



# Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

## **LEGAL FRAMEWORK GOVERNING ASPECTS OF THE AUSTRALIAN SUPERANNUATION SYSTEM**

### **Background paper 25**

A TECHNICAL PAPER FOR

THE ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING,  
SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

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The views expressed are the author's views and are not to be understood as expressing the views of the Commission.

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## 1. INTRODUCTION

This technical paper is prepared for the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Its purpose is to explain aspects of the legal framework for the Australian superannuation system, focusing on the rules that govern the use of members' funds by trustees and other professional financial services providers in the superannuation system. It also deals briefly with advice in superannuation, and member dispute resolution.

Compulsory superannuation is usually described as one of the three pillars of Australia's retirement income system.<sup>1</sup> The other pillars are a government-funded and means-tested Age Pension,<sup>2</sup> and voluntary private savings (including voluntary superannuation contributions). Since the introduction of the Superannuation Guarantee (SG) in 1992, most working Australians have had SG contributions made into one or more superannuation funds on their behalf at some stage over their working lives,<sup>3</sup> and about 70% of individuals over the age of 15 and 90% of employed persons are now covered by the superannuation system.<sup>4</sup> Unlike many overseas systems and earlier iterations of the Australian system, the majority of members are now in defined contribution (DC), as distinct from defined benefit (DB), arrangements.<sup>5</sup> Life, disability and income protection insurance is bundled with superannuation for many members.<sup>6</sup>

The superannuation system is complex; in part that complexity arises from the distinct policy settings and concessional tax and social security treatments applied to the different phases of the system through which a member passes. These are: the accumulation phase (characterised by compulsory contributions and preservation of benefits), the transition to

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<sup>1</sup> Some commentators include housing as a fourth pillar, and Medicare as a fifth.

<sup>2</sup> In 2018, 42% of Australians aged over 65 are on a full Age Pension.

<sup>3</sup> *Superannuation Guarantee (Administration) Act 1992* (Cth). The SG requires employers to provide a minimum level of 'employer contributions' to their employee's superannuation fund. The SG was originally set at 3% of an employee's wage or salary as is now at 9.5% and scheduled to rise to 12% by 2026. In general, employers are required to make SG contributions for any employee who is paid at least \$450 per month and, if below 18 years of age, is working over 30 hours per week.

<sup>4</sup> Productivity Commission 2016, *How to Assess the Competitiveness and Efficiency of the Superannuation System*, Research Report, Canberra, 14.

<sup>5</sup> A defined contribution fund is a superannuation fund where the value of the final retirement benefit payable is based on contributions made plus investment returns less any fees and taxes. A defined benefit fund is a superannuation fund where contributions are pooled rather than allocated to particular members, and where retirement benefits are determined by a formula based on factors such as salary and duration of employment: *ibid*, Glossary.

<sup>6</sup> *Ibid*, 23.

retirement phase (during which members ‘have the opportunity to consider an individual approach’ to managing longevity, investment and sequencing risk ‘using particular ... products, investment strategies and withdrawal strategies’ to arrange their affairs), and the retirement phase (during which the accumulated balance can be withdrawn either as a lump sum or an income stream).<sup>7</sup> However underlying that complexity is, at least for most DC members, a fairly simple principle. They or their employers make contributions to a fund over their working lives, that are held and used by trustees for their benefit in a tax advantaged environment, to provide for an income in retirement that supplements or substitutes for the Age Pension.<sup>8</sup>

Superannuation funds and their trustees are controlled by a complex and changing<sup>9</sup> combination of legislative requirements, binding and non-binding regulatory standards and guidance, private law principles and self-regulatory regimes. The legal framework has evolved over time, from a piecemeal and fragmented set of discrete arrangements<sup>10</sup> prior to the commencement of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act)

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<sup>7</sup> Ibid, 24-26. Many of the transition to retirement arrangements were introduced in 2004: see Commonwealth of Australia, The Treasury, *A more flexible and adaptable retirement income system* (2004).

<sup>8</sup> This description of the objective of superannuation is drawn from the recommendation of the Murray FSI in 2014: see Commonwealth of Australia, Financial System Inquiry 2014, *Final Report* Ch 2. However subsequent attempts to entrench this objective in legislation, as recommended by the Murray FSI, failed to achieve bipartisan support and are stalled in the Senate: Superannuation (Objective) Bill 2016 (Cth); see Commonwealth of Australia, Department of the Treasury, *Objective of superannuation: discussion paper*, Treasury, Canberra, 9 March 2016; Senate Economics Legislation Committee, *Report - Superannuation (Objective) Bill 2016 [Provisions]*, February 2017.

<sup>9</sup> In March 2014 the Commonwealth Parliamentary Library compiled and published a survey of superannuation and retirement income law changes from 1968 – 2014; see Kai Swoboda, Parliamentary Library, *Major superannuation and retirement income changes in Australia: a chronology* Research Papers 2013–14, Parliamentary Library, Canberra, 11 March 2014. Ongoing reform is necessary as the superannuation system matures. For a useful pocket history of the superannuation system, see Ross Clare and Andrew Craston, Association of Superannuation Funds of Australia (ASFA) *The Australian superannuation industry* ASFA Research and Resource Centre, Sydney, March 2016. An explanation of the evolution of the legal framework is provided by Warren J in *Ansett Australia Ground Staff Superannuation Plan Pty Ltd v Ansett Australia Ltd* (2002) 174 FLR 1; [2002] VSC 576 at [12] – [44].

<sup>10</sup> For a description of the (various) regulation of superannuation prior to the enactment of the *Superannuation Industry (Supervision) Act 1993* (Cth), see ALRC and CAMAC, *Report No 59: Collective Investments – Superannuation* (1992) Ch 4 and 5.

and associated legislation, through the Financial Services Reform,<sup>11</sup> superannuation safety,<sup>12</sup> and Super System (Cooper) Review and Stronger Super<sup>13</sup> reform programs.

Consistent with the terms of reference of the Royal Commission, this paper focuses primarily on the legal rules that govern what trustees of superannuation funds, and in particular trustees that are RSE licensees,<sup>14</sup> may do with the money the fund collects for or from members while that money is in the fund. The money is typically put to a variety of uses – it is invested to produce returns, used to pay insurance premiums and taxes, applied to pay or reimburse the trustees’ fees and expenses, and on occasions paid out in other ways – until eventually the balance is distributed to the member in retirement.<sup>15</sup> What follows explains the legal, regulatory and governance environment in which trustees’ decisions about the use of members’ money held in superannuation funds are made.

The framework also includes detailed rules that determine how members are enrolled in a particular fund and the basis on which they may withdraw either before or during retirement, but these aspects of superannuation law are not considered here.<sup>16</sup>

## 1.1 Superannuation funds

A foundation feature of the superannuation system is that SG contributions can only be paid into vehicles – usually structured as trusts<sup>17</sup> – that comply with applicable legal and

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<sup>11</sup> The Financial Services Reform program followed from the recommendations of the Financial System Inquiry in 1997, chaired by Mr Stan Wallis AO (Wallis FSI). They included the introduction of what is now *Corporations Act 2001* (Cth) Ch 7.

<sup>12</sup> *Superannuation Safety Amendment Act 2004* (Cth), which amended the *Superannuation Industry (Supervision) Act 1993* (Cth) to introduce the RSE licensing regime.

<sup>13</sup> Commonwealth of Australia, *Super System Review Final Report - Part One: Overview and Recommendations*, and *Final Report - Part Two: Recommendation Packages*, 2010. Stronger Super was the reform package announced by the Gillard Government in response to the recommendations of the Super System Review in December 2010. See <http://strongersuper.treasury.gov.au/content/Content.aspx?doc=media.htm>. The Stronger Super reforms are discussed in Section 1.4 below.

<sup>14</sup> An RSE licensee is a constitutional corporation, body corporate, or group of individual trustees, that holds an RSE licence granted by the Australian Prudential Regulation Authority under *Superannuation Industry (Supervision) Act 1993* (Cth).

<sup>15</sup> The money may be paid out either a lump sum or an income stream in the form of an account-based pension and an annuity, or as a combination of those options. If the member dies before retirement, the fund may provide benefits to the member’s dependants or heirs.

<sup>16</sup> This includes the basis on which new members are enrolled in funds by their employers or pursuant to industrial awards. See generally Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness, Draft Report – Overview* May 2018.

<sup>17</sup> The exception is retirement savings accounts (RSAs) offered under the *Retirement Savings Account Act 1997* (Cth). These deposit products provide benefits upon retirement or death and may also provide a limited range of other benefits; they have certain restrictions placed upon them to make them like other superannuation products. RSAs are subject to concessional rules under income tax and social security law. The legislation also provides for the approval of the entities that can offer RSAs and provides for supervision of the RSA business of those

regulatory requirements. These trust-based vehicles are described generically as ‘superannuation funds’. Membership of a superannuation fund is the basis for most individuals’ participation in the superannuation system, at least during the accumulation phase. Superannuation funds are usually divided into three broad categories:

- Registrable Superannuation Entities (RSEs) that are regulated by the Australian Prudential Regulation Authority (APRA),
- self-managed superannuation funds (SMSFs) regulated by the Australian Taxation Office (ATO), and
- exempt public-sector superannuation schemes (EPSSS).<sup>18</sup>

As at 31 March 2018, the system comprised:

Total superannuation assets	\$2,606.2 billion
Total APRA-regulated assets	\$1,701.8 billion
<i>Of which:</i> total assets in MySuper products	\$641.8 billion
Total self-managed super fund assets	\$712.0 billion
Exempt public sector superannuation schemes assets	\$138.8 billion
Balance of life office statutory fund assets <sup>19</sup>	\$53.6 billion

Source: APRA *Media Release*, 29 May 2018.

As the table shows, about two-thirds of the system is APRA regulated. RSEs regulated by APRA comprise regulated superannuation funds, approved deposit funds and pooled superannuation trusts;<sup>20</sup> the trustees of RSEs must be RSE licensees within the

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entities but does not deal with the general prudential supervision of these entities. They are not widely used given the current very low interest rate environment. See *Retirement Savings Account Act 1997* (Cth) s 7.

