ENHANCING MEMBER PROTECTIONS IN THE SUPERANNUATION SYSTEM

Equity Trustees

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Thank you for the opportunity to provide input to this consultation process.

About Equity Trustees

Equity Trustees (EQT Holdings Limited) was established as an independent trustee and executor company in 1888. EQT Holdings Limited is the ASX listed holding company of the group. EQT Holdings Limited owns and operates six licensed trustee entities comprising two Responsible Entities (REs), two Registrable Superannuation Entity Licensees (RSELs) and two traditional trustee entities.

Equity Trustees is now Australia's leading specialist trustee company. We offer a unique vantage point within the financial services system in our role as trustee supervising ~$283bn of assets in thousands of trusts, Managed Investment Schemes (MISs) and superannuation funds. We help private individuals and families, fund managers and other corporate and superannuation clients grow, manage and protect wealth.

Our company was established to help people take care of their future. This Review is clearly aligned to our purpose, and we welcome this opportunity to provide input into consumer protections in the financial services sector.

The professional independent trustee model ensures we do not promote or distribute any specific superannuation offer and are less motivated by growing Funds Under Management (FUM), as a result we are able to assess the overall market in an unbiased but informed manner.

Equity Trustees strongly supports the Treasury consultation

We are encouraged to see the examination and consultation by Treasury and ASIC about the broader regulatory change agenda related to protecting the interests of ordinary Australians, including the Federal Budget commitment to increased surveillance of MISs and are strongly supportive of the proposals for REs previously put forward by Treasury

In particular, we strongly support regulation of Lead Generators as well as consideration by ASIC of increasing the Net Tangible Asset requirement for responsible entities. In addition, we recommend that further regulatory change be considered for financial advisors and urge Treasury to consider this aspect of the value chain given their trusted role in the management of the financial futures of families and individuals.

Superannuation is a cornerstone of Australia's financial system and plays a critical role in supporting the long-term financial wellbeing of ordinary Australians. As a mandatory retirement savings scheme, it ensures wage earners accumulate savings throughout their working lives to fund retirement and reduce reliance on taxpayer support through the age pension.

Given this central importance to every individual's financial dignity and security in retirement, it is essential that any regulatory changes carefully consider impacts on superannuation members and preserve confidence in the entire system, including platforms, Self-Managed Super Funds (SMSFs) and Small APRA Funds (SAFs).

Shield and First Guardian Master Funds

Equity Trustees welcomes the Government's considerations of options to address the factors behind the collapses of the Shield and First Guardian Master Funds. The collapses of the two MISs have devastatingly resulted in significant losses to a large number of members of various superannuation funds.

It is important that in considering options to address the collapses, the Government grasps the opportunity to identify and address the root causes of the losses.

ASIC has stated that there has been systemic and large scale misconduct committed in respect of Shield and First Guardian. ASIC is acting on, and investigating, multiple parties such as lead generators, financial planners, REs, fund managers and superannuation platforms and trustees.

In fact, on our assessment, multiple points in the value chain failed.

- **Responsible Entities (REs)** - the most critical point of failure in the value chain was the two REs. The liquidators report into Shield indicated the REs misled the superannuation trustees and their members including by:
    - utilising a material amount of scheme assets for payments to lead generators and not investment; and
    - investing the remaining scheme assets in a manner that was not aligned with the Product Disclosure Statement.

  The misuse of scheme assets for purposes other than investment as disclosed to investors - as the liquidators' reports have revealed - is clearly fraud or theft causing loss to the superannuation funds and their members. ASIC's actions in seeking both REs be placed in liquidation indicates ASIC recognises the REs as a critical point of failure.
- **Fund Managers** - the fund managers utilised by the REs were related parties of the REs and were also a critical point of failure. It is clear they made investments that were not sound. ASIC's actions in seeking both fund managers be placed in liquidation indicates where ASIC saw a critical point of failure.
- **Lead Generators** - the lead generators, some of which were licensed by ASIC and some of which were not, were integral, if not essential, to the failures.
- **Financial Advisors** - the financial advisers and the licensed dealer groups that authorised the financial advisers failed in their duties. ASIC's actions and AFCA's leading decisions against many advisors and dealer groups have shown those parties to have provided advice that was conflicted, not based on fact-finds by the adviser and of unacceptable quality.
- **Superannuation Trustees** - ASIC also contends that the superannuation trustees of platforms failed in certain duties. Given Equity Trustees, through its subsidiary Equity Trustees Superannuation Limited (ETSL) is involved in legal action taken by ASIC, we will not comment on this, except to say there are no allegations of fraud or dishonesty being made against any superannuation trustee.

