Law Council
OF AUSTRALIA

Superannuation Legislation Amendment (MySuper Measures) Regulation 2013

The Treasury

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

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1. About the Law Council of Australia's Superannuation Committee

1.1 The Law Council of Australia is the peak national representative body of the Australian legal profession; it represents some 60,000 legal practitioners nationwide. Attachment A outlines further details in this regard.

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

1.3 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.

2. Executive Summary

2.1 The draft regulations relating to product dashboards and portfolio holdings disclosure have been drafted in a style which is quite unlike other regulations applying to superannuation funds. This style is confusing and unclear. Fund trustees, their staff, service providers and advisers could have difficulty understanding what is required. The rule of law requires that Parliament make laws that are clear and written in such a way that those who are to be bound by them can readily determine the nature and extent of their obligations, and understand the consequences that will arise if they fail to comply. We are concerned that the draft regulations may not meet this standard.[1]

2.2 The drafting which attempts to describe, in words, the layout of the templates for portfolio holdings disclosure is particularly challenging. Given that the proposed templates are eventually set out in the regulations, we query why the layout needs to be described in words at all. After all, superannuation funds are accustomed to using prescribed templates: for example, with regard to fee disclosure in Product Disclosure Statements (PDSs).

2.3 With regard to dashboards, we note with approval that trustees will not be compelled to define their investment objectives by reference to Australian Weekly Ordinary Time Earnings (AWOTE), but issues may remain for trustees that offer products that do not target CPI-linked returns. Some technical ambiguities arise with regard to calculation of the ten year data that underpins the graphs in the dashboard, especially where the investment objectives were changed during the last ten years and/or where the product previously targeted returns over a shorter time period than ten years. There is also ambiguity in the regulations as to whether members must be sent dashboards for every available investment option or only those in which they are invested.

2.4 With regard to portfolio holdings disclosure, it is disappointing that issues identified as part of earlier consultation processes have not been addressed. Disclosure in the manner contemplated will expose trustees to the risk of substantial claims for damages for breaching confidentiality provisions, especially under benchmark

[1] Law Council of Australia, *Rule of Law Principles*, March 2011 http://www.lawcouncil.asn.au/shadomx/apps/fms/fmsdownload.cfm?file_uuid=4858D679-AA9B-27F0-219A-40A47E586C70&siteName=lca.

licensing agreements where investments are managed pursuant to an indexed investment strategy. The drafting is silent as to the treatment of derivatives, securities lending arrangements and assets held or transferred by way of collateral in connection with such arrangements. The drafting is also silent as to whether or not these requirements are intended to apply to defined benefit funds. Finally, disclosing the value of unlisted assets will unfairly prejudice negotiations involving Australian superannuation funds and unlisted assets, and will confer a tactical advantage to sovereign wealth funds, foreign funds and other domestic institutional investors.

2.5 With regard to the provision of reasons to members on request, there is no time limit or sunset date by which a member must make their request. As such, there is a risk of trustees being called upon to provide reasons long after the relevant decision was made, possibly even after the conclusion of legal proceedings, the expiry of limitation periods or after a change in trustee.

2.6 With regard to fee disclosure, we endorse the approach of refreshing the various fee templates and terminology that must be used in connection with PDSs to reflect the MySuper nomenclature. However, there are several technical issues. For example, in some cases there are other templates which also require updating but which have been overlooked; in other cases, an incorrect provision has been updated. The regulations should also be modified to avoid double-counting that may arise in cases where the indirect cost ratio includes both administration fees and investment fees.

2.7 Given the proximity to 30 June 2013, transitional relief is required as it will be extremely onerous for funds to update their disclosure documents and periodic statements by 1 July 2013 in order to comply with the proposed new requirements.

2.8 With regard to the priority to be given to defined benefit interests and accumulation interest on a winding up, we note that this potentially gives rise to constitutional issues in so far as there may be an acquisition of property from those members who forfeit a priority that was previously enjoyed. Given the definitions of ‘defined benefit interest’ and ‘accumulation interest’ (and, in particular, the fact that an accumulation interest is deemed to be anything that is not a defined benefit interest), there is potential, at the periphery, for this drafting to result in priority being given to some kinds of interests that may not have been intended.

