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9 March 2012

Subject: Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

Dear Sir/Madam

We are pleased to forward our comments on the exposure draft of this bill. Our major concerns are set out below, with more details about these and other matters in the Appendix to this letter.

Who is Mercer?

Mercer is a leading global provider of consulting, outsourcing and investment services, with more than 25,000 institutional clients worldwide. Mercer consultants help employers design and manage health, retirement and other benefits, and optimise human capital.

Mercer also provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). Mercer's outsourcing business has $40 billion in funds under administration locally, provides services to over a million super members and 20,000 private clients and is part of a global consulting, outsourcing and investments firm which operates in 42 countries.

We provide our own master trust the Mercer Super Trust in Australia which has approximately 270 participating employers, 240,000 members and more than $15 billion in assets under management. Mercer's investment services include global leadership in investment consulting and multi-manager investment management. We also provide personal financial advisory services for individuals including Self Managed Superannuation Funds.

Summary and conclusions

Mercer generally supports the implementation of higher standards for trustees however we have three significant concerns with the Bill in its current form.

1. Scale Test

We recommend the Scale Test be removed in its current form.

The proposed test concentrates on comparisons with other funds and has an undue emphasis on financial interests, ignoring other significant features of the fund such as service levels, insurance benefits and risk. The Appendix outlines some examples which illustrate the practical difficulties associated with the proposed test and where it could deliver adverse or unfortunate outcomes for members.

Instead, having regard to the evidence of Mr Jonathan Rollings (Treasury) to the Committee on 2 March 2012, we suggest that the requirement should be principles and simply require the trustee to consider, on an annual basis, whether the scale of the MySuper product (or the scale to which the MySuper product has access) is adversely affecting the ability of the trustee to promote the best interests of its members.

2. Claims of disadvantage against the trustee

We recommend the Bill be amended to replace an action for damages for breach of sections 29VN or 29VO with a regulator initiated action (such as a fine).

Exposing trustees and their directors to actions in damages for breach of sections 29VN or 29VO under section 29VP is unfair. As drafted, the scale test in section 29VN arguably remains outcomes based. It is most likely to be tested in hindsight. It contains ambiguities of language and application and requires a causative analysis that will in practise be difficult to do. Even a trustee acting prudently and diligently based on the information available to it at the time may never the less be exposed to actions in damage by individual members if it turns out that in fact members were disadvantaged compared to another MySuper product.

To ensure RSEs continue to attract and retain quality, experienced directors, it is important to not unfairly expose RSEs or their directors to personal liability where they have acted prudently and diligently.

3. Covenants for Trustee Directors

Whilst Mercer generally supports the implementation of higher standards for trustees, we share the concerns of the Financial Services Council (FSC) in regard to the increased personal liabilities for trustee directors that would arise under the new covenants set out in section 52A. We support the comments made in the FSC's submission to the Committee and its recommendation that these individually applicable covenants should be removed from the Bill.

Failing the removal of these individual liability covenants we recommend the Bill is more closely aligned with the concepts outlined in paragraph 1.133 of the EM.

We do not believe new trustee directors can be expected to satisfy the proposed care, skill and diligence requirement. The wording of the Bill is inconsistent with the EM. The Bill requires each and every director, irrespective of their experience, to exercise the same level of skill as a prudent superannuation entity director would exercise. This is in contrast with the intent as outlined in the EM.

We have provided more detail on the above issues and a number of other concerns in the Appendix to this submission.

Mercer would welcome the opportunity to discuss our submission in more detail. Please contact Dr David Knox on 03 9623 5464 if you have any queries on our submission or wish to arrange for us to present to the Committee.

Yours sincerely

David Anderson
Managing Director & Market Leader,
Australia/New Zealand

APPENDIX – Detailed comments on Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

SCHEDULE 1

Section 29VN - Scale test

Section 29VN(b) (Item 9) sets out requirements for trustees to make an annual determination of "scale". We are concerned with the wording of the tests involved.

