# Chapter 4

# Service providers, the remaining provisions of the bill and the committee's conclusions

4.1 This chapter examines the proposed amendments which address various governance issues associated with the superannuation industry, including measures that would:

- override any provision in a fund's governing rules that require the trustee to use a particular service provider, investment entity or financial product that is specified in the rules;
- apply the Corporation Act's requirements for adequate resources (including financial, technological and human resources) and risk management systems to 'dual regulated entities'—RSE licensees that also manage registered management investment schemes; and
- ensure that directors of corporate and individual trustees are only prohibited from voting on fund business in certain circumstances, such as where there is a conflict of interest.

4.2 This chapter also discusses the remaining consequential and other amendments contained in the bill, as well as a number of additional matters that were not addressed by this bill but which were enthusiastically promoted by stakeholders. The committee's overall findings are outlined at the end of this chapter.

## Overriding requirements to use a specified service provider

4.3 The Cooper Review received submissions both expressing concern and highlighting the benefits of specific service providers being vertically integrated into the administration of a trust. The Review ultimately recommended that any provisions in an APRA-regulated fund's governing rules that require the trustee to use a specified service provider should be overridden. The final report of the Cooper Review observed that:

> Generally, when selecting a service provider, the trustee would carry out appropriate due diligence and negotiate terms before making an appointment. However, if the trust deed contains a provision mandating a certain product provider, then the trustee has no discretion to exercise in the matter and is prevented from making another selection.[1]

1 The Cooper Review panel added that its research 'suggests that this practice is not common in modern deeds, but is still present in some older deeds': Super System Review, *Final report: Part two—recommendation packages*, June 2010, p. 60.

4.4 A recent working paper co-authored by a researcher at the University of New South Wales and an APRA staff member investigated whether the 'relatedness' of the trustee and insurance provider has an impact on members' net insurance costs. The paper focused on 52 retail sector funds,[2] of which 19 were related to an insurance company and were nominated to provide insurance to fund members. Eight of the 19 trust deeds required the trustee to use the related insurance company, referred to by the paper as 'bound funds'. The researchers found that:

> … the most relevant characteristic is whether the trust deed establishing the superannuation fund required the trustee to use a related insurance provider … Members of bound funds purchase more insurance than their counterparts in non-bound funds … a member of the median bound fund pays average annual premiums of $252, or roughly twice the average across all other types of funds. However, the benefits received by the fund are only approximately 20 per cent more on a per capita basis. Expressed as the ratio of premiums paid to benefits received, $2.72 in premiums is collected for every dollar of benefits received by the median bound fund. For the median funds in the three non-bound categories, the same ratio ranges between $1.57 and $1.84'.[3]

4.5 The bill proposes to amend the SIS Act to override any provisions in the governing rules of a RSE that require the trustee to use a specified service provider, investment entity or financial product.[4] The proposed amendments do not apply to SMSFs.[5] The explanatory memorandum suggests that the measures 'will restore a trustee's discretion to act in the best interests of members when entering into relevant arrangements'. It provides further detail about the consequences of the amendments:

> The amendments do not require termination of contracts giving effect to arrangements required under a fund's governing rules. However, trustees will be required to determine whether the continuation of the arrangements is consistent with the obligation to act in the best interests of members. Arrangements that can be demonstrated to be in the best interests of members can continue. Arrangements determined not to be in members' best interests will not be able to continue when the current period of a relevant contract comes to an end.
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> If the costs of changing from the current service provider outweigh potential benefits to members then it is possible for trustees to conclude that

2 As not-for-profit funds did not use related insurance providers.

3 Kevin Liu and Bruce R Arnold, 'Superannuation and insurance: Related parties and member cost', *APRA working paper*, November 2012, pp. 1, 2. The paper was also referred to by the Minister in their second reading speech on the bill: see *House of Representatives Hansard*, 29 November 2012, p. 13896.

4 Schedule 1, item 72, proposed section 58A.

5 Schedule 1, item 72, proposed subsection 58A(1).

> the arrangement is in the best interests of members and no change would be required.[6]

### *Views of stakeholders*

*Existing contracts and MySuper products*

4.6 In its submission, the AIST indicated its support for these amendments, noting that the result will be that 'superannuation funds will not be able to have cosy arrangements with service providers that are not in the best interests of members'.[7] It did, however, argue that in situations where arrangements have been determined not to be in members' best interests, yet the services or investments may continue to be provided until the current period of the contract comes to an end, legislation should explicitly preclude the provision of such services or investments to a member who has an interest in a MySuper product:

