



## Parliamentary Joint Committee on Corporations and Financial Services

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Superannuation Legislation Amendment (Service Providers  
and Other Governance Measures) Bill 2012

February 2013

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## Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

- (a) to inquire into, and report to both Houses on:
  - (i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or
  - (ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and
- (b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and
- (c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.



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## Abbreviations

|                         |                                                                                                                 |
|-------------------------|-----------------------------------------------------------------------------------------------------------------|
| ACCC                    | Australian Competition and Consumer Commission                                                                  |
| ACCI                    | Australian Chamber of Commerce and Industry                                                                     |
| AIST                    | Australian Institute of Superannuation Trustees                                                                 |
| APRA                    | Australian Prudential Regulation Authority                                                                      |
| ASFA                    | Association of Superannuation Funds of Australia                                                                |
| ASIC                    | Australian Securities and Investments Commission                                                                |
| ATO                     | Australian Taxation Office                                                                                      |
| CCA                     | <i>Competition and Consumer Act 2010</i>                                                                        |
| CEO                     | Chief executive officer                                                                                         |
| Cooper Review           | The review into the governance, efficiency, structure and operation of Australia's superannuation system (2010) |
| Core Provisions Act     | <i>Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012</i>                                  |
| Corporations Act        | <i>Corporations Act 2001</i>                                                                                    |
| FSCOD Act               | <i>Financial Sector (Collection of Data) Act 2001</i>                                                           |
| Further MySuper Act     | <i>Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012</i>                |
| RSE                     | Registrable superannuation entity                                                                               |
| SCT                     | Superannuation Complaints Tribunal                                                                              |
| SIS Act                 | <i>Superannuation Industry (Supervision) Act 1993</i>                                                           |
| SIS Regulations         | Superannuation Industry (Supervision) Regulations 1994                                                          |
| SMSF                    | Self-managed superannuation fund                                                                                |
| Super System Review     | see Cooper Review                                                                                               |
| TPD                     | Total and permanent disability                                                                                  |
| Trustee Obligations Act | <i>Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012</i>             |



## **List of recommendations**

### **Recommendation 1**

**2.47 That schedule 1, item 74 be amended to require that for a notice in writing from an eligible person to a trustee given in accordance with proposed paragraph 101(1)(d) to be valid:**

- **for complaints regarding total and permanent disability claims, it must be given within six years from the time of the decision; and**
- **for other complaints, it must be given within 12 months of the trustee's decision.**

### **Recommendation 2**

**2.48 That the government amends the Corporations Regulations 2001 to require that when a decision is made in relation to a non-death benefit complaint, the trustee must give the eligible person information about how they can request reasons for the decision.**

### **Recommendation 3**

**3.24 That:**

- **proposed paragraph 224A(1)(e) be amended to omit 'brief'; and**
- **proposed section 224A be amended to require that an infringement notice must contain any other information specified by the regulations.**

### **Recommendation 4**

**3.32 That schedule 1, item 112, proposed subsection 224A(2) be amended to provide that:**

- **for offences, the amount to be stated in the notice for the alleged contravention of the provision must be equal to one-fifth of the maximum penalty that a court could impose on the person for that contravention; and**
- **for civil penalty provisions, the amount to be stated in the notice for the alleged contravention of the provision must be equal to one-fortieth of the maximum penalty that a court could impose on the person for that contravention.**

### **Recommendation 5**

**3.41** That prior to the commencement of the provisions in the bill that will establish an infringement notice regime, the Australian Prudential Regulation Authority publishes guidance on the approach it will take to exercising its discretion to issue, withdraw and correct those notices.

### **Recommendation 6**

**3.48** That proposed subparagraph 223A(1)(i) contained in schedule 1, item 112 of the bill be amended by omitting 'subsection 242M(1)' and substituting 'subsection 242P(1)'.

### **Recommendation 7**

**3.51** That the bill be amended to omit schedule 1, item 71.

### **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.

### **Recommendation 9**

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

# Chapter 1

## Introduction

1.1 On 29 November 2012, the House of Representatives referred the Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012 to the committee for inquiry and report. The committee resolved to table its report by 5 February 2013.

1.2 The bill is the fourth tranche of legislation implementing the MySuper and governance elements of the Stronger Super reforms. This inquiry continues the committee's scrutiny of the legislation that will give effect to these reforms; the earlier tranches of legislation have been the subject of previous inquiries by this committee, and readers can view those reports on the committee's website. The earlier tranches are referred to throughout this report, and for reference are listed below:

- *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* (Core Provisions Act);
- *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Trustee Obligations Act); and
- *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Further MySuper Act).

1.3 Included in this bill are a range of distinct and unrelated measures that form part of the MySuper and governance reforms but which were not addressed by the earlier legislation. The bill includes proposed amendments that would:

- implement certain recommendations of the 2010 final report of the review into the governance, efficiency, structure and operation of Australia's superannuation system (also referred to as the Super System Review or the Cooper Review);
- address concerns raised by the superannuation sector about how some aspects of the earlier tranches will operate; and
- make consequential amendments to ensure the effective operation of the first three tranches of legislation.

1.4 Specifically, this latest bill proposes to amend the *Superannuation Industry (Supervision) Act 1993* (SIS Act), the *Corporations Act 2001* and other Acts to:

- override any provisions in a fund's governing rules that require the trustee to use a specified service provider, investment entity or financial product;
- provide the Australian Prudential Regulation Authority (APRA) with the power to issue infringement notices for certain breaches of the SIS Act;
- require persons to seek leave of the court before bringing action against an individual director for a breach of their duties;

- extend legal defences available for trustees and directors to proceedings involving breaches of MySuper obligations;
- amend existing defences related to the making of an investment or the management of reserves;
- require trustees to provide reasons for decisions made in relation to a complaint;
- increase the time limit for members to lodge complaints with the Superannuation Complaints Tribunal;
- apply the Corporations Act's requirements for adequate resources and risk management systems to dual regulated entities;
- provide that directors of corporate and individual trustees are only prohibited from voting on any company business in limited circumstances; and
- introduce other measures and make consequential amendments.

### **Conduct of the inquiry**

1.5 The committee advertised the inquiry on its website and in *The Australian*, inviting submissions from interested parties by 17 January 2013. The committee also wrote directly to stakeholders to invite submissions. In total, ten submissions were received. Details about these submissions can be found in Appendix 1.

1.6 The committee held a public hearing in Melbourne on 22 January 2013. It received evidence from representative bodies for the superannuation and financial services sectors, a representative of superannuation law practitioners, and the relevant government department—the Australian Treasury. Further details about this hearing can be found in Appendix 2.

1.7 The committee thanks the organisations that made submissions and the witnesses who gave evidence at the public hearing in Melbourne. Given the short period of time between the hearing and the reporting date, the committee would also like to express its appreciation to the witnesses that provided prompt answers to questions on notice.

### **Structure of the report**

1.8 This report is comprised of four chapters. The remainder of this chapter provides some brief details about the Stronger Super reforms with a particular focus on the nature of and rationale behind the MySuper product. Chapter 2 examines the amendments related to legal actions brought against directors, the legal defences available and the requirements for processing and considering certain claims and complaints. Chapter 3 considers the proposed infringement notice scheme. Chapter 4 examines the remaining amendments, including the service provider measures and the proposed dual regulated entities requirements. A discussion of other matters that were raised during the inquiry and the committee's overall assessment of the bill can also be found in chapter 4.

## Background to the Stronger Super reforms<sup>1</sup>

1.9 The Stronger Super reform package was initiated in response to the 2010 report of the Cooper Review. The review panel was tasked with developing options to improve the regulation of the superannuation system, to promote the best interests of members and maximise retirement incomes for Australians, while reducing business costs.<sup>2</sup> One of the main recommendations of the Cooper Review was that a simple, low cost, default superannuation product called 'MySuper' be introduced.

1.10 On 16 December 2010, the government formally responded to the Cooper Review by releasing 'Stronger Super'.<sup>3</sup> The Stronger Super reforms aim to:

- introduce MySuper;
- make the processing of everyday transactions easier, cheaper and faster, through the 'SuperStream' package of measures; and
- strengthen the governance, integrity and regulatory settings of the superannuation system, including in relation to self-managed superannuation funds.<sup>4</sup>

1.11 From 1 July 2013, superannuation funds will be able to offer MySuper. This product is intended to improve the simplicity, transparency and comparability of default superannuation products.<sup>5</sup> From 1 October 2013, employers must make contributions for employees who have not made a choice of fund to a fund that offers a MySuper product in order to satisfy superannuation guarantee requirements.<sup>6</sup>

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1 This section is adapted from the committee's October 2012 report: *Inquiry into the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012*. Further detail about the Stronger Super reforms can be found on pages 1–8 of that report.

2 Australian Government, Terms of reference – Super System Review, [www.supersystemreview.gov.au/content/terms\\_of\\_reference.aspx](http://www.supersystemreview.gov.au/content/terms_of_reference.aspx) (accessed 27 February 2012).

3 The Stronger Super reform package is part of the government's broader reform of Australia's superannuation system. Other reforms include the Future of Financial Advice (FOFA) reform package which applies to financial advice generally, including advice relating to superannuation products; and the government's Stronger & Fairer Superannuation reforms, including a gradual increase in the superannuation guarantee charge from nine per cent to 12 per cent. See the Hon. Chris Bowen MP, Minister for Financial Services, Superannuation and Corporate Law, 'Government releases Cooper review into superannuation', *Media release*, no. 84, 5 July 2010.

4 <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=home.htm> (accessed 24 September 2012).

5 <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=reforms.htm> (accessed 24 September 2012).

6 *Stronger Super Information Pack*, 21 September 2011, [http://strongersuper.treasury.gov.au/content/publications/information\\_pack/downloads/information\\_pack.pdf](http://strongersuper.treasury.gov.au/content/publications/information_pack/downloads/information_pack.pdf) (accessed 24 September 2012).

1.12 The following statements by the Minister for Financial Services and Superannuation and a senior Treasury officer help explain the government's reasoning behind introducing MySuper and the principles that informed its design:

... around 60 per cent of Australians do not make active choices in relation to their superannuation. And this government believes that Australians should not be charged for valet parking when they are catching the train ... Having created an industry which flourishes on the back of compulsory savings mandated by legislation, it is fair that this industry, which benefits so much from the compulsory saving system in Australia, contributes to higher retirement savings through greater efficiency and lower fees.<sup>7</sup>

\* \* \*

... a key driving principle behind MySuper is that, for those people who do not actively choose an option for their superannuation savings, we want public policy to mandate a default option with carefully designed features that we judge will promote the wellbeing of those who use this option.

Crucially, this mandated default option is not imposed on anyone. Freedom of choice is a central feature of the choice architecture model that underpins the MySuper proposal. Actively engaged people can choose a MySuper default option, or they can choose from a potentially wide array of alternative 'choice' options.

The evidence is that around 80 per cent of members of superannuation funds in Australia are invested in the default option in a super fund chosen by their employer or an award. Of that 80 per cent, anecdotal evidence suggests around 20 per cent explicitly choose the default option, with the rest making no active choice.

