after a lengthy period of time has elapsed.

In most jurisdictions a claim must be brought within a specified time limit, which is usually set out in legislation.[6] These time limits serve a number of important functions such as:

- Protecting parties from the burden of having to make, and answer a stale claim.
- Preventing an imbalance between the parties from forming.
- Reducing the burden on the judiciary.

Currently, superannuation fund members must bring a complaint before the SCT within a legislated time limit. The time limit minimises the administrative burden on the SCT and superannuation funds, ensures members are not unduly traumatized, and ultimately makes it easier for the SCT to resolve the dispute. In recognition of the importance that time limits play we strongly advocate for superannuation complaints to have time limits under the proposed new EDR scheme, and for these time limits to be enshrined in legislation.

Allowing access for redress for past disputes effectively removes time limits and has a number of negative effects such as:

- Forcing financial firms, such as superannuation funds, to respond to stale complaints.
- Detrimentally impacting the party responding to a claim. Typically a financial service provider will be the responding party, and will have to gather relevant evidence. If the claim is old there is a real risk that records would have been lost or destroyed.
- Making dispute resolution more complex. For example for superannuation disputes the EDR body will potentially need to use older versions of the governing rules. These rules will need to be interpreted with the regard to the epoch in which they were written, which may be a very difficult process especially if the meaning of words have changed.
- Making the dispute resolution process slower and increasing inefficiency. This is because the EDR body will be required to focus on past complaints, rather than present ones. This shifts the focus of the body and will likely have the effect of clogging the dispute resolution pipeline and take the EDR body's attention away from what is important – current claims.

[6] *Limitation Act 1969 (NSW); Limitation of Actions Act 1958 (Vic).*

No evidence of beneficial change

There is no evidence that opening up access to past disputes would be of any benefit and doing so may have perverse impacts on funds. If past claims are able to be brought then funds will need to develop new work streams dedicated to dealing with past disputes – which is an unnecessary cost in light of fact that there is no evidence this is even a problem. Further, funds will need to gather and retain evidence about each decision made by the trustee which risks increasing administration fees.

For these reasons it is inappropriate to allow for redress for past disputes.

Response to consultation questions on redress for past disputes

Our response to selected consultation questions are below.

35. What evidence is there about the extent to which lack of access to redress for past disputes is a major problem?

We are not aware of any body of evidence indicating that redress for past disputes is a problem within the superannuation context. Without a clear understanding that a lack of redress is a significant problem, it would be concerning to proceed with the development of a scheme.

37. What are the benefits and costs associated with providing access to redress for past disputes?

There are a number of costs related to the provision of access to redress for past disputes. These costs are likely to be borne by superannuation funds, and in turn, their members. The costs include:

- Administrative – the fund will be required to gather and retain evidence of all decisions
- Compliance – the fund will need to comply with EDR decisions relating to old complaints
- Operational – the fund will be required to develop operational procedures and processes to address old complaint procedures and processes.

39. What impact would providing access to redress for past disputes have on the operations of financial firms?

See answer to consultation question 37.