This section requires that a trustee must determine annually "whether the beneficiaries of the fund who had a MySuper product are disadvantaged, in comparison to the beneficiaries of other funds who hold a MySuper product within those other funds, because the financial interests of the beneficiaries of the fund who hold that MySuper product are affected:

> (i) because the number of beneficiaries of the fund who hold the MySuper product is insufficient; or
> (ii) because the number of beneficiaries of the fund is insufficient; or
> (iii) where the assets of the fund that are attributed to the MySuper product are, or are to be, pooled with other assets of the fund or assets of another entity or other entities – because that pool of assets in insufficient; or
> (iv) in a case to which subparagraph (iii) does not apply – because the assets of the fund that are attributed to the MySuper product are insufficient.

In effect, the Bill will require the trustees to conduct **three** scale tests ie based on the number of MySuper members (i), the total number of members in the fund (ii) and one of the two asset tests (iii) or (iv).

Paragraphs 1.21 to 1.27 of the EM implies that it is the impact of administrative scale on costs to members and the impact of investment scale on investment costs and opportunities that need to be considered although the Bill does not refer to these items directly.

Paragraph 1.24 of the EM states that "A trustee must determine whether there is a sufficient number of beneficiaries of the fund to **ensure** that the financial interests of members of its MySuper product are not disadvantaged compared to embers of other funds that hold a MySuper product." Besides it being impossible to ensure that beneficiaries are not disadvantaged, we note that the Bill does not include a similar requirement.

Paragraph 1.27 of the EM indicates that a trustee must take action to rectify any insufficiency of assets or members. However, there is no such rectification requirement in the Bill.

Whilst it is possible that such requirements will be included in Prudential Standards to be issued by APRA, it is difficult to comment on the appropriateness of the Bill due to the lack of detail on any such requirements.

There are a number of problems with the proposed scale tests. These are best illustrated by examples:

- Fund B is the second largest fund (in terms of numbers of members and assets) in the country, behind Fund A. It outsources to the same administrator and provides similar levels of service to Fund A. Its fees are marginally higher than those of Fund A and it has marginally less access to investment opportunities. The trustee of Fund B determines that Fund B disadvantages its beneficiaries (compared to Fund A) because of its lower number of members and assets. It is not clear what the trustee of Fund B must do to rectify this disadvantage to members – spend more on advertising to attract more members, merge with another fund etc. There is a considerable danger that this requirement will lead to a rush to become the biggest - a strategy which caused major problems in the life insurance industry in the 1980's. This example highlights:

    - a lack of clarity in the provisions of 29VN(b). Is it really aiming at a comparison with the biggest fund in the market or is the intention really a comparison with the "average" MySuper product? If it is meant to be a comparison with the average MySuper, this would mean that around 50% of funds would need to take rectification action each year (based on the EM). In practice, a larger percentage of funds are likely to be affected as perhaps 60% to 70% of funds will fail to satisfy at least one of the three scale tests and then need to take some rectification action

    - a difficulty with the term "disadvantage" – the wording could imply that virtually all funds (except the biggest) will need to determine that they are disadvantaging their beneficiaries with the ultimate result that there will only be one fund remaining. The wording is too black and white and does not distinguish between an insignificant disadvantage and a substantial disadvantage. Or to put it another way: what does "disadvantaged" mean in this context?

    - confusion caused by the EM which appears to require more than is specified in the legislation itself

- Fund C has a relatively low number of members but a high average account balance. Overall fees for the majority of members are lower than what would be payable in many other MySuper products. Based on a number of members test, it does not have sufficient scale. However it has sufficient scale on an asset basis. The EM implies that the trustee of Fund A would need to take action to rectify the insufficiency in relation to the number of members. It is however difficult to determine what the trustee could do. Merging with another fund would potentially result in an increase in fees for most members (due to a reduction in the average assets per member) and is therefore not in their best interests. This example highlights the inappropriateness of three separate scale tests. Any scale test should look at the scale of the entity as a whole, not be broken down into members and assets.