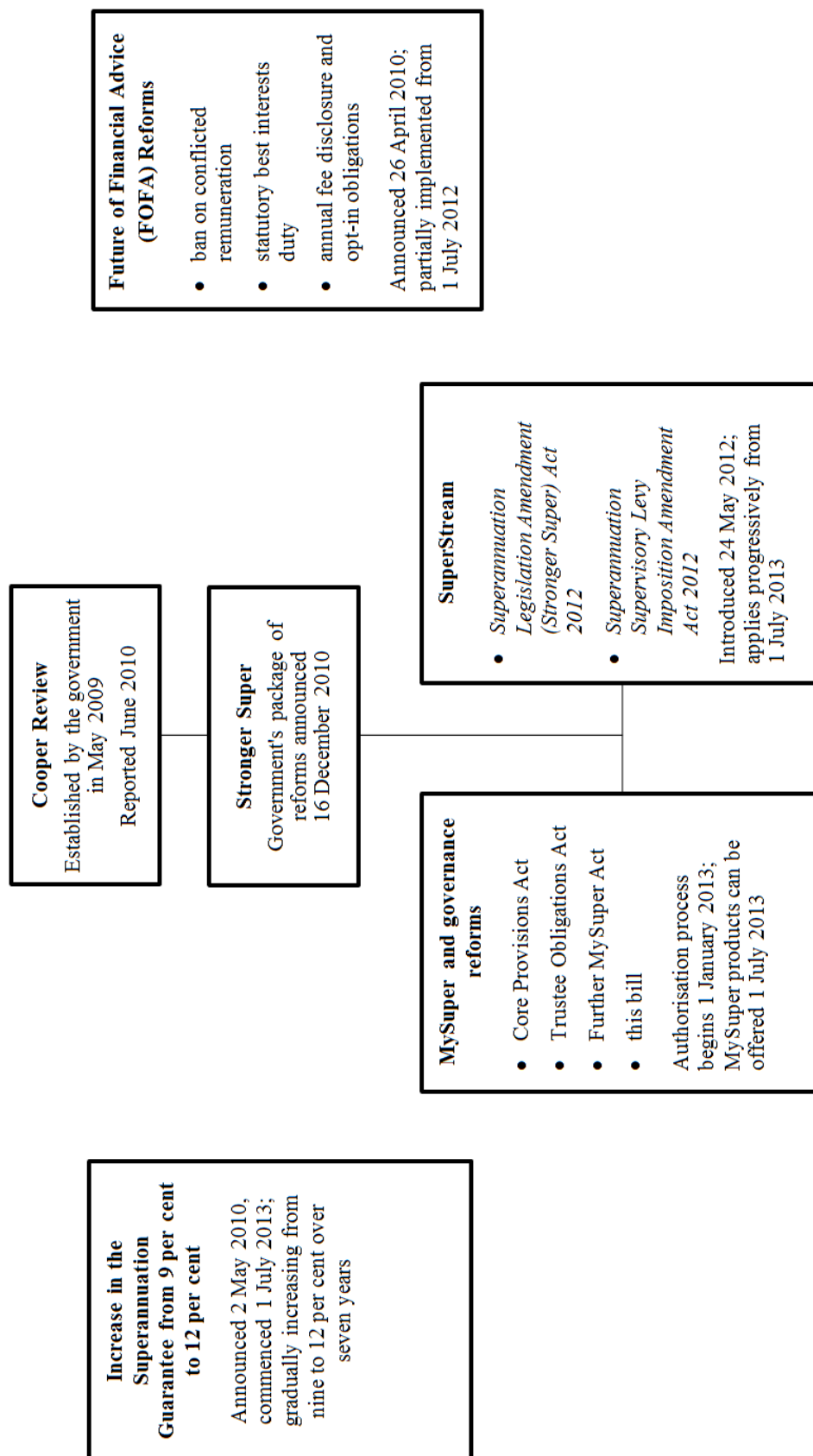
... The idea is not to have a centrally determined option for everybody; nor is it laissez faire. While the system compels people to save into super through the Super Guarantee, the Cooper Review's proposed choice architecture means that people are able to choose between the default option (which must be a MySuper product), or opt for a saving plan with greater choice but greater responsibility.<sup>8</sup>

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7 The Hon. Bill Shorten MP, Minister for Financial Services and Superannuation, second reading speech on the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012, *House of Representatives Hansard*, 3 November 2011, pp.12683–84.

8 Dr David Gruen, 'MySuper—Thinking seriously about the default option', *Paper presented to the special session on Superannuation at the Australian Conference of Economists*, 28 September 2010. [www.treasury.gov.au/PublicationsAndMedia/Speeches/2010/MySuper-Thinking-seriously-about-the-default-option](http://www.treasury.gov.au/PublicationsAndMedia/Speeches/2010/MySuper-Thinking-seriously-about-the-default-option) (accessed 26 September 2012).

**Figure 1.1: Recent reforms to Australia's superannuation system**





## Chapter 2

### **Amendments related to director liability and dispute resolution mechanisms**

2.1 This chapter examines the provisions of the bill which seek to amend the SIS Act and the *Superannuation (Resolution of Complaints) Act 1993* to:

- require persons to seek leave of the court before pursuing an action against a director of a superannuation fund alleging loss or damage due to the director contravening their duties under the SIS Act;
- extend an existing defence available to trustees and directors to cover their MySuper obligations;
- amend the defences available to actions related to loss or damage as a result of the making of an investment or the management of reserves;
- increase the time limits for lodging complaints regarding total and permanent disability claims with the Superannuation Complaints Tribunal; and
- insert a requirement for trustees to provide eligible persons reasons for decisions made on a complaint, either automatically or on request depending on the matter relevant to the complaint.

#### **Requirement to seek leave of the court for actions for breaches of directors' duties**

2.2 The second tranche of the MySuper and governance reforms, the Trustee Obligations Act, made amendments to the SIS Act that will, among other things, apply new duties to directors and trustees of a superannuation fund which offers a MySuper product. However, the explanatory memorandum advises that:

While the superannuation industry has supported heightened obligations and the need for improved accountability of directors concerns have been raised about the potential for frivolous and vexatious legal action being brought against directors.<sup>1</sup>

2.3 Accordingly, the bill proposes amendments to the SIS Act to require a person to seek leave of the court before bringing action against an individual director for a breach of their duties.<sup>2</sup> When considering applications for leave, it is proposed that the court will need to take into account whether the applicant is acting in good faith and

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1 Explanatory memorandum, paragraph 5.5.

2 Schedule 1, items 65 and 66.

whether there is a serious question to be tried.<sup>3</sup> There will also be a six year time limit from the day on which the cause of action arose for leave of the court to be sought.<sup>4</sup>

### *Views of stakeholders*

2.4 In its submission on the exposure draft of the bill, Chartered Secretaries Australia questioned the rationale underpinning the proposed amendments:

CSA notes that pursuing legal action is not a decision which a majority of litigant undertake lightly. Litigation is both expensive and requires a high level of advice before being commenced ... While CSA understands that [the bill's] approach has been adopted to try and curb the pursuit of vexatious or frivolous legal actions, requiring a litigant to overcome a second hurdle in order to bring a legal action against a director could be unfairly prejudicial to those considering their options when confronted with potential director liability issues. CSA is particularly concerned that the extra legal costs associated with this imposition will impact upon low income earners and their legitimate rights, in some instances, to have a matter heard about the negligence or misconduct of a director, in a court of law.<sup>5</sup>

2.5 The Industry Super Network, however, argued that the requirement to seek leave and, therefore, to show that there is an issue to be tried 'removes the bulk of potentially vexatious litigation':

The test beyond that, we believe, is sufficiently low to not provide a bar to the ordinary beneficiary to commence proceedings where they believe they have a cause of action. So we believe that the balance is right.<sup>6</sup>

2.6 The Superannuation Committee of the Law Council of Australia, while supportive of the objective of the proposed amendments, suggested that the requirement that there is a 'serious issue to be tried' could be open to question:

We are very pleased to see that that second aspect has been addressed through the introduction of a threshold test for actions against trustee directors, that the threshold test that has been put into tranche 4 currently is whether there is a serious issue to be tried. That is the test I believe that is used for interlocutory matters before the court. However, without going into the technical detail—I have two High Court cases here with me in case you want to go into the technical detail—there is some uncertainty as to what is actually meant by the expression 'serious issue to be tried'. There is one

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3 Schedule 1, item 66, proposed subsection 4C.

4 Schedule 1, item 65, proposed subsection 4B.

5 Chartered Secretaries Australia, submission to Treasury on the exposure draft of the bill, 2 November 2012, [www.csaust.com/media/447643/final\\_submission\\_exposure\\_draft\\_mysuper\\_further\\_measures.pdf](http://www.csaust.com/media/447643/final_submission_exposure_draft_mysuper_further_measures.pdf) (accessed 5 December 2012), pp. 3–4.

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

High Court case which says all it means is that you have to show that there is a relevant cause of action, which is not really a very high threshold at all. There are other authorities which say that you have to show a sufficient likelihood of success. We think it should be the second one and we think it would be clearer if, rather than using the expression 'serious issue to be tried', which does have some uncertainty about it, the legislation just said 'sufficient likelihood of success'. We think that would be more appropriate.<sup>7</sup>

2.7 The Australian Institute of Superannuation Trustees (AIST) supported the Law Council's argument.<sup>8</sup>

### **Committee view**

2.8 The committee considers that the proposed amendments strike the appropriate balance between the rights of litigants and directors. Accordingly, they are supported.

2.9 The committee notes the evidence provided by the Law Council regarding the phrases 'serious question to be tried' and 'sufficient likelihood of success' and the possible uncertainty that is associated with the former. It appears that neither phrase is commonly used in Commonwealth legislation, although the phrase 'serious question to be tried' used in the bill can be found in paragraph 237(2)(d) of the Corporations Act. The phrase adopted in the bill is in common judicial usage and, despite the Law Council's concern, appears sufficient to address the issue identified by the explanatory memorandum, namely concern about frivolous or vexatious legal action.

### **Defences available to trustees and directors**

2.10 Proposed changes to the legal defences available to trustees and directors are also included in the bill. Under these proposed amendments:

- the defence available in section 323 of the SIS Act that the breach was due to a reasonable mistake or due to the fault of another (and if so, that they acted with reasonable precaution and applied due diligence) will be extended to cover breaches of MySuper duties; and
- for actions for loss arising from an investment or the management of a reserve, the defences available in subsections 55(5) and (6) of the SIS Act will be amended to allow trustees and directors to rely on them if they establish compliance with the covenants and MySuper duties that are *relevant to the loss or damage*, rather than the covenants and MySuper duties that generally apply to the investment or management of the reserves.<sup>9</sup>

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7 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

8 Australian Institute of Superannuation Trustees, *Submission 8*, p. 6.

9 See schedule 1, items 68 and 69.

2.11 The reasoning for why, in addition to leave of the court being required before an action may commence, such amendments are thought necessary was expressed by the Industry Super Network:

Whilst all statutory and fiduciary obligations should be adhered to, ISN is concerned that the proposed regime would result in a proliferation of litigation to the overall detriment of beneficiaries. It is suggested that the onus of proof upon trustees that they have adhered to the covenants contained in s52 of the SIS will encourage broad claims of failure on the part of the trustees. Rather than mount a costly exercise of discharging their onus of proof, it is more likely that trustees will settle most claims. Whilst the requirement to seek leave from the Court to commence an action will have a welcome impact; in the absence of a requirement that there be a nexus between an alleged breach and a purported loss, it is expected that the current arrangements will encourage a significant growth in litigation.<sup>10</sup>

### ***History of subsections 55(5) and (6)***

2.12 It was the defences contained in subsections 55(5) and 55(6) that received the most attention in the evidence received by the committee. Therefore, before discussing the evidence received regarding these proposed amendments it is useful to outline the history of these provisions, using subsection 55(5) as an example. Prior to the MySuper and governance reforms, and until 1 July 2013, subsection 55(5) states:

It is a defence to an action for loss or damage suffered by a person as a result of the making of an investment by or on behalf of a trustee of a superannuation entity if the defendant establishes that the investment was made in accordance with an investment strategy formulated under a covenant referred to in paragraph 52(2)(f).

2.13 The SIS Act includes trustee covenants that are automatically taken to be incorporated into the governing rules of a superannuation fund. As a result of the Trustee Obligations Act, new covenants will apply from 1 July 2013. Amendments to subsection 55(5) of the SIS Act were also made by the Trustee Obligations Act and will similarly commence on 1 July 2013. From that date, the Trustee Obligations Act will amend the subsection so it reads as follows:

It is a defence to an action for loss or damage suffered by a person as a result of the making of an investment by or on behalf of a trustee of a superannuation entity if the defendant establishes that the defendant has complied with all of the covenants referred to in sections 52 to 53 and prescribed under section 54A, and all of the obligations referred to in sections 29VN and 29VO, that apply to the defendant in relation to the investment.