> An existing and continuing contract not in a member's interest should not be permitted to apply in relation to members with an interest in a MySuper product. Under subsection 29VN(a) a trustee must promote the financial interests of members of a MySuper product. It would be inconsistent with subsection 29VN(a) if an existing agreement arising from a requirement to contract with a specific service provider was permitted to continue operating if it is adverse to the financial interests of members of a MySuper product. Any other outcome would not be consistent with a fundamental tenet of the MySuper regime.[8]

4.7 The Industry Super Network similarly argued for the bill to be amended to result in existing contracts that are not consistent with the best interests of MySuper beneficiaries being discontinued.[9]

*'May or must' and making void entire provisions of a fund's governing rules*

4.8 As noted above, the proposed amendments follow a recommendation of the Cooper Review. The Cooper Review was concerned about provisions of a fund's governing rules 'mandating' or that 'requires' the trustee to use a specified service provider.[10] Accordingly it recommended that these types of provisions be overridden. To give effect to this, proposed section 58A of the bill identifies provisions of a fund's governing rules which state that the trustee 'may' or 'must' use a specified service provider. These types of provisions would be made void. To illustrate, below is proposed subsection 58A(2), one of the provisions that includes the phrase 'may or must':

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6 Explanatory memorandum, paragraphs 1.8–1.10.

7 Australian Institute of Superannuation Trustees, *Submission 8*, p. 4.

8 Australian Institute of Superannuation Trustees, *Submission 8*, p. 4.

9 Industry Super Network, *Submission 5*, p. 1.

10 Super System Review, *Final report: Part two—recommendation packages*, June 2010, p. 60.

> A provision in the governing rules of a regulated superannuation fund is void if it specifies a person or persons (whether by name or in any other way, directly or indirectly) from whom the trustee, or one or more of the trustees, of the fund may or must acquire a service.[11]

4.9 According to the explanatory memorandum, the bill has been drafted to override provisions that state that a particular entity 'may' be used as well as those that state a particular entity 'must' be used to ensure 'that the requirements of the provision cannot be avoided through a clause that confers power to use particular named entities which might have the effect of encouraging or sanctioning the use of those entities instead of considering other options in the market'.[12]

4.10 This aspect of the bill's drafting was challenged by some stakeholders. The Law Council suggested that the words 'may or' be omitted from the phrase 'may or must'. It argued that 'it should be acceptable for a particular provider, entity or product to be named in the governing rules as an option for the trustee to consider … so long as the trustee is not compelled to use that named provider, entity or product'.[13] The Financial Services Council similarly raised concern with the drafting of this provision; while supportive of the policy intention, it suggested that it would be preferable for the drafting to be 'unambiguous' by solely using the word 'must'.[14]

4.11 The Law Council also disputed the analysis provided in the explanatory memorandum (see paragraph 4.9 above), stating in its submission that the provision in the bill would not have the effect that is described in the explanatory memorandum. The Law Council provided the following reasoning, highlighting the implications for the trustee's ability to consider the use of associated parties, among other service providers:

> A provision in a trust deed which authorises a trustee to, say, invest in a life policy issued by a named person or any other investment does not relieve the trustee of its obligation to consider an appropriate range of investments. The provision may have been included, not so as to avoid the trustee considering other investments, but rather to give permission to the trustee to invest in a policy issued by a person which might otherwise be prohibited, for example because of a conflict of duty or interest where the life company is related to the trustee.[15]

4.12 ASFA also indicated that, in its view, 'may or must' should be replaced with 'must'. To explain ASFA's concern, its CEO posed the question '[w]hat is the ill that is trying to be resolved here?':

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11 Schedule 1, item 72.

12 Explanatory memorandum, paragraph 1.12.

13 Law Council of Australia, *Submission 2*, p. 3.

14 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 22 January 2013, p. 3.

15 Law Council of Australia, *Submission 2*, p. 3.

> If a trustee 'must' use a third-party provider no matter what then that is an issue. That is not in the best interests. If a provider 'may' use a third party after proper assessment, appropriate review, appropriate monitoring, then they should be allowed to do that and that is the outcome that we want to achieve.[16]

4.13 After reflecting on the Law Council's evidence, the Industry Super Network also subscribed to this argument:

> We think the term 'must' is appropriate in legislation, that you must not insert those obligations within the trust deeds. Having a requirement that you may is a bit nebulous in itself—and you may or may not. To take the Law Council's point, I think it might be too fine a point.[17]

4.14 The committee pressed witnesses for further detail about the practical issues that a provision which included the words 'may or must' would create. ASFA advised that potential liability about the use of an associated party was a key concern in an industry that is 'very, very conservative':