- Fund D's MySuper administration fees are higher than those of many of its competitors. However, the trustee of Fund D has determined that it is appropriate to provide high service levels, a member helpline that provides intra fund advice (included in the fees). It is unclear how the trustee of Fund D will be able to ascertain enough details about other MySuper products to ensure that they are comparing like with like particularly as it will normally be unclear why one fund has a lower fee than another. For example, a higher fee in comparison to another fund might not be a result of insufficient scale. Rather it could be due to different service levels, different investment strategies, different levels of financial advice included in the fee etc. All of these aspects are relevant when considering a disadvantage to a member's financial interest. This example highlights the difficulties trustees will have in complying with the scale tests.

- Fund E has outsourced its administration services to the most efficient (and cheapest) external administrator. As such it has administration fees which are considerably less than most other MySuper products in the market. However, due to its relatively small size, its administration costs, on a per member basis are higher than other funds which use the same efficient administrator. It could then be argued that the fund is disadvantaging its members (compared with the other funds using that administrator) even though it is more efficient than most other funds. This example highlights that scale, by itself, is not necessarily an ideal measure.

- Fund F is a large fund which provides intra fund advice to its members as part of its standard administration fee. The trustee is aware that the administration fee charged is higher than that charged by other funds. As the trustee is concerned with that this could be perceived to be disadvantaging members due to a lack of scale, it decides to remove the intra fund advice service and reduce administration fees. This example highlights that the scale tests may lead to a race to minimum levels of service for the lowest possible fee.

- Fund G has a relatively low number of members and it is clear, on any test of scale, the fund will not be viable in the future and that merger opportunities should be considered. However, without appropriate legislation allowing rollover relief (particularly including the rollover of capital losses), the value of members' accounts would fall considerably if such a merger were to occur because of a loss of deferred tax assets (based on current financial conditions). This would not be in members' best interests. If appropriate rollover relief were available, the fund could merge prior to the introduction of MySuper and would also be able to save the considerable costs that will be incurred in implementing a MySuper product. This example highlights the need for appropriate rollover relief on fund mergers. It is important that this relief be introduced without delay.

In summary:

- There are significant inconsistencies between the Bill and the EM which are creating confusion with some of the requirements specified in the EM being impractical
- The requirements may lead to an over emphasis on scale (and the implication of low cost) to the detriment of other important fund characteristics (eg service levels, availability of intra-fund advice, insurance features and risk)
- It will be extremely difficult for any trustee to determine whether any financial disadvantage is <u>because of</u> the number of members or the level of assets rather than other reasons (less efficient administration processes, higher quality administration processes, the level of service provided)
- How many MySuper products is the trustee expected to compare? Will this include tailored MySuper products? If so, how will the trustee obtain the sort of information about those tailored MySuper products that will enable it to make a decision about whether comparative scale has caused any disadvantage (noting that employers may be subsidising some administrative costs and/or benefits in many of those tailored MySuper products)?
- The use of the term “disadvantage” is problematic. Unless better expressed and explained it leads to the conclusion that eventually there can only be one fund which satisfies the scale test leaving a monopoly player and no competition.

Recommendation

We recommend the Scale Test be removed in its current form.

Instead, having regard to the evidence of Mr Jonathan Rollings (Treasury) to the Committee on 2 March 2012, we suggest that the requirement should be principles and simply require the trustee to consider, on an annual basis, whether the scale of the MySuper product (or the scale to which the MySuper product has access) is adversely affecting the ability of the trustee to promote the best interests of its members.

Section 29VP - Claims of disadvantage against the trustee

Section 29VP specifically provides for members who suffer loss or damage as a result of the conduct of another person who contravenes section 29VN or 29VO to take action against such person. For the reasons set out below we recommend that other types of penalties (for example, regulator actions) apply for persons who deliberately or negligently fail to comply with these sections.