2.14 The amendments were designed to require that trustees must satisfy all of the covenants and the obligations in sections 29VN and 29VO where they are relevant to the investment before relying upon this provision as a defence. The explanatory

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10 Industry Super Network, *Submission 5*, p. 2.

memorandum relevant to the Trustee Obligations Act provides the following reasoning for this approach:

The change recognises the interdependency between the covenants. For example, where a trustee has acted dishonestly and in a conflicted manner, it would be unreasonable to have a defence for investment loss where it had otherwise complied with the investment covenant. The changes are not, however, intended to prevent trustees from accessing the defence in cases where a covenant or duty is not relevant to the particular loss as a result of making an investment.<sup>11</sup>

### ***Reasons for the bill's amendments***

2.15 The explanatory memorandum for this bill noted concern from the superannuation sector about the amendment made by the Trustee Obligations Act.<sup>12</sup> The further amendments proposed by the bill are intended to ensure there is 'a nexus between the act or omission of the director or trustee and the loss or damage which occurred'.<sup>13</sup> Item 68 of the bill proposes to omit the words 'in relation to the investment' and substitute 'in relation to each act, or failure to act, that resulted in the loss or damage'. Accordingly, it is intended by the bill that subsection 55(5) will read as follows:

It is a defence to an action for loss or damage suffered by a person as a result of the making of an investment by or on behalf of a trustee of a superannuation entity if the defendant establishes that the defendant has complied with all of the covenants referred to in sections 52 to 53 and prescribed under section 54A, and all of the obligations referred to in sections 29VN and 29VO, that apply to the defendant in relation to each act, or failure to act, that resulted in the loss or damage.

### ***Operation of section 55 as amended***

2.16 If the proposed amendments contained in the bill are passed, section 55 will operate as follows:

- Subsection 55(1) will continue to provide that a person must not contravene a covenant contained, or taken to be contained, in the governing rules of a superannuation entity.
- Subsection 55(3) will continue to allow a person who suffers loss or damage as a result of the conduct of a trustee or director that was involved in a contravention of subsection 55(1), then the person may recover the amount of the loss or damage from those involved in the contravention.

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11 Explanatory memorandum, Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, paragraph 1.82.

12 Explanatory memorandum, paragraph 5.5.

13 Explanatory memorandum, paragraph 5.24.

- If the action relates to loss or damage suffered as a result of the making of an investment, the defence outlined in the revised subsection 55(5) will be available. If the action relates to loss or damage suffered as a result of the management of any reserves, the defence outlined in the revised subsection 55(6) will be available.<sup>14</sup>

### ***Views of stakeholders***

2.17 The evidence received by the committee on the amendments focused on two areas: how the established rationale underpinning the defences contained in subsections 55(5) and (6) may have been fundamentally changed by the Trustee Obligations Act and whether the revision to the defences contained in this bill addresses the earlier concern about the Trustee Obligations Act's amendments.

#### *Theory behind subsections 55(5) and (6)*

2.18 The Law Council argued that the changes to the legal defences available to trustees and directors have fundamentally altered the nature of the defences. It provided the following explanation of the original purpose of subsection 55(5) and how, in its view, this purpose is no longer achieved:

Section 55(5) as it first appeared in the SIS Act in 1993 was a defence available to a trustee having regard to "modern portfolio theory"—ie, that if a trustee properly chose a diversified portfolio of investments it would be protected if, for example, one of those investments performed badly when, in the context of the whole portfolio, the trustee had properly formulated and implemented an investment strategy. Now, the revised version of section 55(5) turns the original purpose of the defence and protection for trustees on its head, and renders it effectively useless. Therefore, if a member alleges that one of the trustee's investments performed poorly and resulted in a negative interest adjustment to the member's account, the member could seek to take action against the trustee company and/or (with the leave of the court) the directors to claim the loss and the trustee/directors would be put to the task of proving positive compliance with every covenant and obligation related to the making of the investment before it would have a statutory defence.<sup>15</sup>

... if you have to establish that you have met every relevant covenant in relation to each act, that could mean each investment. In that case, the purpose of the original defence has been lost.<sup>16</sup>

2.19 The Corporate Super Association shared the view that the nature of the defence has been changed by the Trustee Obligations Act. It argued that the former

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14 The defences available under subsections 55(5) and 55(6) are available whether the action is brought under subsection 55(3), section 29VP or otherwise.

15 Law Council of Australia, *Submission 2*, pp. 8–9.

16 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 16.

subsection 55(5) provided a defence for a trustee if it had followed the requirements of the former covenant 'to formulate establish and monitor an investment strategy that took account of certain specified requirements, including the requirement to ensure adequate diversification'. Under this defence, where the diversification was appropriate:

... it was accepted that certain investments would do better than others at any particular time, and part of the strategy was that diversification by investment type, by geographical exposure and by sectoral exposure would limit losses by the overall portfolio at any particular time. The amended provisions do not appear to provide trustees and directors with the former protection but instead provide the trustee with a defence only if numerous requirements (compliance with which will be hard to establish) are met. In effect trustees are now deprived of the former protection in the event of loss of value of individual investments, where the investments were undertaken as part of a suitably diversified portfolio.<sup>17</sup>

*Does the bill address the concerns yet still achieve the policy objective?*

2.20 The AIST indicated its support for the amendment, noting that its suggestions made to Treasury during the consultation on the exposure draft have been adopted.<sup>18</sup> Other stakeholders, however, questioned the effectiveness of the approach taken by the bill. They suggested that the proposed revision to subsections 55(5) and 55(6) does not address their key concern that the earlier tranches have made any defence to action taken for loss or damage contingent on the director or trustee demonstrating compliance with every covenant and the additional obligations contained in sections 29VN and 29VO. For example, in its submission the Industry Super Network stated that it supported the intent of the amendment as expressed in the explanatory memorandum—that is, creating the necessary nexus between the act or omission and the claimed loss—however, it suggests that the amendment 'fails to achieve this end':

It remains that case that before a trustee or director could rely upon this defence they would be required to establish that they have complied with all covenants that were potentially relevant to the loss.<sup>19</sup>

2.21 A representative of the Law Council suggested that developing an appropriate investment strategy and making investments in accordance with that strategy—the requirement expressed in the previous version of the defence—provides appropriate cover as compliance with the other covenants would still be required:

I believe, though, that as a matter of law every investment strategy ... still has to comply with the covenants. I accept that, for members who are passive in relation to their superannuation, yes, a more paternalistic approach—to use a shorthand expression—may well be warranted, but

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17 Corporate Super Association, *Submission 1*, p. 3.

18 Australian Institute of Superannuation Trustees, *Submission 8*, p. 6.

19 Industry Super Network, *Submission 5*, p. 3.

I believe that those investment covenants and all of the covenants apply to every investment strategy that is formulated, not merely the default strategy, I guess, to put it that way.<sup>20</sup>

2.22 However, the Law Council argued that actually demonstrating compliance with those other covenants is a key problem, as the 'evidence involved in establishing positive compliance with so many obligations would be extremely onerous',<sup>21</sup> particularly because of the 'broadly-stated nature of many of the covenants and obligations, and ... the positive obligation to establish "compliance"'. Of seemingly greater significance, however, the Law Council also concluded that the defence 'is not a defence at all' because to rely on it the trustee or director would have to show that they met every relevant covenant.<sup>22</sup> As an action brought under subsection 55(3) for the recovery of an amount of loss or damage suffered must be linked to a covenant having been contravened (subsection 55(1)), if the trustee or director were able to demonstrate compliance with every covenant and obligation that was relevant to each act, or failure to act, that resulted in the loss or damage, the legal action taken would 'necessarily fail', and the defence would not be needed. As the further change to the subsection proposed by the bill retains the requirement that the defendant must establish compliance with every potentially relevant covenant, the Law Council suggested that the further change to the subsection proposed by the bill is of 'no practical use':

In other words, the effect of the revised drafting is to provide a defence only where the trustee or director can show that they had done nothing wrong in the first place.<sup>23</sup>

2.23 Regarding the new covenants that are introduced by the Trustee Obligations Act, and the requirement that use of the defences relating to the making of investments or the management of the reserves depends on compliance with every covenant being demonstrated, the Financial Services Council expressed its view that legal action should be linked to a breach of a particular, relevant, covenant:

... if someone breaches a covenant they should be held to account through the covenant that they have breached. If it has resulted in a loss to a member there needs to be a causal link between the breach in the covenant and any loss that is suffered by the member.<sup>24</sup>

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20 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 17.

21 Law Council of Australia, *Submission 2*, p. 8.

22 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

23 Law Council of Australia, *Submission 2*, p. 8.

24 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 22 January 2013, p. 4.

2.24 The Financial Services Council was asked to elaborate on how the other covenants could interact with investment covenant. It noted that action could still be taken for breaches of other covenants if necessary:

Senator THISTLETHWAITE: Are there any circumstances that you could envisage where a director may have followed the investment strategy of the super fund but not some of the other covenants and there was not a loss to a particular beneficiary?

Mr Bragg: Potentially; for example, if all the directors follow the investment covenant related to the strategy but there is a breach of, say, a covenant relating to the risk management of fund, there could be a loss to the fund that had something to do with hedging which a member could then bring an action against. Even if the trustees have failed to meet the covenant in relation to the risk management of the fund, that would be the covenant which we would expect an action would be brought against, not against breaching another covenant related to, say, the reserves of the fund.<sup>25</sup>

2.25 Finally, despite the requirement contained in the bill that leave of the court is needed before action against a director can be taken, concern was expressed that opportunistic claims would be undertaken in an attempt to force a settlement:

We can expect that there will be people looking very closely to see whether there is an opportunity there to make a claim with a view to settling. Given that these are expensive matters to go to trial, in many instances, on balance, I think it would be tempting for many funds simply to settle. That is the main concern we have.<sup>26</sup>

... we were also concerned that perhaps frivolous actions might be brought against individual directors in order to gain settlements through their indemnity insurers.<sup>27</sup>

2.26 However, it was acknowledged that more frivolous forms of these actions may have consequences, as the applicant could have costs awarded against them.<sup>28</sup>

### ***Treasury's response***

2.27 Given the concerns raised by a number of stakeholders, the committee was particularly interested to pursue this matter with Treasury. Treasury provided an explanation as to why it was viewed that the previous defence, which enabled for a defendant to rely solely on an investment strategy, is no longer appropriate:

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25 Mr Andrew Bragg, Senior Policy Manager, Financial Services Council, *Proof Committee Hansard*, 22 January 2013, pp. 4–5.

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

27 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

28 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 17.

The concern was that the trustee may well have followed the investment strategy but otherwise may have not appropriately managed a conflict of interest or there may have been dishonest behaviour or some non-adherence to other obligations that are expected of trustees or directors. The sense was that that defence, while perhaps well intentioned, had gone too far in that it should not be sufficient to just wave an investment strategy and say that we followed it, if there had been other untoward behaviour. So the defence was adjusted to make sure that the trustee had complied with all relevant covenants before accessing the defence.

There have been some refinements to that to try and tighten the nexus between the loss or damage and the relevant covenants, and that point has been raised today. The words in this bill pick up words that were suggested, I think, by ASFA and AIST in the consultation phase. I understand they are comfortable with those words. ISN have suggested some further refinements. But it is clear that the intent is to create that nexus so that you do not have to demonstrate you have complied with covenants that actually have no relationship or relevance to the particular loss or damage. Perhaps it is something that could be further iterated in an EM or somewhere along the line, but that is the clear intention. That is more to the objective with that defence.<sup>29</sup>

### ***Committee view***

2.28 The committee supports the intent, as expressed by Treasury, behind the defences to actions arising from an investment or the management of a reserve available to trustees and directors being revised as part of the Stronger Super reforms. It would be troubling for a trustee to access a defence based only on compliance with an investment strategy if non-compliance with other covenants, such as acting dishonestly, has occurred and was relevant to the loss or damage suffered but could be ignored. The committee supports the intent that a greater nexus be created between the alleged breach and the claimed loss or damage.