> There is always a question mark when you use a third party. The need to actually prove that they are the best is difficult. To be able to safely assess your associated parties, if I were a trustee and on behalf of the industry, I would want that bit of a safety net. We are in a litigious time. A lot of these entities are vast and with deep pockets. You do not want a situation where there is so much fear of being automatically litigated against for using a third party that you deliberately do not use an associated third party and you go to someone else. I think it is very important to have that safety net, and I think that is the fundamental concern of everybody.[18]

4.15 The usage of the term 'may' to enable the use of associated parties was also raised by specific industry participants, such as the Commonwealth Bank of Australia, which advised the committee that it frequently uses the term 'may' in its deeds:

> The use of the term 'may' is currently a standard feature (or inclusion, etc) in the conflict of interest clause used in our Trust Deeds in order to overcome any risk in permitting the use of related parties. For example, a standard conflict clause would prescribe that the trustee may deal with itself, contract with any person associated with the fund and transact or deal with a related party. Moreover, our authorised investment, administration, investment management and custodian clauses may also be adversely impacted by the amendment.[19]

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16 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 9.

17 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 23.

18 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, pp. 9–10.

19 Commonwealth Bank Group Wealth Management, *Submission 6*, p. 3.

4.16 Treasury was questioned about why the phrase 'may or must' has been used. A Treasury officer began by posing the question: 'what does the provision in the governing rules that says a trustee 'may' use a particular service provider actually do'? The answer provided by the Treasury officer was as follows:

> On one view it is doing nothing, because of course a trustee may use any particular provider in the market, in which case, if it is not really doing anything, voiding that provision should also cause no concern. But if those provisions are actually doing some work—if they are giving a trustee permission to use a service provider that, due to other considerations like conflicts of interest, it may otherwise not be permitted to use—then in fact that is also a provision that the bill seeks to void so that, again, the trustee's ability to consider what is in the best interests of members is not compromised or fettered in any way at all. So that is the reason why the approach in the bill refers to both 'must' and 'may'. It is basically ensuring there is no compromising or fettering of the trustee's consideration of what is in the best interests of members in selecting service providers.[20]

4.17 However, it was also suggested that permitting provisions in governing rules that specify persons or entities which may be used poses a relatively low risk to the intent of the bill not being realised. The Law Council argued that trustees cannot be subject to direction. Once provisions that require that a trustee must use a particular person or entity are removed, the trustee would have to exercise their discretion in accordance with their obligation to act in the best interest of members regardless on any provision that indicated a specified person or entity may be used:

> … if there is a genuine option then the trustee has to exercise that discretion properly. So I can see why the perception would arise, but I think that at law, even if there were a named party as an option, the trustee would still have to exercise their discretion and they would still have to consider what other service providers could provide the service in the interests of the members.[21]

4.18 Despite the strong concerns raised by some stakeholders, others were less concerned about the possible consequences of the proposed amendments. The AIST suggested that as part of the transition to MySuper, the trust deeds could be amended if there was concern about the implications that this aspect of the bill would have:

> Having gone through the process of reviewing the appropriateness of all of the service provider arrangements, in the event that an existing contract was found not to be in the best interests of members, I would anticipate that trustees would take whatever steps are open to them to adjust the terms of those agreements. For the sake of completeness, those trustees may also amend their trust deeds, notwithstanding the operation of this act in that

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20 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 31.

21 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 18.

> area but just to make sure that there is consistency between the legislation and its requirements and their trust deeds. They may make amendments to that trust deed to remove those provisions.[22]

*Provisions being voided in their entirety*

4.19 Both the Financial Services Council and the Law Council argued that the bill appears to void entire provisions of the governing rules, and that this notion should be replaced with drafting that would void the offending provision to the extent that it compels a trustee to use a particular provider, entity or financial product. One aspect of the Financial Services Council's argument relates to the 'may or must' issue discussed above:

> … where a provision in a clause contains various elements relating to related parties, as would be the case with a standard type of conflicts clause, the entire clause may be rendered void. Such a provision will be included in the Deed to overcome any risk involved in permitting (not compelling) the use of related parties. These types of clauses are included for prudence and clarity. However, if the clause is rendered void then this will raise considerable legal risk as to whether a related party can be used at all.[23]

4.20 The Law Council's representative at the public hearing, however, advised that they had reviewed provisions in a trust deed where service providers are named and 'what ends up happening is that that clause might be the only investment power'. In these cases, the witness suggested that if the provision is made void in its entirety:

> … the trustee ends up with no investment power whatsoever and then is forced back onto the old Trustee Acts, whereas, if it were voided to the extent that it required investment in a particular service provider, you would be left with the balance of that clause able to operate and give the trustee its investment power.[24]

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22 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 29.

