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# Financial System Inquiry Second Round Submission

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

**26 August 2014**

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## Executive Summary

In this submission, the Law Council of Australia's Superannuation Committee comments on certain of the issues identified in the Interim Report which concern superannuation. Those comments can be summarised as follows.

- **The trust model for superannuation** – The Superannuation Committee supports maintaining the trust model for superannuation.
- **SMSFs** – The Superannuation Committee supports allowing consumers to make active decisions about whether or not it would be in their interests to establish self-managed superannuation funds, without consumer sovereignty being limited by mandatory rules concerning eligibility, minimum fund size and so forth.
- **Corporate governance** – The Superannuation Committee agrees that recent reforms have resulted (or even required) boards to have greater involvement in matters that would more appropriately be delegated to board sub-committees or to management. The Superannuation Committee has identified at least 44 instances where this is the case in superannuation.
- **Disclosure** – The Superannuation Committee considers that disclosure laws require a fresh start, as they have not led to efficient or meaningful disclosure. The Superannuation Committee queries whether a better approach may be for disclosure laws to distinguish between different types of consumers so that issuers are not compelled to prepare product disclosure statements for disengaged consumers, but could instead provide relevant information online. While prescriptive rules concerning the content of disclosure documents set a benchmark for the level of detail required, and potentially encourage shorter documents by providing reassurance about what is sufficient, they preclude the preparation of customised documentation suited to the particular product.
- **Financial advice** – The Superannuation Committee supports reforms that would encourage the provision of limited or scaled advice. The Superannuation Committee also considers that the definitions of 'general advice' and 'personal advice' should be reviewed and amended. It might be that these defined terms could be further subdivided to provide more nuanced regulation better suited to the nature of the advice being provided. Regulatory restrictions on the use of technology to provide cost effective assistance to consumers—for example, through online calculators—should also be revisited.
- **Regulatory stability** – The Superannuation Committee agrees that there is a lack of superannuation policy stability and note that there were proposals in 2013 to establish a 'Charter' of superannuation and a 'Council of Custodians' for the industry, with a view to bolstering policy stability within the industry. While such a commitment to stability would initially send a stabilising signal, it is important to recognise that even a statutory commitment would not be immune to change. Ultimately, policy stability will depend on Governments having the discipline to maintain it. The costs of policy change are in turn higher as a consequence of the pace of change, but also as a result of how it is implemented—for example, with inadequate industry consultation, inadequate advance notice and transition times, and piecemeal approaches being taken.

- **Regulatory architecture and perimeter** – The Superannuation Committee does not support shifting from an established system of prudential regulation across to conduct regulation for superannuation. The Superannuation Committee would be concerned by any reform which empowered regulators to unilaterally expand their own jurisdiction in order to respond to some contemporary perceived issue. Any change in regulatory jurisdiction should require Government mandate through appropriate legislation passed in advance. The Superannuation Committee agrees that there is a policy question whether or not technology providers ought to be subject to licensing requirements.
- **Imputation credits and superannuation investment strategies** – In the Superannuation Committee's view, it is an inaccurate over-simplification to suggest that investment strategies adopted by most superannuation funds are being distorted by domestic imputation credit arrangements. Superannuation legislation requires trustees to have regard to a wide range of matters in formulating investment strategies in the best interests of their members. Tax is merely one consideration among many, as it should be.
- **Retirement incomes** – The Superannuation Committee is in favour of reforms that promote flexibility, discretion and innovation and provide incentives for consumers to take their superannuation benefit in the form of an income-stream. The Superannuation Committee is cautious about reforms that would compel the adoption of particular retirement income solutions, whether by way of default or otherwise.

## **Introduction**

### About the Law Council of Australia's Superannuation Committee

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.
2. This submission has been prepared by the Law Council of Australia's Superannuation Committee (the Superannuation Committee), which is a committee of the Law Council's Legal Practice Section.
3. The Superannuation Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear.
4. The Superannuation 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.

## **Costs and suitability of the trust model**

### *FSI Interim Report 2–115*

5. The Interim Report seeks views on whether the trust structure is best placed to meet the needs of all members in a cost-effective manner.
6. The Superannuation Committee supports the trust model as the regulatory mechanism to deliver superannuation benefits to members in a cost-effective manner.
7. Historically the trust relationship has been successful in regulating the prudential aspects of superannuation. In the Superannuation Committee's view, this is a result of the flexible nature of the trust structure and its inherent protective characteristics.
8. Other options for the provision of superannuation may include a contractual foundation, limited partnerships or investment companies. However, without significant legislative intervention, these legal relationships do not replicate the protective features of the trust and nor do they inherently align the interests of the entity responsible for the management of superannuation assets with those of the members.
9. In the Superannuation Committee's view, the trust structure as a governance model is not inefficient from a cost perspective. Other issues such as the level of regulatory change and instability resulting in constant regulatory tinkering have resulted in cost inefficiencies that are ultimately borne by members. A good example of this is the additional regulatory reform costs passed on to the members in the form of increased fees or levies that have been announced by superannuation funds during the course of this year.

10. Several features of the trust relationship are indicative of its inherent protective nature:

#### Duality of Ownership and Segregation of Assets

11. A primary characteristic of the trust relationship (not replicated in any other structure) is the split of ownership between legal and beneficial interest – the trustee, as legal owner holds trust property for the benefit of the beneficiaries.
12. This ensures that trust assets are held separately from those of the sponsoring-employer or relevant financial institution. Historically this was seen as a major advantage of the trustee relationship, as it prevented the employer-sponsor from utilising fund assets for its own purpose and, upon insolvency of the employer-sponsor, protected the fund from the employer-sponsor's creditors. This advantage is also relevant in the retail superannuation fund context, with fund assets being held separately from the parent or holding company of the corporate trustee.

#### Insolvency Protection

13. Duality of ownership has the further advantage of placing an insolvency shield around trust assets so that on the insolvency of the trustee (in this case a superannuation trustee) trust assets are protected from the creditors of the trustee. A sharp distinction is drawn between the assets of the superannuation fund and the personal / corporate assets of the trustee.<sup>1</sup>

#### Nature of the Trustee Obligation

14. The role of the trustee is one of the most demanding known to the law. Equitable and trust law obligations (which are reinforced through the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act)) embody high level principles of commercial morality which at their very core require the trustee to act exclusively for the benefit of the beneficiaries. This, combined with the fiduciary nature of the relationship, aligns the interests of the trustee with those of the members and the beneficiaries. This is an important feature when it is considered the very purpose of a superannuation trust is the management of members' *compulsory* contributions and investments so as to make provision for the member on retirement.

#### Remedy of Tracing

15. A distinct strength of the trust concept is that it is a hybrid of obligations and rights. Members' rights can be protected, and a breach of obligation can be remedied, not only through personal action against the trustee, but also (in appropriate cases) through a proprietary process such as tracing. Once assets are traced and identified as trust property, a proprietary remedy (for example a constructive trust or an equitable charge) can be awarded to secure the property back to the trust.<sup>2</sup>

#### Guidance

16. A feature unique to equity is that trustees have a right to seek the opinion, advice or direction of the court on any question regarding the management or administration of the trust. Although an approach to the court for judicial advice would not be made

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<sup>1</sup> It must be recognised that creditors may have a limited claim on the trust fund via the doctrine of subrogation.

<sup>2</sup> Except for where the property has been purchased by a bona fide purchaser for value without notice.

lightly, this provides a support network for trustees (including superannuation trustees) that is not necessarily available in the same way in respect of other structures.