2.29 Although some stakeholders suggested that the wording used for the revised defences be further amended, the committee notes that key industry groups are broadly supportive of the revised defences as they are currently drafted. While the committee draws the government's attention to the issues raised in evidence, it is not recommending further amendments to the defences at this time.

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29 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, pp. 36–37.

## Increased time limit for lodging complaints with the Superannuation Complaints Tribunal

2.30 The Superannuation Complaints Tribunal (SCT) is an independent dispute resolution body that provides mechanisms for the 'fair, economical, informal and quick' conciliation or review of disputes about superannuation'.<sup>30</sup> However, the Cooper Review found that the current time limit for members to lodge a complaint with the SCT regarding total and permanent disability (TPD) claims 'can unfairly exclude claimants who had reasonably delayed a claim'. The Review recommended that the time limit be extended.<sup>31</sup>

2.31 The bill proposes amendments to the *Superannuation (Resolution of Complaints) Act 1993* to increase the time limit for members to lodge a complaint with the SCT regarding TPD claims. The time limit will be increased from two years from the time of the decision to six years from the time of the decision. However in cases where a person has permanently ceased employment as a result of the physical or mental condition linked to the claim:

... the time period will only be increased to four years, because in that case, the person has already had two years from ceasing employment to lodge their claim. The four year time period in paragraph 14(6A)(a) reflects the two-year time limit in subsection 14(6B).<sup>32</sup>

### *Views of stakeholders*

2.32 The AIST and the Industry Super Network expressed their support for these amendments,<sup>33</sup> as did the SCT. The SCT stated that the extended time limit 'more closely aligns access to the free Tribunal dispute resolution service with the time limits which apply to proceedings commenced in the courts', adding that the SCT has 'specialist skill and knowledge in the area of superannuation and related insurance disputes'.<sup>34</sup>

### *Committee view*

2.33 The committee supports the increased time limits for lodging complaints with the SCT.

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30 *Superannuation (Resolution of Complaints) Act 1993*, s. 11.

31 Super System Review, *Final report*, part 2: recommendation packages, 2010, p. 147 [recommendation 5.7].

32 Explanatory memorandum, paragraph 3.18.

33 Australian Institute of Superannuation Trustees, *Submission 8*, p. 5; Industry Super Network, *Submission 5*, p. 1.

34 Superannuation Complaints Tribunal, *Submission 4*, p. 2.

## Reasons for decisions made on a complaint

2.34 The Cooper Review observed that, under trust law, beneficiaries often cannot acquire information decisions that affect their interests.<sup>35</sup> At present, while trustees must ensure that they take reasonable steps to ensure an affected beneficiary has the right to make a complaint and for the complaint to be properly considered, trustees are not required to provide a reason for their decision in relation to an eligible person's complaint.<sup>36</sup> The Cooper Review recommended that the SIS Act should require trustees to provide reasons for a decision made on a complaint.<sup>37</sup>

2.35 The bill proposes amendments to implement this recommendation.<sup>38</sup> Separate arrangements are proposed for death benefit complaints compared to other complaints:

- For death benefits, trustees will be required to automatically provide written reasons when notice of the decision is given to the eligible person who made the complaint (such as the beneficiary or executor of the estate of a former beneficiary). Complainants will also be able to request reasons for a non-decision if a decision on a death benefit complaint has not been made within 90 days.
- For other complaints, trustees will be required to provide written reasons for their decision within 28 days of an eligible person requesting them.

2.36 The Australian Securities and Investments Commission (ASIC) will be able to grant an extension to the 28 day period during which decisions must be given.<sup>39</sup>

## Views of stakeholders

2.37 In its submission, the Industry Super Network stated its support for the proposed amendments.<sup>40</sup> The SCT also outlined some of the additional benefits that the amendments could have:

The requirement for a trustee to provide reasons, either with a decision or upon request, in the Tribunal's view, improves the general societal level of

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35 The Cooper Review noted that, in the superannuation context, this aspect of trust law had 'attracted adverse comment by the courts on a number of occasions ... The courts have been persuaded by the fact that participation in a superannuation fund is mandatory for almost everyone in the workforce, that preservation rules mean members cannot easily withdraw their money until retirement and that superannuation contributions are properly regarded as part of the member's remuneration'. See Super System Review, *Final report*, part 2: recommendation packages, 2010, p. 56.

36 Explanatory memorandum, p. 16.

37 Super System Review, *Final report*, part 2: recommendation packages, 2010, p. 57 [recommendation 2.9].

38 Schedule 1, item 74.

39 Schedule 1, item 74, proposed paragraph 101(1)(e).

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

awareness and understanding of the superannuation system. It may have the effect of reducing the number of complaints resulting from trustee decisions.<sup>41</sup>

2.38 Views were also expressed about the obligation to respond within 28 days, with the Industry Super Network stating its view that, 'to the extent that there are problems' with this timeframe:

... systems should be changed and problems addressed with a view to resolving the interests of the beneficiaries rather than the interests of the administrators or the funds themselves. These are matters that can be, we believe, overcome.<sup>42</sup>

2.39 However, the Law Council and the Corporate Super Association recommended that a time limit be imposed for the making of the request for reasons. The Law Council provided the following argument:

... a trustee could potentially have to stand ready indefinitely so as to respond (in a short time frame) to a request for reasons. The trustee's ability to properly respond to a request for reasons will naturally decline as the months and years elapse ... The decision by an applicant to request reasons should not be something which requires detailed consideration or legal advice, and their interest in pursuing reasons should be most heightened shortly after receiving information about the trustee's decision on the complaint.<sup>43</sup>

2.40 The Law Council initially suggested a limit of 90 days from the day the decision has been communicated by the trustee be imposed. The Corporate Super Association supports the Law Council's proposal.<sup>44</sup> At the hearing, however, the Law Council representative revised the 90 day limit and instead suggested a 12 month timeframe:

We note that tranche 4 introduces an ability for complainants to request reasons for why their complaint may have been denied—and we support that. But we think there should be some time limit, some reasonable time frame, in which a complainant must request those reasons. Primarily, we are concerned about retrospective requests where records may not have been kept. So we think there should be some reasonable period, perhaps 12 months after receiving the notice of the decision, in which the request for reasons must be made.<sup>45</sup>

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41 Superannuation Complaints Tribunal, *Submission 4*, p. 2.

42 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 25.

43 Law Council of Australia, *Submission 2*, p. 7.

44 Corporate Super Association, *Submission 1*, p. 2.

45 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 16.

2.41 In response to a question on notice, the AIST outlined a range of record keeping requirements that apply to the superannuation sector. The AIST advised that:

Subsection 22(3)(a) of the *Superannuation (Resolution of Complaints) Act 1993* states that the Superannuation Complaints Tribunal may treat a complaint as withdrawn if more than 12 months elapses between the decision or conduct that is being complained about, and the date that the complaint is made to the Superannuation Complaints Tribunal.

Primarily, complaints are made to the Tribunal about decisions that relate to complaints received by trustees. An exemption applies which relates to the decision of a trustee relating to the payment of a disability benefit because of TPD, where the time limit specified in the Bill will apply.

By implication, a trustee should maintain records of complaints (other than in relation to TPD matters) for at least 12 months from the date of the trustee's decision or conduct that is being complained about.<sup>46</sup>

2.42 The AIST also suggested that there be a requirement for trustees to inform beneficiaries about their entitlement to request reasons for decisions. The AIST noted that superannuation funds are already required to advise their members about their dispute resolution procedures and to provide information about the SCT. It recommended that these requirements be extended to include advising members about their ability to request reasons for decisions, observing that '[k]nowledge of a right is crucial to people being able to access it'.<sup>47</sup> The explanatory memorandum advises that the government will consider including in the regulations a requirement for trustees to inform members that they can request written reasons for decisions.<sup>48</sup>

### ***Committee view***

2.43 Making available to a member the trustee's reasons for a decision on a matter that affects that member is a relatively straightforward change that will increase the transparency of the dispute resolution process and the accountability of trustees. Accordingly, the committee supports the intent of these amendments.

2.44 After examining the proposed amendments and taking evidence from stakeholders, however, the committee considers that it would be ideal for an amount of time to be stipulated during which notices requesting reasons for a decision on a non-death benefit complaint can be given for subsection 101(1) to apply. Such a time limit should not be specified for instances of non-decision.

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46 Australian Institute of Superannuation Trustees, answer to question on notice, 22 January 2013 (received 24 January 2013), p. 4.

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

48 Explanatory memorandum, paragraph 3.13. Section 1017DA of the Corporations Act allows the regulations to specify additional information that trustees of superannuation entities are required to provide. As noted by the AIST, the Corporations Regulations 2001 (subdivision 5.11) already specifies additional information that trustees are required to provide, such as information about the SCT.

2.45 The committee suggests that the timeframe should correspond with the limits that apply to the timeframes in which the SCT may consider a complaint. For complaints regarding total and permanent disability claims the time limit should be six years from the time of the decision, which is the new time limit imposed by the bill. For other complaints, the request for reasons should be required within one year of the trustee's decision.

2.46 The committee also considers that to ensure the amendments are effective, there is a need to ensure that affected persons are advised that they may request from a trustee reasons for a decision. The committee notes the advice contained in the explanatory memorandum that regulations to address this are being considered and encourages the government to make these regulations.

### **Recommendation 1**

**2.47 That schedule 1, item 74 be amended to require that for a notice in writing from an eligible person to a trustee given in accordance with proposed paragraph 101(1)(d) to be valid:**

- **for complaints regarding total and permanent disability claims, it must be given within six years from the time of the decision; and**
- **for other complaints, it must be given within 12 months of the trustee's decision.**

### **Recommendation 2**

**2.48 That the government amends the Corporations Regulations 2001 to require that when a decision is made in relation to a non-death benefit complaint, the trustee must give the eligible person information about how they can request reasons for the decision.**



# Chapter 3

## Infringement notices

3.1 This chapter examines the provisions of the bill that would allow APRA to issue infringement notices for certain alleged contraventions of the SIS Act.

### Overview of the proposed infringement notice regime

3.2 An infringement notice regime gives an agency the power to issue a notice alleging that a particular contravention has occurred and providing the recipient with the option to pay a fine rather than having the matter dealt with by a court. Payment of the fine discharges any liability of the person for the particular contravention but is not an admission of guilt. Infringement notices are intended to be a mechanism for dealing with relatively minor offences 'where a high volume of contraventions is expected, and where a penalty must be imposed immediately to be effective'.<sup>1</sup> APRA currently has the power under Division 3 of the *Financial Sector (Collection of Data) Act 2001* (FSCOD Act) to issue infringement notices for certain offences.<sup>2</sup> APRA, along with the Australian Taxation Office (ATO), also has the power to issue a contravention notice under section 252B of the SIS Act if it has reason to believe that the trustees of a fund have not informed it of its status as being either a self-managed superannuation fund (SMSF) or a registrable superannuation entity (RSE).<sup>3</sup>

3.3 The bill proposes to introduce a new part of the SIS Act (part 22) that would enable APRA to issue infringement notices for a range of 'minor and straight-forward' breaches of the SIS Act.<sup>4</sup> This follows recommendation 10.4 of the Cooper Review.

### Provisions subject to an infringement notice

3.4 Under the proposed amendments, 26 provisions would initially be subject to an infringement notice. The explanatory memorandum provides the following examples of conduct that would be subject to a notice:

... not putting contributions into a MySuper product (in cases where the member has not given the trustee a direction in writing that the contribution is to be invested under one or more specified investment options); not notifying as soon as practicable each beneficiary about an acting trustee's appointment; not having rules in place for the appointment of member or

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1 Attorney-General's Department, *Guide to framing Commonwealth offences, infringement notices and enforcement powers*, September 2011, p. 50.

2 Explanatory memorandum, p. 10.

3 If the bill is passed, the contravention notice regime will be incorporated into the infringement notice regime.

4 Explanatory memorandum, paragraph 2.5.

independent representatives where required to do so; and not meeting APRA's deadline for receipt of a report relating to an investigation.<sup>5</sup>

3.5 The bill also proposes to allow the regulations to provide that further offences against a provision of the SIS Act or the regulations, or civil penalty provisions in the SIS Act or the regulations may be made subject to an infringement notice.