It is not clear what is meant by a contravention of the relevant clauses. It would appear that:

- the trustee must promote the financial interests of the beneficiaries (29VN(a))
- the trustee must make a determination(s) in relation to scale (29VN(b))
- the trustee must include the details of the determination in the fund's investment strategy (29VN(c))
- the trustee must include the investment return target and level of risk that is appropriate in the investment strategy (29VN(d))
- each director must exercise a reasonable degree of care and diligence in relation to the above

Failure to comply with these requirements exposes the trustee (and each director) to an action for damages by the member. This is a particular concern due to the vagueness of some of these requirements (eg to "promote" the "financial interests" of beneficiaries) and all the problems identified above (under "Scale Test") in relation to making the scale determination.

For example, for the reasons discussed under the "Scale Test" above, it will always be difficult to determine whether an advantage or disadvantage is due to scale or some other reason (eg the underlying investment strategy). Even an RSE that has acted diligently and prudently, based on information available to it at the time, may be exposed to an action in damages by beneficiaries where ultimately, the beneficiaries of that MySuper product are found to be disadvantaged compared to other MySuper products.

To attract and retain quality, skilled directors to RSEs, it is particularly important that those RSEs are not exposed to liability (or the threat of liability) where they have acted prudently and diligently. Even the threat of (or ultimately unsuccessful actions for) liability are likely to increase the costs of a RSE which will ultimately be borne by members.

Legislative compliance could be achieved by other means – such as penalties imposed at the instigation of the regulator.

Recommendation

Personal liability should be replaced with some other penalty – such as a regulator action (such as a fine for wilful or negligent breach).

Section 52 - Conflicts between requirements

In some circumstances, we expect that there will be a conflict between the covenants imposed on trustees by this Bill and other superannuation legislation. For example, Section 52(2)(iii) requires trustees to ensure that the interests of beneficiaries are not adversely affected by a conflict (between the trustee's duty to the beneficiaries and the duties to any other person).

However, we expect that as part of the transition to MySuper, trustees who also have a duty to comply with other legislation will be required to take actions which may be considered to be against the interests of members and which will disadvantage those members. Examples may be:

- reduction of a member's insurance cover as part of a transition to MySuper
- increase in administration fees as part of a transition to MySuper
- removal of self insurance
- removal of current disability definitions

It needs to be recognised that trustees will make a decision in the members' best interests as a whole and that such a decision for the fund may not always be in the best interest of an individual member.

Recommendation

> **The Bill needs to be amended to include protection for trustees in cases where the covenants are inconsistent with other superannuation legislative requirements.**

Section 52/52A/52B/52C - Trustee covenants

Impact on willingness of people to become trustees

The additional requirements placed on trustees, together with the lack of clarity of many of the requirements, will make the trustee role far more onerous and risky than at present.

This may lead to the following undesirable consequences:

- some qualified people refusing to become or remain as trustees (either because they do not have the financial expertise that appears to be a requirement, or because they are concerned with the additional liabilities involved)
- increases in trustee indemnity premiums
- less effective trustee indemnity insurance, particularly where claims cannot be made if the trustee has breached legislation or one of the covenants
- significant increases in trustee remuneration as trustees will only be willing to act if they are remunerated for the additional risks and constraints of the role
- the inability of some funds to be able to find appropriate persons to become trustees (or trustee directors) and satisfy the equal representation requirements (noting that they will effectively be limited to acting as trustee director for only one fund)
- a significant increase in legal actions taken against trustees

These consequences will lead to increases in fees charged to members.

We consider that a number of significant changes need to be made to the Bill if a practical outcome is to be achieved. The changes required are largely reflected in our comments below:

The Bill replaces the existing trustee covenants (Section 52 of the Act) with new covenants in Sections 52, 52A, 52B and 52C.

