Law Council
OF AUSTRALIA

Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017

The Treasury

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Introduction

1. This submission has been prepared by the Superannuation Committee (**the Committee**), which is a committee of the Legal Practice Section of the Law Council of Australia.

2. The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

3. The Committee makes this submission to Treasury in response to the release of the exposure draft of the Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017 (**the Exposure Draft Bill**).

4. The submission follows the numbering of the Schedules to the Exposure Draft Bill.

1. Annual *MySuper* outcomes assessment

Summary points:

- Apart from symbolic value, the proposed reforms are likely to lead to little substantive change in current practices as they largely involve attesting on an annual basis to having complied with existing regulatory obligations.
- The obligation in proposed s 29VN(3) to compare the fund's *MySuper* product with other *MySuper* products may be inherently problematic because funds operate in different sectors and for different types of members. At worst, this could incentivise trustees to breach their current duty to formulate investment strategies which are suitable for their membership and their fund's circumstances.
- If these reforms are to be pursued, the legislation should clarify whether the annual determination is intended to focus on retrospective performance or future prospects and, in any event, over what time period.
- As currently framed, a trustee who cannot make a confirmatory determination (ie that they are promoting financial interests) must effectively admit to a breach of the legislation and thereby expose themselves to statutory claims for compensation. This could discourage honest, frank and candid determinations being made. Consideration should be given to designing a determination process which does not involve admitting to a breach of legislation if a confirmatory determination cannot be reached.

5. The proposed amendments to s 29VN of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) replace the current 'no financial interest disadvantage' test with a 'promoting financial interest' requirement. While we express no objection to the intentions behind this reform, we query what value this reform would add. At best, there is perhaps some symbolic value in thrusting a particular issue into the spotlight. At worst, the proposal conflicts with existing regulatory obligations.

6. Superannuation trustees are already required to formulate appropriate investment objectives, risk objectives and investment strategies that take into account all of the

circumstances of their fund and their membership. These obligations arise under s 52(6) of the SIS Act and under *Prudential Standard SPS 530 - Investment Governance* (**SPS 530**). Paragraph 27 of SPS 530 already requires these matters to be reviewed on an annual basis. Similarly, the Insurance Prudential Standard already requires specific matters to be addressed by a trustee in formulating its insurance arrangements and these must also be reviewed periodically.

7. As a general proposition, it seems to the Committee that a trustee that is unable to make the proposed new annual determination would likely be in breach of their existing obligations under the SIS Act and the prudential standards. Conversely, a trustee which forms the view that they have complied with their existing obligations is highly likely to form the view that they can make the proposed new determination. Viewed that way, we query what substantive improvements will be achieved through these reforms.

8. In any event, if the proposed reform is enacted, we recommend that the legislation be specific with regard to the following matters:

    - whether the determination is intended to be:
        - a retrospective confirmation that the trustee has promoted members' financial interests in the past; or
        - a prospective confirmation that the trustee will promote members' financial interests in the future; and
    - if the determination is intended to be a retrospective confirmation, over what historical time period this should be assessed.

9. The current drafting is ambiguous because it focusses on whether financial interests are **being** promoted. Even if financial interests had not been promoted in the past, a trustee could make reactive changes to its business strategy and then form a view that, having made those changes, it can honestly say that it is promoting financial interests again. We query what the intention is in this regard.

10. If a retrospective focus is intended, we also believe that careful consideration should be given to specifying the period or periods over which the assessment should be conducted. If no period is specified, trustees would be able to engage in 'term shopping' and rely on whatever historical period provides the best basis for making the annual determination. That said, if a period is specified, it should be significantly longer than 12 months to avoid encouraging a short term approach to investing. On the other hand, if the period is too long, it is questionable how the new reform would apply to a new *MySuper* product that had not yet been in existence for the relevant period. For example, if the determination is required to be made on the basis of, say, 10 year investment performance (to be consistent with the statutory time horizon for all *MySuper* products), it would take several years until a trustee of a *MySuper* product that had only been in existence for only 2 years could form a view on whether they had promoted financial interests over a 10 year period.

11. We point out that there is a gap in the draft legislation insofar as it is unclear what the consequences will be in the event that a trustee cannot make an affirmative determination that financial interests are being promoted.

12. Since there is a statutory obligation under s 29VN of the SIS Act to promote the financial interests of *MySuper* members, making a determination that financial interests have not been promoted involves admitting to a contravention of s 29VN and,

under s 29VP(3), any member would have a statutory right to recover loss or damage from the trustee.

13. In light of the above, the Committee notes that the design of the proposed new determination is not likely to maximise the level of honest and candid self-reflection that we suspect Government is hoping for. There would be strong incentive to avoid making a determination in the negative to avoid admitting a breach and exposing the trustee to legal action. Consideration could be given to formulating the determination in another way, which does not involve admitting to a breach of the legislation, so that there is no immediate legal penalty or legal prejudice in expressing an honest and candid view on matters.

14. As noted above, the proposed reform creates a conflict and inconsistency with a trustee's existing duties to formulate investment objectives and strategies that are appropriate for their membership and the circumstances of their fund. The proposed s 29VN(3) would require trustees to compare the performance and return targets of their *MySuper* product with other *MySuper* products. There is no reason why one fund's returns should be compared against another fund's returns when they might legitimately have been designed with different return targets and different risk objectives. Items such as return targets and levels of investment risk need to be set to meet the needs of a particular fund's members. For example, a fund whose average *MySuper* member is a 45 year old full-time nurse may set return targets and set risk levels at a much less aggressive level when compared to a fund whose average *MySuper* member is an 18 year old part-time hospitality worker. Any comparison will highlight the differences between fund memberships and the *MySuper* funds, but will be unlikely to provide any valid guide as to how well the financial interests outcomes have been met.