3.6 Generally, an infringement notice will need to relate to a single contravention of a single provision. However, if multiple contraventions of a single offence occur, an infringement notice that covers these alleged contraventions can be issued if the following four conditions are satisfied:

- the provision requires the person to do a thing within a particular period or before a particular time;
- the person fails or refuses to do that thing within that period or before that time;
- the failure or refusal occurs on more than one day; and
- each contravention is constituted by the failure or refusal on one of those days.<sup>6</sup>

### **Penalties**

3.7 The proposed fine is an amount equal to one-fifth of the maximum penalty that a court could impose on the person for the contravention.<sup>7</sup> The Attorney-General's Department's *Guide to framing Commonwealth offences, infringement notices and enforcement powers* recommends that, for offences, infringement notice provisions should generally ensure that the amount payable is one-fifth of the maximum penalty that a court could impose, but not more than 12 penalty units for a natural person and 60 penalty units for a body corporate.<sup>8</sup> The provisions proposed to be subject to an infringement notice are subject to maximum court-imposed penalties ranging from 30 to 100 penalty units.<sup>9</sup> Therefore, the fine included in an infringement notice would range from six to 20 penalty units depending on which provision was alleged to have been contravened.

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5 Explanatory memorandum, paragraph 2.8.

6 Schedule 1, item 112, proposed subsection 224(4). The bill and explanatory memorandum note that multiple offences of this kind may arise as a result of the application of section 4K of the *Crimes Act 1914*.

7 Schedule 1, item 112, proposed subsection 224A(2).

8 Attorney-General's Department, *Guide to framing Commonwealth offences, infringement notices and enforcement powers*, September 2011, p. 59.

9 With the exception of offences against subsection 242M(1), which is discussed at the end of this chapter titled 'Drafting issues'.

3.8 The bill also proposes to make void any governing rule of a superannuation entity that allows the assets of a fund to be used to indemnify a trustee or a director who has been issued with an infringement notice under the SIS Act (or the FSCOD Act).<sup>10</sup> The explanatory memorandum notes that:

One of the reasons the [Cooper] Review recommended providing APRA with the ability to issue infringement notices is to deter uncompliant behaviour. This objective would be undermined if trustees and directors were able to use fund money to pay for the infringement notice.<sup>11</sup>

### ***Infringement officer***

3.9 The bill allows the chair of APRA to determine, by legislative instrument, a class of APRA staff members to be 'infringement officers' who, therefore, may issue infringement notices if they have reasonable grounds to believe that a person has contravened an infringement notice provision.<sup>12</sup> However, the APRA chair is required to be satisfied that the class of APRA staff members have 'suitable training or experience to properly excise the powers of an infringement officer'.<sup>13</sup>

### ***Views of stakeholders on the overall proposal***

3.10 Overall, stakeholders supported the proposed infringement notice arrangements. The following observations made by the CEO of the Association of Superannuation Funds of Australia (ASFA) provide a useful insight into the sector's view on infringement notices as a concept:

Court cases are costly for all parties and not necessarily the best outcome. Fining powers have been used and are a normal part of regulators' toolboxes across the world. There is enough transparency around the application of fines to ensure that misuse is not made of those. So, from a toolbox point of view, I think it is appropriate to have the ability to fine behaviour that is not necessarily reckless but is behaviour where there has been a level of noncompliance, where a more reasonable approach should be applied. I think a fining power is appropriate. APRA as a regulator has a very good reputation, and that is globally. I think it is very important that we make

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10 Schedule 1, item 70, proposed subsections 56(2) and 57(2) and item 71, proposed paragraphs 56(2)(b) and 57(2)(b).

11 Explanatory memorandum, paragraph 2.27.

12 Schedule 1, item 112, proposed subsection 223C(1).

13 Schedule 1, item 112, proposed subsection 223C(2). This appears to comply with the *Guide to framing Commonwealth offences*, which observes that an infringement notice provision drafted to allow 'a person' or 'an APS employee' to issue a notice is 'likely to be inappropriate'. It suggests that '[a] common approach is to require that the person issuing the notice possess special attributes, qualifications or qualities ... Further, if the power to issue a notice can be delegated, the delegation should be restricted to persons of suitable seniority and expertise'. Attorney-General's Department, *Guide to framing Commonwealth offences, infringement notices and enforcement powers*, September 2011, p. 60.

sure that the history of the regulator and its ability to regulate and make appropriate decisions be taken into account.<sup>14</sup>

3.11 A representative of the Industry Super Network also noted that a benefit of an infringement notice regime would be its cost-effectiveness which, in the superannuation context, 'leaves more in the pockets of beneficiaries'.<sup>15</sup> The AIST noted that the ATO and ASIC already have the power to issue infringement notices, and, similarly to the Industry Super Network, it argued that giving APRA the 'same nuanced ability' to encourage compliance would be preferable compared to the alternative of court action, as infringement notices would not 'impose significant additional costs on the fund and, by implication, the members of that fund'.<sup>16</sup>

3.12 However, a number of specific issues were raised about how certain provisions of the bill have been drafted. These issues are discussed in the following paragraphs.

### **Level of detail to be included in the notice**

3.13 Along with other identifying material, the bill proposes to require that notices 'give brief details of the alleged contravention, including':

- (i) the provision that was allegedly contravened; and
- (ii) the maximum penalty that a court could impose if the provision were contravened; and
- (iii) the time (if known) and day of, and the place of, the alleged contravention;<sup>17</sup>

3.14 Both the Law Council and the Corporate Super Association suggested that further details regarding the 'reasonable grounds' for the officer's belief and further details about the circumstances of the alleged breach should be required to be included in the infringement notice. Without such information, the Corporate Super Association argued that the 'ability of the trustee or other affected person to challenge the notice may be impaired'.<sup>18</sup>

3.15 Infringement notices are already used by a number of regulators and there is accepted guidance on how statutory provisions giving an infringement notice power to a regulator should be framed. Accordingly, before progressing further with the

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14 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 7.

15 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 21.

16 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 27.

17 Schedule 1, item 112, proposed paragraph 224(1)(e).

18 Corporate Super Association, *Submission 1*, p. 2.

arguments put forward by stakeholders on this issue, it is useful to examine other infringement notice regimes that have been legislated. Table 3.1 below compares the bill's proposed paragraph 224(1)(e) of the SIS Act (the provision outlined above) with the principles contained in the *Guide to framing Commonwealth offences* and selected existing infringement notice regimes.

**Table 3.1: Comparison of the detail required under different infringement notice regimes**

| Source                                                                                                                                              | Description                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|-----------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Attorney-General's Department's <i>Guide to framing Commonwealth offences, infringement notices and enforcement powers</i> , September 2011 (p. 62) | The <i>Guide</i> suggests that a notice should 'identify the alleged offence (including the offence provision) and the time, nature and place of its alleged commission'.                                                                                                                                                                                                                                                                                                                                 |
| ACCC (relating to consumer law): <i>Competition and Consumer Act 2010</i> , s. 134B                                                                 | The relevant section in the Competition and Consumer Act (CCA) is drafted similarly to the bill with the exception that the phrase 'give details' is used in the CCA whereas the bill uses 'give brief details'.                                                                                                                                                                                                                                                                                          |
| ASIC (relating to market integrity rules): Corporations Regulations 2001, regulations 7.2A.05 and 7.2A.06                                           | ASIC 'must specify details of each alleged contravention' rather than 'give brief details' (as proposed in the bill). Details are also required about 'the <i>conduct</i> that made up each alleged contravention (including, to the extent known, the date on which it occurred and the place at which it occurred)' (emphasis added). ASIC must also give a written statement that sets out ASIC's reasons for believing that the recipient has contravened subsection 798H(1) of the Corporations Act. |
| ASIC (credit infringement notices): National Consumer Credit Protection Regulations 2010, part 6-2                                                  | The details that ASIC includes in a notice reflect those expressed by the <i>Guide to framing Commonwealth offences</i> noted above. ASIC also states on its website that it will issue a covering letter stating why the infringement notice has been issued.                                                                                                                                                                                                                                            |

3.16 As Table 3.1 illustrates, there are some minor differences in the level of detail contained in the infringement notices that would be issued under the bill's proposed framework compared to other infringement notice regimes.

3.17 The Law Council contended that for infringement notices that relate to the superannuation sector, the nature of that sector necessitates further information about the details of the alleged contravention being included. It argued that requiring only brief details about the alleged contravention may be suitable for some offences outside the superannuation sector, but it could be insufficient for 'the often complex web of compliance obligations applying to large superannuation funds'.<sup>19</sup> In the Law Council's view, further details would allow a trustee to 'obtain proper advice about

<sup>19</sup> Law Council of Australia, *Submission 2*, p. 5.

whether to pay the infringement notice or let the matter proceed to court'.<sup>20</sup> The Law Council also suggested that not requiring in the notice detail about the 'reasonable grounds' for an infringement officer's belief that a contravention has occurred may result in it being 'too easy' for an infringement officer to issue a notice.<sup>21</sup>

3.18 Other witnesses considered that further detail in the notice would also assist the recipient understand the nature of the problem and would help avoid future problems of a similar nature from occurring.<sup>22</sup>

3.19 The committee raised this issue with Treasury at the public hearing. Unsurprisingly, Treasury's evidence implicitly acknowledges that the superannuation sector is different from others, however, Treasury focused on this from the perspective of the supervision arrangements that apply to the superannuation sector. Treasury noted the close supervisory relationship that APRA has with superannuation funds, including a framework where particular supervisors are connected with specific funds. A Treasury officer observed that:

You would expect that a fund would not first become aware of this when they open the letter with the infringement notice and that there would have been some conversation between supervisors and the fund in the lead up to issuing an infringement notice.

3.20 The Treasury officer also commented that the straightforward nature of the offences that would be subject to an infringement notice would limit uncertainty about exactly what conduct was of concern:

... because infringement notices are limited to cases where it is more or less a black-and-white issue about whether or not there has been compliance, by reference to the provision that has been infringed it becomes pretty clear what the nature of the infringement was.<sup>23</sup>

3.21 However, it was acknowledged that, in principle, the issue could be considered further.<sup>24</sup>

### ***Committee view***

3.22 The committee does not consider that additional details regarding the reasonable grounds for an APRA officer's belief that a contravention has occurred

20 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

21 Law Council of Australia, *Submission 2*, p. 5.

22 See Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 21.

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

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

should be required by legislation to be included in an infringement notice. Such an approach is uncommon and the offences that are proposed to be made subject to an infringement notice are offences that are straightforward. The information that the bill requires to be included is factual in nature and recipients would be able to assess whether it was accurate or not and, as a consequence, whether they may have contravened the relevant provision. The close engagement that APRA has with the superannuation funds should also alleviate concern in this area, as noted by Treasury. The recipient of a notice can also seek to have it withdrawn and the bill does require that the notice informs the recipient that they may choose not to pay. In any case, for the effectiveness of the infringement notice regime to be maximised APRA may be inclined to provide further detail, where it appropriate to do so, to encourage payment. To ensure the integrity of the regime, it is also likely that APRA would only issue a notice where it was prepared to take further action in the event of non-payment. In the committee's view these features of an infringement notice regime dismiss arguments that it would be 'too easy' for an APRA infringement officer to issue an infringement notice, even if one accepted the proposition that an infringement officer would be casual with their statutory responsibilities.

3.23 Nonetheless, without adding a particularly prescriptive requirement, it may be beneficial for further details about the circumstances of the alleged breach to be provided to the recipient. To guide APRA on this, the word 'brief' in the requirement that APRA 'give brief details of the alleged contravention...' should be omitted. This drafting appears to differ from existing infringement notice provisions contained in other legislation and does not appear helpful. Additionally, in the event that it is considered beneficial for additional information to be included in a notice, perhaps when further offences are made subject to an infringement notice by the regulations, the bill should require APRA to include any additional information as required by the regulations. This would provide a relatively simple mechanism for further information requirements to be stipulated.