<sup>18</sup> EPSSS are superannuation funds providing benefits for government employees, or schemes established by Commonwealth, State or Territory law, that are not directly subject to the *Superannuation Industry (Supervision) Act 1993* (Cth) and APRA regulation. They are not discussed further in this paper.

<sup>19</sup> These are assets held for superannuation or retirement purposes in statutory funds of life insurance companies, excluding the assets held in life office statutory funds by superannuation entities. The balance of life office funds includes annuities and assets backing non-policyholder liabilities. These products are regulated under the *Life Insurance Act 1995* (Cth) and are not considered further in this paper.

<sup>20</sup> See *Superannuation Industry (Supervision) Act 1993* (Cth) ss 10 and 19. An approved deposit fund is an APRA regulated vehicle that can receive, hold and invest certain types of rollovers until they are withdrawn, or a condition of release is satisfied (depending on the preservation status of the assets). They can be either single-member or multi-member. A pooled superannuation trust is a trust in which assets of a number of superannuation funds, approved deposit funds or other pooled superannuation trusts are invested and managed by a professional manager.

meaning of the SIS Act. RSEs include both large institutional superannuation funds and ‘small APRA funds’ that have four members or fewer.<sup>21</sup>

At 30 June 2017 there were 138 APRA-regulated RSE licensees responsible for managing 209 funds with more than four members.<sup>22</sup> These are the large institutional funds; they are generally classified into four types:

- **Retail funds** operate under the trusteeship of a ‘for-profit’ RSE licensee with a corporate, industry or general membership base.
- **Industry funds** operate under the trusteeship of a ‘not-for-profit’ RSE licensee with either an industry or general membership base.
- **Public sector funds** operate under the trusteeship of a not-for-profit RSE licensee with a government membership base.
- **Corporate funds** operate under the trusteeship of a not-for-profit RSE licensee with a corporate membership base.<sup>23</sup>

Members of RSEs are often described as either ‘MySuper’ or ‘Choice’ members. All RSE licensees, regardless of the category into which they fall, must use a MySuper product as the default option in their superannuation funds.<sup>24</sup> MySuper products were introduced following the 2010 Super System Review into the governance, efficiency, structure and operation of Australia’s superannuation system<sup>25</sup> and are designed to have a simple set of product features.<sup>26</sup> MySuper is explained in Section 1.3 below. As at 30 June 2017 there were 112 MySuper products offered by 95 RSEs.<sup>27</sup> About half the accounts in the

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<sup>21</sup> Small APRA funds are not SMSFs. The difference is that all members of SMSFs must also be trustees or directors of the corporate trustee, while in small APRA funds the trustee is not also a member. There are currently about 2,000 small APRA funds with about \$2.1 billion in assets: Australian Prudential Regulation Authority, *Annual Superannuation Bulletin – June 2017* (28 March 2018), 5.

<sup>22</sup> These funds had \$1,615.4 billion in assets and 26.6 million member accounts: see Australian Prudential Regulation Authority, *Annual Superannuation Bulletin – June 2017* (29 March 2018) 5.

<sup>23</sup> Productivity Commission 2016, above n 4, 30. The number of corporate funds (generally open only to members employed by a particular company) has declined from over 4,000 in 1996 to only 30 as of December 2016: See ASFA, above n 9, 16.

<sup>24</sup> Employers are required to make default contributions to an RSE licensee offering a MySuper product from 1 January 2014, and all members under previous default arrangements must have been transferred to a MySuper product by 1 July 2017.

<sup>25</sup> Super System Review Final Report, above n 13.

<sup>26</sup> The commercial terms on which MySuper products operated are more tightly regulated than other funds, by *Superannuation Industry (Supervision) Act 1993* (Cth) Pt 2C.

<sup>27</sup> These comprised 95 generic MySuper products with total assets of \$583.6 billion and 16 large employer MySuper products with total assets of \$10.9 billion at 30 June 2017: Australian Prudential Regulation Authority, *Annual Superannuation Bulletin – June 2017* (29 March 2018). This represents 36.8% of assets held by APRA-regulated superannuation entities.

superannuation system in 2018 are MySuper accounts, representing 24% (\$635 billion) of system assets.<sup>28</sup> The remaining RSE assets are in ‘Choice’ accounts – that is, accounts where members have chosen (rather than defaulted to) a particular investment strategy or product. The Productivity Commission found in 2018 that there are over 40,000 investment options available to RSE members across the superannuation system.<sup>29</sup> This is generally acknowledged to be too many, and to have an adverse impact on competition.<sup>30</sup>

The other main part of the superannuation system is SMSFs, which are regulated by the ATO.<sup>31</sup> These funds may include up to four members all of whom must be trustees or directors of the corporate trustee. SMSFs are exempt from prudential regulation on the basis that there is perceived to be no divergence in interests between members and trustees.<sup>32</sup> The number of SMSFs grew by 70.4% from 350,142 to 596,516 over the 10 years from June 2007 to June 2017.<sup>33</sup> Almost a third of total superannuation assets are now held in SMSFs. Although these funds are described as ‘self-managed’, most SMSF trustees use one or more professional or financial advisers to assist in meeting the fund’s objectives and managing compliance and reporting functions.<sup>34</sup>

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<sup>28</sup> Productivity Commission 2018, above n 16, 25. This is half the number of accounts, not half the number of system participants, and many participants have multiple accounts.

<sup>29</sup> Productivity Commission 2016, above n 4, 32. In 2018 the Productivity Commission said ‘in the choice segment, there has been a proliferation of little used and complex products — over 40 000 in total — which complicates decision making and increases fees without boosting net returns. There are risks that some members who use these products are unwittingly buying a degree of control over their investments at the price of materially lower retirement incomes’: Productivity Commission 2018, above n 16, 19.

<sup>30</sup> In November 2017, APRA Deputy Chairman Helen Rowell said, ‘I have previously expressed the view that there are too many investment options within super’ and went on to observe that, ‘Under APRA’s proposed member outcomes assessment, and as part of sound strategic and business planning, we would expect trustees to seriously consider the optimal number of investment options they should be providing to efficiently deliver quality outcomes for members. Might the time and fees dedicated to administering so many options, many of which appear to be very similar, be better directed elsewhere? In particular, might members be better off with a smaller number of options delivering appropriate risk/return outcomes and a reduction in both fees and fund administration costs? I suspect, in many instances, the answer to both questions is yes’. See Helen Rowell, Australian Prudential Regulation Authority ‘Enhancing Australia’s superannuation system: A vision for a sustainable future’ Speech to the 2017 ASFA Conference, Sydney, 29 November 2017.

<sup>31</sup> Regulation of SMSFs by the ATO as a separate category of fund was introduced by the *Superannuation Legislation Amendment Act (No 3) 1999* (Cth).

<sup>32</sup> Productivity Commission 2016, above n 4, 31. They are also excluded from the mandatory internal and external dispute resolution requirements discussed in Chapter 5 for this reason.

<sup>33</sup> Australian Prudential Regulation Authority, *Annual Superannuation Bulletin – June 2017* (29 March 2018).

<sup>34</sup> See generally, Australian Securities and Investments Commission, *Report 525 - SMSFs: Improving the quality of advice and member experiences* (June 2018).

## 1.2 Sources of law

Superannuation fund trustees operate in a complex legal environment. First and foremost, they are trustees and therefore are subject to all the ordinary principles of the law of trusts,<sup>35</sup> except to the extent these are displaced by legislation. In *Cowan v Scargill*, Sir Robert Megarry V-C said:

... I can see no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts. Of course, there are many provisions in pension schemes which are not to be found in private trusts, and to these the general law of trusts will be subordinated. But subject to that, I think that the trusts of pension funds are subject to the same rules as other trusts.<sup>36</sup>

Their duties as trustee include certain ‘core’ obligations, such as the duty to keep and render accounts; the duty not to allow a conflict between duty and interest; the duty not to obtain an unauthorised benefit from the trust; and the duty to adhere and carry out the terms of the trust deed.<sup>37</sup>

The trustee’s duty to adhere to and carry out the terms of the trust is important in the context of superannuation, because the terms of the trust deed will, subject to some overriding statutory rules including the ‘sole purpose’ test, determine the manner in which the members’ funds may be used. Complying with the terms of the trust has been described as ‘[p]erhaps the most important duty’ of a trustee.<sup>38</sup> One of the ways in which superannuation is regulated in Australia is by prescribing, in legislation, the covenants that must be included in the trust deed as part of the fund’s governing rules. These prescribed covenants are discussed below.

<sup>35</sup> Including the State and Territory trustee legislation.

<sup>36</sup> *Cowan v Scargill* [1985] Ch 270 [1985] 2 All ER 750 at Ch 290, quoted with approval in *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593 at 610 (Waddell CJ in Eq).

<sup>37</sup> See e.g. *Australian Securities and Investments Commission v Letten (No 17)* (2011) 286 ALR 346 (2011) 87 ACSR 155; [2011] FCA 1420 at [17] – [18], referring with approval to *Nolan v Collie* (2003) 7 VR 287; [2003] VSCA 39 at [51] and [53]. See also Pamela F Hanrahan, ‘The Responsible Entity as Trustee’ in Ian Ramsay (ed) *Key Developments in Corporate Law and Trust Law: Essays in Honour of Professor Harold Ford* LexisNexis Sydney 2002, 227-269.

<sup>38</sup> See *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484; [2003] HCA 15 at [32] – [33] (Gleeson CJ, McHugh, Gummow, Kirby & Hayne JJ). A trustee’s function is ‘to take the trusts as it finds them and to administer them as they stand’: *Re Dion Investments Pty Ltd* (2014) 87 NSWLR 753; [2014] NSWCA 367 at [94] (Barrett JA; Beazley P & Gleeson JA agreeing). Cited with approval in *Mercanti v Mercanti* (2016) 50 WAR 495; (2016) 340 ALR 290; (2016) 117 ACSR 222; [2016] WASCA 206 at [81] (Buss P, Newnes and Murphy JJA).