17. A further advantage of the trust relationship is that the structure is inherently flexible, meaning that it can be shaped to cater for new circumstances or relationships. In the superannuation context the trust has proved to be sufficiently flexible to cater for a changing superannuation environment. For example, the nature of superannuation provision has changed over time from traditional corporate employer-sponsored defined benefit plans, to the current choice and MySuper accumulation scheme environment. Similarly, different trustee governance models can also be easily accommodated (for example, whether representative trustees or a corporate trustee model). Added to this, a trust deed can be shaped to limit the scope of some duties. For example, including an express right for trustees to be remunerated for their services (which are increasingly onerous and required under the SIS Act to be at the professional standard).
18. It is in this area of inherent flexibility that the trust has been seen as a potential drawback as the trust deed can be used to modify the extent of (or even exclude) fundamental trustee duties. To this end, the SIS Act has sought to reinforce the fundamental nature of existing general law trust duties through the imposition of the non-modifiable trustee and director covenants. However, beyond these covenants, the flexible nature of the structure can be used to advantage to cater for changing circumstances and a dynamic environment.
19. The advantages of the trust relationship are not replicated in any other structure. While other structures such as contract or the corporate model may appear to have the attraction of perceived simplicity (and therefore potential cost efficiency), the overlay of regulatory intervention required to provide an adequate level of prudential security so that the needs of members are met and their rights sufficiently protected, will negate this perceived simplicity.
20. For example, the contract model is premised on the 'agreement' of the parties. The nature of agreement is to promote and expect self-interested acting. At most a good faith standard may be implied. The purpose of the contract is to mediate between conflicting interests and to allocate the risks of an endeavour between the parties. Fundamentally the interests of the superannuation provider are not aligned to the members' interests. Under the contract model, the provider would (absent regulatory intervention) be permitted and be expected to be self-interested.
21. By way of comparison with the trust structure, there is no duality of ownership, no insolvency protection, and proprietary rights are not available on breach to bring the affected property back to its owner. The contract structure creates only personal rights.
22. To illustrate this point, the Retirement Savings Account (RSA) is an example of superannuation provided through a contractual structure. An RSA resembles a depositor interest bearing account. The contractual relationship between the parties is essentially that of debtor and creditor. The RSA holder is a creditor of the bank to the sum of the amount credited to the account. Although commonly viewed as being 'your money in the bank', essentially a depositor has a chose in action – a right to recover the amount (as a debt). The actual contributions made become an asset of the bank. As a result, both legal and equitable interests in the contributions deposited in an RSA account pass to the authorised deposit-taking institution (ADI). Absent regulatory intervention, there is no insolvency protection, no proprietary rights to secure the property and no segregated fund in which the RSA holder has an interest.

23. The upshot is, that without significant legislative intervention, legal relationships other than the trust, do not replicate the protective features of the trust and do not impose obligations on trustees to prioritise and promote the interests of the members and beneficiaries. The nature of these fiduciary and trust obligations aligns the interests of trustees to those of the members and beneficiaries. Other legal relationships require significant legislative intervention to strive for trust-like characteristics.

## **Self-managed superannuation funds**

### FSI Interim Report 2–126

24. The Interim Report seeks comments on perceived high operating costs of self managed superannuation funds (SMSFs) and whether there should be limits on their establishment.
25. The Superannuation Committee notes that the inability to benefit from the economies of scale available to large funds is the natural consequence of selecting an SMSF as the vehicle for one's retirement savings. However, the Superannuation Committee does not see this as an issue requiring particular attention from the Inquiry.
26. The Superannuation Committee is not aware of any facts which would suggest that SMSF trustees/members are not able to determine and understand the running costs of their fund, or to make comparisons with the costs of other superannuation options. In any event, costs should be relatively transparent for SMSFs and SMSF trustees/members are in a position to control those costs with regard to the underlying investment activities of the SMSF.
27. Further, the Superannuation Committee expects, based on anecdotal evidence, that most individuals who operate SMSFs do so for reasons other than costs alone. The establishment of an SMSF is an 'active' choice for an individual and demonstrates a level of engagement with the superannuation system which differs to that of individuals in large funds, particularly MySuper products.
28. For a person deciding whether to establish an SMSF, the ongoing running costs of the SMSF will be only one factor taken into account. The experience of Committee members indicates that tax efficiency, access to investment opportunities, issues of control, succession planning matters and flexibility are other important factors.
29. The Superannuation Committee does not support the imposition of a minimum size for SMSFs on establishment. It is not uncommon for funds to be established with a relatively small amount of money, pursuant to a plan whereby over time future contributions, together with rollovers and returns, will bring the fund to a more substantial size.
30. Further, it is consistent within a 'choice architecture framework' that individuals should be able to choose to establish and operate an SMSF for their own reasons, which are likely to go beyond matters such as size and cost.

## **Corporate governance**

### FSI Interim Report 3–43

31. The Superannuation Committee agrees with the concern expressed about the blurred delineation between the role of the board and that of management as a result of superannuation funds transitioning to the new prudential standards. The

Superannuation Committee agrees that a board's role is to govern – meaning to set the strategy, approve a plan to achieve the strategy and review progress, while management's role is to manage – meaning to facilitate achievement of the strategy, create an operational environment for implementing the plan and report to the board on progress. This conceptualisation of the role of a director has recently been judicially endorsed by the Court in *ASIC v Healey* [20011] FCA 717 (colloquially referred to as the 'Centro decision') in the following terms:

*[20] Nothing I decide in this case should indicate that directors are required to have infinite knowledge or ability. Directors are entitled to delegate to others the preparation of books and accounts and the carrying on of the day-to-day affairs of the company. What each director is expected to do is to take a diligent and intelligent interest in the information available to him or her, to understand that information, and apply an enquiring mind to the responsibilities placed upon him or her.*

32. In contrast, the new prudential standards for superannuation impose a number of requirements on superannuation boards, without any apparent ability to delegate the requirements. For example, the Superannuation Committee has identified 44 matters under the prudential standards relevant to superannuation that must be either approved or satisfied by the board or for which the board is held to be responsible. APRA does not allow boards to delegate these matters to a specialist sub-committee of the board, let alone to management. These are:

1. Business plan,<sup>3</sup>
2. Maintaining solvency and ensuring adequate resources,<sup>4</sup>
3. Sound and prudent management of business operations,<sup>5</sup>
4. Risk Management framework,<sup>6</sup>
5. Risk appetite statement,<sup>7</sup>
6. Risk management strategy,<sup>8</sup>
7. Declaration to APRA on risk management,<sup>9</sup>
8. Ensuring outsourcing risks and controls and business continuity risks and controls form part of risk management framework and risk management declaration,<sup>10</sup>
9. Investment strategy,<sup>11</sup>
10. Investment objectives for each investment option,<sup>12</sup>
11. Monitoring and assessing whether investment objectives are being met,<sup>13</sup>

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<sup>3</sup> SPS 220, paragraph 18

<sup>4</sup> SPS 220, paragraph 8

<sup>5</sup> SPS 510, paragraph 8

<sup>6</sup> SPS 220, paragraph 7

<sup>7</sup> SPS 220, paragraph 20

<sup>8</sup> SPS 220, paragraph 22

<sup>9</sup> SPS 220, paragraph 33

<sup>10</sup> SPS 231, paragraph 14; SPS 232, paragraph 11

<sup>11</sup> SPS 530, paragraph 6(b)

<sup>12</sup> SPS 530, paragraph 6(a)

<sup>13</sup> SPS 530, paragraph 6(c)

12. Taking action in response to information contained in investment reports,<sup>14</sup>
13. Investment governance framework,<sup>15</sup>
14. Measures to monitor performance of each investment,<sup>16</sup>
15. Investment strategy review policy,<sup>17</sup>
16. Justification for amendments to investment strategy,<sup>18</sup>
17. Liquidity management plan,<sup>19</sup>
18. Business continuity management,<sup>20</sup>
19. Appropriateness of approach to business continuity management,<sup>21</sup>
20. Business Continuity Management Policy,<sup>22</sup>
21. Target amount for Operational Risk Financial Resources (ORFR),<sup>23</sup>
22. ORFR strategy,<sup>24</sup>
23. ORFR replenishment plan,<sup>25</sup>
24. ORFR transition plan,<sup>26</sup>
25. Outsourcing of material business activities,<sup>27</sup>
26. Outsourcing policy,<sup>28</sup>
27. Insurance Management Framework,<sup>29</sup>
28. Board charter,<sup>30</sup>
29. Use of group policies,<sup>31</sup>
30. Adequacy of director and management skills,<sup>32</sup>
31. Processes for assessing board performance,<sup>33</sup>
32. Board renewal policy,<sup>34</sup>

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<sup>14</sup> SPS 530, paragraph 6(d)