15. By requiring trustees, in effect, to compete against *MySuper* products which they ought not be compared against, this reform potentially incentivises trustees to breach their duty to do what is best for their membership in order to give them the best prospect of being able to make the annual determination.

16. The Committee therefore queries whether an attempt at making a comparison with other *MySuper* products will deliver the outcome sought by the proposed new outcomes assessment. Potentially requiring comparisons to be made may encourage trustees to target a narrow band of outcomes that are tailored at being competitive with other *MySuper* products, rather than achieving the expected outcomes of fund members.

17. The outcomes assessment process at proposed s 29VN(2)(a) requires consideration as to whether the options, benefits and facilities offered are appropriate for fund beneficiaries. While the terms 'options and benefits' are well understood, 'facilities' is a term which is not so well understood. It would be helpful to have some guidance as to what is intended to be covered with this term.

18. It is also noted that, under ss 29VN(2)(a)-(d), trustees must assess whether various items are 'appropriate' or 'inappropriately erode' beneficiaries' financial interests. Section 29VN(2)(e) however uses the term 'problems of scale' in relation to the amended scale test. It is not clear what is meant by 'problems of scale'. The Committee suggests that it would be preferable to use terminology that is consistent with the preceding paragraphs, for example, 'inappropriate disadvantages'.

19. Finally, the Committee queries whether it is correct to refer to the amendments as requiring an annual *MySuper* 'outcomes' assessment. The factors specified in proposed ss 29VN(2)(a)-(d) address the appropriateness of the product's design. The

majority of the factors in proposed s 29VN(3) do not concern outcomes at all. It is accepted that proposed s 29VN(3)(c) refers to the return for a MySuper product and that this factor focusses attention on an outcome. However, taking all of the factors as a whole the Committee questions the characterisation of the assessment as one concerned with outcomes.

2. Authority to offer a *MySuper* product

Summary points:

- Is there a need for the change to enhance the Australian Prudential Regulation Authority's (**APRA**) powers in these sections?
- The proposals – perhaps inadvertently – make it easier to obtain MySuper authorisation.

20. The Committee notes that the proposed amendments to ss 29T and 29U are relatively minor in terms of drafting changes to the existing text of those provisions, but these changes appear to alter the ease with which *MySuper* authorisations can be obtained – possibly in ways which were unintended.

21. In one sense, the current law is stricter in relation to obtaining MySuper authorisation. The current law requires APRA to form a positive belief that a Registrable Superannuation Entity licensee (**RSE licensee**) is likely to comply with their *MySuper* obligations. In order to be satisfied of this, APRA must necessarily make enquiries in order to form a view. Under the proposal, to grant a *MySuper* authorisation, APRA must merely not have any reason to believe that the RSE licensee may fail to comply with those obligations. In other words, under the proposal, it is the absence of a belief which is essential to obtaining authorisation. Technically, prior to even considering the contents of an application, it would be true to say that, at that moment in time, APRA would not have any reason to believe that the particular applicant would be likely to breach their obligations.

22. Viewed that way, it could be said that, under these proposals, it is technically easier to obtain *MySuper* authorisation.

23. Also, the Committee queries the rationale for the proposed amendments to s 29U(2). APRA already has a broad power to cancel a *MySuper* authorisation under s 29U(1). Section 29U(2) expressly states that nothing in it limits the power in s 29U(1). There is no need for the amendment.

3. Director penalties

Summary points:

- These changes expose superannuation trustee directors to more risk of personal liability than any other directors in Australia. In the Committee's view, this aspect of the reforms should not proceed.
- If the Government does want to impose pecuniary penalties for breach of the SIS Act director covenants, the Committee considers that it should align all aspects of the SIS Act liability regime with the managed investment scheme regime by removing the direct liability to members that superannuation directors currently have.

24. Proposed new s 29VPA(2) makes s 29VPA(1) a civil penalty provision. This means that a superannuation trustee director who fails to exercise a reasonable degree of care and diligence for the purposes of ensuring that the trustee carries out its *MySuper* obligations under s 29VN will be exposed to civil claims for loss under section 29VPA(3) (which is presently the case) **and** subject to both civil and criminal sanctions under Part 21 of the SIS Act.

25. Proposed new s 55AA inserts a civil penalty provision for breaches of a director's covenants under s 52A. This means that a director who breaches a covenant under s 52A will be exposed to civil claims for loss under s 55(3) (which is presently the case) **and** subject to both civil and criminal sanctions under Part 21 of the SIS Act.

26. As a result, each director will have direct and personal liability to each and every member of a superannuation fund as well as civil and criminal sanctions.

27. Given the rate of consolidation of superannuation funds and their anticipated size, this means that a director of a large industry or retail fund can expect to owe duties (and potentially be personally liable to) millions of members. The potential for legal action to be taken directly against a director by anyone of such a large number of people in addition to both civil and criminal sanctions is inconsistent with the duties (and potential liability) of directors of other financial services entities (such as banks, life insurance companies and managed funds) which are of comparable or even greater size.

28. These changes expose superannuation trustee directors to more risk of personal liability than any other directors in Australia. This is because the *MySuper* director obligations and the director covenants would carry both direct liability to individual members for loss arising from a breach **plus** liability for civil penalty sanctions.

29. **Relativities with duties and liabilities of directors of other entities:** The Committee suggests that this level of exposure is not present in other financial institutions. To impose such onerous exposure on superannuation trustee directors will make it harder for the superannuation industry to attract highly skilled professional to serve on superannuation trustee boards. The Committee notes that directors of a superannuation fund would be placed in an adverse position as regards liability when compared against, for example, directors of banks.