Overlaying the private law of trusts is a raft of relevant legislation, including:

- *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) which establishes the broad framework for the regulation of superannuation funds and for payments into the system, investments and the requirements for eligibility for tax concessions;
- *Superannuation Guarantee (Administration) Act 1992* (Cth) which establishes the framework for the SG compulsory employer contributions;
- *Retirement Savings Account Act 1997* (Cth) establishing RSAs;
- *Income Tax Assessment Act 1997* (Cth) (ITAA) which includes many of the tax rules and rates relating to superannuation contributions, investments and benefits;
- *Corporations Act 2001* (Cth) (Corporations Act) which includes the Australian financial services licence (AFSL) requirements relating to the provision of financial services by and to trustees, a range of mandatory disclosure requirements and (from 1 November 2018) dispute resolution arrangements;
- *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) containing the consumer protection laws for the financial sector;
- *Superannuation (Resolution of Complaints) Act 1993* (Cth) establishing the Superannuation Complaints Tribunal for adjudication of member disputes lodged prior to 31 October 2018.

The *Superannuation (Industry) Supervision Regulations 1993* (Cth) (SIS Regulations) contain operating standards made under Part 3 of the SIS Act. A trustee must ensure that the prescribed standards applicable to the operation of the entity are complied with at all times.<sup>39</sup> An operating standard may elaborate, supplement or otherwise deal with any aspect of a matter relating to the operation of the entity to which a covenant referred to in ss 52 to 53 or prescribed under s 54A of the SIS Act relates, or to the operation of the entity to which a provision of the SIS Act or another provision of the regulations relates. However, a standard applicable to the operation of a superannuation entity is of no effect to the extent that it conflicts with the principal Act.<sup>40</sup> The range of matters dealt with in operating standards is significant.<sup>41</sup>

<sup>39</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 34(1).

<sup>40</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 33A.

<sup>41</sup> For example, *Superannuation Industry (Supervision) Act 1993* (Cth) s 31(2) provides that, for regulated superannuation funds, The standards that may be prescribed include, but are not limited to, standards relating to

RSE licensees are also subject to APRA prudential standards, including those made under Part 3A of the SIS Act. These standards have force of law,<sup>42</sup> and set out certain minimum capital, governance and risk management requirements. The power to make prudential standards in relation to superannuation was given to APRA following the Super System Review by the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth). Currently, the standards are:

- Governance: *APRA Prudential Standards SPS 160 Defined Benefit Matters; SPS 310 Audit and Related Matters; SPS 510 Governance; SPS 520 Fit and proper; SPS 521 Conflicts of Interest; and SPS 530 Investment Governance.*
- Risk management: *APRA Prudential Standards SPS 114 Operational Risk Financial Requirement; SPS 220 Risk Management; CPS 226 Margining and Risk Mitigation for Non-Centrally Cleared Derivatives; SPS 231 Outsourcing; and SPS 232 Business Continuity Management.*
- Other requirements: *APRA Prudential Standards SPS 250 Insurance in Superannuation; SPS 410 MySuper Transition; and SPS 450 Eligible Rollover Fund (ERF) Transition.*

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the following matters: (a) the persons who may contribute to funds; (b) the vesting in beneficiaries in funds of benefits arising directly or indirectly from amounts contributed to the funds; (c) the amount of contributions that a fund may accept; (d) the circumstances in which a fund may accept contributions; (da) the charging of fees (including the calculation of the amount of fees) to members of a fund and members who hold a particular class of beneficial interest in a fund; (db) the attribution of costs between classes of beneficial interest in a fund; (e) the form in which benefits may be provided by funds; (ea) the kinds of benefits that must not be provided by taking out insurance, or insurance of a particular kind; (eb) the kinds of benefits that must not be provided other than by taking out insurance, or insurance of a particular kind; (f) the actuarial standards that will apply to funds; (g) the preservation of benefits arising directly or indirectly from amounts contributed to funds; (h) the payment by funds of benefits arising directly or indirectly from amounts contributed to the funds; (i) the portability of benefits arising directly or indirectly from amounts contributed to funds; (j) the levels of benefits that may be provided by funds and the levels of assets that may be held by funds; (k) the application by funds of money no longer required to meet payments of benefits to beneficiaries because the beneficiaries have ceased to be entitled to receive those benefits; (l) the investment of assets of funds and the management of the investment; (m) the number of trustees, and the composition of boards or committees of trustees, of funds; (ma) the requirements relating to fitness and propriety for RSE licensees of funds and trustees of funds; (n) the keeping and retention of records in relation to funds; (o) the financial and actuarial reports to be prepared in relation to funds; (p) the disclosure of information to beneficiaries in funds; (pa) the disclosure of information by a trustee of a fund who is a member of a group of individual trustees to the other trustees in that group; (q) the disclosure of information about funds to the Regulator; (r) the disclosure of information about funds to persons other than beneficiaries or the Regulator; (s) the financial position of funds; (sa) the outsourcing arrangements relating to the operation of funds; (sb) the adequacy of resources (including human resources, technical resources, and financial resources) of, or available to, trustees of funds; (t) the funding and solvency of funds; and (u) the winding-up of funds.

<sup>42</sup> Prudential standards are part of the 'RSE licensee law' as defined in *Superannuation Industry (Supervision) Act 1993* (Cth) s 10. An RSE licensee must comply with the prudential standards, because it is a condition of their RSE licence imposed by *Superannuation Industry (Supervision) Act 1993* (Cth) s 29E(1)(a).

Both APRA and ASIC routinely issue guidance material explaining how trustees should comply with applicable laws and standards, including APRA Prudential Practice Guides (SPG) and Reporting Standards (SRS) and ASIC Regulatory Guides. These do not have force of law but are appropriately taken into account by trustees in determining compliance matters.

In addition, codes of practice exist at the individual fund and sector levels, including the Australian Institute of Superannuation Trustees (AIST) *Governance Code 2017*<sup>43</sup> and the Financial Services Council (FSC) *Standard 20 – Superannuation Governance Policy*.<sup>44</sup> In December 2017, the superannuation industry announced the release of the *Insurance in Superannuation Voluntary Code of Practice*, which came into effect on 1 July 2018.<sup>45</sup>

### 1.3 The Stronger Super reforms

Much of the law discussed in this Background Paper was introduced as part of the Commonwealth Government's Stronger Super Reform package in 2011 and 2012.<sup>46</sup> The reforms followed from the Super System Review, chaired by Mr Jeremy Cooper, that was commissioned in May 2009 and delivered its final report to Government on 30 June 2010.<sup>47</sup> The Terms of Reference for the Review required that it 'comprehensively examine and analyse the governance, efficiency, structure and operation of Australia's superannuation system, including both compulsory and voluntary aspects', including:

**Governance:** examining the legal and regulatory framework of the superannuation system, including issues of trustee knowledge, skills and training; and thoroughly assess the risks involved in the use of debt and leverage and the development of investment options that lead to a weakening of the diversification principle in the superannuation system;

**Efficiency:** ensuring the most efficient operation of the superannuation system for all members, whether active or passive members and whether

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<sup>43</sup> AIST is an industry body representing the 'profit-for-members' sector. Available at [http://www.aist.asn.au/media/1015695/aist\\_governancecode\\_2017\\_web.pdf](http://www.aist.asn.au/media/1015695/aist_governancecode_2017_web.pdf).

<sup>44</sup> FSC is an industry body representing the for-profit sector. Available at <https://www.fsc.org.au/resources/standards/20s-superannuation-governance-final-fsc-standard-no-20-issued-26-march-2013.pdf>.

<sup>45</sup> Available at [http://www.aist.asn.au/media/1099546/insurance\\_in\\_superannuation\\_voluntary\\_code.pdf](http://www.aist.asn.au/media/1099546/insurance_in_superannuation_voluntary_code.pdf). The government has since signalled its preference for a mandatory code; see also the Australian Government *Response to the ASIC Enforcement Review Taskforce* (April 2018). Participating trustees have until 31 December 2018 to prepare their transition plans to the new arrangements.

<sup>46</sup> See generally, Commonwealth of Australia, *The Treasury, Stronger Super: Information Pack* (21 September 2011).

<sup>47</sup> See n 13.

making compulsory or voluntary contributions, including removing unnecessary complexities from the system and ensuring, in light of its compulsory nature, that it operates in the most cost effective manner and in the best interests of members;

**Structure:** promoting effective competition in the superannuation system that leads to downward pressure on system costs, examining current add-on features of the superannuation system; and, examining other structural legacy features of the system; and

**Operation:** maximising returns to members, including through minimising costs, covering both passive defaulting members, who should receive maximum returns and value for money through soundly regulated default products, and active selecting members, who should not be negatively impacted by conflicts of interest that may inhibit advice being in the best interests of members.<sup>48</sup>

The key elements of the Stronger Super Reforms were described in the following terms:

- the introduction of *MySuper*, a new simple, cost-effective default superannuation product;
- making the process of everyday transactions easier, cheaper and faster through the *SuperStream* package of measures;
- clearer duties for directors of superannuation trustee boards and other measures to improve the *governance and integrity* of the superannuation system; and
- improved integrity and increased community confidence in the *self-managed superannuation fund sector*.<sup>49</sup>

These measures were expected by Government to ‘reduce the average fees paid by members by up to 40 per cent’,<sup>50</sup> although this saving did not eventuate.

Particularly relevant to the matters under discussion here were the introduction of MySuper as a simple default product for the accumulation (pre-retirement) phase of

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<sup>48</sup> The Hon Nick Sherry, ‘Expert Panel and Terms of Reference for Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System’ Media Release 066/2009 (29 May 2009).

<sup>49</sup> Treasury, above n 46, 1.