2.9 Finally, the requirements concerning the disclosure of executive remuneration are extensive and involve a level of detail that will likely exceed industry’s expectations and potentially go beyond the requirements that apply to listed companies. Clarification that the provisions would not require the disclosure of remuneration genuinely for services unrelated to roles concerning the superannuation fund, nor the disclosure of information that is not in the trustee’s possession, would be helpful.

3. Product dashboards

3.1 Previously there had been some suggestion that investment objectives would have to be disclosed by reference to AWOTE. This would have been problematic for investment options that did not have a return objective linked to AWOTE.

3.2 Draft regulation 7.9.07P will therefore benefit funds that have CPI-linked investment return objectives. However, a problem will still exist for MySuper products that do not have a CPI-linked investment return objective (and also for

choice products, if the same approach is taken in that context). For example, some products may target an absolute rate of return or may target returns that track those of a particular market index. The product dashboard requirements ought not to require trustees to disclose their investment objectives in terms which do not align with what their actual investment objectives really are.

3.3 We note that the product dashboard requirements for MySuper products will require most of the return data to be calculated on a ten year basis, which aligns with the legislative requirement for MySuper products to have a ten year return objective.

3.4 However, we query how these requirements are to be applied in cases where the MySuper product is a re-badged version of a predecessor product, especially where the predecessor product targeted a particular return objective over a shorter period. For example, to take an extreme example, a product which was previously targeting a particular return in every financial year should arguably not be permitted (or required) to hide historical underperformance behind ten year return data. This would ordinarily be misleading or deceptive conduct, in the absence of a legal requirement to engage in that conduct. This impacts the way in which the return objective graph, and also the moving-average return graph, is calculated.

3.5 It would also appear to be sensible to clarify in the drafting that the return objective is a concept that can change through time and that the dashboard must reflect the investment objective that actually prevailed at each point during the ten year period. Otherwise there is a risk that some funds may interpret the requirements as requiring the currently framed return objective to be retrospectively recalculated for the years that preceded the adoption of the new return objective. Again, this impacts the way in which the return objective graph, and also the moving-average return graph, is calculated.

3.6 We note that the product dashboard requirements do not expressly contemplate the inclusion of the customary warning that past performance is not an indicator of future performance.

3.7 The product dashboard requirements would involve returns being targeted and disclosed on a basis which is net of investment fees and administration fees. Not all funds target or publish returns on this basis. For example, where administration fees are dollar-based and deducted directly from member accounts, it is not possible to accurately incorporate this into a percentage-based investment return that is applicable to all members. Either the requirement should be relaxed so as not to require a focus on investment returns after dollar-based fees or, alternatively, a mandatory assumption should be prescribed for converting a dollar-based fee into a percentage: for example, if the assumption is that all members have a particular balance, a dollar-based administration fee (converted in this way) could be deducted from the investment returns.

3.8 Although the explanatory memorandum suggests that members would only have to be sent product dashboards for the investment options in which they have invested (that is, when sent their periodic statements), there is nothing in draft regulation 7.9.20(1)(o) which limits the obligation in this way. The draft regulation, on one view, could require members to be posted a product dashboard for all investment options that are able to be chosen from.

4. Portfolio holdings disclosure

4.1 The proposed requirements dealing with portfolio holdings disclosure fail to address a number of significant issues that we have identified in earlier submissions on this topic.

4.2 The requirements are silent as to how derivative positions are to be disclosed, if at all. This is a complicated area that requires careful attention so as not to mislead members and to ensure consistency in approach between funds. For example, if derivatives are expected to be disclosed:

(a) are exchange traded derivatives expected to be disclosed in the same way as over- the-counter derivatives?

(b) are derivatives expected to be valued on an effective exposure basis or on a profit/loss basis (for example, relatively cheap (or even costless) options may represent a substantial liability)?

(c) how are assets received and/or transferred by way of collateral expected to be disclosed – for example, are these expected to be disclosed together with (or deducted from) other asset holdings?

(d) different treatment may be required for different kinds of derivatives.

4.3 Similarly, guidance is also required as to the treatment of securities lending arrangements. For example, if securities are on loan as at 30 June or 31 December, is it intended that they be excluded from the disclosure, or should they be included on the basis that they will ultimately be returned? As with derivatives, it is also unclear how assets held by way of collateral (that is, pending the return of borrowed securities) are intended to be treated for the purposes of disclosure.