30. **Boards make decisions as a collective:** In the Committee's view, that Boards make decisions collectively, and individual directors acting alone will not be in a position to make a decision in respect of any matter. Individual directors are not trustees. It should also be remembered that those Boards which are structured according to the SIS Act equal representation rules require a two-thirds majority for resolutions to be passed.

31. **Negative impact on decisions that are 'out of the ordinary':** Such onerous exposure over matters such as whether decisions were taken in the best interests of the beneficiaries may result in changed behaviour at board level, such as an increased reliance on expert reports and input (at further cost to members), an unwillingness to deviate from what is seen to be 'standard' practice among funds and to take measured and justifiable risks, and an increased demand by directors to take separate independent legal advice (in many cases ultimately at a cost to members).

32. The Committee is not aware of any research or other evidence suggesting that the avenues of redress already available if directors are thought to have breached their obligations are insufficient.

33. Paragraph 4.3 of the Exposure Draft Explanatory Memorandum states that the changes are being made in order to align the penalty regime for superannuation trustee directors with the penalty regime applying to directors of responsible entities of managed investment scheme, as recommended in the Final Report of the Financial System Inquiry (**FSI**). However this recommendation failed to recognise that directors of responsible entities do **not** have direct personal liability to individual scheme members, as do superannuation trustee directors.

34. The penalty regime for managed investment schemes is constructed differently from the SIS Act. Under Chapter 5C of the *Corporations Act 2001* (Cth) (**Corporations Act**), a breach of a director's statutory duties is a civil penalty provision.[1] In addition, an intentional or reckless breach of a director's statutory duties is an offence carrying 2000 penalty units, 5 years' imprisonment or both.

35. However, under the managed investment scheme regime, directors of a responsible entity (**RE**) have **no** direct liability to individual scheme members for a breach of their statutory duties. Rather, once the court makes a declaration that a civil penalty provision is breached, the Australian Securities and Investments Commission (**ASIC**) can seek both a pecuniary penalty (up to $200,000 payable to ASIC) if the breach is serious and materially prejudices the interests of the scheme or its members. In addition, the court may order compensation to be paid to the scheme on application by ASIC or the responsible entity.[2]

36. As there is no direct civil liability to members of the scheme, a court may instead order an RE director who has breached his or her statutory duties to pay compensation *to the scheme* (but not to individual scheme members).

37. By way of comparison, under the SIS Act there is civil liability for loss (owed directly to members) for breach of a *MySuper* director obligation or director covenant.[3] This means that a superannuation director could be sued by an individual member or by a class of members who allege that they have suffered loss as a result of a breach.[4] This threat of class actions is already a deterrent and, anecdotally, we understand that many professional directors are seeking extensive indemnities from the trustee company itself before they are prepared to assume office.

38. If the proposed changes are made, superannuation trustee directors will have direct civil liability to members for loss (and exposure to class actions as at present) but will also face the prospect of pecuniary penalties payable to the regulator and criminal sanctions for intentional or reckless breach of the covenants.

39. Example 4.1 in the Exposure Draft Explanatory Memorandum cites the case of Semi, who prefers his own interests to the interests of fund beneficiaries in conversations about the future sustainability of the fund, as justification for the new sanctions.

40. If the Government does want to impose pecuniary penalties for breach of the SIS Act director covenants in cases like this, the Committee considers that it should align **all** aspects of the SIS Act liability regime with the managed investment scheme regime by, at the same time, removing the direct liability to members that superannuation directors currently have. In other words:

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[1] These duties also apply to other 'officers' of the RE.

[2] *Corporations Act 2001* (Cth) ss 1317H, 1317J. As with the SIS Act, there are powers for the court to give judicial relief to persons who have acted honestly and ought fairly to be excused having regard to all the circumstances.

[3] *SIS Act* s 55(3).

[4] Subject to leave of the court: see *SIS Act* ss 55(4A)–(4D).

- ss 29VAP(3) and 55(3) would be removed (or limited) so that fund members would no longer be able to sue a director personally for a breach; and
- any compensation payable by the director would be awarded by the court on application by APRA or the trustee and such compensation would be payable to the fund, not to individual members, under a new provision similar to ss 1317H and 1317J of the Corporations Act.

41. Alternatively, a better course may be to make it clear that the duties in s 52A are not covenants deemed to be included in the governing rules of the fund but rather statutory duties owed by the directors to the Trustee company itself with a right of action by the Regulators. That way, the Trustee, ASIC or APRA could take action against a director where a regulatory outcome is desired (which is more likely to be the case where many people are affected) rather than in any individual's case.

4. Approval to own or control an RSE licensee

Summary points:

- The circumstances in which the transitional relief applies are too narrow.
- The notification requirement should be subject to a materiality and knowledge threshold.
- The pro forma additional RSE licence conditions published by APRA concerning change of control will need to be removed.
- The language for examples 5.1 and 5.2 in the Exposure Draft Explanatory Memorandum should be brought into conformity with the actual wording of the test proposed in the new law (instead of 'significant prudential concerns').
- Division 2 of Part 16A should be drafted more clearly to use the concepts of 'controlling stake' and/or 'practical control'.
- The Committee has noted two specific drafting corrections which should be made.

4.1 Transitional relief – deemed approval

42. The Exposure Draft Bill proposes that, if a person holds a controlling stake in an RSE licensee immediately before the commencement day, they will be taken to have approval (under proposed s 29HD) to hold the controlling stake from the commencement day (item 14).