<sup>50</sup> Ibid.

superannuation, and the governance and integrity measures. These reforms were implemented through several tranches of legislation.<sup>51</sup>

### *MySuper*

An important element of the Super System Review was its treatment, influenced by the insights of behavioural economics, of ‘choice architecture’. The Review recognised that many people who are compulsorily included in the superannuation system had no real appetite to exercise active choice in their superannuation arrangements, particularly early on in their working lives. The majority simply enrolled in their employer’s default fund, which may have included expensive add-ons or options that most (particularly lower balance) members did not need. The Review proposed a new model that would see disinterested members defaulted into simple, sound and lower-cost options that worked for most people, while leaving those who wished to do so the capacity to elect to move from that default option to a Choice structure within a large superannuation fund, or to a self-managed fund.<sup>52</sup>

The change was effected by requiring that, from 1 January 2014, employers’ superannuation guarantee contributions for employees who had not made a choice of fund could only be directed to a fund that offered a MySuper product. There were additional transitional arrangements to deal with situations involving funds nominated in enterprise agreements and awards. Trustees of superannuation funds offering MySuper products were required to transfer the existing balances of their default members to a MySuper product by 1 July 2017.

The key features of the MySuper products were described in the Revised Explanatory Memorandum to the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 in the following terms:

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<sup>51</sup> Including *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth); *Superannuation Legislation Amendment (MySuper Core Provisions) Act 2012* (Cth); *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth); and *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* (Cth).

<sup>52</sup> The Revised Explanatory Memorandum to the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 says at [1.7], ‘It is clear that the superannuation system already adequately caters for those who wish to make choices about their retirement savings. Importantly, MySuper products will not reduce the level of choice that is available within superannuation. For individuals that wish to choose an alternative product they will be free to do so’.

First, MySuper will lift the standards that apply to default superannuation funds. RSE licensees will have a heightened obligation to act in the best financial interests of members that accept the default option. RSE licensees will also need to actively consider whether their MySuper product has access to sufficient scale to provide net returns that are in the best financial interests of members. MySuper products will also be appropriate for members that do not require or generally do not request additional services. Importantly, MySuper products will not allow commissions to be paid from the product.

Second, MySuper will simplify and standardise the default superannuation product available to Australians. Funds will be limited in the number of MySuper products that they will be able to offer. This will make comparisons more manageable by having a well-known and distinct cohort of MySuper products.

MySuper products will also have common characteristics meaning that they will be able to be compared based on a few key differences — cost, investment performance and the level of insurance coverage. MySuper products will be restricted to charging fees that are described in the same way so that they can be directly compared. Members of a particular MySuper product will also be generally charged the same fees, except in limited circumstances. This will enable members, employers and market analysts to make comparisons across MySuper products based on the actual fees paid and investment returns received by members. In addition, APRA will collect and publish data on MySuper products to ensure they are transparent and comparable.<sup>53</sup>

The attributes of a MySuper product are fixed by s 29TC of the SIS Act. For APRA to authorise an RSE licensee to offer a MySuper product,<sup>54</sup> it must be satisfied that the governing rules of the fund ensure that the MySuper product has:

- a single, diversified investment strategy;
- equal access to options, benefits and facilities for all members of the MySuper product;<sup>55</sup>

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<sup>53</sup> Revised Explanatory Memorandum to the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012, [1.9] – [1.11].

<sup>54</sup> Revised Explanatory Memorandum, [4.3].

<sup>55</sup> Access to insurance cover may differ for members as a result of their age, medical status, occupation or other factors.

- processes for amounts to be attributed to members in a way that does not stream gains or losses to only some members of the MySuper product, with an exemption for lifecycle investment strategies;<sup>56</sup>
- no differences in the extent of fee subsidisation of employees of a certain employer if fee subsidisation is allowed by employers;
- no limits on the source or kinds of contributions made by or on behalf of members;
- a prohibition on replacing a member's interest in that MySuper product with another beneficial interest unless the member consents in writing to the replacement no more than 30 days before the replacement occurs or the replacement is permitted, or is required, by a law of the Commonwealth; or
- no pension benefits paid from the assets of the MySuper product to members in retirement.

Fees must be standard across the MySuper product and comply with the requirements in s 29V, with two exceptions. A specific set of charging rules apply to the administration fee for employees of an employer that are members of the MySuper product if their employer has secured a discounted administration fee under the single employer exemption,<sup>57</sup> and to investment fees for lifecycle investment strategies. Insurance premiums are charged to the individual members based on their individual cover.

### ***Governance and integrity reforms***

The second relevant change made in the Stronger Super reforms was to the governance and integrity rules for superannuation funds other than SMSFs. Here the Government departed from the recommendations of the Super System Review in some respects.<sup>58</sup> The changes

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<sup>56</sup> MySuper products may adopt a lifecycle investment strategy as the single diversified investment strategy of the MySuper product. RSE licensees that offer a lifecycle investment strategy for their MySuper product may vary the method of crediting investment returns to a member's account, on the basis of the member's age and other factors prescribed by the regulations.

<sup>57</sup> RSE licensees will be able to offer to employers an arrangement that secures a discounted administration fee for their employees in relation to a generic MySuper product. This will allow RSE licensee to pass on the lower costs from any administrative efficiency of dealing with an employer to the employees of that employer. See Revised Explanatory Memorandum at [6.18]

<sup>58</sup> In particular, the Super System Review recommended creating a new statutory office of 'trustee-director' whereby the duties, power and standards required of this office would be fully set out in the SIS Act; this recommendation was not adopted. The Super System Review also recommended directors of corporate trustees be required to include in their deliberations the impact of their decisions on the environment, the community and the fund's reputation; the Government chose to leave this for APRA to address through relevant guidance material.

were introduced by the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012 (Cth)* and *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013 (Cth)*.

The 2012 Act amended the SIS Act to enhance the obligations of superannuation trustees and directors, both in relation to MySuper products and more generally, and to give APRA the power to issue prudential standards in relation to prudential matters in superannuation. In terms of trustee and director obligations, the key changes were summarised in the following table from the Explanatory Memorandum to the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 as follows:

<b>New law</b>	<b>Current law</b>
<p>Trustees of RSEs that offer a MySuper product will have new obligations in relation to the MySuper product. These obligations are:</p> <ul style="list-style-type: none"> <li>• to promote the financial interests of beneficiaries, in particular returns to those beneficiaries (after the deduction of fees, costs and taxes);</li> <li>• to determine on an annual basis that there is sufficient scale, in terms of assets and beneficiaries, such as to not disadvantage the financial interests of beneficiaries relative to the financial interests of beneficiaries in MySuper products in other RSEs;</li> <li>• to include in the investment strategy the details of the trustee's determination of scale; and</li> <li>• to include in the investment strategy the investment return target (over a rolling 10 year period) and the level of risk appropriate to members of the MySuper product.</li> </ul>	<p>There are no existing duties for trustees that apply specifically to default investment options.</p>
<p>Each trustee of an RSE must exercise the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments.</p>	<p>Each trustee must exercise the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with the property of another for whom the person felt morally bound to provide.</p>
<p>Where a conflict exists between the trustee's or its associate's duties to, or the interests of, beneficiaries (on the one hand) and the trustee's or its associate's duties to another person, or the interests of the trustee or an associate (on the other hand) then the trustee must give priority to the duties to, and interests of, beneficiaries.</p> <p>The trustee must also ensure that the duties to beneficiaries are met despite the conflict, that the interests of beneficiaries are not adversely affected by the conflict and that they comply with prudential standards in relation to conflicts.</p>	<p>There are no provisions in the SIS Act expressly relating to conflict of interest.</p>
<p>Trustees of RSEs must act fairly in dealing with classes of beneficiaries within an RSE and with beneficiaries within a class.</p>	<p>There are no provisions in the SIS Act expressly imposing general requirements to act fairly.</p>

Trustees of RSEs must formulate, review regularly and give effect to investment strategies for the whole of the entity, and for each investment option offered by the trustee in the entity.	Trustees of RSEs are required to formulate and give effect to an investment strategy for the whole of the fund only.
Additional factors to which a trustee of an RSE must have regard when developing an investment strategy include: <ul style="list-style-type: none"> <li>the availability of valuation information;</li> <li>the expected taxation consequences;</li> <li>the expected costs of the strategy; and</li> <li>appropriate due diligence in the selection and monitoring of investment options made available to members.</li> </ul>	When developing an investment strategy, the trustee must have regard to the whole of the circumstances of the entity, including, but not limited to the: <ul style="list-style-type: none"> <li>risk involved;</li> <li>degree of diversification;</li> <li>liquidity of the RSE's investments; and</li> <li>ability to discharge the RSE's liabilities.</li> </ul>
Trustees of RSEs must ensure investment options offered to each beneficiary allows adequate diversification.	Where superannuation funds offer members a choice of investment strategies and the member directs the trustee on the investment strategy to be followed in respect of their benefits, the investment strategy is taken to be in accordance with paragraph 52(2)(f).
Each trustee of an RSE is required to formulate, review regularly and give effect to an insurance strategy for the benefit of beneficiaries of the RSE. The insurance strategy is to address, among other things: the kinds of insurance to be offered; the level or levels of insurance cover offered; the basis for the decision to offer or acquire insurance of those kinds; and the method by which the insurer (or insurers) is determined.	There is no requirement for an insurance strategy in the SIS Act.
Each trustee of an RSE is required to consider the cost to all members when offering insurance of a particular kind or level and should only offer insurance of a particular kind or level if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries.	There is no provision in the SIS Act expressly requiring consideration of the impact of insurance costs on benefits.
Each trustee of an RSE must formulate, review regularly and give effect to a risk management strategy in respect of the RSE. The risk management strategy is to cover the trustee's actions as they relate to the exercise of powers, or the performance of duties and functions, as trustee of the RSE, and the risks which arise from the operation of the RSE.	The conditions imposed on all RSE licences include requirements to: <ul style="list-style-type: none"> <li>have a risk management strategy that complies with Division 8 of Part 2A;</li> <li>comply with that risk management strategy; and</li> <li>comply with each measure and procedure set out in the RSE's risk management plan.</li> </ul>
RSE licensees must maintain and manage financial resources to cover operational risk in respect of each RSE under their trusteeship.	Trustees of public-offer superannuation funds must meet capital requirements.
The governing rules of an RSE must not prohibit the maintenance of an operational risk reserve.	The SIS Act allows the governing rules to prohibit the maintenance of reserves including an operational risk reserve.
Where the financial resources used to cover operational risk are held as capital by an RSE licensee, the licensee cannot indemnify themselves from RSE assets as a means of recouping this draw-down of their capital.	An RSE licensee can indemnify itself from the assets of the RSE, except in cases involving dishonesty or insufficient care and diligence by the licensee or where the licensee is liable for a monetary penalty under a civil order.
An RSE licensee must exhaust all the financial resources maintained for the purpose of covering the operational risk of an RSE (whether held as capital at licensee level and/or a reserve within the RSE) before being indemnified from the assets of the RSE (other than any operational risk reserve in the RSE) for the costs of operational risk.	There is no provision in the SIS Act requiring particular resources to be exhausted before a trustee's indemnity is exercised.