<sup>15</sup> SPS 530, paragraph 10

<sup>16</sup> SPS 530, paragraph 24

<sup>17</sup> SPS 530, paragraph 27

<sup>18</sup> SPS 530, paragraph 28

<sup>19</sup> SPS 530, paragraph 32

<sup>20</sup> SPS 232, paragraph 8

<sup>21</sup> SPS 232, paragraph 9

<sup>22</sup> SPS 232, paragraph 15

<sup>23</sup> SPS 114, paragraphs 9 and 12

<sup>24</sup> SPS 114, paragraph 18

<sup>25</sup> SPS 114, paragraph 21

<sup>26</sup> SPS 114, paragraph 30

<sup>27</sup> SPS 231, paragraph 13

<sup>28</sup> SPS 231, paragraph 15

<sup>29</sup> SPS 250, paragraph 11

<sup>30</sup> SPS 510, paragraph 9

<sup>31</sup> SPS 510, paragraph 18; SPS 530, paragraph 7; SPS 250, paragraph 7; SPS 220, paragraph 9; SPS 114, paragraph 13; SPS 160, paragraph 9; SPS 231, paragraph 4; SPS 232, paragraph 5; SPS 520, paragraph 10

<sup>32</sup> SPS 510, paragraph 11

<sup>33</sup> SPS 510, paragraph 19

<sup>34</sup> SPS 510, paragraph 20

- 33. Remuneration policy,<sup>35</sup>
  - 34. Satisfaction of auditor independence,<sup>36</sup>
  - 35. Fit and proper policy,<sup>37</sup>
  - 36. Conflicts management framework,<sup>38</sup>
  - 37. Staff understanding of conflicts,<sup>39</sup>
  - 38. Appointment procedures for responsible persons,<sup>40</sup>
  - 39. Conflicts management policy,<sup>41</sup>
  - 40. Defined Benefit shortfall limit,<sup>42</sup>
  - 41. Shortfall monitoring process,<sup>43</sup>
  - 42. Defined Benefit restoration plan,<sup>44</sup>
  - 43. Determining whether self-insurance continues to be in the best interests of beneficiaries,<sup>45</sup> and
  - 44. MySuper transition business plan.<sup>46</sup>
33. While some of these matters are entirely appropriate for board responsibility and involvement, with this level of prescription it is not surprising that boards may be left with insufficient time to provide strategic oversight and direction. While stringent prudential regulation is necessary in the context of mandatory superannuation savings, the Superannuation Committee shares industry concerns that the level of prescription has gone too far.
34. For example, matters such as investment strategy ought to be capable of being delegated to a specialist investment sub-committee of the board.
35. The Superannuation Committee recommends that APRA should be asked to re-consider and amend the requirements currently imposed on boards under the prudential standards to ensure that they neither draw boards into operational matters nor preclude delegation of appropriate matters to specialist board committees and other qualified people. While it may be appropriate for boards to have ultimate responsibility for certain frameworks and policies, it should be made clear that delegation of *functional* responsibility is permissible.

*Is it appropriate for directors in different parts of the financial system to have different duties? Who should directors' primary duty be to?*

36. Apart from the current level of prescription in the prudential standards, another reason for superannuation trustee boards becoming increasingly concerned with

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<sup>35</sup> SPS 510, paragraph 22  
<sup>36</sup> SPS 510, paragraph 59  
<sup>37</sup> SPS 520, paragraph 7  
<sup>38</sup> SPS 521, paragraph 10  
<sup>39</sup> SPS 521, paragraph 11  
<sup>40</sup> SPS 521, paragraph 12  
<sup>41</sup> SPS 521, paragraph 18  
<sup>42</sup> SPS 160, paragraph 10  
<sup>43</sup> SPS 160, paragraph 13  
<sup>44</sup> SPS 160, paragraph 32(d)  
<sup>45</sup> SPS 160, paragraph 36(c)  
<sup>46</sup> SPS 410, paragraph 7

operational detail may well be the recent imposition of direct duties owed by the directors to members and the consequent prospect of being sued directly by members, perhaps even by class action.<sup>47</sup> The spectre of personal liability to members for a breach of the new covenant ‘to exercise *in all matters affecting the entity* the same degree of care, skill and diligence as a prudent superannuation director would exercise ...’ has triggered a greater degree of board scrutiny of matters that might otherwise be considered the province of management. The fact that a ‘prudent superannuation director’ is defined objectively, without reference to the circumstances of the particular fund or the particular responsibilities of the director exacerbates the situation.<sup>48</sup> In addition, there is no ‘business judgment’ rule available under s 52A(2) (b) of the SIS Act.

37. The Superannuation Committee does not believe that there is any public policy reason for directors of superannuation trustees to be subject to different duties than those applying to directors of other companies in the financial system, or indeed other APRA-regulated entities. In all cases, the Superannuation Committee believes that directors should owe their duties to the company. Certain companies (acting as trustees or responsible entities) will, in turn, owe duties to fund members<sup>49</sup> and this may well inform the way directors of those companies perform their duties,<sup>50</sup> but fundamentally all directors should owe the same duties to their company.
38. If there is a perceived need to further regulate director behaviour in a superannuation context to address discrete issues, such as conflicts of interest or conflicts of duty that may be unique to the superannuation sector, then specific statutory obligations can be imposed (such as the new duty in s 52A(2)(d) to manage conflicts of interest and duty by giving priority to the interests of beneficiaries). However, even in this situation, the Superannuation Committee considers that the duty should be owed to the trustee company, rather than to the members. The Superannuation Committee also queries whether the public disclosure of director interests and duties<sup>51</sup> achieves any positive purpose and may, in fact, inhibit a director’s willingness to make full and frank disclosure or perversely promote the use of opaque ownership structures.
39. There is precedent with other regulated entities of imposing statutory obligations with statutory penalties without creating direct liability to consumers. For example, directors of responsible entities have statutory duties to act in the interests of scheme members,<sup>52</sup> but the relevant section does not create a civil right for scheme members to sue the directors for loss. Rather, a breach of the statutory duties gives rise to statutory penalties only. Alternatively, directors of life companies owe statutory duties to policy owners, but their duty is fundamentally to see that the life company itself gives priority to the interests of policy owners (as a group) over those of the company’s shareholders.<sup>53</sup> This means that a right of compensation only arises if a director’s breach of duty results in a loss to a statutory fund of the company.<sup>54</sup>

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<sup>47</sup> See *Superannuation Industry (Supervision) Act 1993*, ss 52A(2) and 55(3)

<sup>48</sup> Compare the definition of ‘superannuation entity director’ in s 29VO(3) with the standard of care imposed under s 180 (1) of the *Corporations Act 2001* (Corporations Act)—see also the business judgment rule under s 180(2) of the Act

<sup>49</sup> For example, under s 601MA of the *Corporations Act 2001* in the case of responsible entities and in both equity and under s s 52 and 55(3) of the *Superannuation Industry (Supervision) Act 1993* in the case of superannuation trustees

<sup>50</sup> See *Australian Securities Commission v AS Nominees Ltd* (1995) 133 ALR 1

<sup>51</sup> Under s 29QB of the *Superannuation Industry (Supervision) Act 1993* and regulation 2.37 of the *Superannuation Industry (Supervision) Regulations 1994*

<sup>52</sup> *Corporations Act 2001*, s. 601FD

<sup>53</sup> *Life Insurance Act 1995*, ss. 48(3) and 48(4)

<sup>54</sup> *Life Insurance Act 1995*, s. 48(6)

40. By comparison, by virtue of s 52A and 55(3) of the SIS Act, the directors of a superannuation entity now owe a direct obligation to each member of a superannuation fund for the performance of their 'covenants' and can be sued directly by a member for personal loss suffered by the member as a result of a breach (even if the loss is not suffered by the fund or by other members). This undermines the collective nature of a superannuation trust.
41. Some of the practical reasons why The Superannuation Committee considers that it is inappropriate to 'single out' superannuation entity directors in terms of direct and personal liability to members are:
- Boards make decisions as a collective, rather than individually.
  - The threat of being personally sued by members drives 'peer focused' behaviour and unwillingness to take measured and justifiable risks in the interests of the fund as a whole.
  - Despite the fact that leave of the court is required before action may be commenced against an individual director,<sup>55</sup> there is a risk that the litigation process may be misused to obtain settlements against a director's professional indemnity insurance. This in turn may increase the cost of professional indemnity insurance or make it prohibitive to obtain for superannuation entity directors.<sup>56</sup>
  - The prospect of personal liability and publication of relevant interest and relevant duty information may deter competent and experienced directors from accepting positions on superannuation entity boards, which is particularly relevant to the Government's proposal to require independent directors on superannuation trustee boards.<sup>57</sup>
  - There are situations where a superannuation entity director should be entitled to consider the interests of the trustee company (for example, in exercising the company's personal rights and making commercial decisions) and the imposition of a fiduciary duty for directors to act in members' interests (as opposed to a duty to ensure that the trustee company exercises its powers and performs its obligations in members' interests) may only serve to confuse the situation.
42. The Superannuation Committee is not aware of any compelling inadequacy in the previous statutory framework that would have required superannuation entity directors to be exposed to direct personal liability to fund members. If egregious breaches of a director's duty of care to the company had resulted in loss to the fund members, members could always have taken derivative action against the directors through the trustee company or sought to recover against the directors under principles of accessorial liability. These avenues of redress were and remain, in the Superannuation Committee's view, sufficient to protect members from a lack of due care and attention on the part of superannuation entity directors.