23 Financial Services Council, *Submission 7*, p. 5. The Financial Services Council gave three examples of types of clauses in a trust deed that may be affected by the proposed amendment: conflict clauses (a clause which provides that the trustee may deal with itself, contract with any person associated with the fund and transact or deal with a related party); authorised investments clauses (a clause which provides that the trustee may invest in a fund of which the trustee or a related party is the manager, operator or trustee or invest in an insurance policy where the trustee or a related party is the insurer; and administration/investment management/custodian clauses (a clause which provides that the trustee may use the services of a related party administrator/investment manager/custodian). *Submission 7*, p. 6.

24 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 18.

4.21 Treasury was asked about this issue and acknowledged that the interpretation of this provision may need to be considered further.[25]

***Committee view***

4.22 The committee is concerned about the unintended consequences that could arise from entire provisions of a fund's governing rules being made void by the proposed amendments. The committee considers that such a provision should be made void to the extent that it compels a trustee to use particular service providers, entities or financial products. The committee notes that this drafting approach is commonly taken; for example, it was used in other provisions of the bill as well as in the Trustee Obligations Act.[26]

4.23 The committee appreciates the arguments made by stakeholders regarding the use of the phrase 'may or must'. The committee acknowledges that it is a provision in the governing rules that requires that trustees *must* use specified persons or entities that is clearly unlikely to be in the members' interests, as these types of provisions explicitly remove the trustee's discretion. To ensure that the amendments will be effective, however, it is important to void arrangements that may, as the explanatory memorandum suggests, encourage or sanction the use of particular service providers.

**Recommendation 8**

**4.24 That schedule 1, item 72, proposed subsections 58A(1), (2), (3) and (4) be amended by inserting text that specifies that a provision in the governing rules of a regulated superannuation fund will only be void *to the extent* that it would require that a trustee may or must use a specified service provider or investment entity, or that a trustee may or must invest in or purchase a specified financial product.**

## Dual regulated entities

4.25 In a superannuation context, dual regulated entities refer to RSE licensees that manage RSEs and are also the responsible entities of one or more non-superannuation registered managed investment schemes.[27] The committee's recent inquiry into the collapse of Trio Capital noted that Trio was both a licensed superannuation fund

25 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 32.

26 Schedule 1, item 73, proposed subsection 68C states: 'A provision in the governing rules of the fund is void to the extent that it purports to preclude a director of the trustee from voting on a matter relating to the fund'. Section 29VQ of the SIS Act (introduced by the Trustee Obligations Act) states: 'A provision of the governing rules of a regulated superannuation fund is void to the extent that it is inconsistent with: (a) the obligations that apply to a trustee of the fund under section 29VN; or (b) if the trustee of the fund is a body corporate—the obligations that apply to the directors of the body corporate under section 29VO'.

27 Explanatory memorandum, paragraph 4.3.

trustee and the responsible entity for several managed investment schemes. ASIC noted in its submission to that inquiry that there are approximately 33 dual regulated entities.[28]

4.26 Dual regulated entities are regulated by APRA for matters relating to superannuation. However, the entities are also regulated by ASIC as they are required to hold an Australian Financial Services Licence issued by ASIC and, therefore, must comply with a number of obligations under section 912A of the Corporations Act. In particular, paragraphs 912A(1)(d) and (h) of the Corporations Act requires licensees to have:

- available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and
- adequate risk management systems.

4.27 However, these provisions of the Corporations Act do not apply to bodies regulated by APRA. Accordingly, a gap in regulatory coverage exists which the bill proposes amendments to the Corporations Act to address.[29] A Treasury officer provided a further explanation of the issue addressed by this measure:

> The concern that was initially raised by Cooper but that the government has taken action on here is that APRA's focus in looking at what is the appropriate level of financial requirement is reasonably limited to the superannuation business—that is their expertise, that is their prudential role: looking at the superannuation operations. They did not look at non-superannuation business of this particular dual-regulated entity [the managed investment scheme(s)].[30]

4.28 If the bill is passed, dual regulated entities will be required to meet the Corporations Act's adequate resources and risk management systems requirements, although risks that relate solely to the operation of a regulated superannuation fund by the entity will be excluded.[31]

### *Views of stakeholders*

4.29 This amendment is supported by the AIST and the Industry Super Network.[32] The AIST stated that it is 'an anomaly that the non-superannuation businesses of RSE

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28 Australian Securities and Investments Commission, *Submission 51* to the Parliamentary Joint Committee on Corporations and Financial Services' inquiry into the collapse of Trio Capital and any other related matters, September 2011, p. 96.