4.4 The disclosure requirements will systematically place Australian superannuation funds in a position of strategic disadvantage when negotiating the acquisition or sale of unlisted assets with other institutional investors, which may be based in Australia or offshore. In any transaction concerning an unlisted asset, it is advantageous to know how much the other party to the transaction believes the asset to be worth. This is information which will now be publicly available on a superannuation fund's website and which will be detrimental to the transaction prices negotiated by Australian superannuation funds. For example, when selling an asset, absent other forms of price competition, an Australian superannuation fund may find it more difficult to persuade a buyer to pay a higher price (that is, a price higher than the book value of the asset). Equally, when buying further interests in an unlisted vehicle in which an Australian superannuation fund has already invested, the Australian superannuation fund may find it more difficult to negotiate the price downwards in cases where the seller knows (from website disclosures) that the Australian superannuation fund values the asset more highly.

4.5 It is not a case of simply exempting superannuation funds from the disclosure obligations in cases where a transaction is afoot. This is because commercial parties could simply wait until after portfolio holdings data has been published on a superannuation fund's website before announcing details of a proposed transaction.

4.6 These portfolio holdings disclosure requirements will place Australian superannuation funds in a position where they must breach third party confidential

restrictions and thereby expose members to the risk of claims for damages. This risk is particularly acute in the case of investment options (or investing products) which are passively managed on an indexed basis. In these cases, the assets held by the investment option (or by the investing product) will largely replicate the constituents of a benchmark index (for example, the S&P 500 Index). The constituents of a benchmark index constitute valuable intellectual property, typically owned by a benchmark manufacturer such as MSCI, Standard & Poor's or FTSE. The confidentiality of the benchmark constituents is typically provided for in strict benchmark licensing agreements governed by US laws, without any exemption for disclosures where compelled by Australian laws. These agreements may have been executed by the trustee of the superannuation fund or by its investment managers or by those responsible for the investing products in which the superannuation fund has invested. Whatever the case, there is a risk of superannuation funds being exposed to large claims for damages resulting from the breach of confidentiality. Australian superannuation funds could potentially be the source of confidentiality breaches which result in parties from around the world gaining access to the intellectual property of the benchmark manufacturers without payment. For funds which offer passively managed investment options (or which invest via passively managed investing products), this is a significant issue which still requires attention. Similar issues will arise in the case of private equity funds that are governed by documentation imposing strict confidentiality requirements.

4.7 The draft regulations make no reference to defined benefit funds. If defined benefit funds are intended to be excluded from these requirements, it would be helpful if this could be clarified in the explanatory memorandum.

4.8 Note that the draft regulations include two regulations numbered 7.9.07X and should be renumbered accordingly.

5. Provision of reasons for decisions made (other than for death benefits)

5.1 We note that proposed new regulation 7.9.48C of the Corporations Act fails to establish any time limit within which members must make their request for reasons. The 'decision-maker' must provide written reasons within 28 days of the request by the 'eligible person', but there is no time limit within which the 'eligible person' has to make such a request. Accordingly, we envisage that the proposed requirement could lead to a scenario where:

- a member makes a complaint pursuant to which a decision is made by a trustee of a superannuation fund;
- the trustee duly notifies the member within 30 days of the decision having been made that the member may make a written request for reasons;
- the member may not immediately request reasons but may lodge a complaint with the Superannuation Complaints Tribunal or commence court proceedings;
- some time after these proceedings are concluded – which may not be to the satisfaction of the member – the member could then seek reasons pursuant to new sub-regulation 7.9.48C(2)(b).

5.2 Accordingly, we suggest that a time-limit be imposed upon 'eligible persons' within which they may request reasons from a 'decision-maker' once they have been notified of their right to request reasons pursuant to sub-regulation 7.9.48C(2)(a).

5.3 A similar issue arises in respect of proposed new sub-regulation 7.9.48D with respect to a 'decision-maker' who has failed to make a decision within 90 days. In

this context we also note there is a need to impose a time-limit on the 'eligible person' to make a request for reasons.

6. Disclosure of fees and costs in PDS

6.1 Items 7 – 14 of the proposed regulations make changes to the fee templates and worked example templates in relation to both a simplified PDS and a long form PDS for a superannuation product.