New duties apply to the directors of corporate trustees of RSEs (for example, a director must perform their duties and exercise their powers in the best interests of beneficiaries).	A director of a corporate trustee is required to exercise a reasonable degree of care and diligence (to the standard of a reasonable person) for the purpose of ensuring that the corporate trustee carries out its covenants. However, personal duties (for example, to act in the best interests of beneficiaries) do not apply to the directors of corporate trustees in their own right.
Duties for trustees of SMSFs are moved into new section 52B and duties for directors of SMSFs are moved to new section 52C.	SMSF trustee and director duties are contained in section 52 of the SIS Act.
Trustees must comply with relevant covenants and MySuper duties in order to be able to access the defence to an action for loss or damage in relation to the making of an investment.  Trustees must comply with relevant covenants and MySuper duties in order to be able to access the defence to an action for loss or damage in relation to the management of reserves.	To access the defence to an action for loss or damage in relation to investment, a trustee must show that an investment was made in accordance with the investment strategy formulated under the paragraph 52(2)(f) covenant.  To access the defence to an action for loss or damage in relation to management of reserves, a trustee must show that the management of the reserves was in accordance with the strategy for reserves.

Further governance and integrity reforms were made by the 2013 Act. They included measures 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; to expand APRA's powers to issue infringement notices; to require trustees to provide with reasons for decisions made in relation to a complaint (generally on request) and to increase the time limits within which beneficiaries can lodge complaints with the Superannuation Complaints Tribunal (SCT) regarding total and permanent disability (TPD) claims; to harmonise requirements for adequate resources and risk management systems for RSE licensees that also manage non-superannuation registered managed investment schemes with Corporations Act requirements; and to limit directors' potential personal liability.<sup>59</sup> The 2013 Act also introduced s 58B of the SIS Act relating to conflicts of interest in the appointment of related party service providers, discussed in Chapter 5 below.

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<sup>59</sup> This included requiring persons who have suffered loss or damage due to a director's contravention of duties under the SIS Act to seek leave from the court before bringing an action against a director; extending the availability of the legal defence for trustees and directors in court proceedings to proceedings involving breaches of MySuper obligations; and amending the defences to actions for loss or damage suffered as a result of the making of an investment or the management of reserves to take into account the relevance of the breach of covenants or MySuper obligations to the loss or damage suffered.

## 1.4 Regulatory responsibility

Regulatory responsibility for superannuation is shared between various agencies, including APRA, ASIC and the ATO. The role of each regulator was summarised by the Productivity Commission in the following terms.

### *Australian Prudential Regulation Authority*

APRA is responsible for the prudential regulation of RSEs and RSE licensees. APRA took over responsibility for the prudential regulation of aspects of superannuation from the Insurance and Superannuation Commission following its formation on the recommendation of the Wallis FSI in 1998.<sup>60</sup> APRA's role in the regulation of superannuation has expanded since the introduction of RSE licensing in 2004.<sup>61</sup>

As the regulatory body that registers and licenses superannuation trustees, APRA is responsible for the oversight of trustee conduct. APRA licenses trustees to ensure they have the appropriate qualifications and ability to manage a superannuation fund in the best interests of members. Applicants must provide evidence of likely compliance with prudential standards.... For example, one aspect of APRA's prudential standard for governance requires that registrable superannuation entity (RSE) licensees are adequately qualified, and another 'establishes requirements for the identification, avoidance and management of conflicts of duty and interest by a RSE licensee' .... In addition, APRA registers superannuation funds (RSEs) and authorises MySuper products, giving it the ability to monitor funds and publish information to improve transparency. For example, APRA maintains a publicly available register of RSE licensees (trustees), RSEs, Retirement Savings Accounts, MySuper authorisations and eligible rollover fund authorisations on its website ....<sup>62</sup>

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<sup>60</sup> For a discussion of APRA regulation of superannuation funds between 1998 and 2003, see Australian National Audit Office, *APRA's Prudential Regulation of Superannuation Entities* (15 September 2003).

<sup>61</sup> From 1 July 2004, the *Superannuation Safety Amendment Act 2004* amended the SIS Act to require all trustees of superannuation entities regulated by APRA to obtain an RSE licence and to register the entities for which they are responsible. The reforms aimed to ensure that all trustees of RSEs met certain minimum standards, including in relation to the fitness and propriety of trustees, the adequacy of resources available to trustees, capital requirements and risk management requirements. The transition period, which ended in 2006, saw significant consolidation in the industry.

<sup>62</sup> Productivity Commission 2016, above n 4, 287-8 (references omitted).

### *Australian Securities and Investments Commission*

ASIC is the financial services and financial products disclosure regulator.<sup>63</sup> An RSE licensee that deals in financial products or provides financial product advice must also hold an AFS licence issued by ASIC under Part 7.6 of the Corporations Act. RSE licensees are also subject to extensive disclosure requirements, both at the time a member joins a fund (in the form of a Product Disclosure Statement (PDS)) and on an ongoing basis (in the form of periodic reporting and episodic disclosure of material events). ASIC is also responsible for overseeing funds' MySuper dashboard disclosure.<sup>64</sup> ASIC licenses and regulates the financial sector entities that provide financial services to funds and members, such as custodians, asset managers and financial advisers. The Productivity Commission says:

ASIC regulates the conduct and disclosure obligations of superannuation trustees and financial service providers. ASIC assumes its regulatory role within the superannuation system primarily from the [Corporations Act] and the SIS Act. These powers give ASIC several instruments for administering its objectives, including: licensing and registration, enforcement, complaints management, stakeholder engagement, surveillance, guidance, education and policy advice.<sup>65</sup>

### *Australian Taxation Office*

What distinguishes superannuation from other forms of collective or individual savings and investment vehicles is the special treatment members' contributions and earnings receive in the tax and social security systems. The ATO is therefore involved in the regulation of the superannuation system and is the sole regulator of SMSFs:

The ATO has a general administrative role over several aspects of the superannuation system. This includes oversight of employer contributions, collecting certain information from APRA and administering SuperStream. One of its main roles is to regulate SMSFs, which are not subject to prudential regulation by APRA because the trustee of the fund is also the member.... However, SMSFs are still regulated under superannuation legislation, particularly the SIS Act.... Therefore, the ATO focuses on

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<sup>63</sup> ASIC describes its role in superannuation in the following terms: 'As the conduct and disclosure regulator, ASIC's role primarily concerns the relationship between trustees and individual consumers. ASIC aims to look after consumers ensuring they receive proper disclosure, are dealt with fairly by qualified people, continue to receive useful information about their investment or product and can access proper complaints-handling procedures.' See <https://asic.gov.au/regulatory-resources/superannuation-funds/asics-role-in-super/>.

<sup>64</sup> Corporations Act 2001 (Cth) s 1017BA. See Australian Securities and Investments Commission, *Information Sheet 170 - MySuper product dashboard requirements for superannuation trustees* (August 2014).

<sup>65</sup> Productivity Commission 2016, above n 4, 292 (references omitted).

regulating SMSFs by ensuring members comply with tax and superannuation law.<sup>66</sup>

## 1.5 Regulatory overlap

In its draft report on efficiency and competitiveness in the superannuation system released in April 2018, the Productivity Commission made some observations about the current regulatory architecture. It said:

There has been much recent evolution in the respective roles of APRA and ASIC in superannuation. Revisiting the delineation of regulatory roles is timely. There remain some areas of clear or potential overlap which were not sufficiently addressed in implementing the post-Cooper Review governance reforms. In particular, a clearer articulation of which regulator is responsible for strategic conduct regulation is needed — and in a way that allows for much of this activity to be public and provide a strong demonstration effect to all trustee directors. This would also help to improve the accountability of each regulator.<sup>67</sup>

The Productivity Commission’s draft finding 10.2 was that ‘Conduct regulation arrangements for the superannuation system are confusing and opaque, with significant overlap between the roles of APRA and ASIC. These arrangements have the potential to lead to poor accountability and contribute to the lack of strategic conduct regulation, with poor outcomes for members’.<sup>68</sup> The areas of potential overlap identified by the Productivity Commission include:

- APRA is responsible for the vast majority of the SIS Act, including the Section 52 covenants, covering directors’ responsibilities and duties. These include general covenants, investment covenants, insurance covenants, and covenants relating to risk. ASIC is responsible for provisions of Parts 3 and 6 of the SIS Act (including the Section 52 covenants) to the extent to which they relate to keeping of reports or disclosure of information.
- There is potential for overlap between the regulators (for example, a failure to exercise care by trustees, or a failure to enable beneficiaries to receive information — both contained in the general covenants — could in part relate to disclosure or record keeping).

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<sup>66</sup> Productivity Commission 2016, above n 4, 295-6 (references omitted).

<sup>67</sup> Productivity Commission 2018, above n 16, 41.

<sup>68</sup> *Ibid*, 55.