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<sup>55</sup> See *Superannuation Industry (Supervision) Act 1993*, s 55(4A)

<sup>56</sup> For example, one of the providers of trustee indemnity insurance, Chubb, has recently exited the Australian market.

<sup>57</sup> Discussion Paper: *Better regulation and governance, enhanced transparency and improved competition in superannuation*, November 2013

## Disclosure

### FSI Interim Report, from 3–54

43. The Superannuation Committee agrees that the current disclosure regime often produces complex and lengthy documents that often do not enhance consumer understanding and impose significant costs on industry participants.
44. Where shorter Product Disclosure Statements (shorter PDSs) are required, brevity has come at the expense of customisation and meaningful disclosure since the content of shorter PDSs is largely prescribed. In this case, the level of prescription impedes comparability across products because of how similar the resulting disclosure documentation has become.
45. Even for shorter PDSs, the legislative and regulatory framework is voluminous and fragmented. A simpler legislative framework should be developed which provides for layered disclosure and focuses on the consumer.
46. For a consumer who does not or is unlikely to make a decision about a financial product (such as default superannuation), making key product information available on the product issuer's website should be sufficient.
47. For a consumer who does make a decision about a financial product, the law might be amended so that a PDS is still required to be given to the customer, but without any mandatory prescribed form. Some issuers take comfort from the prescribed form as it reduces uncertainty as to what must be disclosed in order to meet the legislative requirements. For these issuers, the Superannuation Committee suggests that a 'safe harbour' approach could be taken. By this the Superannuation Committee means that the regulations could prescribe the form and content for a PDS and a product issuer would be deemed to comply with its disclosure obligations if it adopts the prescribed form and content. For this purpose it might be useful to retain the option of using a prescribed format.
48. However, product issuers ought not be deprived from preparing customised documentation to explain their products, if they prefer. For example, a product issuer could merely be required to give a PDS that includes 'all the information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product' (current s 1013E of the Corporations Act) and which is 'worded and presented in a clear, concise and effective manner' (current s 1013C(3)). Consideration should be given to whether such PDSs should be consumer tested by the product issuer.
49. Legislation and the regulatory approach should encourage electronic disclosure methods, and also the development of online advice tools.

### Product disclosure statements

50. The Superannuation Committee notes that few areas of financial services regulation have received as much attention and been the subject of so much attention as product disclosure.
51. Notwithstanding, the Interim Report makes the observation that 'the current disclosure regime produces complex and lengthy documents that often do not enhance consumer understanding and impose significant costs on industry participants'. The Superannuation Committee agrees with this observation.

52. The Interim Report says that disclosure rules are intended to help consumers understand the features and risks of financial products and to make informed decisions.
53. However, very few people make active decisions about financial products. The Cooper Review concluded that overwhelmingly consumers do not make decisions about their superannuation or life insurance. These are the most important and often the only financial products held by many people. Given this, the Superannuation Committee considers that the Inquiry should identify the purpose or purposes of the product disclosure regime.
54. In the Superannuation Committee's view, a product disclosure regime should turn on the intended recipient. The current law imposes different content obligations on product issuers depending on the nature of the product. This has led to a multitude of detailed and complex requirements.
55. The Corporations Act, the Corporations Regulations and ASIC class orders contain literally hundreds of provisions, which currently provide separate disclosure regimes for:
- superannuation products (other than a product that is solely a defined benefit product, solely a pension product or a risk-only superannuation product);
  - simple managed investment schemes (other than 'quoted products', some 'stapled securities' and some investor-directed products);
  - investor-directed portfolio services;
  - investor-directed portfolio service-like schemes;
  - other investment products, such as superannuation platforms, multi-funds and hedge funds, as well as risk products;
  - margin loans;
  - first home saver accounts; and
  - products to which short-form product disclosure statements are applicable.
56. In the Superannuation Committee's view it is not only product disclosure statements that are too long and complex, length and complexity are also a feature of the regulatory regime itself.
57. The Superannuation Committee suggests that a simpler set of regulations focused on attributes of the consumer (for example, engaged or disengaged), rather than the product, would produce better product disclosure documents. The Superannuation Committee also queries whether the level of prescription in the current law assists. The Superannuation Committee also suggest that electronic disclosure be facilitated without complexity.

#### Focusing on the consumer

58. As the Interim Report notes, product disclosure statements are intended to assist consumers to compare products and make decisions. The Superannuation Committee has two comments about this.

59. First, the Superannuation Committee questions whether the current regime (which is heavily prescriptive and includes prescribed content and format) in fact achieves this.
60. The second is whether comparison is in fact the right measure for considering how to design a product disclosure regime. The Superannuation Committee considers each below.

#### Do PDSs in fact promote product comparison?

61. The Superannuation Committee agrees with the proposition that consumers who wish to make a decision about a financial product need sufficient and meaningful information about the features and risks of the product that will allow them to do so.
62. The high level of prescription that applies to superannuation product disclosure statements is intended to assist consumers to make comparisons.
63. However, in the Superannuation Committee's experience it is in fact difficult to do so when the product disclosure statements are largely the same. This is the result of two things – the highly prescriptive product disclosure regime and the prescriptive rules that apply to MySuper products. For example, those rules require all MySuper products to have a single diversified investment strategy or a lifecycle strategy and to offer similar kinds of insurance. This does not in fact assist in making comparisons and means that comparisons are also less useful.
64. Where there are product differences, they can be hard to identify. The most obvious example is fees. PDSs are required to include prescribed fee information and a fee table in the prescribed form. However, even then it is hard for consumers to make a true comparison because many product issuers still disclose fees in different ways. Some disclose no indirect costs (because they have included them in their investment fees or because they have interpreted the law in a particular way) and others do. More difficult is that, in many cases, fee tables do not set out actual fees since these are subject to special arrangements with employers, which may mean discounted fees from 'rack rates'.

#### Should PDSs be designed to promote product comparison?

65. Leaving aside the practical difficulties of comparing very similar products, the Superannuation Committee queries the value of a superannuation product disclosure statement for consumers who do not in fact make decisions about their superannuation. They are default members in the superannuation fund nominated by their employer (or a previous employer) who are provided with a PDS for the product **after** their employer makes a contribution to the fund for them.
66. In a case where a consumer does not or is unlikely to make a decision about a financial product (such as default superannuation), the Superannuation Committee queries whether making key product information on the product issuer's website might be sufficient. It would provide the consumer with access to information if and when they wanted it and would mean that the product issuer would not need to issue product disclosure statements that no one needs or reads. It would also mean that the content requirements for any disclosure document could be different. It would no longer be a 'marketing' document, but more of an information guide.
67. Less prescription would also allow product issuers to create more tailored documents – for example by combining information usually included in periodic statements about the member's balance, the actual fees they are paying, their investment option, any

insurance they hold and any they might be eligible to hold. Documents of this type would most likely be far more useful to consumers.