It is apparent that the major investment failures in the Australian market over recent decades, including those involving superannuation, have primarily stemmed from failures of REs. We welcome the reform of REs and Managed Investment Schemes that was the subject of Treasury's first consultation and ASIC's consultation in respect of the Net Tangible Asset capital requirements for REs.

It is encouraging to see Treasury considering options regarding superannuation platforms and their trustees. This is particularly pleasing given the importance of this market which represents some $1.8 trillion of superannuation assets (when also including its aligned SMSF market).

Summary of our position

- The superannuation market is a continuum of fund offers, investment options and other features. It is inappropriate to demarcate platforms as many other funds share similar characteristics. Demarcation of the market is futile as all funds are increasingly providing similar offers.

  There is a reason that the platform market is growing quickly. It is because it has been the most responsive sector of the industry in terms of providing services to members and meeting their personal objectives. Together with the SMSF market, the aligned markets offer products and services most aligned to the Retirement Income Covenant and are the market segments most organised to achieve the individual objectives of members. APRA's recently imposed licensee

conditions for platforms relating to investment governance are positive and we believe no other regulatory change is required for this leading sector.

- The professional independent trustee model has been the fastest growing segment of the superannuation market in the last ten years and has been responsible for material innovation in the industry. The market has grown from ~$10bn to ~$150bn in ten years. The model currently looks after the interests of 990,000 members. The model has a solid record of delivering to members and not suffering from systemic failures that have been prevalent in the vertically integrated in-house models – both commercial models and Not-For-Profit models. There is no sound basis for banning the professional independent trustee model.
- All trustees have the same responsibility for delivery on members best financial interests. All trustees should have the same capital requirements. If trustees are to meet eligible fraud costs (the opposite of the objective of Part 23 of the SIS Act), fraud needs to be carefully defined and all trustees should be treated in exactly the same manner to avoid the illogicality of the same fraud causing loss to two superannuation funds, yet only the platform being required to make the fraud good. It also entrenches the moral hazard that other ASIC licensed entities are effectively utilising the superannuation trustee as protection of last resort.

Our observations and recommendations aim to inform the Treasury's considerations towards the objective of enhancing member protections across each element of the superannuation industry.

We have not made comment on every question raised in the Consultation paper, but we have focused on key foundations underlying the reform proposals.

We welcome the Minister's commitment to reform in this area, and also the opportunity to further discuss this important issue with Treasury.

Sincerely,

Mick O'Brien
Managing Director
EQT Holdings Limited

Part 1: Strengthening platform governance

Proposal 1 Strengthening governance requirements for Platform Trustees

Q1. How should a Platform RSE and a Platform Trustee be defined?

Equity Trustees is strongly opposed to defining Platform RSE and Platform Trustee. In recent months APRA has been acting in respect of RSEs of platforms and applying licence conditions. We suggest that this APRA initiative alone is sufficient to ensure the continued efficient, fair and honest functioning of the superannuation platform market and other changes are not required.