- ASIC is responsible for the Australian Financial Services Licence (AFSL) regime under the Corporations Act. This requires public offer superannuation funds to hold an AFSL and also requires an AFSL where fund trustees give financial product advice or provide another financial service. There is potential overlap, for example between conditions placed on licences, between AFSL and APRA superannuation entity licensing (a SIS Act responsibility).
- The SIS Act was amended in 2012 to give APRA power to develop prudential standards. APRA can develop standards in various areas relating to conduct of superannuation entity licensees and connected entities, including to protect the interests of beneficiaries, to ensure funds maintain a strong financial position and to ensure the activities of funds are undertaken with integrity, prudence and professional skill.
- Prudential standards cannot be in conflict with the SIS Act or the SIS Regulations, but are not legally constrained by traditional areas of regulator responsibility, leading to potential overlap. Prudential standards dealing with management of conflicts could, for example, overlap with [Corporations Act] provisions (an ASIC responsibility) in this area. APRA consults with ASIC when developing prudential standards.
- Where a trustee Board had failed to undertake a merger that was clearly in the best interests of members, it is unclear whether APRA or ASIC would deal with this matter (as both deal with the requirement to act in the best interests of members, APRA through the SIS Act, and ASIC through the Corporations Act).<sup>69</sup>

ASIC explains its role in superannuation in general terms on its website.<sup>70</sup> As the Productivity Commission notes, the Memorandum of Understanding between ASIC and APRA has not been updated since 2010.

In significant part the regulatory overlap can be explained by the steady expansion of APRA's responsibilities into areas of non-financial risks, which often crosses into the realm of conduct regulation. This element has always been present in APRA's prudential regulation of superannuation,<sup>71</sup> but expanded with the introduction of RSE licensing in 2004 and the Stronger Super governance and integrity reforms and introduction of prudential

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<sup>69</sup> Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness* (Draft Report, April 2018) 396-399.

<sup>70</sup> See <https://asic.gov.au/regulatory-resources/superannuation-funds/asics-role-in-super/>.

<sup>71</sup> Wallis FSI, above n 11, 332-3. For an early example of regulatory overlap, see *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504; (1995) 133 ALR 1; (1995) 18 ACSR 459; (1995) 13 ACLC 1822; [1995] FCA 1663 (Finn J), explaining the respective powers and responsibilities of the Australian Securities Commission and the Insurance and Superannuation Commission in relation to a superannuation fund.

standards from 2013 onwards. The effect of this expansion is that maladministration of a superannuation fund involving breach of the requirements explained in Chapter 4 below, if it is detected by regulators, may potential trigger protective, remedial or enforcement action by APRA – for breach of the RSE licensing laws, breach of prudential standards, or breach by the trustee or its directors of the SIS Act duties and statutory covenants – and by ASIC – for breach of AFS licensing laws, breach of the SIS Act statutory covenants relating to reporting and disclosure, or breach by the directors of their Corporations Act duties as directors of the RSE licensee.<sup>72</sup>

These overlapping responsibilities mean that it is not always clear which agency has ‘first mover’ responsibility; in particular whose regulatory mandate requires it to take the lead when fund performance or reports of misconduct suggest breaches of law. The problem is confounded by the fact that the powers and remedies available to the two agencies in respect of the same misconduct are not well harmonised.<sup>73</sup>

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<sup>72</sup> Pamela F Hanrahan, ‘Directors’ liability in superannuation trustee companies’ (2008) 2 *Journal of Equity* 204.

<sup>73</sup> See Tom Middleton, ‘Banning, disqualification and licensing powers: ACCC, APRA, ASIC and the ATO - regulatory overlap, penalty privilege and law reform’ (2015) 33 *Company and Securities Law Journal* 555.

## 2. TRUSTEE LICENSING AND GOVERNANCE

This Chapter summarises trustee licensing and governance arrangements for APRA regulated funds, including the rules relating to the composition of trustee boards.

All trustees of APRA regulated funds must be RSE licensees. The RSE licensee will be either a body corporate (usually a proprietary limited company) or, if the fund is not a public offer fund, either a body corporate or a group of individual trustees; in the latter case the group is jointly licensed. The trustee is also required to hold an AFS licence issued by ASIC if it deals in financial products in its capacity as a trustee (such as interests in securities) or provides financial product advice (usually in relation to interests in its own funds or investment life products associated with those funds).<sup>74</sup>

RSE licensees are subject to specific governance requirements, including requirements relating to the composition of the trustee board and to conflicts management arrangements. These arise through a combination of legal prescription, fund rules and self-regulatory best practice. They are also subject to a range of reporting obligations on an ongoing basis.

### 2.1 RSE licensing

This part explains briefly the RSE licensing regime administered by APRA under Part 2A of the SIS Act. The regime was introduced in 2004 subject to a two-year transition period, during which there was significant consolidation in the sector.<sup>75</sup> The legislation provides for different classes of RSE licences,<sup>76</sup> including (relevantly):

- a public offer entity licence, which allows the licensee to operate a public offer RSE as defined in s18 of the SIS Act.<sup>77</sup> The applicant must be a constitutional corporation;

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<sup>74</sup> See Australian Securities and Investments Commission, 'How do RSE and AFS licensing application processes work together' (July 2015).

<sup>75</sup> Between July 2001 and July 2007 the number of corporate funds fell from 3,224 to 289; of industry funds from 150 to 74; of public sector funds from 81 to 40; of retail funds from 275 to 172; and of pooled superannuation trusts from 177 to 101. See Australian Prudential Regulation Authority *Annual Superannuation Bulletin June 2007* (26 March 2008) Table 1. That consolidation has continued; in 2017 the numbers were 26 corporate funds, 40 industry funds, 37 public sector funds and 125 retail funds: see Australian Prudential Regulation Authority *Annual Superannuation Bulletin June 2017* (28 March 2018) Table 3.

<sup>76</sup> *Superannuation (Industry) Supervision Regulations 1993* (Cth), Pt 3A.

<sup>77</sup> A public offer entity is defined as a public offer superannuation fund; an approved deposit fund that is not an excluded approved deposit fund; or a pooled superannuation trust. A public offer superannuation fund is a fund

- a non-public offer entity licence, which allows the licensee to be the trustee of RSEs which are not covered by the public offer entity licence, such as corporate superannuation funds. The applicant may be a body corporate or a group of individual trustees; or
- an extended public offer entity licence, which allows the licensee to operate both.

In its licensing application, the applicant must specify its ownership structure. The categories recognised by APRA are:<sup>78</sup>

- financial services corporation ownership<sup>79</sup>
- employer sponsor corporation ownership<sup>80</sup>
- public sector organisation ownership<sup>81</sup>
- nominating organisation ownership<sup>82</sup>
- public company ownership<sup>83</sup> or other ownership type.

These categories are significant because they point to the different structures present in the superannuation system and flow through to governance requirements.

The applicant must provide details of its ‘responsible persons’, defined in *APRA Prudential Standard SPS 520* to include its directors, secretary and senior managers, the RSE auditor and the RSE actuary. The applicant must specify whether individual directors are executive or non-executive directors, and whether they are independent directors, member representatives or employee representatives within the meaning of s 10 of the SIS Act. It

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in which membership is not limited to employees or a particular employer or group of employers and is therefore open to the public generally.

<sup>78</sup> See Australian Prudential Regulation Authority, *Instruction Guide – Application Form RSE Licence* (August 2017).

<sup>79</sup> Where the owner is a financial services corporation – that is, a legal entity created for the purpose of producing financial goods and services for the market, that may be a source of profit or other financial gain to its owner(s) and it is collectively owned by shareholders who have the authority to appoint directors responsible for its general management. This category excludes a financial service corporation that is the principal employer-sponsor of the proposed superannuation entity.

<sup>80</sup> This category is used where the owner is the principal employer-sponsor corporation of the proposed superannuation entity and includes where the applicant is owned by employees of the employer-sponsor corporation: see *Superannuation (Industry) Supervision Act 1993 (SIS)* s 16(1).

<sup>81</sup> Where the owner is an organisation within the government sector or a resident corporation and quasi-corporation controlled by the general government sector. Note this is different from an EPSSS, which is not APRA regulated.

<sup>82</sup> Where the owner is one or more employee or employer associations that represents the members or employers of the proposed superannuation entity.

<sup>83</sup> Excluding a public company that is a financial services corporation, or a public company that is the principal employer-sponsor of the proposed superannuation entity.

must also include information about any ‘controlling influence’ on the trustee, defined in s 70E of the SIS Act as influence on or control over the trustee’s decisions, direction, operation or strategy.

The following table shows the profile of RSE licensees as at June 2017.<sup>84</sup>

<i><b>RSE licensees as at June 2017</b></i>	RSE licensees	RSEs under trusteeship	Assets under management (\$ billion)	Member accounts ('000)
Total	138	209	1,615.4	26,571
<i>By licence type</i>				
Public offer licensee	69	99	1,167.5	23,350
Non-public offer licensee	39	34	158.1	1,040
Extended public offer licensee	19	70	289.7	2,181
Acting trustee licensee	9	5	0.0	0
Group of individual trustees	2	1	0.0	0
<i>By board structure</i>				
Equal representation required by legislation	45	43	477.8	3,676
Equal representation required by governing rules	37	38	546.8	10,516
Non-equal representation	56	128	590.8	12,378
<i>By ownership structure</i>				
Financial services corporation ownership	55	130	611.7	12,766
Employer sponsor (non-public sector) ownership	20	20	82.7	851
Public sector organisation ownership	6	9	302.3	1,331
Nominating organisation ownership	27	26	418.6	9,528
Public company ownership	2	2	70.2	469
Other ownership type	28	22	130.0	1,627
<i>By profit status</i>				
For profit	54	128	588.7	12,313
Not for profit	84	81	1,026.7	14,258

Part B of the RSE licence application requires information to demonstrate the applicant’s likely compliance with the prudential standards determined under the SIS Act, dealing with operational risk financial requirements (SPS 114); risk management (SPS 220); outsourcing (SPS 231); business continuity management (SPS 232); insurance in superannuation (SPS 250); audit and related matters (SPS 310); governance (SPS 510); fit

<sup>84</sup> Source: Australian Prudential Regulation Authority *Annual Superannuation Bulletin June 2017* (28 March 2018) Table 1.

and proper (SPS 520); conflicts of interest (SPS 521); and investment governance (SPS 530). As this list suggests, an RSE licensee is subject to detailed controls over these aspects of its structure and operations.