29 Explanatory memorandum, paragraph 4.7.

30 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 33.

31 Schedule 1, items 4 and 5.

32 Australian Institute of Superannuation Trustees, *Submission 8*, p. 5; Industry Super Network, *Submission 5*, p. 2.

licensees are not required to ensure that adequate resources or risk management systems are maintained in respect of these businesses'.[33] The AIST also highlighted some of the potential administrative benefits of this amendment for participants in the sector:

> A difficulty at the moment—and I have been in a situation of managing organisations that are regulated in different ways—is that a fund can actually be maintaining separate documents covering resource adequacy across different types of entities. To have a risk management strategy that is submitted to APRA that covers all of the entities for which you have a responsibility actually makes life easier for a trustee and would have made life easier for me as a trustee when I had responsibility for such entities.[34]

4.30 Other stakeholders that commented on these provisions recognised the rationale for the proposed amendments, but expressed concerns about unintended consequences. In its submission, the Financial Services Council stated:

> It is likely that the removal of the exemption will duplicate requirements and require a substantial increase of financial resources to be held by dual regulated entities. For example, many of our members have indicated that the removal of the exemption effectively doubles the capital reserve that must be held against their RSE and RE businesses—this may be onerous in light of APRA's new operational risk reserve requirements. We estimate the increase in capital required across the wealth management industry will be hundreds of millions of dollars.[35]

4.31 This matter was also discussed at the public hearing, with the Financial Services Council providing the following additional evidence on the issue:

> For instance, for managed investment scheme operators for the life insurance industry or for the superannuation industry there appear to be different types of requirements and measures applicable for different kinds of entities so that does give rise potentially to regulatory arbitrage. So although we support the removal of the exemption of fiscal regulated entities, we think it important that there be a coordinated and consistent approach across all the regulated entities in the industry. Secondly, where there is a potential for double counting, which is explained in our submission, there should be a provision made for entities to have an allowance for double counting where the risks are the same and the assets are the same and they are able to hold a lower level of capital giving regard to the lower level of risk related to that measure.[36]

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33 Australian Institute of Superannuation Trustees, *Submission 8*, p. 5.

34 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 26.

35 Financial Services Council, *Submission 7*, p. 4.

36 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 22 January 2013, pp. 1–2.

4.32 ASFA recommended that the provisions be redrafted to 'ensure that the same resources and/or risk management mechanisms can be utilised to offset the same risk in different businesses and that additional resources/mechanisms would be required only to the extent that the risks differ'. Specifically, it argued that the word 'solely' in proposed paragraph 912A(4)(b) 'may not recognise the extent to which resources can be used to address risk which relate to super and non-super business', necessitating that entities hold resources and establish risk management systems that are differentiated for superannuation and non-superannuation purposes.[37] The Financial Services Council, however, suggested that an alternative option could be to stipulate in the explanatory memorandum that the regulator should develop a framework in their regulatory guidance.[38]

4.33 A Treasury officer noted that as a result of the consultation undertaken on the exposure draft of the bill the commencement date of this measure has been extended by one year to 1 July 2015. The Treasury officer advised the committee that APRA and ASIC will work together and with the sector to 'reach a sensible and workable solution as to how the respective requirements will deal with the concerns that have been raised'. Moreover, the Treasury officer stated:

> The actual financial requirements each regulator comes up with are not hard-wired in legislation; they are left for the regulators themselves to develop, and often … [they] will look at particular circumstances on the particular facts of an entity. So it is very difficult to hard-wire legislative rules that will deal with the potential range of circumstances here. So the approach at the moment is to give more time for the regulators to consult with industry, come up with some workable solutions and then give some lead time for these entities to transition to the new approach if there are in fact additional financial requirements. But I think there is reasonably widespread acceptance that closing this regulatory gap is a sensible thing to do.[39]

### *Committee view*

4.34 The committee considers that addressing the regulatory gap in the treatment of dual regulated entities is a prudent measure that should be supported. This gap in the regulatory framework was of concern to the committee during its inquiry into the collapse of Trio Capital. It is important that tighter resource and risk management strategies are in place to ensure that dual regulated entities meet the adequate resources requirements in the Corporations Act.

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37 Association of Superannuation Funds of Australia, *Submission 10*, p. 4 (emphasis omitted).

38 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 22 January 2013, p. 2.

39 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 33.