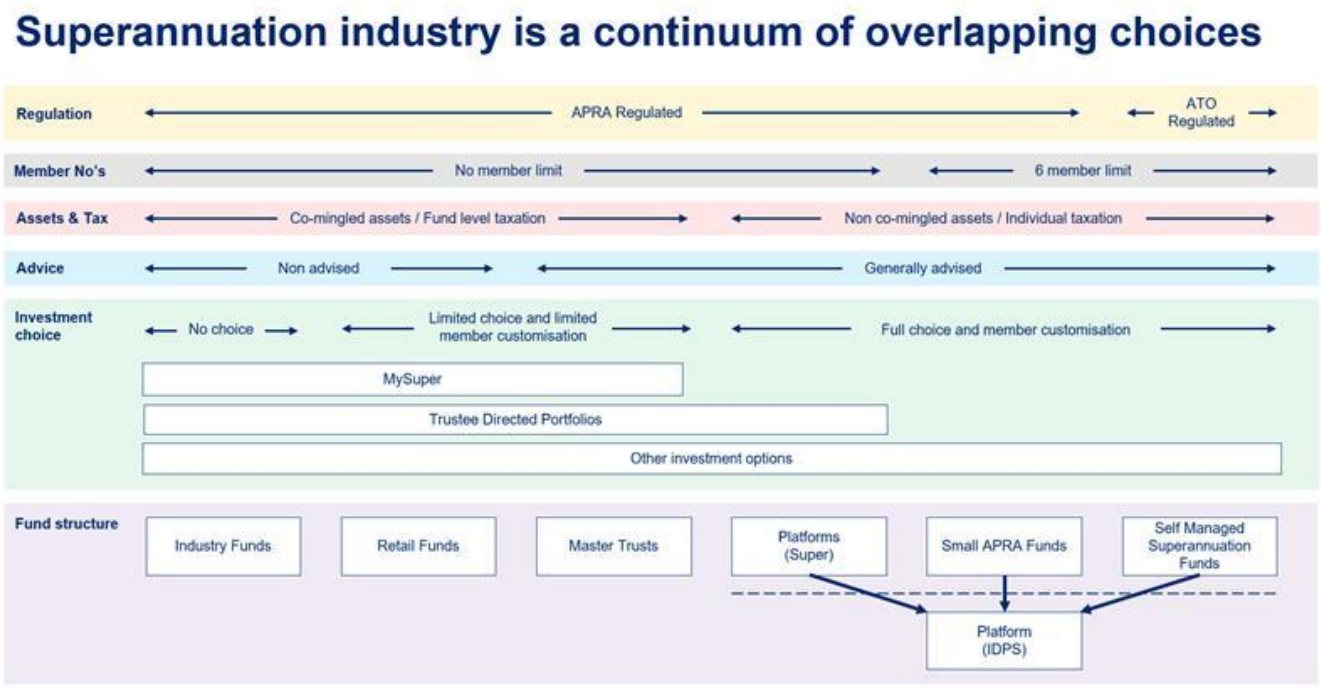
The superannuation industry provides a number of options for members to select according to their individual financial objectives. Every RSE Licensee governing these options has exactly the same responsibility to members within a fund.

The main characteristics of the optionality available in the market relate to:

- Type of trustee;
- Limits, or not, on number of members allowed within a fund;
- Whether assets are comingled or not with other members;
- Whether taxation is applied at the fund level and imperfectly allocated to members or more precisely allocated to members;
- Whether the offer is delivered through a financial planner or not; and
- What types of investment options are made available to members.
- Fund type

The schematic below shows the overlapping aspects of the market and the difficulty in making any clear demarcation for platforms. Furthermore, there is no utility in the demarcation, given every RSE Licensee has the same responsibility and investment options are increasingly overlapping and will do so further as more assets move to retirement draw down mode.

Figure 1: Overview of superannuation industry



Important consideration must be given to the platform market and its performance in delivering financial services ***efficiently honestly and fairly, and in the members best financial interests,*** versus the other superannuation models available in the market when considered the utility of defining Platform RSE and Platform Trustee.

The platform market and SMSF market should be considered as one market in that they both provide individualised retirement investment programs, individualised taxation arrangements and the non-comingling of assets. The total market is responsible for approximately $1.8 trillion of funds (not all SMSFs are managed through platforms, however the vast majority are). The total superannuation and non-superannuation platform market is estimated at $1.2 trillion.

The combined superannuation platform and SMSF market provides member offers that are most aligned to the Government's Retirement Income Covenant as they provide tailored investment strategies that consider a members' entire financial position.

The platform market has existed since 1985 and SMSFs have existed since 1999. In that time these markets have proven to be the most advanced and flexible segments of the superannuation market. Central to this is the fact that they do not co-mingle member assets, allow for precise individual taxation outcomes, and for an individualised investment program to be built which is tailored to the member's retirement goals and objectives. They deliver exactly the objectives espoused in the Retirement Income Covenant.

It is unfortunate that it has taken a material incident such as the Shield and First Guardian Master Fund collapses for regulators to turn their mind to standards of regulation for the platform market. This is clearly highlighted by the fact that despite the enormous scale of the market a "platform" is currently not contemplated in legislation, prudential standards or regulatory guides. It is for these reasons that Equity Trustees fully embraces the reviews that are currently underway.

It is clear that the superannuation market is constantly evolving. As industry funds evolve their product offers from a simple choice of ~5 balanced funds of differing risk/return profiles, to a wider choice to more appropriately meet the needs of members in retirement (as platforms and SMSFs are already designed), there will be little differentiation between offers. Most major industry funds are already offering the stocks in the ASX200 or ASX300, a range of bonds, term deposits and indexed and active ETFs, which are listed forms of open-ended managed investment schemes (an increasingly favoured form of investment vehicle for the whole funds management market).