### **Recommendation 3**

#### **3.24 That:**

- **proposed paragraph 224A(1)(e) be amended to omit 'brief'; and**
- **proposed section 224A be amended to require that an infringement notice must contain any other information specified by the regulations.**

### **Prohibiting indemnification from the assets of the fund**

3.25 As noted at paragraph 3.8, the bill proposes to make void any governing rule of a superannuation entity that allows the fund's assets to be used to indemnify a trustee or a director who has been issued with an infringement notice. In its submission, the Law Council expressed some concern about this proposal. First, the Law Council suggested that many trustees, such as those of industry funds, will have

corporate assets available to pay the infringement notices.<sup>25</sup> Second, the Law Council argued that not allowing indemnification from the assets of the fund may raise a conflict of interest between the trustee's interests and the interests of fund members. It was reasoned that, because the trustee would not be able to be indemnified from the fund's assets for the infringement notice, they could elect not to pay the notice and essentially challenge APRA to take the matter to court, where for strict liability offences such as those included as infringement notice provisions 'under their broad rights of the indemnity they would be able to claim reimbursement from the fund'. The Law Council concluded that the restriction on indemnification could make infringement notices as an enforcement tool 'practically useless'.<sup>26</sup>

3.26 The committee raised these concerns with Treasury. Treasury's response focused on how the proposed infringement notice regime complements the earlier tranches of the MySuper reforms:

This goes to the issue of new obligations for directors of trustee boards, as opposed to obligations that apply to the corporate trustee as a collective. The new obligations have been crafted quite carefully, recognising that the general administration and running of a superannuation fund is a matter for the collective trustee board, and those obligations are appropriately applied to the corporate trustee as a collective. The new obligations, though, that attach to individual directors are really behavioural ones. They do not go to decision making of the fund per se, but they go to behaviours like acting honestly and managing your conflicts of interest—they are more behavioural, and they really are within the control of individual directors. So, that is the demarcation there between obligations of the corporate trustee and obligations of individual directors. Again, the government's and the Cooper review's objective here was to raise standards and accountability of individual directors to not leave the impression—and this was Cooper's concern—that the corporate structure shielded them from all responsibility and accountability for their behaviour, but in fact they did have some personal behaviours that they needed to adhere to as part of their role of being a director on a trustee board.<sup>27</sup>

### **Committee view**

3.27 The committee notes the arguments put forward by the Law Council regarding the possible consequences of not allowing a fund's assets to be used to indemnify a trustee or a director who has been issued with an infringement notice. At this time, the committee has decided against recommending amendments in this area. The government's approach is based on a clear principle and this principle

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25 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

26 Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice Section, Law Council of Australia, *Proof Committee Hansard*, 22 January 2013, p. 15.

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

should not, at this stage, be deviated from as a result of assumptions regarding the behaviour of notice recipients. Regardless of indemnification, recipients of notices may not be willing to expend the time and effort necessary to respond to court action. Moreover, once the provisions are in effect, the committee expects that APRA will advise the government if it is established that this aspect of the legislation has negative consequences for the effectiveness of the infringement notice regime.

### **Scope of future infringement notice provisions**

3.28 Both the Law Council and the Corporate Super Association expressed concern about the ability for further offences under the SIS Act or SIS Regulations to be made subject to an infringement notice. The Corporate Super Association stated:

We are concerned that a regime which is intended to provide APRA with the power to issue infringement notices for minor and straight-forward breaches of the Act may end up providing APRA with power to issue notices in relation to more complex matters and that this may be undesirable in view of the ease of issue and the summary treatment of alleged offenders.<sup>28</sup>

3.29 The Law Council suggested that some limitation on the scope of possible provisions be introduced, such as excluding civil penalty provisions.<sup>29</sup> The *Guide to framing Commonwealth offences* suggests that infringement notice schemes can apply to civil penalty provisions, although offences should be limited to matters where 'an enforcement officer can easily make an assessment of guilt or innocence', such as strict or absolute liability offences.<sup>30</sup>

### **Committee view**

3.30 The committee notes that infringement notice provisions contained in other legislation provide for regulations to specify other provisions that will be subject to an infringement notice. The drafting of the bill is, therefore, not unusual in this regard, and the committee does not object to this approach being used in the SIS Act. The committee also notes that regulations which include further offences may be disallowed by either the Senate or the House of Representatives.

3.31 However, the committee does consider that further consideration should be given to the penalties that would apply in the event that civil penalty provisions are included in the infringement notice scheme in the future. For contraventions of civil penalty provisions, the court may order a penalty that does not exceed 2,000 penalty units.<sup>31</sup> While an infringement notice fine of an amount equal to one-fifth of the

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28 Corporate Super Association, *Submission 1*, p. 2.

29 Law Council of Australia, *Submission 2*, p. 5.

30 Attorney-General's Department, *Guide to framing Commonwealth offences, infringement notices and enforcement powers*, September 2011, pp. 57, 58.

31 *Superannuation Industry (Supervision) Act 1993*, s. 196(3).

maximum penalty that a court could impose for the contravention is appropriate for strict liability offences, it is unlikely to be for civil penalties. Other legislation that allow for infringement notices for civil penalty provisions contain different methods for calculating the fine associated with those provisions. For example, the *National Consumer Credit Protection Act 2009*, in which civil penalties equal 2,000 penalty units, provides that the penalty that the regulations could impose must not exceed one-fortieth of the maximum penalty that a court could impose.<sup>32</sup>

#### **Recommendation 4**

**3.32 That schedule 1, item 112, proposed subsection 224A(2) be amended to provide that:**

- **for offences, the amount to be stated in the notice for the alleged contravention of the provision must be equal to one-fifth of the maximum penalty that a court could impose on the person for that contravention; and**
- **for civil penalty provisions, the amount to be stated in the notice for the alleged contravention of the provision must be equal to one-fortieth of the maximum penalty that a court could impose on the person for that contravention.**

#### **Is APRA the appropriate regulator?**

3.33 As noted earlier in this chapter, stakeholders support the idea of infringement notices being issued for straightforward contraventions. Stakeholders also expressed support for APRA having the responsibility for infringement notices:

Whenever you have a regulatory power, you must be able to assess the behaviour. [APRA's] job and its mandate is to know each and every entity across the superannuation industry. That enables it to make a more appropriate decision in terms of the attitude and the culture of an organisation. It is not the role of the ATO to understand the nature, the culture, of the organisation. Therefore they are more likely to have a black-and-white pure breach of legislation. With a lot of the legislation, particularly around pooled funds, particularly if there is a noncompliance, it is not a black-and-white matter. As such, we believe APRA is the more appropriate body.<sup>33</sup>

3.34 In its submission, however, the Australian Chamber of Commerce and Industry (ACCI) noted the inclusion of subsection 64(3A) in the list of offences that will be subject to an infringement notice unless the offence relates to an SMSF.<sup>34</sup> Section 64 of the SIS Act requires superannuation contributions that are deducted

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32 *National Consumer Credit Protection Act 2009*, s. 331(2).

33 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 7.

34 Schedule 1, item 112, proposed subsection 223A(2).

from salary or wages to be remitted promptly. As ACCI notes, the section refers to regulated superannuation funds which include SMSFs. ACCI suggested that:

It seems arguable that where an authorised deduction from salary or wages for a non-concessional contribution into a SMSF is not paid within the required time, the contravention is one which relates to a SMSF. If so, the operation of s 223A(2)(c) seems to exclude contraventions under s 64(3A) where the deducted contribution is to be made into a SMSF from the infringement notice regime. This does not appear to be an intended result.<sup>35</sup>

3.35 Continuing with this line of reasoning, ACCI questioned whether APRA is the appropriate regulator for issuing infringement notices related to section 64. ACCI argued that:

Late payment or non-payment of superannuation guarantee contributions (attracting a superannuation guarantee charge) is overseen by the ATO and the ATO is significantly involved in implementing SuperStream. Most employers do not have any dealings with APRA, and vice versa, and many employers would not know what APRA is ... From the perspective of a complainant there seems little sense or logic in distinguishing between regulators for perceived late or non-payment of contributions because one contribution is concessional and the other is non-concessional.<sup>36</sup>

#### *Committee comment*

3.36 The committee notes the arguments made by ACCI. Regarding the possibility that APRA be permitted to issue infringement notices to SMSFs for alleged breaches of section 64 of the SIS Act, the committee notes that the ATO is the regulator of SMSFs and, within this framework, it may not be ideal for APRA to be involved in one aspect of regulation that relates to SMSFs (albeit an aspect of the SIS Act that is focused on employers) and not others. It is apparent that ACCI's arguments touch on issues beyond those contained in the bill such as the division in responsibility between APRA and the ATO. Accordingly the committee has not focused on this issue; however, it has included this discussion in the report for consideration by policymakers.

### **APRA's approach to issuing infringement notices**

3.37 ACCI expressed some concern about the commencement of the infringement notice provisions; not because ACCI considers the planned commencement is inappropriate,<sup>37</sup> but for the reason that the commencement will coincide with the

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35 Australian Chamber of Commerce and Industry, *Submission 3*, p. 5.

36 Australian Chamber of Commerce and Industry, *Submission 3*, p. 5.

37 To the contrary, ACCI acknowledged that applying infringement notices to contraventions from 1 July 2013 'is appropriate' given that the MySuper obligations commence from that date. Australian Chamber of Commerce and Industry, *Submission 3*, p. 2.

implementation of SuperStream.<sup>38</sup> ACCI noted that during this period it 'is a[t] least possible that there will be system errors which give rise to late payments', and called for APRA to be sensitive to these type of SuperStream-related complications when considering the issuance of an infringement notice or instituting court proceedings.<sup>39</sup>

3.38 When the approach that APRA would take to infringement notices was discussed with Treasury, a Treasury officer noted that a contravention of a strict liability offence does not require the regulator to automatically take action:

The regulator always has the discretion whether or not to enforce a penalty. And that allows a regulator to take a reasonable and pragmatic approach to things that either are inadvertent or there is a reasonable excuse for why they have occurred. I guess though the reason that strict liability provisions exist is because they provide a general deterrent for funds not to breach the provisions.<sup>40</sup>

3.39 ACCI also suggested that publicly available enforcement policy guidelines regarding the use of infringement notices be published by APRA.<sup>41</sup> The general desirability of publicly available guidance was also noted by ASFA:

... one of the key messages which we have been delivering for quite some time now is that we urge all the regulators—APRA, ASIC and the ATO—to issue statements in terms of the way in which they will enforce and apply the legislation and the type of pragmatic approach they are intending. So we can work through it.<sup>42</sup>

3.40 The development and publication of guidelines regarding a regulator's strategy for infringement notices appears to be a best practice approach. In its 2003 report *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, the Australian Law Reform Commission recommended that regulators that have the ability to issue infringement notices should develop and publish guidelines on how they will exercise their discretion to issue, withdraw and correct those notices.<sup>43</sup>

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38 The SuperStream measures are designed to enhance the 'back office' of superannuation and result in the processing of everyday transactions being easier, cheaper and faster. See <http://strongersuper.treasury.gov.au/>.

39 Australian Chamber of Commerce and Industry, *Submission 3*, pp. 2–3.

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

41 Australian Chamber of Commerce and Industry, *Submission 3*, p. 3.

42 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 8.

43 Australian Law Reform Commission, *Principled Regulation: Federal Civil and Administrative Penalties in Australia*, report no. 95, March 2003, p. 34 [recommendation 12-8].

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## Recommendation 5

**3.41 That prior to the commencement of the provisions in the bill that will establish an infringement notice regime, the Australian Prudential Regulation Authority publishes guidance on the approach it will take to exercising its discretion to issue, withdraw and correct those notices.**

### Committee view

3.42 Enabling APRA to issue infringement notices for minor and straightforward contraventions of the SIS Act and regulations is a welcome enhancement of the options currently available for enforcing superannuation law. An infringement notice regime will provide a low-cost alternative to court proceedings for both the recipient of the notice and the regulator. It will add to the options available in the regulator's enforcement toolbox for ensuring the desired regulatory outcome is achieved and will increase the likelihood that the enforcement response is appropriate and proportional to the offence.