4.35 The concerns raised by stakeholders have been considered, however, the committee agrees with Treasury that the legislation provides a framework for addressing the regulatory gap; the specific financial requirements are best resolved between industry and the regulators. In this regard, the deferred start date is particularly important as there will be sufficient time for the issues to be thoroughly considered and for the necessary regulatory requirements to be developed. If, after this process, there is an issue that needs to be addressed by legislation, APRA and ASIC will be able to advise the government accordingly.

## Restricting voting prohibitions

4.36 The final report of the Cooper Review stated:

> It has been brought to the Panel's attention that not all independent trustee-directors are presently afforded the right to vote on trustee company business under the terms of the company constitution. While the Panel questions the validity of such a provision, it believes that it is important that all trustee-directors be eligible to vote on all company business (subject to any conflicts) and, consequently, any trustee company constitution provision to the contrary should be ineffective.[40]

4.37 The bill proposes amendments to make void any provision in the governing rules of an RSE to the extent that it precludes a director of a corporate trustee or an individual trustee from voting on a matter relating to the fund.[41] These amendments do not cover situations where the director has a material personal interest or a conflict of duty or interest. They also do not apply to provisions precluding a trustee from exercising a casting vote or that ensure compliance with a prudential standard that deals with conflicts of interest or duty. Based on the evidence received by the committee, these amendments appear to be supported by stakeholders.

## Other and consequential amendments

4.38 Other measures and consequential amendments proposed by the bill include:

- clarifying the definition of superannuation contributions in the Corporations Act 'to ensure defined benefits are treated consistently with superannuation contributions in the event of an insolvency';[42]
- in relation to the disqualification of an individual from being or acting as a trustee or responsible officer, the term 'fitness and propriety' will be referenced to the criteria used in APRA's prudential standards, to enable the court to consider relevant criteria in the prudential standards;

40 Super System Review, *Final report: Part two—recommendation packages*, June 2010, p. 56.

41 Schedule 1, item 73, proposed sections 68C and 68D.

42 Explanatory memorandum, paragraph 6.4.

- inserting other references to the prudential standards developed by APRA, such as the eligibility criteria for auditors and actuaries, to indicate that these matters will be addressed by APRA; and
- regarding the obligation to retain members in a MySuper product unless they have consented in writing to be transferred, inserting an option to be exercised at the trustee's discretion for a member's beneficial interest to be moved to another class of beneficial interest in the fund where the member has died.[43] Criteria that will need to be met before this can occur will be prescribed in the regulations.

## Evidence from stakeholders on other aspects of the MySuper legislative package

4.39 Given that this bill has been described as the final legislative tranche of the MySuper and governance reforms, a number of submissions raised issues that were not addressed by this bill. This section discusses two of the key issues relating to the broader package that were discussed at the public hearing, namely the product dashboard and percentage-based administration fees.

### *Product dashboard*

4.40 The Cooper Review noted that the quality and usefulness of current information disclosure requirements regarding investment objectives and risk 'is limited, resulting in a lack of trustee accountability on the performance of investment options'.[44] The Review recommended that in addition to current product disclosure requirements, a simple, standardised, plain-English 'product dashboard' should display this information. The Further MySuper Act addressed this recommendation by requiring trustees to publish a product dashboard for each of the fund's MySuper and choice products on their website. In its October 2012 report on that legislation, the committee concluded that 'the case for introducing a product dashboard for each of a fund's MySuper products is compelling', but observed:

> … the negotiations with APRA that began in September 2012 appear to have uncovered several areas of potential difficulty and confusion. It urges APRA in further consultations with stakeholders to examine these issues carefully. The prime consideration must be the usefulness of the

43 Schedule 1, item 39, proposed paragraph 29TC(1)(g). The explanatory memorandum states that '[g]iving trustees discretion will mean the trustee could put the money into a cash option such as bank deposits or Government bonds. This could be done to reduce risk and preserve the balance accumulated by the member until a beneficiary can be identified and the benefits paid out, which in some cases may take several years'. Explanatory memorandum, paragraph 6.47.

44 Super System Review, *Final report: Part two—recommendation packages*, June 2010, p. 113.

information to members and to ensure that any confusion that may arise from information through other sources is minimised.[45]

4.41 The committee recommended that APRA continue its consultation with stakeholders on the product dashboard with a view to considering:

- a requirement that the investment return target be net of investment and administration fees;
- how best to quantify the likelihood of a negative return as part of the risk measure;
- a clear definition of the liquidity; and
- the options to minimise discrepancies between the information in the product dashboard and the information contained in the new short product disclosure statement regime.[46]

4.42 In its submission to the committee for this inquiry, ASFA outlined a number of issues with the product dashboard that it believes need to be resolved. ASFA's concerns were about:

- the requirement to update information about the average amount of fees and other costs as a percentage of the assets of the fund within 14 days after the end of each quarter, which ASFA argued is too short;
- the requirement to update information (other than the average amount of fees and other costs) within 14 days after any change to the information, an obligation which ASFA argued was unclear;
- how the investment return target is to be determined and whether the number of times the target has been achieved is meaningful (or even if it is misleading);
- the definition and measurement of the level of investment risk;
- how liquidity will be measured for the statement about liquidity; and
- the average amount of fees and other costs in relation to the product, specifically the possibility of double counting and the treatment of cost recovery.[47]

45 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012*, October 2012, p. 37.