It is not clear there is any utility in creating fundamentally different rules in relation to investment governance, switching, capital requirements and treatment of fraud, based on whether a fund offers a greater or lesser level of choice of investment options.

Any differentiation of fund offers that may stand on some broadly reasonable basis today, will not stand that way in the future, as industry funds develop their Retirement Income Covenant strategies and move past simple cohort analysis and increasingly towards providing individualised investment programs per member.

Equity Trustees accepts that the level of investment choice available on superannuation platforms is extensive – it is designed to cater for the widest possible market. It could be argued that some of the extensive choice should be more limited, particularly if the advice market cannot be relied on.

In recent months APRA has been acting in respect of RSEs of platforms and applying licence conditions (rather than issuing a Prudential Standard in respect of investment governance that is appropriate to the scale and complexity of the platform market). These license conditions will lead to some narrowing of investment choice on platforms, but the narrowing is likely to be minimal. As mentioned, Equity Trustees contends that this APRA initiative alone is sufficient to ensure the continued efficient, fair and honest functioning of the superannuation platform market and other changes are not required.

The argument can be made that these markets are the best performing segments of the superannuation market in delivering to members, and there is no need for additional regulation to protect members (on the assumption that there is reform for REs, MISs, Lead Generators, and financial advisors).

Q9. What features of an outsourced model may reduce governance effectiveness?

The superannuation industry effectively has four segments of trustee models in operation. One is the model of SMSF trusteeship where members effectively take on their own trusteeship. The other three models of trusteeship are provided by RSE Licensees, that is:

1. In-house vertically integrated trustees that are governing and promoting not for profit (NFP) industry funds. ***(NFP Trustees***)
2. In-house vertically integrated trustees owned by commercial businesses overseeing retail funds and platform funds ***(In-house Commercial Trustees***)
3. Professional independent trustees overseeing funds originated, promoted and distributed by other parties such as platforms, insurers, dealer groups, online marketers etc. ***(Professional Independent Trustees)***

Over the last ten years the industry has undertaken material evolution and development. The more significant events have been:

- The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2019 (Hayne) highlighted the weaknesses in the ***In-house Commercial Trustee*** model, where many trustees were found to:
    - favour the provision of in-house investments (which we note is increasingly becoming the norm for NFP Trustees)
    - be charging members after death for advice fees, and
    - for related party advice businesses, not providing appropriate independent advice services.
- More recently in the last three years we have seen the failure of the ***NFP Trustee*** model, with material failures of service, overcharging of fees and inadequate disclosure issues, among others.

Equity Trustees notes that trustees are not outsourced, they are trustees independent from the Platform provider and Investment Managers. Trustees appoint all the service providers under all models. In the Professional Independent Trustee model, this includes the appointment of the promoter of the funds. In this model the trustee is not appointed as if it is an outsourced service provider.

We believe there are no material features of a professional independent trustee model that are less effective than the two in-house models. On the contrary, we believe the professional independent superannuation trustee model is the most independent model when compared to:

1. A trustee that is manufacturing and operating its own trustee directed portfolios where there is opaqueness in the impact of poor trustee decision making (for example, substantial write downs on various single asset in excess of the losses in respect of Shield and First Guardian), or
2. A trustee embedded within a platform where the platform substantially makes money from the operation of the platform.

It should be noted that professional platform operators provide their own levels of good governance and the independent trustee provides a full layer of trustee governance over the top. In the independent model there is zero risk of overlapping and confusion between promotion and trusteeship which often causes conflict in the two in-house models.

If we were forced to identify any reduced effectiveness it would be that the trustee is one step away from all other providers of services to the fund and therefore may not have access to all internal knowledge all aspects of a promoter's business. Equity Trustees has not experienced this to lead to ineffective governance.

Governance effectiveness should not be assessed on structure, but rather the governance processes themselves. The Shield and First Guardian matters were not specific to any particular trustee model, with both in-house trustees and professional independent trustees being impacted. The issues arose due to the behaviour of lead generators, licensed advisors and REs.