3.43 The proposed regime is generally supported by the superannuation sector, and the committee notes that infringement notice regimes have operated successfully in several other regulatory areas. Stakeholders did raise some consequential and technical issues. Fundamentally, many of these issues relate to the approach that APRA will take to its new power. The committee expects that APRA will take a sensible and considered approach to issuing infringement notices. To ensure the integrity of the infringement notice regime is maintained, the committee anticipates that APRA would only issue an infringement notice where it will proceed with court proceedings if the recipient of the notice elects not to pay. To further promote compliance with infringement notices, the committee expects that APRA will be willing to engage with recipients to discuss the conduct that is of concern. These principles, and the recommendations that the committee has made, should alleviate concern and help improve the operation of the provisions.

### Drafting issues

3.44 The committee has identified some drafting issues in item 112 of the bill. Included in the bill is one proposed infringement notice provision that appears outside the scope of 'minor and straight-forward' breaches. Offences against subsection 242M(1) are proposed to be subject to an infringement notice.<sup>44</sup> Subsection 242M(1) is inserted into the SIS Act by the Further MySuper Act that was passed in November 2012. It provides for civil and criminal consequences for contraventions of sections 242K and 242L—provisions that require trustees of eligible rollover funds to promote the financial interests of the beneficiaries of the fund and directors of those funds to exercise a reasonable degree of care and diligence for the purposes of ensuring that the trustee carries out the obligations.

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44 Schedule 1, item 112, proposed subparagraph 223A(1)(i).

3.45 It appears likely that the provision intended to be subject to an infringement notice is actually section 242P, which is also inserted by the Further MySuper Bill. Section 242P makes it a strict liability offence if a person represents that they offer an eligible rollover fund when they are not authorised by APRA.

3.46 Two observations support this conclusion. As the Further MySuper Bill progressed from the exposure draft stage to the bill that was introduced into the Parliament (which ultimately became the Further MySuper Act), the numbering of the sections changed. In the exposure draft, subsection 242M(1) was a strict liability offence if a person represents that they offer an eligible rollover fund when they are not authorised by APRA. However, this provision became subsection 242P(1) in the Further MySuper Bill as introduced to the Parliament, as well as in the Further MySuper Act.

3.47 In addition to the changes to section numbering, it has been identified that the notation in chapter 7 of the original and revised explanatory memorandums for the Further MySuper Bill differ; that is, paragraph 7.40 of the revised explanatory memorandum discusses the matters addressed by section 242P; however, section 242M is stated in the notation that follows the paragraph.

## Recommendation 6

**3.48 That proposed subparagraph 223A(1)(i) contained in schedule 1, item 112 of the bill be amended by omitting 'subsection 242M(1)' and substituting 'subsection 242P(1)'.**

3.49 The committee has also observed that items 70 and 71 of the bill both propose the same amendment, namely the introduction of paragraphs 56(2)(c) and 57(2)(c).<sup>45</sup> However, as shown below, the use of ';' or 'or' differs:

70 At the end of subsections 56(2) and 57(2)

Add:

; or (c) the payment of any amount payable under an infringement notice.

71 After paragraphs 56(2)(b) and 57(2)(b)

Insert:

(c) the payment of any amount payable under an infringement notice; or

3.50 Item 70 appears to be drafted so that the ';' or 'or' is placed in the correct position for relating the proposed paragraph with the existing series (i.e. paragraphs (a) and (b)). Accordingly, item 71 should not be proceeded with.

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<sup>45</sup> This was also identified by the Law Council: *Submission 2*, p. 6.

**Recommendation 7**

**3.51 That the bill be amended to omit schedule 1, item 71.**



## 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.<sup>1</sup>

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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,<sup>2</sup> 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'.<sup>3</sup>

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.<sup>4</sup> The proposed amendments do not apply to SMSFs.<sup>5</sup> 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.

If the costs of changing from the current service provider outweigh potential benefits to members then it is possible for trustees to conclude that

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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.<sup>6</sup>

## ***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'.<sup>7</sup> 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.<sup>8</sup>

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.<sup>9</sup>

### *'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.<sup>10</sup> 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.<sup>11</sup>

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'.<sup>12</sup>

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'.<sup>13</sup> 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'.<sup>14</sup>

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.<sup>15</sup>

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.<sup>16</sup>

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.<sup>17</sup>

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.<sup>18</sup>

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.<sup>19</sup>

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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.<sup>20</sup>

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.<sup>21</sup>

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.<sup>22</sup>

*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.<sup>23</sup>

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.<sup>24</sup>

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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.<sup>25</sup>

### ***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.<sup>26</sup>

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.<sup>27</sup> The committee's recent inquiry into the collapse of Trio Capital noted that Trio was both a licensed superannuation fund

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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.<sup>28</sup>

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.<sup>29</sup> 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)].<sup>30</sup>

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.<sup>31</sup>

### ***Views of stakeholders***

4.29 This amendment is supported by the AIST and the Industry Super Network.<sup>32</sup> 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'.<sup>33</sup> 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.<sup>34</sup>

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.<sup>35</sup>

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.<sup>36</sup>

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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.<sup>37</sup> 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.<sup>38</sup>

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.<sup>39</sup>

### ***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.<sup>40</sup>

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.<sup>41</sup> 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';<sup>42</sup>
- 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;

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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.<sup>43</sup> 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'.<sup>44</sup> 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

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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.<sup>45</sup>

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.<sup>46</sup>

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.<sup>47</sup>

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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.<sup>48</sup>

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.<sup>49</sup>

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.<sup>50</sup>

### ***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.<sup>51</sup>

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.<sup>52</sup>

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.

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account for a member with a \$1 million account balance is much less than this.<sup>53</sup>

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'.<sup>54</sup> ASFA and the Industry Super Network provided similar arguments about the desirability of a cap on percentage-based administration fees.<sup>55</sup> 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.<sup>56</sup>

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'.<sup>57</sup>

### ***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.<sup>58</sup> 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.<sup>59</sup>

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**



## **Additional Comments by Coalition Members**

1.1 This Bill is the fourth tranche of MySuper legislation and also makes governance changes flowing from the Super System Review (Cooper Review) and the government's response to that review (Stronger Super).

1.2 Whilst Coalition members of the Committee broadly support the majority report, two outstanding issues should be addressed when this legislation is considered by Parliament.

1.3 In the meantime it should be noted that this is yet another piece of legislation in relation to superannuation that appears to have been rushed and poorly drafted and is in need of numerous amendments after being introduced into Parliament as a result.

### **Independent directors**

1.4 Good corporate governance of superannuation funds is of vital importance to those Australians whose retirements savings are entrusted to those funds.

1.5 The goal of regulators must be to deliver the most transparent, the most efficient and the most competitive superannuation system possible, with appropriately high corporate governance and transparency standards.

1.6 Only the most transparent, efficient and competitive superannuation system with appropriately high corporate governance arrangements will lead to Australians' retirement savings through their super being maximised.

1.7 The equal representation model was introduced in 1993, supposedly to balance employer and employee representation. The Cooper Review described a number of reasons why this system was no longer contemporary or appropriate, including:

- The superannuation system has moved substantially away from single-employer defined benefit funds that were dominant in 1993. The introduction of fund choice, together with the prevalence of defined contribution funds today, materially changes (and in many cases severs) the close relationship that previously existed between the employer and the super fund.
- The representatives on many trustee boards nominated by third party organisations, such as trade unions. Current employment and industrial relations practices mean that these organisations do not necessarily represent all employers or all employees. Thus, the democracy that the equal representation policy appears to embed in the governance of superannuation funds is not always present in reality. The equal representation model also could result in a perception that individual trustee-directors are required to answer to the organisation that appointed them in respect of trustee decisions or that they are dictated to by that organisation.

- The large number of employers, employer organisations and employee organisations related to a fund can sometimes result in trustee boards being far larger than makes sense for efficient governance of that fund.
- Equal representation leaves significant groups 'unrepresented.' Key among these are members who are pensioners and members who have joined the fund because they exercised fund choice. These groups of members, already sizeable in some funds, can be expected to grow in the future.

1.8 The Cooper Review recommended an end to the equal representation model on superannuation boards (under which union and employer representatives dominate Industry Super funds):

Recommendation 2.7

For those boards that have equal representation because their company constitutions or other binding arrangements so require, the SIS Act should be amended so that no less than one-third of the total number of member representative trustee-directors must be non-associated and no less than one-third of employer representative trustee-directors must be non-associated.

1.9 The Cooper Review found that the equal representation model was not serving the best interest of Australians saving for their retirement.

1.10 In the Coalition's view the equal representation model creates clear conflicts of interest that disadvantage superannuation fund members—working families across Australia.

1.11 The government has failed to act on this recommendation despite a broad industry consensus on its value, as revealed in the inquiry into this Bill:

*Financial Services Council*

Mr Bragg: We thought that the Cooper review recommendations were sensible, particularly as they related to independent directors. That was not accepted in the government's response. Subsequently we have said it was important that it move to a more contemporaneous government model. Through self-regulation we have adopted a model of a majority of independent directors for our members. That commences on 1 July 2013, rolling through transition arrangements to 1 July 2014. So, on balance, we thought the recommendations in the review were sensible and so have in part adopted those through industry self-regulation.

Senator CORMANN: If the coalition were to move amendments to give effect to that recommendation of the Cooper review, the FSC would be supportive?

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Mr Bragg: The interesting thing is that it has been on the record that the model recommended by people was a step in the right direction.<sup>1</sup>

*Association of Superannuation Funds of Australia*

Senator CORMANN: So does that mean that it would be appropriate to have more diversity of perspectives represented on super boards than is currently the case?

Ms Vamos: Yes. In ASFA's view we have some funds that have adopted the model of 3-3-3: three employer, three employee and three independent. We believe that goes a long way towards ensuring that there is that flexibility to have that breadth of experience on the trustee board.<sup>2</sup>

*Law Council of Australia*

Ms McAlister: I believe that, when we made our original submission on the Cooper report, we were in favour of that recommendation. We could see that it had merit—the idea of having, I think it was, one-third independent, one-third employer representatives and one-third members. We could see that there would be some merit in that.<sup>3</sup>

1.12 The Labor government continues to ignore this important governance reform. This is because the current Minister for Superannuation is more focused on the vested interests of his friends in the union movement than on the public interest as outlined in the Cooper Review. This is even though the Cooper Review was commissioned by his own government.

1.13 It is proposed that this Bill be amended to give effect to the principle that each affected trustee board or group of trustees at a minimum will contain one-third in number of independent directors or trustees.

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

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

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

## **Ban on caps for administration fees**

1.14 This Bill is the fourth and (as the government anticipates) last tranche of legislation implementing the MySuper proposal that arose from the Cooper Review. The first bill (Tranche I) established the core provisions for MySuper, which included rules around the charging of fees in relation to member accounts. This included, in effect, a ban on caps for administration fees (as paragraph 6.14 of the explanatory memorandum of the Tranche I Bill discussed):

For any fee that applies to all members of the MySuper product, such as an administration fee or an investment fee, each member is to be charged the fee under the same charging rule. For example, if 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.

1.15 This caused an adverse reaction among industry stakeholders at the time. These stakeholders, as well as the Coalition, were anticipating that the government's current and final MySuper bill (Tranche IV) would include amendments to remove this unnecessary and counter-productive requirement. However, such amendments have not been forthcoming in this Bill.

1.16 As such, the Coalition considers that the current Bill should be amended to allow trustees of MySuper accounts greater flexibility in how they charge fees, and especially in relation to administration fees that are asset-based (ie based on the size of the account balance).

1.17 In particular, a cap or limit to asset-based administration fees should be allowed under the legislation to ensure that fees remain commensurate (or align as close as practicable) with the actual costs of holding accounts, irrespective of the magnitude of their balances.