46 Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012*, October 2012, pp. 37–38 [recommendation 1].

47 Association of Superannuation Funds of Australia, *Submission 10*, pp. 7–10.

4.43 Given its earlier recommendation, the committee was interested in exploring how the matter had progressed since October 2012. A degree of urgency for finalising product dashboard issues was expressed by the Industry Super Network:

> Senator BOYCE: You have spoken a little bit about the product dashboard issues and the unresolved issues there. You say they must be addressed in tranche 4 of the Stronger Super legislation. My question is: why? Why do you say it must be addressed in tranche 4?
>
> Mr Watts: That is because primarily the industry as a whole is designing product now, preparing their products for market, and these are important issues that need to be resolved as soon as possible. The product dashboard issues, in terms of implementation, are going to take some time for the industry to resolve, and we need to have those issues resolved as soon as possible.[48]

4.44 The AIST confirmed that its views on product dashboard issues were essentially the same as the Industry Super Network's. The AIST's representative advised that:

> … there is a large measure of common ground in the discussions that the industry has been having with the government and regulators about dashboard issues. We look forward to concluding these discussions over the next fortnight and are hopeful that this will see a resolution of the product dashboard matters raised in our submission and we anticipate—or are hopeful at least—that these may result in the government making some amendments to the legislation.[49]

4.45 Treasury confirmed that work on the product dashboard was progressing, with a meeting with stakeholders about the issue being held on 21 January 2013:

> Mr Rollings: When the tranche 3 bill was in parliament, the minister indicated a willingness to continue to consult with industry on the issues around the product dashboard. Several of the submissions to this committee on this bill have raised issues in relation to the product dashboard, and essentially it was those issues that were discussed. They were around the five proposed elements of the dashboard: firstly, whether the principle enunciated in the legislation is correct; and, secondly, where there is a methodology for calculating the relevant entry in the dashboard and those methodologies are largely being determined by APRA through their reporting standard process, whether the methodologies that APRA had consulted on are appropriate. So really the focus was on whether the legislation around the dashboard needed further refinement and then, flowing from that, whether APRA's approaches to methodologies also needed to be reconsidered.

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48 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 23.

49 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 26.

> Senator BOYCE: Will the legislation around the dashboards be settled by tranche 4?
>
> Mr Rollings: Certainly that is the hope. I think other witnesses have indicated an optimism that there is a broad degree of consensus around directions on these things. As to whether amendments are brought forward, that is a matter for the government. Certainly I would be optimistic that we are not far away from resolution on those issues.[50]

### *Capping administration fees*

4.46 The issue of administration fees was also raised in evidence. Stakeholders that discussed this issue recognised that the administration costs associated with a member's account do not increase directly in proportion to a growing balance, and that there is ultimately a maximum cost related to administration. ASFA advised that many funds currently determine administration fees by reference to fee scales or by capping the maximum fee that can be charged. For example, a fund may calculate the administration fee by reference to a fixed percentage of assets on the first $100,000 of the account balance, a lower percentage on the next $100,000 and no fee on any remaining balance.[51]

4.47 However, the Core Provisions Act introduced a requirement that the fees charged to members of a MySuper product must be in accordance with one of three fee charging rules, namely a flat fee, a percentage fee (also referred to as an asset-based fee) or a flat fee plus a percentage fee. For any fee charged to all members of a MySuper product, the same charging rule must be applied. For example:

> [I[f one member is charged a percentage of their account balance in relation to the MySuper product as an administration fee, then each member of the MySuper product should be charged the same percentage of their account balance in relation to the MySuper product at the same point in time. This is to avoid any discrimination on the process under which a member is charged a fee.[52]

4.48 The amendments made by the Core Provisions Act do not provide for the capping of a percentage-based fee. According to the AIST, this would have undesirable implications for administration fees that were percentage-based without being subject to a cap:

> Members of a fund might, for example, be subject to a fee of 1%. This would mean that a member with an account balance of $10,000 would be subject to a fee of $100, whereas a member with $1 million would be subject to a fee of $10,000. It is obvious that the cost to administer an

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50 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 37.