Significant failures have occurred across all trustee models including in-house vertically integrated trustee models. Examples of recent significant losses include:

- Expenditure management, resulting in additional licence conditions being imposed on an in-house commercial trustee by APRA following a review which identified deficiencies regarding the robustness of its approach to related-party expenditure, particularly in relation to investment management agreements with its parent company.
- A NFP Trustee being fined $20 million where 25,000 customers were charged ~$50 million in ongoing advice fees for services that were not provided.
- Material failures of service by a NFP Trustee, who were ordered to pay a $23.5 million fine following admissions that its serious failures caused delays in processing death benefits and total and permanent disability (TPD) insurance claims and impacted more than 7,000 Australians in distressing situations.
- Overcharging of fees by a NFP Trustee, who were fined $27 million for failing to merge multiple member accounts
- Misleading disclosure issues by an in-house commercial trustee who were found to be making misleading claims about environmental, social and governance exclusionary screens and ordered to pay a $12.9 million penalty.
- A NFP Trustee incurring an investment loss which resulted in a ~$1 billion write down.

The governance risks in any trustee model can be mitigated through effective risk management frameworks and practices, contractual arrangements that enable effective oversight of third parties, and clear roles and responsibilities.

Q10. What are the characteristics that could be reflected when differentiating between varying trustee business models, to ensure governance obligations are appropriately calibrated to Platform Trustee environments?

Choice is a fundamental feature of superannuation and members should be able to choose where their money is invested. Member protections should be applied consistently across all models to avoid disadvantage. Platforms, and platform products, are not inherently higher-risk than any other model – risk comes from the underlying assets, not the vehicle structure of investing. Industry funds have incurred some notable single material investment losses in individual companies – these have not been the subject of any regulatory review and the losses have simply been absorbed by all members of the relevant funds.

Equity Trustees submits that the requirements should be the same under all trustee models. Any differentiation between trustee models should take into account characteristics that are relevant to governance risks not only for professional independent trustees but also for in-house trustees.

Q11. What would the impact be of banning the trustee for hire model?

The Professional Independent Trustee model is an important part of the overall superannuation market. It has been the fastest growing segment of the superannuation market over the last ten years, growing from ~$10bn to ~$150bn today, a CAGR of over 30%. The model currently looks after the interests of 990,000 members. It is a remarkable performance given it has been achieved without the privileged position of the funds being listed in industrial awards.

Today, this model represents 4% of the overall market. It would seem perverse and lacking in a robust public policy justification to ban a model that has had the highest growth rate in the market and the least level of failures compared to other models.

The model of independent trusteeship has been:

- An **innovation facilitator**, having facilitated the establishment and growth of successful funds such as HUB24, Praemium, Future Group, RAIZ and ING Direct. Those funds have operated with a Professional Independent Trustee since they were established. There have been very few examples of new providers establishing themselves in the market not using this model.

  Banning the model would lead to virtually no new start up providers of superannuation in Australia.

- The model used to **extend the life of certain long standing superannuation products**, such as life company guaranteed products, whole of life and endowment products and others.

  Banning the model would mean APRA would be required to determine future solutions for such members, which would be inherently complex and likely be detrimental to members' best financial interests.

- The model **used by almost all major life insurance companies** providing insurance through a superannuation life insurance policy.

  Banning the model would likely mean less availability of insurance through superannuation funds leading to higher premiums for members, due to unavailability of tax deductions.

- Professional Independent Trustees have been instrumental in undertaking a significant number of Successor Fund Transfers (SFT) that have **simplified the overall Australian market and delivered better outcomes to members**. It is estimated that these trustees have undertaken 12 fund consolidations over the last 7 years.

  Banning the model would require APRA to determine future solutions for such funds and members, which would be inherently complex and likely be detrimental to members' best financial interests.

- The industry includes ~700 Small APRA Funds ($1.6bn FUM), a structure analogous to a SMSF, but utilising a RSE Licensee. **All the SAFs of Australia are under trusteeship via this model**.

  Banning the model would require APRA to determine future solutions for such members, which would be inherently complex. It would likely be detrimental to members' best financial interests. It would lead to the elimination of this market.

- The professional independent trustees have tended to utilise administration service providers (such as Apex and SS&C) that are new to Australia making the Australian superannuation industry ultimately **more robust and competitive**.

  Banning the model is likely to provide less entry points for capable new global or local entrants providing services to trustees, into the Australian superannuation market.

In summary, banning the model would likely lead to stifled innovation in the superannuation market, the elimination of the SAF market, members being forced to move to a superannuation offer not of their choice, increased costs to some members and would cause APRA to undertake many years of extensive work.