#### Consumers who do make decisions

68. Where a consumer will make a decision about a financial product, then different information will be needed in a product disclosure statement. In the Superannuation Committee's view, the existing requirement in the Corporations Act that a product disclosure statement 'must also contain all the information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product' (s 1013E) sets the right parameters for product disclosure. It requires the product issuer to put themselves in the shoes of their customers and to tell them what they need to know. The Corporations Act also requires the information in a product disclosure statement to be 'worded and presented in a clear, concise and effective manner' (s 1013C(3)). In the Superannuation Committee's opinion this is also the right obligation to impose on product issuers.
69. The Superannuation Committee acknowledge that with greater freedom comes greater uncertainty and responsibility for product issuers, and potentially regulators. Nevertheless, the Superannuation Committee queries whether these apparent drawbacks could be addressed by the product issuer spending more time in testing their documents with consumers. In the Superannuation Committee's view this might be a better use of time for product issuers than the existing lengthy compliance driven process currently required to be followed by product issuers in preparing PDSs.
70. ASIC would also have an important role to play. ASIC would not require any additional powers to improve the quality of PDSs. ASIC has the power now to prevent product issuers issuing inappropriately lengthy and complex PDSs. Such a PDS would not be clear, concise and effective and the product issuer will breach s 1013C(3) of the Corporations Act. Under the existing law, ASIC could issue a stop order prohibiting the use of the product disclosure statement in that form.
71. The Superannuation Committee suggests that a regime that allowed the product issuer to decide what information a particular customer (or customer segment) would reasonably require, and which then made the product issuer accountable for that information, might provide a more effective disclosure regime. However, the option of following a prescribed format could perhaps be retained for issuers who find this preferable. Further, the existence of a prescribed format (as an optional rather than a mandatory approach) would send a clear signal and set a benchmark as to what constitutes sufficient disclosure and this could continue to be an indirect tool for encouraging succinct disclosure practices.

#### Proposals raised by the Inquiry on disclosure

72. The Inquiry asks for feedback on certain policy options to deal with the failings identified in product disclosure rules. One option is that there is no change. In the Superannuation Committee's opinion the current product disclosure regimes are overly complex and poorly suited in many cases to their purpose. The Superannuation Committee thinks there is merit in exploring an alternative model for disclosure.
73. The report asks whether layered disclosure, risk profile disclosure and online comparators might be better. The Superannuation Committee considers that a layered disclosure regime may allow better tailored disclosure. As outlined above, a consumer who does not wish to, and will not, make a decision about their

superannuation fund or investment choice within the fund does not need a product disclosure statement that allows them to compare their product to another product or their investment option to other options. However, the Superannuation Committee considers that all consumers should have access to all relevant information about any financial product they hold if they ask for it. This might be done through some kind of layered disclosure.

74. In their practices, members of the Superannuation Committee increasingly advise clients (i.e. superannuation funds) who are developing online tools that allow consumers to obtain a great deal of useful information that is tailored to them – for example, retirement benefit forecasts and estimates of an appropriate level of retirement cover. In some cases these are simple calculators that do not contain financial product advice or they might only contain general advice. The Superannuation Committee notes that ASIC has issued class order relief to encourage some of these calculators, but that the conditions to the class order mean that very few providers can rely on the relief. In other cases, clients of the Superannuation Committee has developed more sophisticated online tools that could be used to provide significantly tailored information to consumers or customers and often certain kinds of financial product advice. In very many cases the information would be valuable, but it cannot be made available because it contains personal advice. This means that these tools are largely unavailable in Australia.
75. The Inquiry and the Government and the Opposition all support greater access to affordable financial product advice. This could be readily facilitated by allowing product issuers and other industry participants to provide their customers and consumers access to these kinds of tools. In order to do so, product issuers would need relief from existing obligations to provide statements of advice and to provide advice that is in the interests of the user. The Superannuation Committee queries the value of a statement of advice for an online tool. As to the best interests duty, the Superannuation Committee does not advocate that a provider be able to provide advice that is not appropriate, but that some recognition and perhaps relief be provided from the obligations that would otherwise apply to a person who provides personal advice to retail clients.

#### Proposals raised by Inquiry on product design requirements

76. The Superannuation Committee does not express any view on whether product suitability rules or design rules should apply. The Superannuation Committee merely note that product suitability rules already apply to margin lending facilities and consumer credit and prescriptive product design rules apply to MySuper products. In addition, unfair contract terms in the Competition and Consumer Act apply to some arrangements between financial product issuers and customers, there are similar provisions in the Insurance Contracts Act, and an obligation for a financial services licensee to provide financial services efficiently, honestly and fairly. All of these could be used to address egregious product terms now.
77. Given this, the Superannuation Committee queries whether a better, more tailored disclosure regime, including online advice tools, combined with greater use by the regulator of its existing powers might promote better disclosure, more engagement and more suitable products for consumers.

## Financial advice

### FSI Interim Report, from 3–63

78. As a starting point, the Superannuation Committee agrees with the observation in the Report:

*... Improving standards of adviser competence and removing the impact of conflicted remuneration can improve the quality of advice. Comprehensive financial advice can be costly, and there is a consumer demand for lower-cost scaled advice.*

79. It is acknowledged that there is a tension between the objectives of improving the quality of advice and lowering the cost of advice, and the Superannuation Committee agrees with the observation in the Report that achieving both objectives is 'challenging'.

80. The Superannuation Committee understands that 'current arrangements' in the Report refers to the regulation of financial product advice in the expectation that the Government's amendments to the FOFA regime (announced at the time the Report was released and since then introduced in the *Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014*) (FOFA Streamlining Regulations) will be substantially adopted by amendment to the Corporations Act in due course.

### Accessibility

81. The Inquiry has asked for further information on the following issues:

- What opportunities exist for enhancing consumer access to low-cost effective advice?
- What opportunities are there for using technology to deliver advice services and what are the regulatory impediments, if any, to those being realised?
- What are the potential costs or risks of this form of financial advice, and what measures could be taken to mitigate any risks?

82. Superannuation funds are permitted to provide 'intra-fund advice' to their members on the basis that the cost of that advice is not charged to the member but is funded from the general assets of the fund (and therefore effectively borne by all members of the fund). 'Intra-fund advice' is advice on a limited range of topics related to an existing member's superannuation interest in the fund (such as making contributions, selecting an investment strategy or selecting insurance options within the fund) but does not include the consolidation of a member's interests in other superannuation funds.

83. The Superannuation Committee understands that intra-fund advice services are widely offered by superannuation funds and, where offered, are generally considered an intrinsic component of a fund's member service offering.

84. The FOFA Streamlining Regulations include amendments with a stated objective of facilitating scaled or 'limited' advice. Intra-fund advice is a form of limited advice, because of its restricted scope. As a result, the adviser does not consider the whole of the member's circumstances – only those that are relevant to the subject matter of the advice.

85. The Superannuation Committee's view is that there is some doubt as to whether the amendments to the 'best interests' duty in the FOFA Streamlining Regulations are sufficient to achieve the objective of facilitating limited advice. The intention of the amendments appears to be to allow the scope of the provider's enquiries and investigation to be limited, as well as the scope of the advice. However, the Regulations do not expressly state this. A risk therefore remains that advisers providing limited advice could be subject to claims that they have breached their best interests obligations by not conducting more extensive inquiries about the whole of their clients' circumstances (known as a 'fact find').
86. The Superannuation Committee suggests therefore, if the policy position is that limited scope advice is to be more widely available as a solution to the cost issue, the ability of advisers to conduct a limited fact find should be more clearly specified. For example, the regulation could expressly recognise that the scope of advice, and the scope of the client's circumstances that are considered, can be limited by agreement between the adviser and the client.