43. The Committee considers that the circumstances in which this transitional relief applies are too narrow. The Committee considers that the relief should apply, at a minimum, if a person enters into an agreement or other arrangement, before the commencement day, to acquire a controlling stake in an RSE licensee. Indeed, since the commencement day will fall very shortly after the Act receives Royal Assent, the Committee considers that the relief should extend to any agreement or arrangement entered into within a reasonable period after the commencement day, with 3 months being a reasonable period. In other words, the Committee submits that the relief should apply if a person enters into an agreement or other arrangement, before the day that is 3 months after the commencement day, to acquire a controlling stake in an RSE licensee.

44. The problem with the relief proposed in the Bill can be illustrated by the following example. Some months ago, a party entered into an agreement to acquire an RSE licensee. Because, at the time, there was no legal requirement to obtain any regulatory approval, the sale and purchase agreement does not contain any condition precedent for such approval. The agreement is due to complete 3 months and 1 week after the commencement day (or perhaps even longer) and the seller requires the purchaser to complete notwithstanding the offence of holding a controlling stake without APRA's approval. The purchaser is faced with breaching the contract, on the one hand, and committing an offence, on the other. While the purchaser may be able to defend a claim for breach of contract, it should not be put in the position of having to do so in the first place.

45. The Committee submits that broadening the relief in the way suggested does not pose any material prudential risk. In the example outlined above, the change in control will be reported to APRA and if APRA has concerns it will be able to use its power to give a direction to relinquish control.

4.2 Transitional relief – offence

46. The Exposure Draft Bill proposes that the offence of holding a controlling stake without APRA's approval (under proposed s 29JCB) will only apply where a person begins to hold the controlling stake on or after the day that is 3 months after the commencement day (item 15).

47. If the Committee's submission set out above concerning the general transitional relief is accepted, no specific transitional relief in relation to s 29JCB would be required. In this case, item 15 could be removed from the Bill.

4.3 Conditions imposed on RSE licences

48. The Exposure Draft Bill will replace the existing requirement to notify APRA of a change in the composition of the RSE licensee with a requirement to notify APRA of a change in the composition or control of the RSE licensee (items 5 – 7). In this context, a change in control refers to 'a person's stake in the RSE licensee changing' (proposed s 29E(2)(a)(ii)). The Committee queries whether this is intended. It would capture any change in a stake, no matter how small. Take the example of a superannuation trustee that is 100 per cent owned by a non-operating holding company that has, in turn, issued 1,000 shares which are held by various shareholders. Suppose one shareholder transfers 1 share in the non-operating holding company. In that case, the trustee's licence condition would require it to notify APRA of the 0.1 per cent change in ultimate ownership, and assumes that the trustee had any knowledge of the transfer.

49. The Committee submits that if the notification requirement is to turn on a person's stake in the RSE licensee changing, there should be a materiality threshold and, further, the requirement should be qualified so that it only applies if the trustee knows about the change or could reasonably be expected to know about the change.

50. The Committee also notes that the pro forma additional RSE licence conditions published by APRA contain a notification requirement concerning a change of control. The Committee acknowledges that these matters fall within APRA's remit, not Treasury's. Nevertheless, the Committee submits that Treasury should recommend to APRA that APRA amend its pro forma licence conditions to remove the change of control notification requirement. In addition, APRA should be asked to amend existing RSE licences to remove the change of control notification requirement they contain.

Otherwise, RSE licensees will be subject to differing change of control notification requirements under their licences and under the SIS Act. The Committee considers that the same topic should not be dealt with in different ways under different obligations.

4.4 Approval to hold a controlling stake

51. The Exposure Draft Bill proposes the key test to be applied as part of the approval process to be whether APRA has reason to believe that, because of the applicant's controlling stake in the RSE licensee, or the way in which that controlling stake is likely to be used, the RSE licensee may be unable to satisfy one or more of the trustee's obligations contained in a covenant set out in ss 52 to 53, or prescribed under s 54A, or referred to in ss 29VN or 29VO (item 8, proposed s 29HD).

52. The Committee submits that this test is generally appropriate compared to the other possible alternatives mentioned below. That said, we reiterate our comments above with regard to the granting of *MySuper* authorisations – specifically, that consideration should be given to introducing a common sense materiality threshold around the inevitable possibility that a licensee 'may' breach a regulatory obligation at some point in time in the future.

53. The test contained in the *Financial Sector (Shareholdings) Act 1998* (Cth) (**FSSA**), which turns on whether the controlling stake would be in the 'national interest', would not be appropriate in a superannuation context. The Committee is nevertheless concerned that examples 5.1 and 5.2 in the Exposure Draft Explanatory Memorandum are not aligned with the key test as proposed to be inserted into the law. In each case, the proposed ownership is said to raise 'significant prudential concerns'. As noted above, the test does not turn on 'significant prudential concerns' (nor on whether ownership would be in the 'national interest'), it turns on whether the proposed ownership is likely to impair the trustee's ability to comply with specific obligations. The Committee suggests that the examples should be brought into conformity with the proposed test. The broader notion of 'significant prudential concerns' should be removed. It would also be better if the examples related to a situation of fraud or likely fraud. The potential for fraud is the stated rationale for the new requirement and the Trio Capital episode is cited – see paragraphs 5.1 and 5.4 of the Explanatory Memorandum. The facts stated in examples 5.1 and 5.2 seem far removed from a case of fraud or likely fraud and, without wishing to appear to suggest that the facts in those examples are not serious, the Committee suggests that more serious facts should be used in the examples.

4.5 Directions to relinquish control over an RSE licensee

54. The Exposure Draft Bill proposes to insert a new Division 2 into Part 16A of the SIS Act (item 10).

55. The provisions refer, in various places, to a direction to relinquish 'control' over an RSE licensee – see, for example, the opening words of proposed ss 131EB(1)-(3). In this context, the term 'control' is not defined. However, in context it seems to be intended to refer to a person having a controlling stake or having practical control. The Committee suggests that it would be preferable to be clearer in the drafting. Greater clarity could be achieved by expressly defining control as referring to a person having a controlling stake or having practical control. Alternatively, greater clarity could be achieved simply by using the concepts of controlling stake and practical control and dispensing with references to 'control'. The Committee does not express a preference

as between these two alternatives, but it does consider that either of them would be better than the approach taken in the Exposure Draft Bill.