Part 2: Superannuation Switching

We are making no comments in respect of Part 2.

Part 3: Compensation for members

Proposal 5 Requiring Platform Trustees to compensate members for eligible losses

Q39. Should the requirement to compensate members from trustee capital be pre or post funded?

At present there are no shareholder capital requirements in superannuation which results in effectively zero trustee capital. We strongly recommend that Treasury consider addressing this shortcoming for all trustees. It is incongruous that shareholder capital is required to be held by custodians, Responsible Entities, life insurers, general insurers and banks, but superannuation trustees are required to hold no capital.

The absence of shareholder capital in the system is a structural weakness, and with the system already bigger than Australian GDP and forecast to be 180% of Australian GDP in 2035, the implication will be that failure within the system without trustee capital will render the systemic failures too big for Government bail outs. The absence of capital requirements equates to insufficient member protection. We strongly support the increase of the Net Tangible Assets requirement of REs which ASIC is considering as part of its recent consultation (CP388), and we outlined this in our submission to ASIC on this topic.

The general provision of capital would cause the shareholders of RSE Licensees to put in place the best governance, with the most skilled directors, if their capital was at risk. This is unlikely to be the position today given shareholders of many trustees are not risking any capital.

A distinction between Trustee types in relation to compensation and shareholder capital risks disadvantaging members in certain parts of the superannuation system. As outlined in response to Q9, member losses have been incurred across the superannuation system for various reasons. At present those losses are paid for by members (in the NFP sector) or trustee capital (i.e. shareholder capital) for members in the commercial sector. It is inappropriate and contrary to the public interest that members would pay for losses in one sector while other members enjoy capital protection in another. Similarly, it is conflicting that capital be required to be held by one part of the industry and not uniformly across the entire industry, especially for risks that are common, regardless of the trustee operating model.

Notwithstanding, Trustees should not be required to be the last resort for compensation relating to failures in other parts of the financial system – particularly fraud within regulated REs of MISs and/or licensed financial advisors. This is incompatible with the legislated purpose of superannuation '*to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.*'[1] This purpose would need to be altered to include the underwriting of losses arising from any part of the financial system. Such a proposal is deeply flawed in that it introduces significant moral hazard for other financial system operators, members and regulators given the exercise of diligence and prudence would be obviated by a compensating superannuation trustee.

[1] Superannuation (Objective) Act 2024 (Cth) s 5.

Equity Trustees proposes that the focus should be on ensuring each part of the financial system has access to capital or insurance to compensate members for losses caused by their actions (excluding investment losses).

Q41. What criteria and evidentiary threshold should apply to determine that a loss is attributable to external fraud or theft and therefore an "eligible loss"?

Any definition of "eligible loss" should be narrow, focusing only on direct investment governance failures by the trustee, rather than a broader definition that would capture external fraud, theft, or investment losses generally. If a definition of "eligible loss" is implemented, specific exclusions should apply including losses arising from investment risk or market volatility, and losses arising from decisions made based on advice from a regulated financial adviser.

Additionally, "fraud" also needs careful definition. Fraud can occur in managed investment schemes, but it can also occur in an RSE Licensee directly, and also in any company that is invested in.

It is patently flawed that a single fraud committed in a company or a managed investment scheme would be an eligible loss for some superannuation funds but not others.

Q46. Would providing ASIC with a power to direct trustees to commence remediation processes provide an effective avenue to redress to members?

Equity Trustees does not support providing ASIC with a power to direct trustees to commence remediation processes given the moral hazard it introduces. ASIC's motivation rightly would be on member redress. It is likely that they would seek redress through the most expedient mechanism (superannuation trustee capital) irrespective of the cause of the loss. As a result, the superannuation system could end up underwriting failures in other parts of the financial system including Responsible Entities and financial advisers.

There is also the question of procedural fairness, and a right of review or appeal would need to be available for Trustees who disagree that the loss was caused by governance failures by the trustee, or where there is disagreement as to the amount of compensation.

Equity Trustees submits that remediation powers are already available under section 1101B of the Corporations Act upon application to a Court. Those powers are required to be exercised judicially, meaning that they must respond to the circumstances at hand, which would include the contributing acts of any third parties. It is appropriate that the Court continues to be the repository of the power to order remediation so that such powers can be exercised following the adjudication of issues of liability and causation with the benefit of all relevant evidence.