#### Using technology to deliver advice services

87. On-line calculators are widely used in sectors such as general insurance to assist consumers in their understanding of how a product works and to compare products.
88. Trustees of superannuation funds increasingly use, or want to use, on-line calculators to assist members in better understanding the product and to provide them with information about the likely effect of increases in contributions, the impact of different earning rates on their superannuation balance and similar scenarios.
89. As noted in the section about disclosure and electronic delivery, the regulatory settings make it very hard for trustees to provide these kinds of interactive tools to their members.
90. Use of on-line calculators is restricted in the superannuation sector by the 'personal advice' regime. The concern is that because these calculators ask members to input their personal details, it is arguable that the results of the calculator 'take into account' the consumer's personal circumstances and therefore result in 'personal advice' being provided, triggering the full regulatory regime (including best interests obligations and the requirement to provide a compliant Statement of Advice).<sup>58</sup>
91. In December 2005 ASIC granted relief from the personal advice regulatory regime for calculators that meet specified requirements. The relief is rarely relied on by superannuation fund trustees as the conditions of the relief (in particular, the requirement that the calculator does not 'advertise or promote' a specific financial product) are difficult to comply with when the calculator appears on a fund's website alongside other promotional material.
92. The Superannuation Committee supports re-visiting the exemption for on-line calculators, with a view to relaxing the conditions on which the exemption is available so that the appropriate use of calculators for specific products is clearly permissible, together with other measures to promote the provision of online advice tools by trustees and other product issuers.
93. The rationale for the Superannuation Committee's view is that the purpose of on-line calculators is as an **educational tool**, and the exemption should be on the basis that

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<sup>58</sup> ASIC Regulatory Guide 167, at paragraphs RG 167.56–RG 167.62, explains this analysis.

the results of the calculator should not be treated as personal advice and are not labelled as personal advice.<sup>59</sup> It is difficult to envisage that an on-line calculator provided merely as an educational tool could operate as a suitable substitute for personal advice

94. The Superannuation Committee acknowledges, however, that ‘mass customisation’ techniques may be developed that are able to provide **automated personal advice** on specific matters, in compliance with the regulatory requirements (including generating a compliant Statement of Advice). The Superannuation Committee believes that the usual regulatory regime should apply to personal advice provided by these techniques, subject to the Superannuation Committee’s comments on regulatory issues for limited scope advice.

## Independence

95. The Inquiry has sought further information on the following issues:

- Is there a case to more clearly distinguish between independent and aligned advisers, and what options exist for doing this?
- Would consumers be likely to understand the difference between aligned and independent advisers and, if so, to what extent would this be likely to factor into a consumer’s decision to take the advice?

96. The Superannuation Committee supports stricter requirements for labelling advisers as independent or aligned. The current framework limits advisers who can call themselves independent, but there are no specific disclosure requirements in relation to aligned advisers and it is often difficult to identify the ownership of an aligned adviser.

97. The Superannuation Committee suggests aligned advisers should be required to prominently disclose their ownership or other alignment and explain the impact on the products they are able to offer.

98. The Superannuation Committee believes that clear disclosure of ownership or other alignment will not be difficult for consumers to understand, and appropriately prominent disclosure may affect a consumer’s decision either way – i.e. the consumer may prefer an independent adviser or may prefer an adviser aligned with a ‘brand’ and actively choose a branded product.

99. The Superannuation Committee supports the introduction of requirements for clear disclosure of limitations on an adviser’s approved product list.

100. The Superannuation Committee’s view is that aligned advisers should continue to be permitted to either advise only on aligned product ranges, or to advise on both aligned products and non-aligned products. However the Superannuation Committee suggests that the inclusion of non-aligned products in the adviser’s approved product list should not enable the adviser to avoid disclosing the full details of their alignment. It is acknowledged that this may present some complexities in drafting the disclosure requirements.

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<sup>59</sup> The Superannuation Committee supports ASIC’s commentary that calculators to which relief applies should be educational in nature.

101. The Superannuation Committee's view is that aligned advisers should continue to be permitted to either advise only on aligned product ranges, or to advise on both aligned products and non-aligned products. However the Superannuation Committee suggests that the inclusion of non-aligned products in the adviser's approved product list should not enable the adviser to avoid disclosing the full details of their alignment. It is acknowledged that this may present some complexities in drafting the disclosure requirements.

### General advice

102. The Inquiry has sought views on reforms involving renaming general advice as 'sales' or 'product information' and mandating that the term 'advice' can only be used in relation to personal advice.

103. The Superannuation Committee's view is that the distinction between 'general' and 'personal' advice can be difficult to determine and is frequently not clearly understood, particularly by consumers.<sup>60</sup>

104. The main legal difference is that an individual's personal circumstances are, or are expected to be, considered when personal advice is provided, whereas they are not when general advice is provided.<sup>61</sup> However, this does not mean that all general advice is 'sales' advice. While general advice frequently does include a specific product recommendation and may well be sales advice, this is not always the case and therefore the Superannuation Committee does not support the relabeling of 'general advice' as 'sales advice'. Nevertheless, the Superannuation Committee thinks that there may be some merit in considering whether general advice should be relabelled as a different category of communication, which might include a 'sales' category. The purpose of doing so would be to provide better targeted regulation.

105. To this end, there may be merit in reviewing the current definitions for the purpose of determining the regulatory regime that applies, in terms of whether:

- the conduct is not regulated under the Corporations Act advice regime (noting that other regulatory requirements such as the prohibitions on misleading and deceptive conduct will still apply);
- the conduct is regulated under the 'general advice' regime as provided in the current arrangements – this regime requires an AFS licence authorisation,<sup>62</sup> the provision of a Financial Services Guide to consumers<sup>63</sup> and a warning to consumers that the advice does not take into account the consumer's circumstances;<sup>64</sup>
- the conduct is regulated under the 'personal advice' regime as provided in the current arrangements – this regime requires an AFS licence authorisation,<sup>65</sup> the provision of a Financial Services Guide to consumers,<sup>66</sup> the imposition of statutory requirements such as the requirement to comply with best interests

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<sup>60</sup> The Superannuation Committee made this observation in the Superannuation Committee's submission to Treasury on the exposure draft of the FOFA Streamlining Regulations and the *Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014*.

<sup>61</sup> Corporations Act, ss. 766B(3) and 766B(4)

<sup>62</sup> Corporations Act, s 911A, with s s 766A and 766B

<sup>63</sup> Corporations Act, s 941A

<sup>64</sup> Corporations Act, s 949A

<sup>65</sup> Above n62

<sup>66</sup> Above n 63

obligations,<sup>67</sup> the requirement to give appropriate advice,<sup>68</sup> the obligation to give priority to the client's interests in the case of conflict with the provider's interests<sup>69</sup> and the requirement to give a Statement of Advice.<sup>70</sup>

106. The Superannuation Committee would support consideration of a more sophisticated distinction between information and advice. For example, the following distinction could be considered:

- 'advice' – i.e. an interaction which takes into account one or more personal circumstances of the client – this could be regulated under the current arrangements for 'personal advice';
- 'product recommendations'- i.e. an interaction that recommends a product or products (or the characteristics of a product or products) - e.g. *this insurance policy provides excellent cover for travellers* – but which would be commonly understood by consumers as not involving any analysis of the product's suitability for the particular consumer – this type of interaction could be regulated under the current arrangements for 'general advice' but would no longer be called 'general advice'; and
- 'information' – i.e. information which is purely factual. This conduct would potentially not have to be regulated under the Corporations Act advice regime (but would be subject to general misleading and deceptive conduct prohibitions).

107. The Superannuation Committee would not, however, oppose regulatory changes that would mean some requirements of the current arrangements for 'personal advice' (e.g., the requirement to conduct a complete 'fact find' or to provide a Statement of Advice) do not apply to certain forms of 'personal advice' such as 'intra-fund advice' (see the Superannuation Committee's comments on 'Accessibility').

## **Stability of superannuation policy settings, regulatory architecture & costs and benefits of regulation**

FSI Interim Report Pages 2–118, 3–93, 3–94, 3–97

108. The Superannuation Committee agrees with the observation made in the Interim Report that superannuation policy settings lack stability and that this adds to the costs and reduces the long-term confidence and trust in the system.

109. Similarly, the Superannuation Committee agrees with the observations in the Interim Report that implementation costs are compounded by poor timing around the start of regulation, inadequate consultation with industry and regulatory requirements that are overly prescriptive.

110. The rapid pace of change, and recent approaches to making those changes, have detracted from the quality of consultation with industry and ultimately from the overall quality of regulatory reform.

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<sup>67</sup> Corporations Act, s 961B

<sup>68</sup> Corporations Act, s 961G

<sup>69</sup> Corporations Act, s 961J

<sup>70</sup> Corporations Act, s 946A

111. One precaution that could be taken would be to introduce documented limits and safeguards around the pace of regulatory reform, and/or to establish key principles which should inform future regulatory reform initiatives. These options (and their limitations) are canvassed below.
112. The Superannuation Committee has also identified numerous other contributing factors and consequences of policy instability, some of which compound the first-order consequences of policy instability.