Long form PDS – changes to Schedule 10

6.2 We note that the fee template prescribed at paragraph 201 of Schedule 10 (that must be used in a long form PDS and incorporated by reference in a simplified PDS) has been changed for superannuation products in relation to a *multiple fee* structure in order to refer to the five main fee types permitted under the MySuper fee charging rules (i.e. administration fees, investment fees, investment switching fees, exit fees and buy-sell spread).[2] It is unclear why the fee template prescribed at paragraph 202 for a superannuation product with a *single fee* structure has not similarly been changed, particularly since it is now more likely (in view of the Future of Financial Advice (FOFA) reforms) that most superannuation products will have a single fee structure.

6.3 In relation to the new fee template itself, for consistency with the new fee charging rules we query whether the administration fee should be described as 'the fees and costs for the administration *or operation* of the fund' and whether the buy-sell spread should be described as 'the *cost* for purchasing units in the fund'.

6.4 We also query whether there should continue to be a field for 'Contribution fee' (in respect of choice products, where FOFA grandfathering could apply).

6.5 As a technical point, in relation to the proposed template for *non-superannuation* products, we note that the 'Contribution fee' description should no longer include a reference to 'either by you or your employer' since that text was originally worded to accommodate superannuation contributions.

6.6 We also note that paragraph 211 of Schedule 10 requires the worked example of annual fees and costs to be updated for the new fee labels: see point 9 below.

6.7 Item 10 of the proposed regulations inserts a new sub-paragraph 218(4) requiring administration fees and investment fees that are not deducted directly from a member's account to be calculated using the indirect cost ratio for the fund. Since it is possible that both administration fees and investment fees could be deducted from fund earnings, we suggest it be made clear that there is intended to be no 'double counting' through this requirement. For example, the drafting could make it clear that administration fees that are charged on an indirect basis must be calculated by using only that part of the indirect cost ratio that relates to administration fees; and that indirectly charged investment fees must be calculated by using only that part of the indirect cost ratio that relates to investment fees. Alternatively, the drafting could contemplate a separate indirect cost ratio for administration fee purposes, and a separate indirect cost ratio for investment fee purposes. This issue is particularly relevant at this point in time because, whereas indirect cost ratios may have typically related to investment fees in the past, some

[2] See section 29V of the *Superannuation Industry (Supervision) Act 1993* – see also Part 11A

funds will now be funding their Operational Risk Financial Requirements indirectly, and this will not be classified as an investment fee. As such, whereas the indirect cost ratio may have predominantly been an investment-related cost in the past, this may no longer be the case in future.

Simplified PDS – changes to Schedule 10D

6.8 The fee template substituted by item 14 in the simplified PDS appears to be incorrect, as it is in the form of a worked example template. It appears from the Explanatory Memorandum that it was intended that the current template for a simplified PDS would incorporate the five main MySuper fee labels outlined above and should therefore be as follows:

TYPE OF FEE OR COST	AMOUNT
Fees when your money moves in or out of the fund	
Exit fee	
Buy-sell spread	
Management costs	
Investment fee	
Administration fee	

[*If there are other service fees such as investment switching fees, adviser service fees or special request fees, include a reference to the document that contains the information mentioned in paragraph ten(a)*.]

6.9 The worked example templates purported to be inserted by item 14 should actually be inserted in Schedule ten at paragraph 211, because paragraph 8(7) of Schedule 10D cross refers to Divisions 5 and 6 of Schedule ten.

6.10 In relation to those worked example templates, the wording in the Note below the example relating to additional fees may need some re-working. In some cases, the exit fee may be a dollar amount, not a percentage.

6.11 An exit fee may also apply to a MySuper product (usually dollar based).

7. Transitional provisions for PDS and periodic statement requirements

7.1 Most importantly, we note that these PDS changes are to take effect from 1 July 2013. So that an existing PDS does not become 'defective' as at 1 July 2013 some transitional provisions should be included so that the new requirements only apply from the time that a MySuper PDS is required to be issued or for choice products at the next issue of the PDS. From a practical perspective, it will be impossible for the industry to issue new PDSs for all products on 1 July 2013, particularly given the late release of these regulations.

7.2 The same comments apply with regard to the proposed changes concerning periodic statements, for example, draft regulation 9.46A, at least in so far as periodic statements for the period 30 June 2013 are concerned.

8. Priorities in relation to technically insolvent defined benefit funds

8.1 Amendments are proposed to regulation 9.25 of the SIS Regulations in respect of the division of assets of a fund (after winding up costs have been met) so as to address what has been described as an 'unfair' arrangement for accumulation members by application of adverse investment returns and by application of the minimum benefit index. In contrast, the explanatory memorandum notes that defined benefit members' benefits are only reduced by the application of the minimum benefit index (as they are not exposed to investment risk).