We have the following concerns in relation to these covenants:

Section 52 (general covenants)

Section (2)(b): Requires each trustee to exercise the same degree of care, skill and diligence as a prudent superannuation trustee (as defined). We support this requirement at the corporate trustee level, however have significant concerns with its application for individual trustees and directors of a corporate trustee (refer to our comments on Section 52A(2)(b).

Section (6)(a): This covenant requires the trustee to formulate an investment strategy for the fund as a whole and for each investment option. Whilst this is broadly appropriate, we note that for a fund which has more than one investment strategy, a number of the considerations listed in the exposure draft are more relevant to each of the investment options rather than to the fund as a whole. Applying all considerations at the overall fund level may add little or no value. Generally a fund will have a number of discrete options (eg shares, property, fixed interest etc together with diversified options which provide a combination of these discrete options). One of these diversified investment options will be the fund's MySuper product. It is certainly appropriate for the trustee to have a strategy for each of these discrete and diversified options including objectives and analysis of liquidity, risk etc.

It might be practical to require a general overarching fund strategy which would draw on the more detailed strategies for the various options. It is those investment options which must have clearly articulated objectives and within those objectives, have a strategy covering liquidity, risk etc. If the objective is framed as 'return of Y% pa generated from international shares', then liquidity and diversity etc is tested within that confine – ie only within international shares.

Secondly, the requirements should be designed in a manner which would allow trustees to offer investment options that may be illiquid or have increased volatility (e.g. investment in a single company's shares).

Section (7)(c): Trustees will be prohibited from acquiring insurance of a particular kind, or at a particular level, if the cost of insurance inappropriately erodes the retirement income of beneficiaries.

The EM sensibly states that the erosion test is to apply at the overall fund level. It also indicates that the covenant would not restrict the trustee from offering an insurance only strategy for some groups of members.

Whilst we are comfortable with the requirements as explained in the EM, we consider that there is some doubt as to whether this is an appropriate interpretation of the Bill itself. It will be therefore be important that APRA's prudential standard on insurance replicates the explanation in the EM.

Section 52A Covenants applying to directors of a corporate trustee

The changes proposed significantly increase the personal liability of a director of a corporate trustee. We share the FSC's concerns with this approach and support their recommendation that individually applicable covenants should be removed from the Bill.

If this recommendation is not accepted, we believe that Section (2)(b) should be modified as set out below.

Care, skill and diligence requirement - Section (2)(b): This section requires that individual directors must exercise, "in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation entity director would exercise ………" Whilst we support the similar requirement imposed at the corporate trustee level in proposed Section 52(2)(b), we have significant concerns with its application for individual directors.

It is difficult to understand how any new trustee director could be expected to satisfy this care, skill and diligence requirement. Whilst care and diligence might be generic concepts which can be learnt in other roles, this is not the case with "skill" in which a strong knowledge and understanding of superannuation would be required. We note that the EM states "The level of skill required does not necessarily require particular qualifications, and new directors will not be expected to have the level of skill and knowledge of an experienced superannuation director immediately." These might be comforting words however they appear to be totally inconsistent with the wording of the Bill. The Bill requires each and every director, irrespective of their experience, to exercise the level of skill as a prudent superannuation entity director would exercise. If the words in the EM are the intention, then the Bill needs to be amended to reflect them.

Further, such a requirement appears to be inconsistent with the current equal representation requirements for superannuation trustees. If each individual trustee director is required to act as a prudent superannuation entity director (as defined), then this will make the equal representation requirements extremely difficult to apply. For example, many existing trustee directors will not have the financial skills and knowledge that would be necessary for them to satisfy the requirements of this covenant. This includes:

- many member elected trustees
- many union appointed trustees
- many employer appointed trustees (e.g. a human resources director)

Whilst we generally support the enhancement of the quality of trustees, we expect that this can only be achieved in conjunction with modifications to the current equal representation requirements.

