

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

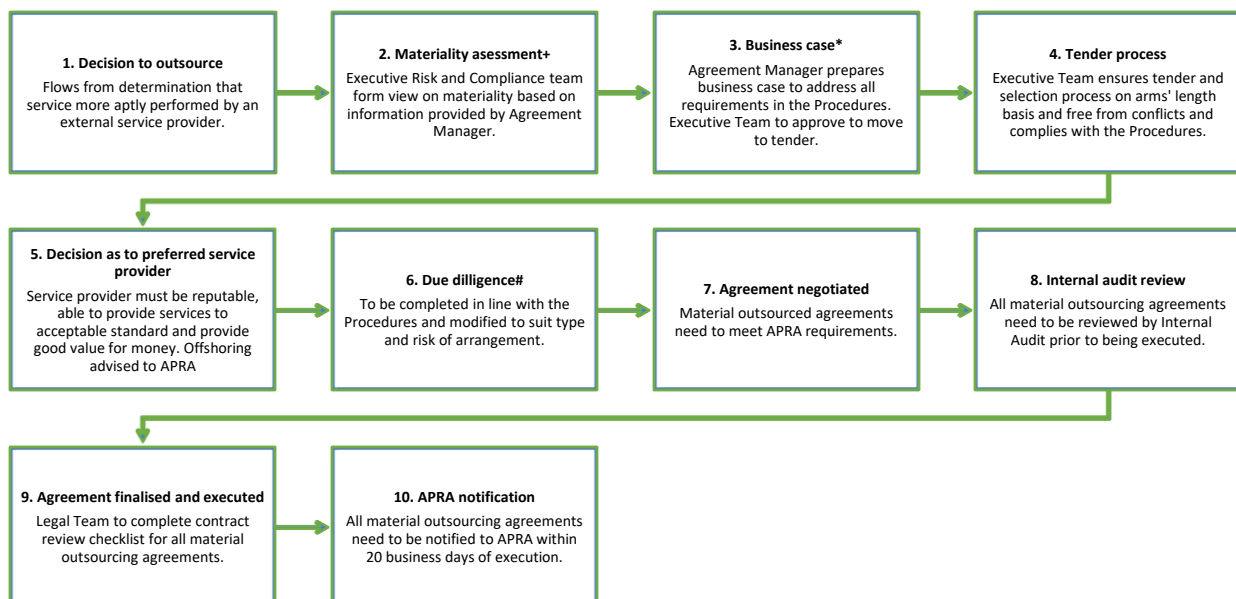
REVIEW OF THE FOUR MAJOR BANKS AND OTHER FINANCIAL INSTITUTIONS SUPERANNUATION SECTOR – IOOF

IOOF26QON: Several case studies in the Royal Commission highlighted that related party contracts in vertically integrated super funds (into the wealth management arms of banks) led to conflicts where the interest of the shareholder came before the super fund members.

- a) Please describe your tender process for related party contracts such as custodial services, insurance, brokerage, administration and investment management.
- b) How do you determine that these contract arrangements reflect value for money for members?
- c) Please describe the potential conflicts of interest with such arrangements and how you manage them?
- d) How do you evaluate whether your management of conflicts of interest is working?
- e) Have you prepared or commissioned any reports focussed on benchmarking the performance and cost of contracts with related-party service providers, relative to the wider market? If so, please provide these for the period covering the last five years.

Answer: a) IOOF maintains an Outsourcing Policy (Policy) which sets out the group’s approach to the selection, engagement and monitoring of vendors and outsourced service providers. The Policy has been developed to assist with the identification and management of risks associated with outsourcing and to meet various legislative and prudential obligations. The Policy applies to all entities in IOOF.

Under the Policy, IOOF must be confident any proposed arrangement will be at arm’s length and free of any potential conflicts of interest. Before a service provider is appointed, the following process must occur:¹



¹ + = Review of the materiality assessment may be required if new information is provided as part of the business case, tender or due diligence processes. ** = IT Security, IOOF Group Privacy Officer and Internal Audit are also engaged during the due diligence process if required.

The Office of the Superannuation Trustee (OST) is an independent function (independent of the IOOF Group) that supports IOOF's APRA Regulated Entities (AREs). The role of the OST is to review, challenge and oversee the services provided to the AREs by internal and external outsourced providers and to advocate for member outcomes. The OST is involved in all aspects of the appointment of potential service providers and provides assurance to the ARE Board(s) that proper process was followed before ultimately providing a recommendation to the ARE Board(s) on whether a service provider should be appointed.

- b) IOOF's Outsourcing Policy requires an assessment to be made about the appropriateness of any proposed arrangement to establish the benefits of the proposed arrangement to members. Factors which must be considered in this assessment include:

Analysis of options	<ul style="list-style-type: none"> • What options were considered, including 'do nothing' and/or using an existing service provider already engaged by the IOOF Group? • Are there any possible alternatives that could bridge the gap between the current situation and the proposed service provider? • Is the proposed arrangement in the best interests of superannuation members, trustee clients or investors (as applicable)? If so, how?
Cost	<ul style="list-style-type: none"> • How will each option outlined above impact revenue and costs for both IOOF and the member? • What is the cost of each option? • Does implementation require system or process changes or a transition plan? If so, have the costs of this been considered? • What will be the ongoing cost of monitoring? What assumptions have been included in this analysis?
Benefits	<ul style="list-style-type: none"> • What strategic objectives will be achieved by the preferred option? • Will the option result in an improved customer experience? • What cost savings will occur due to the outsourcing? Will productivity gains be achieved? • Will risks be reduced or removed? (Must be linked to the Business Unit risk profile) • What assumptions have been included in this analysis?
Risks	<ul style="list-style-type: none"> • Will the option reduce operational or strategic risk? • Will the option increase existing risks or create new risks? • Are there any IT security risks to consider (including offshoring and cloud computing)? • Does the service involve the sharing of client information or commercially sensitive IOOF data? If so, this will trigger a risk assessment. • Are there many alternative service providers (if selected provider fails)? • How easily can IOOF disengage the service provider should performance be unsatisfactory
Other considerations	<ul style="list-style-type: none"> • What controls does the service provider have in place to manage business continuity risk? • Are there any alternative service providers that we can engage if the selected provider fails?