1.18 Providing super (and other) accounts tend to involve fixed costs (set-up, collecting contributions, investing them, providing statements, reporting, website service, etc) that are large relative to their variable costs. As such, fee formulae are often based on a fixed cost plus a small fixed percentage of the account balance, but only up to a certain threshold or cap, to ensure fees don't become excessive or disproportionate (especially on large account balances).

1.19 The key concern of the Coalition is that, without a cap on fees, a \$500,000 account, for example, could be charged an administration fee one hundred times greater than that of a \$5,000 account. This is despite the fact that the costs to administer those accounts may actually be quite similar and unrelated to size of balance.

1.20 Without caps, the more you have in your super account, the more you can end up paying, even though you might not be receiving any additional service, which is

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inherently unfair, inequitable and inefficient (through the perverse signals and incentives that arise).

1.21 Assuming no profiteering (ie that adequate competition in the market place already exists), this will lead to excessive fees being charged on accounts with larger balances being used to cross-subsidise the under-charging of fees on small-balance accounts. Such obvious and significant cross-subsidisation—which in this instance is so easily avoided by allowing caps—is in no way efficient nor equitable.

1.22 The great irony is that the latter principle (equity and equality) is stated as a key objective of the Bill and (quite absurdly) is put up as a key justification for why no cap on fees is being proposed.

1.23 Ultimately, competition and innovation should discipline and drive fee structures, which should wherever possible be left to the discretion of the account/service provider (the expert).

### **Views of industry stakeholders**

1.24 The industry stakeholders that will be imposing the administration fees on MySuper accounts going forward strongly advocate that caps be allowed, as the following key and pivotal comments, particularly from the inquiry's hearing, attest.

#### ***Association of Superannuation Funds of Australia***

1.25 In its comments to the inquiry's hearing, the Association of Superannuation Funds of Australia (ASFA) not only advocated the flexibility to have caps but also explained the undesirable and perverse incentive that would otherwise arise:

Ms Vamos: So we have advocated for quite some time that there needs to be the flexibility, as there is now, for trustees to ensure that the fees that they charge are equitable **and that, if it is appropriate to put a cap on fees, they are able to do so.** Otherwise, we are going to have the bizarre situation—and it was confirmed by one fund yesterday—that they will feel they have an obligation to contact all of their larger account balance members in their MySuper products and encourage them to move to a choice product. This may not be in their best interest in terms of long-term returns.<sup>4</sup>

1.26 Also from ASFA:

Ms Vamos: I cannot answer on behalf of the government as to why they do not think a cap is appropriate. I can say that certainly we understand as an association that this is an intended policy. We understand this is not a

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4 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 6 (emphasis added).

drafting error and that is why it is covered off as one of the significant issues. **We think this is not good policy.**<sup>5</sup>

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Ms Galbraith: ... Cooper was quite clear that MySuper would not only be for the people who wanted a default but would be available by active choice. Just because someone has a higher account balance does not necessarily mean either that they are especially financially literate or, even if they are, that they actually want to take on the risk of having to manage a portfolio. They might rather have the trustee, with their expertise, exercising that. **To have a prohibition on scales and caps meaning that MySuper is no longer a suitable product for people with high account balances, we think, is contrary to the intent.**<sup>6</sup>

1.27 The likely implications, including overall cost to the industry and confidence in the legislation, are further explained by ASFA:

Ms Vamos: ... My concern is that it is a significant cost. Truth be said, I think the concern of some funds is that, if they ring a member and say, 'Look, we cannot apply a cap anymore; even though the overall fees may be lower, yours will be higher,' that starts to have a confidence issue in the system and maybe even in the legislation, and confidence in the system and in the industry is paramount at this time.<sup>7</sup>

### **Industry Super Network**

1.28 In its comments to the inquiry's hearing, the Industry Super Network (ISN) in its opening statement was also categorical about its support for allowing a cap on fees:

Mr Watts: We have raised the issue of the fee cap on asset based fees in our submission is well. **Our view is that the fee cap should apply to administration fees.** We believe it need not necessarily apply to investment fees, but historically there has not been a concern about fee caps in relation to investment fees, that they are generally being treated equally within the industry. **There are some funds that will have an existing cap on asset based fees and the removal of that ability to cap is a concern.** It is not, I believe, a widespread problem within the industry and it is related to administration fees but we should share that concern. That concludes my opening remarks.<sup>8</sup>

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5 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 8 (emphasis added).

6 Ms Fiona Galbraith, Acting General Manager, Policy and Industry Practice, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 12 (emphasis added).

7 Ms Pauline Vamos, Chief Executive Officer, Association of Superannuation Funds of Australia, *Proof Committee Hansard*, 22 January 2013, p. 10.

8 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 21 (emphasis added).

1.29 Also, when asked about caps being disallowed and the likelihood of fees being significantly higher for large-balance accounts without additional services necessarily being provided, ISN said:

Mr Watts: Yes. ISN supports those views that asset based fees should be capped in relation to administration fees. **We believe that there is a finite cost involved in administration of an account. It is not necessarily related to the size of the account beyond a certain point.** Although it has limited application within the industry, we believe that for those funds that have this particular issue it should be resolved: a cap should be imposed on asset based administration fees.<sup>9</sup>

### *Australian Institute of Superannuation Trustees*

1.30 In its comments to the inquiry's hearing, the Australian Institute of Superannuation Trustees (AIST) in its opening statement was also clear on its advocacy for fee caps:

Mr Haynes: In relation to the prohibition of the existing MySuper legislation on fee capping—a matter that has already been extensively canvassed in the hearing this morning—**we too remain that this prohibition is not in the best interests of all members.** Put simply, the prohibition will result in higher account balance members currently entitled to a cap paying more in a MySuper product and, in some cases, much more than they do in the fund's existing default options. This affects only a minority of funds but the funds involved are not insignificant. Amongst AIST members, they include CareSuper, VicSuper, Non-Government Schools Super, Equisuper and Energy Super.<sup>10</sup>

1.31 Also, when asked about whether fee caps introduce greater complexity and make fee comparisons more complicated (key arguments put up against allowing fee caps), AIST said:

Mr Haynes: We support one cap. We do not support there being a number of different steps. **We see that that does not introduce a great deal of complexity,** and in any event the government, through changes to the original MySuper structure in relation to, say, the introduction of large employer MySuper products, has been prepared to introduce measures that, to our mind, are significantly more complicated than what we are suggesting here.<sup>11</sup>

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9 Mr Richard Watts, External Relations Manager and Legal Counsel, Industry Super Network, *Proof Committee Hansard*, 22 January 2013, p. 24 (emphasis added).

10 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 26 (emphasis added).

11 Mr David Haynes, Project Director, Australian Institute of Superannuation Trustees, *Proof Committee Hansard*, 22 January 2012, p. 28 (emphasis added).

## **Treasury**

1.32 In its comments to the inquiry's hearing, the Treasury spelt out the types of administrative costs involved in providing a member with an account and acknowledged that these costs would not likely vary much with the size of the account's balance:

Mr Rollings: I think the point I was making was to at least question the argument that administrative costs rise with the member's account balance, even below a cap. Given the level of automation for nearly all cases, the administrative service being provided to a member is that of collecting their contributions and investing it, providing regular statements and providing a website service and information. These sorts of costs are pretty much generic across the membership. So the argument that the costs for particular members go up with their account balance is at least open to some questioning.<sup>12</sup>

1.33 Treasury admitted that the government was trying to strike a balance among key design parameters:

Mr Rollings: ... but there are some competing considerations on this issue. The starting point with MySuper, as you know, is to treat all MySuper members equally and equitably. 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.<sup>13</sup>

1.34 The Coalition argues that, precisely by *not* allowing a cap on asset-based administration fees, tiers of first class and second class members (the very inequity the rules try to avoid) will arise. This is because significant cross-subsidisation cannot be avoided.

1.35 Unless a flat fee only is charged for all members (a recipe for cross-subsidisation and inequity), with asset-based fees and no cap, members with large account balances will inevitably end up cross-subsidising those with small account balances.

1.36 Without the allowance of a cap, there are insufficient degrees of freedom for trustees to deliver equitable outcomes to their members in terms of aligning actual

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12 Mr Jonathan Rollings, Principal Adviser, Financial System Division, Treasury, *Proof Committee Hansard*, 22 January 2013, p. 36.

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

costs with fees charged. This is despite Treasury's observation at the inquiry's hearing that 'there are options at the trustees' disposal... [to] recalibrate their fee structure'.<sup>14</sup>

1.37 Treasury further added:

Mr Rollings: There are competing arguments on all of these things. There are trade-offs to be made between the sorts of arguments that have been put forward and the arguments around MySuper **for equitable treatment of members, simplicity and comparability** that some of the witnesses also talked about—none of which on their own are determinants; they require balancing up against each other.<sup>15</sup>

### **Conclusion – current ban on fee caps (remaining from Tranche I Bill)**

1.38 Treasury's comments make clear that this is ultimately a delicate balancing act involving a number of trade-offs and that industry stakeholders provide vital intelligence and practical insight into how that balance can be best struck.

1.39 The key industry stakeholders in this inquiry and its hearing make clear that the current ban on caps for administration fees on MySuper accounts is inappropriate and counter-productive in terms of equality, equity and efficiency and that such a ban should be removed for the benefit of members and the industry more generally.

1.40 The Coalition supports this consensual view and considers that, at the very least, the ban on caps for asset-based administration fees (ie those based on the size of the account balance) that remains from the Tranche I Bill be removed – by adding an amendment to this Tranche IV Bill. More generally, competition and innovation should provide the discipline and motivation for what fee structures arise and prevail and, wherever possible, this should be left to the discretion of the account/service provider (the experts in the field).

1.41 As such, the Coalition proposes to move amendments to this Bill to allow trustees of MySuper fund accounts greater flexibility in the charging of fees so they can remain commensurate with actual costs, and in particular, the ability for trustees to cap asset-based administration fees on superannuation accounts.

### **Recommendation 1**

**1.42 That the Bill be amended to give effect to the principle that each affected trustee board or group of trustees at a minimum will contain one-third in number of independent directors or trustees.**

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

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

**Recommendation 2**

**1.43 That the Bill be amended to remove the ban on caps for asset-based administration fees.**

**Senator Sue Boyce  
Deputy Chair**

**Senator Mathias Cormann  
Shadow Minister for Superannuation**

**Paul Fletcher MP**

**The Hon. Tony Smith MP**

# **Appendix 1**

## **Submissions**

- 1 Corporate Superannuation Association Inc
- 2 Law Council of Australia  
Covering Letter
- 3 Australian Chamber of Commerce and Industry (ACCI)
- 4 Superannuation Complaints Tribunal
- 5 Industry Super Network
- 6 Commonwealth Bank Wealth Management
- 7 Financial Services Council
- 8 Australian Institute of Superannuation Trustees (AIST)
- 9 Confidential
- 10 Association of Superannuation Funds of Australia (ASFA)

## **Answers to questions on notice**

- 1 Received from the Australian Institute of Superannuation Trustees on 24 January 2013
- 2 Received from the Industry Super Network on 25 January 2013
- 3 Received from the Financial Services Council on 25 January 2013
- 4 Received from the Association of Superannuation Funds of Australia Limited on 25 January 2013



## **Appendix 2**

### **Public hearings and witnesses**

**Melbourne, 22 January 2013**

*Financial Services Council*

Mr Andrew Bragg, Senior Policy Manager, Investment and Superannuation

*Association of Superannuation Funds of Australia*

Ms Pauline Vamos, Chief Executive Officer

Ms Fiona Galbraith, Acting General Manager, Policy and Industry Practice

*Law Council of Australia*

Ms Pamela McAlister, Deputy Chair, Superannuation Committee, Legal Practice  
Section

*Industry Super Network*

Mr Richard Watts, External Relations Manager and Legal Counsel

*Australian Institute of Superannuation Trustees*

Mr David Haynes, Project Director

*Treasury*

Mr Jonathan Rollings, Principal Adviser, Superannuation