The "skill" requirement in particular is also likely to mean that persons who do not have experience in financial management and corporate governance will not be able to become or remain as trustee directors. This would include, for example, a Human Resource Manager, a member elected trustee from the shop floor of a manufacturing plant or a union official). In each of these examples, the particular person may have other important skills to offer but, without financial experience, may not be able to satisfy the onerous new conditions.

This is likely to result in two significant problems:

Concern 1: If many existing trustee directors decide to stand down, then this could leave funds with a decision making vacuum at a time of significant change. Even if new directors can be found, major turnover on the board is not optimal during a period when such major decisions as establishing a MySuper product and new policies to satisfy new prudential standards have to be taken and implemented.

Concern 2: Where trustees are elected by members, there may be difficulties in finding adequate replacements from the fund's membership (many corporate funds require trustee directors to be a member of the fund). Even if the fund's rules are changed to enable members to elect an external person with appropriate skills, it will take time to develop such a process including solving practical problems such as determining how such persons might be nominated and approached. Such persons would also require appropriate remuneration for undertaking the role whereas, in most corporate funds, acting as a trustee director would currently be on a voluntary and unpaid basis. Employers may also find it necessary to appoint 'professional' superannuation directors as their employer representatives – again such external appointments would require appropriate remuneration and the scope for 'professional' superannuation directors is very limited given they will generally not be able to take on multiple directorships due to the conflict requirements.

The sector likely to be least affected under these requirements are the retail funds (including corporate master trusts) where the trustee directors are generally experienced professionals in the field who are appointed by the financial organisation that established the fund and are appropriately remunerated for their role. However, even in these cases, the requirements may limit the ability of the trustee to appoint new inexperienced independent directors.

Without modifications to the equal representation requirements we believe that many funds subject to those rules may find it increasingly difficult to attract people with the appropriate skills to become trustees.

Indemnification for costs of legal advice: If individual directors are to be given the additional exposure of new covenants and personal liability for breaches, they need a clear defence provision where they have exercised reasonable care, including the right to take any advice they individually consider necessary and to have that advice paid for from fund assets as for a trustee. Accordingly, section 56(3) should be extended to apply to individual directors of a trustee too.

Recommendations

Individually applicable covenants should be removed from the Bill.

Failing the removal of section 52A we would recommend:

The Bill needs to be amended to more closely align with the concepts as outlined in paragraph 1.133 of the EM.

Corporate trustees which satisfy the current equal representation requirements should be given the flexibility to determine, acting in the interests of members, their own rules relating to the composition of the board going forward. This could include decisions to:

- **increase the number of independent directors**
- **increase/reduce the number of member appointed and employer appointed representatives**

- **move away from equal numbers of member/employer representatives**

Section 56(3) should be extended to apply to individual directors of a trustee too.

Section 52A Section 2(e)(i) - Contracts that prevent or hinder a director

This section includes the following covenant for an individual director:
“not to enter into any contract, or do anything else, that would:
(i) prevent the director from, or hinder the director in, properly performing or exercising the director’s functions and powers as director of the corporate trustee; or”.

At the extreme, this could be read as not letting the director have another job as this might result in them not being available at all times to immediately address any trustee director responsibilities that arise. Similarly it could be read as requiring that the director never goes on leave or becomes ill or resigns.

Recommendation

This section should be amended to “unreasonably prevent the director from or unreasonably hinder the director ……..”.

Section 52(7)(d) – Pursuit of insurance claims

This section requires the trustee to do "everything that is reasonable to pursue an insurance claim for the benefit of the beneficiary if the claim has a reasonable prospect of success". This needs qualification to avoid requiring the trustee to pursue claims where the costs to recover (including out of pocket costs on litigation that will not be recovered even if successful) may be prohibitive for the size of the claim. In some cases it may be more prudent acting in all members’ interests to compromise on the claim or to use other avenues to have the matter resolved against the insurer (via the SCT, for example).