	<ul style="list-style-type: none"> • How easily can IOOF disengage the service provider should their performance be unsatisfactory? • Are any of the service providers we are considering a related party? If so, what measures are proposed to ensure that the appointment is at 'arm's length' and that any conflict of duty or interest is managed?
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- c) The IOOF Group Conflicts Management Policy states a 'conflict' (actual or perceived) may occur where the duties or interest of one entity in respect of an outcome are not aligned with that entity's obligations or duties to others to achieve a different outcome.

An example of where an actual or perceived conflict may arise is where an executive holds a directorship on both the board of a service provider and another body corporate seeking to appoint the service provider, and the executive is involved in the appointment of that service provider.

Two key approaches are used to manage conflicts of interest:

1. adherence with the Conflicts Management Framework
2. the review, challenge and oversight activities of the Office of the Superannuation Trustee.

1. Conflicts Management Framework

IOOF maintains a Conflicts Management Framework to recognise, treat, monitor and manage conflicts of interest. The Conflicts Management Framework applies across the whole business and comprises the following:

- i. IOOF Group Conflicts Management Policy
- ii. Superannuation Trustee Conflicts Management Policy
- iii. Policy Schedules.

The IOOF Group Conflicts Management Policy applies to all employees, contractors or directors of an IOOF group company and its controlled entities (other than as a superannuation fund trustee). The Superannuation Trustee Conflicts Management Policy applies to activities involving an IOOF entity acting as a superannuation fund trustee.

The Policy Schedules contain specific details on the identification and management of (actual or perceived) conflicts, including the roles and responsibilities of employees, contractors or directors of an IOOF group company, the identification of any related party conflicts (actual or perceived) that may be inherent within the IOOF group, and treatment plans that have been adopted to ensure conflicts are avoided or actively managed.

IOOF undertakes an ongoing program of training to ensure that people understand their obligations under the Conflicts Management Framework.

2. Office of the Superannuation Trustee (OST)

The OST is an independent function (independent of the IOOF Group) that supports IOOF's APRA Regulated Entities. The role of the OST is to review, challenge and oversee the services provided to the AREs by internal and external outsourced providers and to advocate for member outcomes.

The OST supports the relevant ARE boards or committee in meeting their obligations. This includes challenging and evaluating whether a conflict of interest has been avoided or, if it cannot be avoided, appropriately managed.

For example, the OST is a key stakeholder in all advice and proposals submitted to each relevant board or committee and is responsible for ensuring that, among other matters, the interest of members have been considered, member outcomes are advanced, and all conflicts of interest have been avoided or appropriately managed.

- d) IOOF evaluates whether its management of conflicts of interest is working in several ways, including:
- i. Testing of internal controls and treatment plans: The Enterprise Risk and Compliance (ERC) team conducts risk based internal controls testing of treatment plans at least annually.
 - ii. Policy framework assessment: ERC objectively reviews the Conflicts Management Framework on an annual basis and report the results to the IOOF Risk and Compliance Committee and relevant boards.
 - iii. Independent external reviews: In September 2018, EY conducted an independent review of IOOF's risk culture and approach to conflicts of interest management, and an assessment of conflicts inherent in IOOF's business model. EY made a series of recommendations which were adopted and implemented in full by IOOF.
 - iv. Internal audit: KPMG, IOOF's internal auditor, will raise matters relating to potential or actual conflicts of interests where, in the course of undertaking their broader audit activities, these are identified (KPMG does not do any specific conflict evaluations).
 - v. Office of the Superannuation Trustee (OST): OST will raise any matters of concern about any potential or actual conflicts of interests to ensure these are avoided or appropriately managed.
 - vi. Incidents of non-compliance: Compliance with the Conflict Management Framework is a condition of each person's employment or engagement as a contractor. Non-compliance (including non-compliance with a treatment plan) can result in disciplinary action, including ineligibility for a bonus payment, termination of employment or termination of contract.
 - vii. Whistleblowing: Reports or concerns raised with management or anonymously under IOOF's Whistleblower policy.
- e) On 26 June 2019, Australian Executors Trustee Limited (AET) was appointed as the custodian for IOOF Investment Management Limited (IIML). Prior to AET's appointment, IIML undertook due diligence on the appropriateness and ability of AET to undertake the relevant custodial activities. An independent expert was engaged to review the due diligence process and business case documentation, as

well as the steps undertaken to appoint AET, against the IOOF Vendor Management and Outsourcing Policy.

Factors considered by the independent expert included:

- i. the proposed custodial and safekeeping services
- ii. evaluation criteria utilised for selection of custodian
- iii. ability of custodian to meet relevant stakeholder requirements
- iv. stakeholder involvement in decision making
- v. the commercial terms of the custody agreement
- vi. reviewing and assessing whether the proposed fee arrangements are consistent with arm's length prices
- vii. whether the proposed custodial and safekeeping fees reflect an arm's length fee.

This report is subject to release restrictions imposed by the independent expert and we currently do not have authority to release it.