51 Association of Superannuation Funds of Australia, *Submission 10*, p. 2.

52 Revised explanatory memorandum, Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012, paragraph 6.14.

> account for a member with a $1 million account balance is much less than this.[53]

4.49 At the public hearing, an AIST representative argued that the arrangements could result in members who currently have a higher account balance with capped administration fees paying more in a MySuper product and 'in some cases, much more than they do in the fund's existing default options'.[54] ASFA and the Industry Super Network provided similar arguments about the desirability of a cap on percentage-based administration fees.[55] However, a Treasury officer advised that concern about this issue in the industry 'is not across the board' and that there are 'some competing considerations on this issue'. The Treasury officer provided a summary of the reason behind the approach to fees:

> The goal here is not to have different tiers or classes of members within MySuper—first-class members and second-class members. Prima facie, the ability to have tiered pricing arrangements opens the door for that kind of outcome. I am not saying it would be impossible to deal with that, but there is a complexity, once you allow caps, to ensure that they are applied in an equitable way.[56]

4.50 Recognising the argument that administration costs may not increase in direct proportion to the size of a member's account balance, and therefore that asset-based administration fees may be inappropriate, Treasury observed that 'there are options at the trustees' disposal … [to] recalibrate their fee structure'.[57]

### *Committee view*

4.51 In undertaking this inquiry, the committee has focused on the provisions that are contained in the bill. The committee understands why stakeholders have raised additional issues at this time, and it sees merit in some of the arguments put forward. The committee has been interested in ensuring that the product dashboard operates effectively and provides useful information. On the issue of administration fees, the committee understands the rationale that members should be charged fees on a consistent basis. However, the arguments put to the committee that suggest the application of this principle to administration fees may have adverse consequences for some members also appear sound.

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53 Australian Institute of Superannuation Trustees, *Submission 8*, p. 11.

54 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 26.

55 See Industry Super Network, *Submission 5*, p. 10; Association of Superannuation Funds of Australia, *Submission 10*, p. 2.

56 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 34.

57 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 35.

4.52 The committee also understands, however, that the government has been in ongoing consultation with the sector regarding some of these issues. On the product dashboard, the Minister for Superannuation and Financial Services noted during the debate on the Further MySuper Bill the continuing discussion with industry regarding the practical operation of the product dashboard. The Minister advised that it is likely that amendments to clarify the requirements will be required.[58] The committee notes that Treasury has been engaging with stakeholders on these issues, including as recently as 21 January 2013.

4.53 The committee commends the government for its ongoing consultation with the industry to ensure that the legislation will operate as effectively as possible. The committee notes that stakeholders have also expressed their appreciation for the government's receptiveness to the issue that have been raised. For example, a representative of the Industry Super Network stated that the ongoing discussions and consultations with the government, Treasury and the regulators:

> … have been very productive and fruitful and have concentrated on a practical resolution of industry concerns. They have also acted, I think, as a conduit for the industry itself to get together to resolve some of these issues and concerns amongst themselves and come up with practical joint solutions. So we would like to thank the government for coordinating those consultations.[59]

4.54 Given the consultation occurring between the government and industry, the committee does not consider it prudent or necessary for it to recommend that new measures be inserted into the bill, although the committee encourages the government to carefully consider the issues related to the product dashboard and administration fees, and to expedite any further changes that are being developed.

## Concluding comments

4.55 This bill will implement a number of important measures that will add to or support the government's MySuper and other superannuation governance reforms. This bill is part of a significant reform to Australia's superannuation system that will replace existing default superannuation products with one that is designed to be simple and cost-effective. The reforms will also result in the governance and integrity of the superannuation system being strengthened.

4.56 The committee supports the passage of the bill. There are, however, some amendments of a technical or drafting nature that the committee has proposed throughout this report. The recommendations do not, in the committee's view, diverge from the policy intent behind the bill but, rather, are intended to improve how the legislation will operate.

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58 The Hon. Bill Shorten MP, *House of Representatives Hansard*, 28 November 2012, p. 13782.

59 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 19.

4.57 This inquiry has provided stakeholders with another opportunity to inform the final form of the MySuper legislation. The committee takes this opportunity to thank the stakeholders who engaged with the committee during this inquiry, as well as during the committee's previous inquiries into the earlier tranches of legislation.

**Recommendation 9**

**4.58 After due consideration of recommendations 1–8, the committee recommends that the bill be passed.**

**Deborah O'Neill MP**
**Chair**