Recommendation

This section should be amended to “to do everything that is reasonable (having regard to the best interests of all beneficiaries) to pursue an insurance claim for the benefit of the beneficiary if the claim has a reasonable prospect of success".

Item 19 – Section 58(2)(d)

This item modifies the ability of a trustee to be directed by a beneficiary to take up an investment option. It is difficult to comment on this item as the requirements are to be specified in regulations. It will be important that the regulations are subject to appropriately consultation.

Allocation of costs

This Bill does not cover the allocation of costs between different products. This will be covered in a subsequent tranche of legislation. We accept that there needs to be a fair and reasonable allocation of costs between products and classes of members.

However, paragraph 1.23 of the EM appears to take such allocation to an extreme level. It states:

> "Certain administrative requirements will only be relevant to members of a MySuper product. For example, the trustee must comply with fee rules that limit the type of fees that may be charged members of a MySuper product. Administrative systems to ensure a trustee complies with these rules will have costs that will be spread among members of the MySuper product only."

If the cost allocation rules are as precise as implied by this statement, the following outcomes will arise:

- costs will rise across the board as trustees will need to build expensive systems and processes to properly allocate costs between products
- fees for a MySuper product will be higher than for choice products with similar investment strategies (as presumably all of the very considerable costs of developing a MySuper product will need to be recouped from MySuper members)
- it will not be possible for trustees to introduce new or innovative products. For example, it would not be possible for a trustee to introduce a new pension product as the development costs would need to be met by the pensioners (making such a product unattractive until the pension product reached critical mass). If the Government wishes to encourage income streams, it will need to allow development costs to be funded by the MySuper and Choice sections (ie by members who will eventually be able to use the pension product).

Cost allocation area is another area on which trustees need more information before they can appropriately design a MySuper product.

Recommendation

> **The Government needs to ensure that cost allocation rules are practical and are not framed in a manner which will discourage the provision of income streams in retirement and other valuable innovations.**

SCHEDULE 2

Item 1

This item adds provisions to enable APRA to make prudential standards. The provisions are extremely broad.

Section 34C

APRA's powers will include the ability to make standards to be applied to all or some RSE licensees or to specified classes of RSE licensees.

A significant concern is that APRA will have the power (34C(1)) to specify standards in relation to connected entities of RSE licensees. Connected entities include a subsidiary of an RSE licensee and any other entity of a kind prescribed by the regulations (10(1)).

We consider that the breadth of this power in Section 34C(1) is too wide and needs to be restricted to RSE licensees. Otherwise, it will be possible for APRA, without oversight by Parliament, to impose conditions on entities that are not regulated by APRA.

Whilst we suspect that it is most likely that the impact on connected entities would be restricted to superannuation matters (eg where the connected entity provides insurance, administration, consulting, actuarial or accounting services), it is important for any business that it operate freely in order to make an appropriate return on capital. The exposure draft appears to give APRA the power to make businesses operate more like a trustee placing the interests of fund members ahead of the entity itself.

Section 34C(3) provides further concerns. This section gives APRA the power to set standards requiring an RSE licensee ensure that their connected entities satisfy particular requirements. Again this is inappropriate. In any case, it will not always be possible for the RSE licensee to ensure compliance by a connected entity. Each entity will have its own Board which will be required to look after the interests of that entity. It is inappropriate that superannuation prudential standards override existing duties of the directors of the connected entity. It will have its own business interests which may be broader than involvement in superannuation. Requiring compliance with certain superannuation based standards may adversely impact those other interests.

Item 23 Additional conditions imposed on individual licences by APRA

This item amends Section 29EA relating to the imposition of additional conditions imposed on individual licensees by APRA. It allows APRA to impose a condition "despite anything in the prudential standards". We are concerned that there is no protection for trustees where the condition conflicts with a prudential standard or other legislation.