56. As a matter of fairness and to facilitate alternative acceptable outcomes, it should be sufficient for an RSE licence to be relinquished as an alternative to relinquishing control of the RSE licensee. There may be reasons why a controlling entity would be more willing to relinquish the RSE licence as opposed to relinquishing control over the RSE licensee. For example, the entity holding the RSE licence may have other assets and businesses which are valued more highly than the RSE licence and the superannuation business to which it attaches.

57. Further, the Exposure Draft Explanatory Memorandum contemplates that APRA may direct a person to relinquish control even if the acquisition of control had previously been approved (or deemed to be approved). This means that persons who already have control of RSE licensees can take very little real comfort from the transitional relief. Their deemed approval could be immediately revoked. Similarly, this prospect will give rise to considerable uncertainty in a corporate transaction setting. While APRA approval will certainly become a standard condition precedent in any transaction involving the acquisition of a superannuation business, the fact that the approval could subsequently be revoked will add uncertainty to those kinds of transactions. We suggest that it would be appropriate, and would encourage appropriate discipline when vetting requests for approval, to limit APRA's ability to revoke approvals to cases where a development arises **after** approval was granted which gives rise to a concern that future breaches may occur.

4.6 Miscellaneous

58. The Committee suggests that:

- in proposed s 131EF(3)(c)(i), 'has' should be replaced with 'holds' (compare proposed s 131EF(3)(b)(i)); and
- in proposed s 131EF(4), 'may' should be inserted before 'include' (the Committee acknowledges the section is copied from the corresponding section from the FSSA but it seems the word 'may' was inadvertently left out from the section when the FSSA was enacted).

5. APRA directions power

Summary points:

- The proposed new power to be given to APRA is far-reaching. So as to limit the risks inherent in such a power, APRA should in most cases be required to afford trustees with a reasonable opportunity to respond and submit argument prior to the formal direction being applied.
- A new provision should be added to require APRA to form the view that, if it were to consult with the trustee on the proposed direction prior to it being issued, the trustee would be unlikely of its own volition to act in the manner proposed in the direction.
- APRA already has direction powers under the SIS Act which are still significant and arguably sufficient for its purpose.
- It is unclear whether APRA has power under proposed section 131FA to direct a trustee to act contrary to the terms of its trust or governing rules.

- Nevertheless, if these reforms are to be implemented, we strongly endorse the foresight in providing statutory safe harbours for trustees which comply with any directions which may be given. These protections are essential.
- However, even though a trustee cannot be sued for complying with an APRA direction, this does not mean that the trustee is entitled to recover the costs of complying with the direction from the fund assets if the relevant course of action would otherwise have been beyond the trustee's powers and/or outside the scope of the trustee's indemnity under the trust deed. A statutory right of indemnity should be created to ensure that this is the case.

59. The exercise of such far-reaching powers by APRA (however well intentioned) runs the risk of causing significant reputational and economic damage to a superannuation fund and its members – depending on the media coverage given to the exercise involved. Depending on the circumstances, that damage may outweigh the benefit APRA may be seeking to achieve through the exercise of the directions power in certain circumstances. This is particularly the case where it is subsequently determined that, while APRA had 'reason to believe' that circumstances existed that would warrant the exercise of these interventionist powers, subsequently it was shown that those reasons were ill-founded. In such circumstances, it will be impossible to restore the fund to the position it was in prior to the exercise of those powers.

60. Accordingly, to limit the risks associated with exercise of such a power (without the normal constraints around its exercise, as is intended), we suggest that only certain of the specified circumstances in which APRA could exercise the power may be so exercised without affording the fund's trustee with a reasonable opportunity to respond and submit argument prior to the formal direction being applied.

61. For example, referring to proposed new s 131D (within new proposed Part 16A of the SIS Act), APRA should only be able to exercise a direction power without prior reference and procedural fairness to a fund trustee where it has 'reason to believe' that the circumstances specified in proposed new paragraphs 131D 1(b) and 1(e)-(j) exist.

62. Consideration could also be given to requiring APRA to form the view that if it were to consult with the trustee on the proposed direction prior to it being issued, the trustee would be unlikely of its own volition to act in the manner proposed in the direction, or that APRA considers the trustee does not have the requisite power to act in the manner intended unless the direction is issued.

63. It is noted from the Exposure Draft Explanatory Memorandum that APRA already has direction powers under the SIS Act which, while not as broad as that applying in the banking and insurance industries, are still significant and arguably sufficient for its purpose. While this assessment is a policy matter, some further consideration of the adequacy of the existing powers may be warranted. For example, as noted in the Exposure Draft Explanatory Memorandum, APRA already has the power to issue directions requiring a licensee to comply with condition of its licence, including compliance with any particular condition of the SIS legislation, or indeed the Prudential Standards. It is noted that the SIS legislation includes at its core the s 52 trustee covenants which, in our view, would be broad enough to encompass almost any of the specific circumstances for which it is proposed APRA be given specific direction powers as set out in the proposed new s 131D.

64. It is noted that APRA does not currently have the same directions power in relation to a 'connected entity'; but extension of its direction powers in relation to connected entities is a separate policy matter.