Once licensed, an RSE licensee must comply with the licence conditions contained in s 29E of the SIS Act,<sup>85</sup> including that it must comply with the RSE licensee law and that the duties of a trustee in respect of each registrable superannuation entity of which it is an RSE licensee must be properly performed by it.<sup>86</sup> The RSE licensee law includes the SIS Act and Regulations, the prudential standards, the *Financial Sector (Collection of Data) Act 2001* (Cth), the *Financial Institutions Supervisory Levies Collection Act 1998* (Cth), and certain designated provisions of the Corporations Act relating to disclosure.<sup>87</sup>

## 2.2 AFS licensing

ASIC takes the view that RSE licensees which:

- deal in financial products (such as securities) in their capacity as trustee of a fund, or
- provide general or personal financial product advice, including in relation to interests in the own funds

must be licensed to do so under Part 7.6 of the Corporations Act, unless otherwise exempt.<sup>88</sup>

As a result, most RSE licensees are also AFS licensees. The AFS licensing regime is explained in Background Paper 7 provided to the Royal Commission in April 2018. Among other things an AFS licensee must: do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee

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<sup>85</sup> Breach of a licence condition may lead to consequences such as a direction from APRA to comply with the condition (see *Superannuation Industry (Supervision) Act 1993* (Cth) s 29EB) or cancellation of the licence (see *Superannuation Industry (Supervision) Act 1993* (Cth) s 29G).

<sup>86</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29E(1)(a) and (b).

<sup>87</sup> These are any of the following provisions of the Corporations Act as applying in relation to financial products that are interests in the RSE: *Corporations Act 2001* (Cth) ss 1013K(1) or (2); 1016A(2) or (3); 1017B(1); 1017C(2), (3) or (5); 1017D(1); 1017DA(3); 1017E(3) or (4); 1020E(8) or (9); 1021C(1) or (3); 1021D(1); 1021E(1); 1021O(1) or (3); 1041E; 1041F(1); and 1043A(1) or (2); and any of the following: ss 1021NA(1), (2) or (3); 1021NB(1), (2) or (3); and 1021NC(1), (2), (3) or (4).

<sup>88</sup> *Corporations Act 2001* (Cth) s 911A.

or the representative; comply with the conditions on the licence; and comply with the financial services laws.<sup>89</sup>

ASIC explains the interaction between the RSE licensing and AFS licensing processes in the following terms:

APRA's licensing requirements are prudentially focused and concentrate on the probity and competence of superannuation trustees, as measured by the fitness and propriety of their 'responsible persons' against APRA's Fit and Proper prudential standards. The APRA licensing process also focuses on the operations, systems and resources (including risk management systems and financial resources) that trustees have in place to prevent or minimise losses to those who hold interests in the superannuation fund. This means that APRA needs information to assess the honesty and integrity of an applicant for an RSE licence, as well as their competence to operate the superannuation fund for the benefit of the members and beneficiaries.

ASIC's licensing requirements mainly focus on consumer protection and market integrity. ASIC assesses whether an applicant for an AFS licence will provide financial services in an efficient, honest and fair manner, including an assessment of the applicant's competence to provide financial services (such as providing advice about interests in a superannuation fund). In order to conduct this assessment, ASIC usually needs the applicant to provide information about the qualifications of its 'responsible managers' and whether they are of good fame and character. ASIC may also ask the applicant to provide information relevant to the assessment of matters such as its compliance measures and its processes for handling complaints from retail clients.<sup>90</sup>

### **2.3 Board composition and structure**

Another distinguishing feature of the superannuation system is that the composition of the boards of RSE licensees is often prescribed to ensure an equal representation of members and employers. The table above indicates that 45 RSE licensees have equal representation required by legislation (that is, Part 9 of the SIS Act) and 37 have equal representation required by the governing rules of the fund. Legislation introduced by the government in 2017 would, if passed, require that all RSE licensees have an independent chair and at least

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<sup>89</sup> *Corporations Act 2001* (Cth) s 912A.

<sup>90</sup> Australian Securities and Investments Commission, 'How do RSE and AFS licensing application processes work together' (July 2015).

one-third independent directors, as defined.<sup>91</sup> The equal representation requirement is discussed below.

Directors, along with the company secretary and senior managers, are ‘responsible persons’ of the RSE licensee, and must be ‘fit and proper’ according to *APRA Prudential Standard SPS 520*. It requires that:

- an RSE licensee must have and implement a Fit and Proper Policy that meets the requirements of this Prudential Standard;
- the fitness and propriety of a responsible person must generally be assessed prior to initial appointment and then re-assessed annually;
- an RSE licensee must take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a responsible person position for which they are not fit and proper;
- additional requirements must be met for RSE auditors and RSE actuaries; and
- certain information must be provided to APRA regarding responsible persons and the RSE licensee’s assessment of their fitness and propriety.<sup>92</sup>

More generally, RSE licensees are required to comply with *APRA Prudential Standard SPS 510*, dealing with governance. Its key requirements are that:

- the Board must have a governance framework which includes, at a minimum, the Board’s charter (or equivalent document) and policies and processes that achieve appropriate skills, structure and composition of the Board;
- the Board must have a written policy which sets out requirements relating to the nomination, appointment and removal of directors that support appropriate Board composition and renewal on an ongoing basis;

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<sup>91</sup> Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017 (Cth). For a thoughtful discussion of independent directors in superannuation, see M Scott Donald and Suzanne Le Mire, ‘Independence and the governance of Australian superannuation funds’ (2016) 31 *Australian Journal of Corporate Law* 80.

<sup>92</sup> Australian Prudential Regulation Authority, *Prudential Standard SPS 520 – Fit and Proper* (28 June 2013) 1.

- a Board Remuneration Committee must be established and the RSE licensee must have a Remuneration Policy that aligns remuneration and risk management;
- a Board Audit Committee must be established; and
- an RSE licensee must have a dedicated internal audit function.<sup>93</sup>

In May 2018, after conducting a thematic review of board governance, APRA provided additional guidance to RSE licensees on board governance, including recommendations about board composition, appointment, renewal and assessment.<sup>94</sup> The Productivity Commission's draft findings released in May 2018 also include recommendations on board composition.<sup>95</sup>

Both the *AIST Governance Code 2017* and *FSC Standard 20 – Superannuation Governance Policy*, mentioned above, deal with board composition and structure – albeit adopting different positions.

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<sup>93</sup> Australian Prudential Regulation Authority, *Prudential Standard SPS 510 - Governance* (31 October 2016) 1.

<sup>94</sup> Australian Prudential Regulation Authority letter to RSE Licensees *Board Governance Thematic Review* 17 May 2018. The recommendations were: that RSE licensees consider, determine, document and regularly review the optimal composition for the board and board committees in the context of the RSE licensee's business operations and strategic plan; that boards consider the extent to which the use of independent experts signals a skills deficiency on the board that would be more appropriately addressed through appointment of a director with the requisite skills and experience; that RSE licensees have a director selection process that provides a clear role for the board (and not just nominating bodies) in the appointment of candidates, with a view to ensuring that candidates with the necessary skills and capabilities are appointed; that RSE licensees have sound renewal and succession planning processes that include policies in relation to tenure limits and reappointment that strike an appropriate balance between ensuring continuity and bringing diversity and fresh perspectives, where the criteria for any exceptions to tenure policy are clear and limited, and the policy is demonstrably implemented in practice; and that RSE licensees have a robust and objective board assessment process that considers the performance of the board as a whole, as well as performance of individual directors, and identifies recommendations to improve performance that are effectively implemented.

<sup>95</sup> Draft recommendation 5 is that 'The Australian Government should legislate to: (a) require trustees of all superannuation funds to use and disclose a process to assess, at least annually, their board's performance relative to its objectives and the performance of individual directors; (b) require all trustee boards to maintain a skills matrix and annually publish a consolidated summary of it, along with the skills of each trustee director; (c) require trustees to have and disclose a process to seek external third party evaluation of the performance of the board (including its committees and individual trustee directors) and capability (against the skills matrix) at least every three years. The evaluation should consider whether the matrix sufficiently captures the skills that the board needs (and will need in the future) to meet its objectives, and highlight any capability gaps. APRA should be provided with the outcomes of such evaluations as soon as they have been completed; and (d) remove legislative restrictions on the ability of superannuation funds to appoint independent directors to trustee boards (with or without explicit approval from APRA)'. Productivity Commission 2018, above n 16, 60.

### ***Equal representation***

As noted, 45 RSE licensees have equal representation required by legislation (that is, Part 9 of the SIS Act) and 37 have equal representation required by the governing rules of the fund.

As the Super System Review observed, the equal representation rules were developed at a time when single-employer defined benefit funds were much more prevalent.<sup>96</sup> Because of the way the SIS Act works, the circumstances in which a fund will follow the equal representation model cannot be stated in general terms. However most of the for-profit RSE licensees do not have equal representation, most corporate funds have equal representation required by legislation, and most industry funds have equal representation (or a variation thereof) required by their governing rules.<sup>97</sup>

Part 9 of the SIS Act applies to a ‘standard employer-sponsored fund’. This is defined in s 16(4) of the SIS Act as a fund that has ‘at least one standard employer-sponsor’. If an employer contributes to a regulated superannuation fund ‘wholly or partly pursuant to an arrangement between the employer and a trustee of the regulated superannuation fund concerned, the employer is a standard employer-sponsor of the fund’. However, if the employer only contributes ‘pursuant to an arrangement between the employer and a member or members of the fund, the employer is not a standard employer-sponsor’.

The current equal representation requirement (which has applied since 1995) is contained in s 92 (for funds with more than four but fewer than 50 members) and s 93 (for funds with more than 49 members) of the SIS Act. The requirements differ depending on whether the fund is a public offer superannuation fund.<sup>98</sup> For example, for a standard

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<sup>96</sup> See n 107 below.