### **Are there mechanisms for limiting the pace of change?**

113. In 2013, the Superannuation Committee prepared a submission to Treasury in connection with a proposal to establish a national 'Charter' of superannuation and a 'Council of Superannuation Custodians'. According to the proposal, the Charter and the Council would introduce fetters on the pace of superannuation regulatory change.
114. As the Superannuation Committee pointed out at the time, a Government cannot bind or fetter future Governments.
115. As such, short of constitutional change, there is no legal mechanism that could limit the pace of change in a binding sense. Even if a commitment to regulatory stability were to be enshrined in a charter or in legislation, those documents themselves could be subject to change or repeal.
116. The extent to which any commitment to regulatory stability is complied with, in practice, will ultimately depend on the willingness of the Government of the day to comply with it.
117. A Government could of course simply abide by its own articulated principles without the need for a charter or legislative commitment to stability.
118. That said, documenting a commitment to stability does represent an opportunity to clarify and articulate principles which should inform future reforms and to make a demonstrable commitment to those principles.

### **Principles that could inform structured reforms**

119. In 2013, in proposing the so-called Charter of Superannuation, principles such as certainty, adequacy, fairness and sustainability were mooted as potential criteria for assessing future superannuation regulatory reforms. At the time, the Superannuation Committee's view was that such principles are not contentious and not objectionable when considered in the abstract. This remains the Superannuation Committee's view.
120. However, for principles ever to gain traction, it would be necessary to describe the relevant principles with some degree of particularity so that they can be objectively applied in practice. Abstract principles may be so malleable and open to interpretation that they provide little practical assistance or comfort.
121. There may also be merit in revisiting and articulating the purpose of the superannuation system, as there can be differing opinions in this regard. It seems well accepted that superannuation savings, as the 'second pillar' of Australia's retirement incomes policy, are intended to improve standards of living for Australians in retirement and to reduce reliance on the age pension. When these concepts are analysed further, however, in light of developments in policy and within the industry since the introduction of the Superannuation Guarantee, numerous questions arise. For example:

- Is the superannuation system best perceived simply as a form of compulsory saving, or as a tax effective portal for making investments?
- Are the tax concessions intended to represent a retirement benefit in and of themselves, or merely an incentive for making voluntary contributions, or are they compensation for the fact that members cannot access their superannuation benefits until after they have retired or satisfied a condition of release?
- Is the purpose of the superannuation system to provide an adequate retirement income?

122. Along similar lines, there may be merit in clarifying whether superannuation benefits ought to be thought of as belonging to the member, or whether they belong to the superannuation fund, with the member (or their beneficiaries) merely having a right to receive them in future.

123. Other principles are readily conceivable which would treat the negative externalities which arise from rapid and unexpected regulatory reforms. For example, as matters of principle, superannuation laws ought to:

- (i) be well-informed and considered;
- (ii) be comprehensible for members insofar as they impact members directly;
- (iii) be capable of being implemented and complied with by industry within reasonable timeframes and reasonable cost parameters; and
- (iv) apply prospectively to future events and decisions (as opposed to historical events and decisions).

## **Other contributors to policy instability and associated impacts**

124. In recent years, the Superannuation Committee has observed a trend towards sub-optimal approaches being adopted by the Australian Government, Treasury and regulators when undertaking financial services regulatory reform.

125. This leads to periods of unnecessary uncertainty within industry, unnecessary compliance-related costs, and regulatory requirements that are not well-suited to achieving their policy objectives.

126. Several trends which the Superannuation Committee has observed in the financial services space – specifically, within the superannuation industry – are listed below:

- Sub-optimal approaches to consultation with industry, with insufficient time for industry to provide feedback and insufficient time for that feedback to be taken into account;
- A piecemeal approach to the implementation of reforms, including introducing legislation in ‘tranches’;
- Reforms being introduced through Government announcements without accompanying legislation;
- Relief and clarification being provided too late to be of assistance to industry;

- Inconsistent statements by regulators as to their regulatory expectations; and
- Incidental and subordinate requirements having a disproportionate impact on superior legal obligations.

127. These trends were explained in detail in the Superannuation Committee's original submission to the Inquiry. These trends provide examples of how the financial system might be regulated more efficiently in future.

128. Ultimately, it is the Superannuation Committee's view that Government, Treasury and regulators should adopt a more structured, coherent and co-ordinated approach when implementing regulatory changes which will impact the financial system, including when consulting with stakeholders on those proposed changes.

## **Reducing complexity**

129. When the Financial Services Reform Act was passed more than a decade ago, there were aspirations that all financial services would be primarily regulated through the Corporations Act. While that may technically be the case, the hierarchy of regulatory requirements has become increasingly complex to navigate. Regulatory requirements applicable to the superannuation industry, for example, are situated within statutory provisions, regulations (many of which modify the statutory provisions), schedules to the regulations (some of which also modify the statutory provisions and other regulations), not to mention the body of regulation which is contained within class orders granted by ASIC.

130. This makes it difficult for industry participants to understand what their legal obligations are and for consumers to understand what their rights are, which adds to the costs of compliance and legal advice for all.

131. This is compounded by the fact that the websites for some regulators do not readily lend themselves to searching for relevant class orders and regulatory materials by subject matter.

## **Data collection burdens (IR 3-97)**

132. It is well understood that the data collection burden on superannuation funds has recently increased significantly as a consequence of APRA's new reporting standards for superannuation funds and proposals regarding the disclosure of portfolio holdings.

133. While the Superannuation Committee does not comment on policy drivers underpinning particular reforms, the Superannuation Committee notes that aspects of the data which superannuation funds will be required to disclose are not necessarily being collected for prudential regulation purposes or for the direct benefit of members.

134. For example, in requiring superannuation funds to disclose details of all investments in their portfolios, it has been acknowledged that this information will most likely not be accessed or understood by members. Instead, it has been stated that the information would most likely be of use to researchers, academics and peers wishing to analyse the positions of particular superannuation funds, the outputs of which could potentially be accessed by members. The Superannuation Committee merely note this in passing and pose the question whether this is a sufficient basis for imposing significant data collection burdens on industry (and the associated costs on members).

## **Regulatory perimeters (IR 3-98)**

### Type of regulation for superannuation

135. The Interim Report poses the question whether superannuation funds ought to be subject to greater conduct regulation instead of prudential regulation. The Interim Report makes reference to the view of the Wallis Inquiry that prudential regulation was warranted for superannuation (as opposed to managed investments) by virtue of the mandatory long-term nature of superannuation and its tax concessions, amongst other things.
136. Clearly, there is a comprehensive - although complex - system of regulation in place (for both superannuation and managed investments) which is functioning with a degree of effectiveness.
137. Given the lack of policy stability in the superannuation space (which is acknowledged in the Interim Report), the case for making a fundamental change to the regulatory model for superannuation should need to be particularly convincing before embarking on a change of that scale – one which would be susceptible to the criticism that it was more a change in form than a change in substance.

### Regulation of superannuation administrators and technology providers (IR 3-108)

138. The Interim Report assumes that fund administrators are not subject to the Australian financial services licence requirements. This is not the case, as administrators are required to have an Australian financial services licence authorising them to deal in financial products, including arranging for others to acquire and dispose of financial products. Administrators are not subject to prudential regulation, however; which means that APRA's recourse to an administrator will be via its supervision of the trustee.
139. However, it is correct that technology providers (including those who provide technology to fund administrators) are not necessarily required to hold an Australian financial services licence.
140. The question of whether or not technology providers should be subject to licensing requirements is a question of policy and one which the Superannuation Committee does not express a view on. However, the Superannuation Committee can make the following observations that may inform that policy debate.
141. Trustees of superannuation funds are heavily reliant upon their fund administrators who are in turn heavily reliant upon the technology providers responsible for the software and systems that are used to administer member accounts.
142. It is readily conceivable that defective software or systems issues could result in significant errors affecting member accounts which result in losses being suffered by members, incorrect account balances and payment errors. In the event of a major issue, the rectification costs could themselves be significant.
143. In this situation, members would potentially have rights of action against the trustee of the superannuation fund. The trustee of the superannuation fund would potentially have rights of action against the fund administrator. APRA and potentially ASIC would have regulatory powers with respect to the trustee and there would potentially be regulatory intervention to protect members and potential for civil penalties and the imposition of additional licence conditions. Similarly, ASIC would have regulatory powers with respect to the fund administrator, meaning there would be potential for

some regulatory action against the fund administrator in respect of its 'conduct' obligations.