65. The Exposure Draft Explanatory Memorandum assumes that a RSE licensee would be able to control any connected entity in order to procure that the connected entity complies with a direction by APRA. This assumption would not be true in all cases. For example, if the RSE licensee owns 51 per cent of the connected entity, this would not be sufficient to procure the connected entity to take action if, for example:

    - The relevant action requires a special resolution to be passed by the shareholders of the connected entity (i.e. 75 per cent approval); or
    - The relevant action requires approval by the connected entity's board and the RSE licensee does not have sufficient control in the board room to ensure that approval is granted. Alternatively, even if the RSE licensee has appointed directors to the board of the connected entity, their fiduciary duties to the connected entity would override any obligation to have regard to the wishes of the shareholder who appointed them.

66. We note that the proposed legislation provides for a broad defence for any person acting in good faith and without negligence in compliance with a direction given under the new legislation. However, it is unclear whether APRA has power to direct a trustee to act contrary to the terms of its trust or governing rules. It is noted that s 131FA merely provides a power for an RSE licensee in receipt of such a direction to act in compliance with a direction from APRA despite anything in its '**constitution** or any contract or arrangement to which it is a party'. This may put the trustee in an invidious position contrary to the best interests of its members. The section should be expanded so that a trustee is protected despite anything in its trust deed.

67. Further, even though a trustee cannot be sued for complying with an APRA direction, this does not mean that the trustee is entitled to recover the costs of complying with the direction from the fund assets if the relevant course of action would otherwise have been beyond the trustee's powers and/or outside the scope of the trustee's indemnity under the trust deed. A statutory right of indemnity should be created to ensure that this is the case.

68. Given the far reaching nature of these interventionist powers, and the absence of evidence to suggest that the availability of these powers would have prevented loss to members, further consultation on what may be justified in terms of enhancement of the existing powers is suggested.

69. Finally, the Committee notes that while the general protection from liability in proposed s 131FB will apply to any 'person', the specific protection from liability in relation to a direction in proposed s 131FC will only apply to officers, employees and agents. It will not apply to the RSE licensee itself (or the connected entity itself). The Committee submits that s 131FC should apply to any 'person', in the same way as is proposed in s 131FB.

70. To give an example, APRA will have the power to direct a trustee not to pay a benefit. If a benefit is otherwise payable under the trust deed, the trustee faces the prospect of complaint and challenge by the member who is entitled to the benefit. The trustee should have the benefit of the protection in s 131FC in this circumstance.

6. Annual members' meeting

Summary points:

- The Committee is uncertain about the need for or benefits arising from a requirement to hold annual member meetings because superannuation fund members already have very clear existing rights to make enquiries and request information.
- In contrast to an annual general meeting of shareholders in a company where business is transacted and resolutions are voted upon, an annual meeting of members would effectively be a mandatory attempt to engage with members on an annual basis.
- Since there would be no resolutions to be voted upon, there would be no need for all members to attend or be present at the same meeting at the same time. Flexibility should be allowed so that trustees can choose to conduct multiple annual meetings (for example, in different States and territories) on different days in order to facilitate attendance by a greater number of members in person. For similar reasons, greater flexibility should be allowed in terms of which responsible persons are in attendance at meetings.
- Similarly, where a trustee acts as trustee of multiple funds, they should be permitted to conduct the annual meeting for all of those funds simultaneously.
- If member meetings were to be required:
  - tensions may arise between the trustee's duty to manage and administer the fund and members seeking to direct how the board of the trustee fulfils that duty;
  - the grounds on which a trustee can decline to answer a question should be expanded – for example, where there is insufficient time, where questions are repetitive, vexatious, offensive or designed to ridicule or concern confidential or privileged matters (rather than relying on the exemption for questions which pose a detriment to members) or relate to persons other than the member asking the question;
  - there is no clear provision for how individual member issues raised might be addressed at such meetings;
  - the definition of 'member' should be made certain for the purposes of proposed section 29P;
  - the exceptions to proposed section 29PB need further clarity; and
  - the new provisions do not establish fundamental matters about how a meeting of members of a superannuation fund might be properly held.

71. The proposed s 29P would introduce an obligation on RSE licensees to conduct an annual meeting of members of the entity in respect of each year of income of the entity.

72. The Committee questions the merit of a requirement to hold an annual meeting of members if the principal purpose of such meetings is only to provide members with an opportunity to ask questions of the trustee board, other responsible officers of the

trustee and the auditor and actuary. The Committee considers that alternative forums for such questions to be put in public should be considered. Funds are already required to have a published process for handling enquiries and complaints (s 101 of the SIS Act). In addition, fund members have a right to request a broad range of information under s 1017C of the Corporations Act and reg 7.9.45 of the *Corporations Regulations 2001* (Cth).

73. The Committee understands that the proposed new s 29P adopts a similar approach to meetings as that which would apply to public companies. However, superannuation funds differ to companies in many respects and key to this is the trust structure of funds compared to what might be viewed as a more contractual based structure for companies. The shareholders, board and company have a contractual relationship governed by the terms of the company's constitution - giving rights to the shareholders with respect to certain core matters affecting the company and to ultimately replace the board. Provisions of a company's constitution are generally only able to be amended by a special resolution of shareholders passed at a meeting of shareholders. For superannuation funds, the rules governing the structure and operation of the trust are typically set out in the trust deed establishing the fund and may be varied according to the amendment power – which power is typically vested in the trustee and subject to restrictions designed to protect members' interests (including regulation 13.16 of the *Superannuation Industry (Supervision) Regulations 1994* (Cth)).

74. Further, shareholders' voting rights are an important entitlement of shareholders embedded in the constitution of the company and recognised by the Corporations Act and supplemented by ASX listing rules for listed public companies. Various significant aspects of a company may be subject to approval by shareholders via ordinary or special resolutions passed at a meeting of shareholders, such as director appointments/removals, directors and officers remuneration and auditor appointments and remuneration. In contrast, members of superannuation funds do not generally have voting rights, other than with respect to the appointment of member representatives to an equal representation trustee board. Further, the trustee of a superannuation fund is generally viewed as solely responsible for the management and administration of the fund and the trust deed cannot permit the trustee to be subject to the direction of members, other than in certain limited circumstances (see s 58 SIS Act).