8.2 Accordingly, the proposed amendments to regulation 9.25 may of itself have the effect of causing a defined benefit accrued (and even a benefit to which a member has become absolutely entitled) to be reduced below that to which such member would have been entitled were the proposed amendments to regulation 9.25 not made.

8.3 We suggest that at least in respect of former members who may have an absolute entitlement to their proportionate share of fund assets, the proposed operation of the amendments to regulation 9.25 may therefore have the effect of violating the constitutional protection afforded by section 51(xxxi) of the Commonwealth Constitution with respect to the acquisition of property on unjust terms. If a member (or former member) has crystallised an entitlement to benefits under a superannuation fund, then the proposed treatment under new regulation 9.25 to reduce such benefit (proportionately with the application of the minimum benefit index) may, in effect, result in the acquisition of a relevant proportion of such member's interest in the fund. We have not had sufficient time to fully investigate this issue, but suggest that it be given proper consideration by the legislature prior to finalisation of the regulations.

8.4 Further, we note that proposed new sub-regulation 9.25(3) of the SIS Regulations provides for the trustee to give priority to an 'accumulation interest' over a 'defined benefit interest'. An 'accumulation interest' is defined under sub-regulation 1.03(1) of the SIS Regulations as a 'superannuation interest' that is not a 'defined benefit interest'. 'Superannuation interest' is given a broad meaning under section 10(1) of the SIS Act, being a 'beneficial interest in a superannuation entity'. The extent to which certain rights, interests and expectancies might be taken to constitute a 'beneficial interest' is not certain and, in part, would depend upon the governing rules of a fund and other factors, such as whether an entitlement might have crystallised – for example with respect to potential beneficiaries for a death benefit. It is also possible, that a person who has a mere expectancy might be taken to have a 'beneficial interest' in a trust. Thus, to the extent that a person is found to have a beneficial interest in a trust (including, for example, an entitlement which requires the trustee to exercise a discretionary in favour of the beneficiary) which is not a 'defined benefit interest', such interest will be taken to be an 'accumulation interest'. We suggest that there is therefore scope for confusion to arise for a trustee who is required to allocate assets on a winding up by giving priority to an 'accumulation interest'. We suggest that these provisions require further review in terms of their potential to require a trustee to give priority to allocation of assets to all kinds of interests in a superannuation fund (potentially to discretionary interests of potential death benefit recipients and even to an interest of an employer) that do not amount to 'defined benefit interests'.

8.5 We suggest that there is also scope for confusion in terms of new sub-regulation 9.25(3) specifying that priority be given to accumulation interests over defined benefit interests, but then new sub-regulations 9.25(4) and 9.25(5) going on to prescribe a particular formulation for how the trustee must allocate a benefit entitlement to each member according to the fund's minimum benefit index. This is in contrast to the current regulation 9.25 which adopts a similar formulation for sub-regulations (4) and (5), but where sub-regulation (3) directs the trustee to comply with those sub-regulations (4) and (5) such that there is no scope for the provisions to conflict with sub-regulation (3).

8.6 We also query whether proposed new sub-regulation (6) results in a duplication of the deduction of former members' benefit entitlements (to the extent that those amounts might represent accumulation interests) from the numerator under sub-regulation 9.15(1) because such amounts are already required to be deducted by reference to the 'BEF' amount in the formula set out under that sub-regulation.

8.7 Finally, we suggest that it would be helpful to include some worked examples of how the legislature anticipates these provisions operating in the context of a defined benefit fund with significant accumulation interests.

The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact the Chair of the Law Council of Australia's Superannuation Committee, Pamela McAlister on (03) 9670 9632 or at pam.mcalister@hallandwilcox.com.au.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its constituent bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's constituent bodies. The Law Council's constituent bodies are:

- Australian Capital Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Independent Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of approximately 60,000 lawyers across Australia.

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2013 Executive are:

- Mr Joe Catanzariti, President
- Mr Michael Colbran QC, President-elect
- Mr Duncan McConnel, Treasurer
- Ms Fiona McLeod SC, Member
- Mr Justin Dowd, Member
- Ms Leanne Topfer, Member

The Secretariat serves the Law Council nationally and is based in Canberra.