144. The prospect of regulatory intervention inevitably brings discipline to bear and exerts pressure on the affected parties to promptly resolve the underlying issues and compensate affected members.
145. However, the regulators presently have no (or limited) jurisdiction with regard to the technology providers who may have supplied the software and systems which were the underlying cause of the issues.
146. As such, the question of whether a technology provider bears any responsibility for remediating the issues or any liability for losses to members will almost entirely turn on the terms of the legal agreements executed by the technology provider and the relevant fund administrator. These types of legal agreements typically include extensive disclaimers and limitations of liability. As such, there may be limited rights of recourse against the technology provider and without any real prospect of regulatory pressure being brought to bear upon the technology provider, the prospect of voluntary corrective action being taken could potentially be less than would otherwise be the case.
147. Even if technology providers were to be regulated, it would be important to ensure that the regulatory perimeter was appropriately defined to avoid anomalies – for example, inadvertently imposing licensing obligations on providers of orthodox word processing and spreadsheet software and email technology which is used in connection with providing financial product advice or dealing in financial products or communicating with members.

#### Risks outside the regulatory perimeter (IR 3–108)

148. The Interim Report queries whether there should be a mechanism to allow a heightened level of regulatory intensity to be applied where risks arise outside the regulatory perimeter.
149. From a rule of Law perspective, the Superannuation Committee would be concerned by any reform which gave a regulator power to unilaterally broaden its own jurisdiction.
150. The powers and discretions granted to regulators ought to be clearly defined, in advance, in appropriately passed legislation, so that Parliament, industry, the general public and the regulators have a clear understanding of what conduct is regulated and the consequences of non-compliance. This is essential in order for participants in financial markets (or indeed in any part of society) to manage their affairs in a structured manner with appropriate certainty concerning the regulatory environment.
151. When it becomes appropriate or necessary to vary the jurisdiction of a regulator, this should be implemented by way of legislative reform following due consultation with relevant stakeholders.

### **Imputation credits and superannuation**

#### FSI Interim Report Pages 2–59, 2–122

152. In the Superannuation Committee's view, it is an inaccurate over-simplification to suggest that investment strategies adopted by most superannuation funds are being distorted by domestic imputation credit arrangements.

153. Superannuation legislation requires trustees to have regard to a wide range of matters in formulating an investment strategies in the best interests of their members. Tax is merely one consideration among many, such as risk, return, cash flow requirements and the need for liquidity, diversification and access to reliable valuation information.

154. To make the point, s 52(6) of the SIS Act is extracted below:

*(6) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:*

*(a) to formulate, review regularly and give effect to an investment strategy for the whole of the entity, and for each investment option offered by the trustee in the entity, having regard to:*

*(i) the risk involved in making, holding and realising, and the likely return from, the investments covered by the strategy, having regard to the trustee's objectives in relation to the strategy and to the expected cash flow requirements in relation to the entity; and*

*(ii) the composition of the investments covered by the strategy, including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification; and*

*(iii) the liquidity of the investments covered by the strategy, having regard to the expected cash flow requirements in relation to the entity; and*

*(iv) whether reliable valuation information is available in relation to the investments covered by the strategy; and*

*(v) the ability of the entity to discharge its existing and prospective liabilities; and*

*(vi) the expected tax consequences for the entity in relation to the investments covered by the strategy; and*

*(vii) the costs that might be incurred by the entity in relation to the investments covered by the strategy; and*

*(viii) any other relevant matters;*

*(b) to exercise due diligence in developing, offering and reviewing regularly each investment option;*

*(c) to ensure the investment options offered to each beneficiary allow adequate diversification.*

155. In the Superannuation Committee's view, s 52(6) adequately outlines the matters that any prudent professional investor should take into account when making investments by way of due diligence. In the experience of the Superannuation Committee's members, as a general proposition, funds genuinely have regard to these various matters (and others) when formulating investment strategies.

## Retirement incomes

### FSI Interim Report, from 4–3

156. The Inquiry has sought views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- Maintain the status quo with improved provision of financial advice and removal of impediments to product development.
- Provide policy incentives to encourage retirees to purchase retirement income products that help manage longevity and other risks.
- Introduce a default option for how individuals take their retirement benefits.
- Mandate the use of particular retirement income products (in full or in part, or for later stages of retirement).

157. The Superannuation Committee does not believe that maintaining the status quo with improved provision of financial advice will address the concerns raised by the inquiry. For the reasons cited in the Superannuation Committee's initial submission, the Superannuation Committee submits that:

- removing the various legal and regulatory impediments to product development (such as the complex, restrictive and inflexible pension rules in the *Superannuation Industry (Supervision) Regulations 1994*); and
- providing policy incentives (such in the form of tax incentives) to encourage:
  - superannuation funds to offer innovative retirement income products, and
  - retirees to purchase retirement income products that help manage longevity and other risks,

will greatly assist in encouraging product innovation in the retirement income market and a greater demand for retirement income products. This would, in turn, assist in managing the challenges presented by Australia's ageing population.

158. The Superannuation Committee does not support mandating the use of particular retirement income products (whether in full or in part, or for later stages of retirement).

159. This would assume that all retirees have the same needs in relation to retirement incomes. (Also, the Superannuation Committee notes in passing that it would potentially entrench the commercial position of particular product issuers which already have developed capabilities to provide those types of products.)

160. A retiree that has investments outside of superannuation which are income producing would not, for example, have the same needs as a retiree that did not. Further, a retiree may need to access lump sums for good reason (such as for medical treatment or to modify their home for special needs).

161. Instead, the Superannuation Committee advocates that retirees should be able to continue choosing the best form of retirement income for themselves but that:

- the providers of those products be encouraged to produce innovative products that deal with the varying needs of retirees; and
- retirees be incentivised to take out those products where there is no other compelling reason for the retiree to access their benefits in the form of a lump sum.

162. The Superannuation Committee does not have a firm view one way or another on whether a default option for how individuals take their retirement benefits should be introduced except to say that:

- For reasons set out above; retirees should be able to opt out of that default (without financial penalty) to enable the retiree to choose the best form of retirement income for themselves.
- The cost to a fund of providing a pension is generally accepted as being greater than the cost of paying a single lump sum. The imposition of a default form of benefit should not have the effect of unnecessarily further driving costs up. This is particularly so given that the main reasons behind introducing MySuper as a default product was that it is a 'back to basics' product and, therefore, low cost.
- Restrictions would need to be placed on this to ensure that the default option remained appropriate even where a retiree's account balance was relatively small. For example, it would not serve the interests of a retiree if a small account balance (of say, \$5000) was required to be paid as a pension.

163. The Inquiry has also sought views on the costs, benefits and trade-offs of the following policy options or other alternatives:

- No change to current arrangements.
- Take a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests.
- For product providers, streamline administrative arrangements for assessing the eligibility for tax concessions and Age Pension means-tests treatment of retirement income products.
- Issue longer-dated Government bonds, including inflation-linked bonds, to support the development of retirement income products.

164. The Superannuation Committee supports the adoption of a more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests. In the Superannuation Committee's view:

- The provision of tax exemptions to superannuation funds on income earned on fund assets which support only current (as opposed to future) pension liabilities acts as a barrier to the creation of innovative retirement income products. In particular, it does not incentivise the development of products that seamlessly transform into retirement income products from the outset.

- Currently:
  - retirement income products purchased on or after 20 September 2007 are fully assessed for the purposes of the assets test; and
  - the Age Pension means-tests are applied to deferred lifetime annuities, even during the deferral period.

This reduces the scope of investors to access the Age Pension, thereby reducing the demand for such retirement income products.

165. A more flexible, principles-based approach to determining the eligibility of retirement income products for tax concessions and their treatment by the Age Pension means-tests would address each of these concerns.

## **Attachment A: Profile of the Law Council of Australia**

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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 Territory 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 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 23 Directors – one from each of the constituent bodies and six elected Executive members. 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 members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2014 Executive are:

- Mr Michael Colbran QC, President
- Mr Duncan McConnel President-Elect
- Ms Leanne Topfer, Treasurer
- Ms Fiona McLeod SC, Executive Member
- Mr Justin Dowd, Executive Member
- Dr Christopher Kendall, Executive Member

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