75. Further, the Committee is concerned that providing members with an opportunity to put questions to the board of a trustee at an annual meeting of members may give rise to a tension between the trustee's duty to manage and administer the fund and members seeking to direct how the board of the trustee fulfils that duty. Particular examples of how this might be borne out include:

    - an older cohort of members (who are generally more engaged) attending the annual meeting and seeking to influence trustee decision-making in favour of retired members and members closer to retirement;
    - members interested in a particular investment option may, for example, pose questions for their own benefit in connection with that option and seek to influence the decision-making for the benefit of those members invested in that option; and
    - under-representation of default members.

76. In addition, there is no clear provision for how individual member issues raised might be addressed at such a meeting or whether, for example, potential beneficiaries of a disputed death benefit might seek to appear at such meetings by reference to another interest they hold in the fund as a member – or by reference to their contingent

entitlement. These matters could become problematic for trustees to manage and may cause significant delays in the holding of the meetings. If media are also in attendance (and they may not be excluded if they hold an interest in the fund) there is a significant reputational risk for funds and the industry as a whole to suffer if provocative questions are put (including, potentially, between competing funds or sectors of funds).

77. The definition of 'member' should be made certain for the purposes of s 29P. For many funds the definition is not clear under the deed and the concept varies between funds as to whether certain persons are included within the meaning of 'member' – such as, potential beneficiaries, actual beneficiaries, pensioners and certain former members.

78. Consideration might be given to whether the annual meeting requirement could be satisfied for holding numerous meetings for various cohorts of members – based on geographical location, category of membership, common large employers (for sub-plans of master funds). For similar reasons, greater flexibility should be allowed in terms of which responsible persons are in attendance at meetings

79. Similarly, where a trustee acts as trustee of multiple funds, they should be permitted to conduct the annual meeting for all of those funds simultaneously

80. Proposed new s 29PB requires responsible officers (and others under equivalent provisions) to respond to questions put at a meeting (or within one month of the meeting if it is not practicable to do so at the meeting). The proposed carve-out against this obligation at s 29PB(3) is not clear, for example, the question need not be answered if it would be in breach of the governing rules; as most governing rules do not contemplate the trustee responding to questions raised by members at a meeting of members, it is not clear how the governing rules would prevent a response being provided. Further, the carve-out regarding whether the proposed answer would be of 'detriment to members' will likely be difficult to apply in practice. At a minimum, if the provision is to remain, clearer guidance on the operation of the carve-out should be provided. Further, as for public companies, questions to the auditor (and actuary) should be required to be submitted prior to the meeting.

81. The governing rules of most regulated superannuation funds do not make provision for the meeting of members. To the extent that governing rules do provide for such meetings to be held they were typically introduced many years ago and have not been applied. Further, there is either no provision for how such meetings are to be held or there is very limited guidance. This should be contrasted with the position of companies where the Corporations Act provides replaceable rules for the conduct of shareholders meetings if those provisions are not contained in the company's constitution or governed by listing rules. For instance, fundamental matters about how a meeting of members of a superannuation fund might be properly held are not established by the new provisions or by the governing rules of most superannuation fund, including with respect to:

    - quorum requirements;
    - how the meeting is to be chaired;
    - arrangements for proxies to attend meetings and speak;
    - notices of meetings;
    - governance issues for electronic meetings.

82. The grounds on which a trustee can decline to answer a question should be expanded – for example, where there is insufficient time, where questions are repetitive, vexatious, offensive or designed to ridicule or concern confidential or privileged

matters (rather than relying on the exemption for questions which pose a detriment to members) or relate to persons other than the member asking the question.

83. If meetings are conducted electronically, it is possible that hundreds of thousands of questions could be submitted electronically by members in the case of large superannuation funds. It is not reasonably practicable for trustees to reply to every question that is submitted in these circumstances.

84. The Committee encourages consultation on the costs of conducting annual member meetings, including the costs of disseminating meeting materials in the case of funds which do not currently communicate with their members electronically. While most modern trust deeds would allow trustees to recoup these costs from the assets of the fund, old trust deeds which specify the categories of costs which can be expensed to the fund may not allow this. A statutory right of cost recovery should be created.

85. In this regard, we note that annual member meetings are perhaps more likely to be attended by engaged members, which are perhaps more likely to be members of non-*MySuper* products. Where that is the case, this could pose some challenging issues in connection with the fee charging rules for *MySuper* products which require costs to be fairly apportioned between members.

Reporting standards

Summary points:

- The Committee is uncertain about the need for or benefits arising from a requirement to hold annual member meetings because superannuation fund members already have very clear existing rights to make enquiries and request information.
- The reference to 'another entity' in proposed s 13(4D) should be clarified as to whether it is intended to be a reference only to an entity which is a 'financial sector entity' covered by the *Financial Sector (Collection of Data) Act 2001* (Cth), or any entity more broadly.
- Proposed s 13(4D) would capture an extremely broad range of transactions, and require disclosure of information which at present may be considered commercially confidential.
- Compliance costs will be difficult to justify by reference to the stated regulatory outcomes which are sought to be achieved by the new reporting standards.

86. The Committee has a number of concerns about the proposed new reporting standards provision in section 13(4D) and what might be termed the 'contract deeming provision' in s 13(4E) of the *Financial Sector (Collection of Data) Act 2001* (**FSCD Act**).

Meaning of 'another entity'

87. As a preliminary matter, the Committee notes that the new reporting standards provision allows APRA to issue reporting standards that require information to be provided in relation to the giving of money, consideration or other benefits out of the assets of an RSE to 'another entity'. It is not clear whether the reference to 'another entity' in the sub-section is intended to be a reference only to 'another entity' which is an entity covered by the FSCD Act (that is, a 'financial sector entity' under s 5) or

whether 'another entity' is intended to have a broader operation, so as to include 'entities' which are not covered by the FSCD Act. This should be clarified.

New reporting standards would capture an extremely broad range of transactions

88. The new reporting standards provision has an extremely broad scope, having regard to the wide variety of different types of payments which can be made *'out of the assets of a registrable superannuation entity' to 'another entity'* as part of an RSE licensee's operation and management of an RSE.

89. For example, RSE licensees could be required to report to APRA information in relation to:

- fees paid by an RSE license to an administrator;
- fees paid by the RSE licensee to professional advisers (such as actuaries, accountants and law firms);
- ex-gratia payments made to members to resolve disputes and settlements paid to plaintiffs in legal proceedings; and
- remuneration paid to employees of the RSE licensee.

90. Under proposed s 13(4D), the information required to be reported to APRA in relation to these and other such payments is proposed to include information about:

- the details of the entity to which the payment is made;
- the purpose of the payment; and
- the way in which the payment is used by the recipient (and any other entity with which the recipient 'deals').

91. The Committee queries whether this proposal is an over-reach of the law. It is unclear what the present regulatory or legal deficit is which requires remedy through the proposed new provision. It is not clear whether there would be any other entities regulated by APRA (or indeed by any other regulator) where such a deep and broad power exists so as to compel the routine production of information about money or consideration paid or benefits provided to another entity in the normal course of management and operations of the entity.

Compliance costs are difficult to justify by reference to stated regulatory outcome sought to be achieved by new reporting standards

92. It is unclear how the provision of the required information to APRA in relation to such a broad range of transactions is necessary to enable APRA to satisfy its mandate or 'mission statement'.[5] For example:

- How would reporting the required information (which includes information about how money is used by an entity who receives it out of the assets of an RSE) in relation to an ex-gratia payment from the assets of an RSE to an RSE member to resolve a dispute with the member assist APRA to fulfil its mandate or mission?

[5] APRA's mission statement is to 'establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system.'

- Likewise, how would reporting information about the payment from the assets of an RSE of a service fee to a law firm engaged by the RSE licensee assist APRA to fulfil its mandate or mission?

- How would APRA be in a position to assess whether such payments are 'in line with the RSE licensee's obligations under the SIS Act, including the obligation to act in the best interests of beneficiaries?'[6]

93. It is the Committee's view that the significant time and resources that would be required, and compliance costs that would be incurred, by RSE licensees to comply with new reporting standards issued under the New Reporting Standard Provision are difficult to justify by reference to the stated regulatory outcome of enabling APRA to 'understand the full picture of how RSEs are using member contributions' and 'consider whether expenses of individual RSEs are in line with the RSE licensee's obligations under the SIS Act' (as per the Exposure Draft Explanatory Memorandum), having regard to APRA's purpose and mandate.

94. RSE licensees are already subject to very significant regulatory oversight, including by APRA. The additional regulatory burden which would result from the proposed additional reporting requirements under the new reporting standards provision may have adverse effects on competition in the superannuation industry by increasing the existing barriers to entry, and may even stifle innovation or distort the market. Under section 8(2) of the *Australian Prudential Regulation Authority Act 1998* (Cth), APRA must, in performing and exercising its functions and powers, balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

95. The new reporting standards provision would also apply indirectly to entities which are not regulated by APRA due to the operation of the contract deeming provision. Again, there are a wide variety of entities which contract with RSE licensees as part of an RSE licensee's management and operation of an RSE, including entities not regulated by APRA, such as administration companies and natural persons. The required information to be provided to APRA in relation to any money, consideration or other benefit given out of the assets of an RSE includes information about the way the money, consideration or benefit is used by the recipient entity. This is a significant intrusion into the private affairs of such entities and, again, it is difficult to justify this by reference to APRA's stated regulatory outcomes.

96. Further, APRA already has significant powers to compel an RSE licensee to furnish it with information under the monitoring and investigation provisions under Part 25 of the SIS Act. It is not clear whether there is a pressing need or public concern about how RSE licensees are 'using member contributions' (paragraph 8.8 of the Exposure Draft Explanatory Memorandum) which would warrant the reporting obligations which could be issued under the new reporting standards provision, which would apply to *all* RSE licensees.

Confidentiality

97. Many of the payments made out of the assets of an RSE would be made in circumstances where the information in relation to the payment would be considered to be confidential as between the parties. Often the payment will be made under an agreement which contains an express confidentiality clause (although such clauses

[6] The Explanatory Memorandum to the Exposure Draft Bill (at paragraph 8.8) states that the Required Information in relation to payments made out of RSE assets will 'enable APRA to understand the full picture of how RSEs are using member contributions and will enable APRA to consider whether expenses of individual RSEs are in line with the RSE licensee's obligations under the SIS Act, including the obligation to act in the best interests of beneficiaries as per paragraph 52(2)(c).'

often contain an exception whereby disclosure of the confidential information is ‘subject to law’).

98. Again, the Committee considers that it is difficult to justify APRA collecting such confidential information by reference to the stated regulatory outcome that is sought to be achieved. The Committee is concerned that government agencies only collect confidential information (including commercial information) where there are legitimate grounds or a clear need to achieve some worthwhile regulatory outcome. In this case it is not clear that the provision of the Required Information to APRA in relation to the relevant transactions serves a legitimate or worthwhile regulatory outcome for the reasons given above.