<sup>97</sup> Of the 37 RSE licensees with equal representation required by the governing rules, one is classified as for-profit status and employer sponsor (non-public sector) ownership and the remainder are non-profit status of which 21 are nominating organisation owned, five are employer sponsor (non-public sector) owned, four are financial services corporation owned, one is public company owned, one is public sector organisation owned and five are classified as other ownership type. Of 38 RSE licensees with equal representation required by legislation, one is for-profit status, nominating organisation owned and the remainder are non-profit status. Of these, three are nominating organisation owned, 15 are employer sponsor (non-public sector) owned, seven are financial services corporation owned, one is public company owned, four are public sector organisation owned and eight are classified as other ownership type. Of 40 RSE licensees with non-equal representation, all but two are for-profit status and of those, all but three are financial services corporation owned. Source: Australian Prudential Regulation Authority *Annual Fund-level Superannuation Statistics June 2017* available at <https://www.apra.gov.au/publications/annual-fund-level-superannuation-statistics>.

<sup>98</sup> This is a fund that meets the requirements of *Superannuation Industry (Supervision) Act 1993* (Cth) s 18(1). A superannuation fund is a **public offer superannuation fund** if: (a) one of the following subparagraphs applies to the fund: (i) it is a regulated superannuation fund that is not a standard

employer-sponsored fund that is a public offer superannuation fund with more than 49 members, the requirement is that either the trustee of the fund is an independent trustee, or the fund complies with the basic equal representation rules. Further, if the SIS Regulations provide that the fund is subject to rules about the existence, number and functions of policy committees, the fund must comply with those rules, and each prescribed policy committee must consist of equal numbers of employer representatives and member representatives.<sup>99</sup>

The trustee of the fund is an ‘independent trustee’ if it is not a member of the fund; is neither an employer-sponsor of the fund nor an associate of such an employer-sponsor; is neither an employee of an employer-sponsor of the fund nor an employee of an associate of such an employer-sponsor; is not, in any capacity, a representative of a trade union, or other organisation, representing the interests of one or more members of the fund; and is not, in any capacity, a representative of an organisation representing the interests of one or more employer-sponsors of the fund.<sup>100</sup>

The basic equal representation rule is in s 89 of the SIS Act; it is that the corporate trustee of a standard employer-sponsored fund has an equal number of employer

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employer-sponsored fund; (ii) it is a standard employer-sponsored fund that has at least one member: (A) who is not a standard employer-sponsored member; and (B) who is not a member of a prescribed class; (iii) it is a standard employer-sponsored fund in relation to which an election under subsection (2) has been made; (iv) a declaration under subsection (6) (which allows for funds to be declared to be public offer superannuation funds) is in force in relation to the fund; and (aa) the fund is not a self managed superannuation fund; and (b) no declaration under subsection (7) (which allows for funds to be declared not to be public offer superannuation funds) is in force in relation to the fund.

<sup>99</sup> Policy committees are dealt with in *Superannuation Industry (Supervision) Regulations 1993* (Cth) reg 3.05 – 3.09. In broad terms, a public offer superannuation fund to which s 93 of the SIS Act applies is subject to rules requiring the trustee to take all reasonable steps to ensure that, if there are more than 49 of its members (a **group**) each of whom is a standard employer-sponsored member and has a standard employer-sponsor who is the, or is an associate of a, standard employer-sponsor of each other member of that group, at least one policy committee is established for that group. If such a group comprises at least 5 but fewer than 50 members, a policy committee for that group must be established on request. A policy committee is a body that advises and informs the trustee about matters of concern relating to the fund, which have been raised by members, or employer-sponsors of the fund.

<sup>100</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 10.

representatives and member representatives on its board.<sup>101</sup> There may be an additional independent director.<sup>102</sup>

It is important to understand that, while the member and employer representatives are appointed as such, they must exercise their powers and discharge their duties in the interests of the members as a whole rather than in the interests of the appointer. The duties of directors of superannuation trustee companies are discussed below. As the Super System Review noted in 2010:

There was a strong consensus in submissions that for the most part trustee-directors understand and respect the principle that they are required to safeguard the interests of members as a whole, and not simply to represent one class of member, an appointing organisation or some other stakeholder. However, this result does not appear to arise from the equal representation model, but from the overarching SIS Act and general law requirements that all trustees (and their trustee-directors) have regard for the interests of members as a whole.<sup>103</sup>

Despite the clear legal requirement to avoid partiality, APRA notes that this manner of appointment gives rise to a potential for conflicts. APRA's *Prudential Practice Guide SPG 521 – Conflicts of Interest* (July 2013) states that:

A director of an RSE licensee will often be nominated or appointed by, and may be under an expectation that they will represent the interests of, a nominating body or appointer. APRA considers that this relationship would ordinarily give rise to the director having an obligation to the nominating body or appointer. APRA expects that an RSE licensee would implement

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<sup>101</sup> These terms are defined in *Superannuation Industry (Supervision) Act 1993* (Cth) s 10: **employer representative**, in relation to a group of trustees of a fund, a policy committee of a fund or the board of directors of a corporate trustee of a fund, means a member of the group, committee or board, as the case may be, nominated by: (a) the employer or employers of the members of the fund; or (b) an organisation representing the interests of that employer or those employers; and **member representative**, in relation to a group of trustees of a fund, a policy committee of a fund or the board of directors of a corporate trustee of a fund, means a member of the group, committee or board, as the case may be, nominated by: (a) the members of the fund; or (b) a trade union, or other organisation, representing the interests of those members.

<sup>102</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 89(2) provides that: 'For the purposes of the application of the basic equal representation rules to a fund, a group of trustees, or the board of a corporate trustee, is taken to consist of equal numbers of employer representatives and member representatives if: (a) the group or board includes an additional independent trustee or an additional independent director, as the case may be; and (b) the additional independent trustee or additional independent director, as the case may be, is appointed at the request of the employer representatives, or the member representatives, who are the members of the group or board; and (c) provision is made in the governing rules for the appointment of the independent additional trustee or additional independent director, as the case may be; and (d) the governing rules do not allow the additional independent trustee or additional independent director, as the case may be, to exercise a casting vote in any proceedings of the group or board concerned.'

<sup>103</sup> Super System Review Final Report, above n 13, 54.

processes to ensure that, when appointed, such directors are aware of the strong possibility of a conflict between the interests of beneficiaries and the interests of the nominating or appointing body, as well as the need to disclose relevant duties and interests and avoid, if not manage, any resulting actual or perceived conflicts.<sup>104</sup>

The Super System Review recommended that the equal representation requirement, and the requirement for policy committees, be abolished, because ‘changes in the industry over time and certain implementation practices mean that equal representation no longer seems to achieve its original stated objective’,<sup>105</sup> and ‘the equal representation model appears to impose rigidity into fund governance practices and reduce accountability, without contributing materially to the representation objective on which it was predicated’.<sup>106</sup> The Review put forward various arguments in support of that recommendation.<sup>107</sup>

## 2.4 Legal position of trustee company directors

Directors of superannuation trustee companies are differently positioned from directors of other, unregulated trustee companies.<sup>108</sup> The normal pattern of accountability in trusts with

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<sup>104</sup> Australian Prudential Regulation Authority, *Prudential Practice Guide SPG 521 – Conflicts of Interest* (July 2013) [23].

<sup>105</sup> *Ibid.*, 53.

<sup>106</sup> *Ibid.*, 54.

<sup>107</sup> *Ibid.* These are: ‘(1) The superannuation system has moved substantially away from single-employer defined benefit funds that were dominant in 1993. In that environment, an employer and its employees might both be regarded as having a legitimate interest in the operation of the fund. 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. (2) The employer and employee representatives on many trustee boards are not, in fact, elected by employers or members, but rather are nominated by third party organisations, such as employer associations and 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. (3) 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. (4) ‘Policy committees’ have been an adjunct to the equal representation model as the SIS Act requires a public offer trustee, which does not have equal representation on its board, to establish ‘policy committees’ in respect of each employer with a group of 50 or more employees who are members. The SIS Act requires policy committees to meet even though they have no responsibility. Consequently, many public offer fund trustees have been reluctant to move away from equal representation due to the additional work that policy committees require. The Panel is of the view that maintaining equal representation merely because of the administrative burden of policy committees is not in keeping with the spirit of what the SIS Act and equal representation intended to achieve. (5) Equal representation leaves significant groups ‘unrepresented.’ Key among these are members who are pensioners (and potentially other post-retirement members in the future) 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.’

<sup>108</sup> See generally, Pamela F Hanrahan, ‘Directors’ liability in superannuation trustee companies’ (2008) 2 *Journal of Equity* 204 - 224.

corporate trustees is that the trustee is liable to the beneficiary for the performance of its duties and obligations as trustee, and the directors are liable to the trustee for the performance of their duties and obligations as directors. Absent circumstances creating a ‘special fact’ fiduciary relationship between a director and a beneficiary, directors are not ordinarily directly accountable to beneficiaries.<sup>109</sup> That position is altered for directors of RSE licensees by the statutory covenants in s 52A of the SIS Act, discussed below. These covenants impose obligations of care and loyalty on trustee company directors personally in relation to the management of the fund.

The duties imposed on directors by the statutory covenants are in addition to those owed by the directors to the trustee company itself.<sup>110</sup> This is important, because the ordinary rules that apply to all company directors (for example, relating to the management of directors’ conflicts) apply here. The fact that the director is a director of a trustee company affects the scope and content of their duties as directors in important ways. In *Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd*, Garde AJA stated the position as:

In circumstances where a company is a corporate trustee, a director acting in the best interests of the company as a whole must act in good faith to ensure that the company administers the trust in accordance with the trust deed having regard to the rights and interests of the beneficiaries of the trust. The best interests of the company as a corporate trustee are to act properly in accordance with the trust deed in managing the business of the trust and in dealing with the assets and liabilities of the trust. A director of a corporate trustee must act in good faith to ensure that the company complies with its obligations as a trustee, and properly discharges the duties imposed on it by the trust deed and by trust law generally. It is not in the best interests of the company for it to act in breach of its duties of a trustee, for the company has assumed the responsibilities of that office and must see to it that they are fulfilled.<sup>111</sup>

The standard of care required of the trustee director mirrors that required of the trustee itself;<sup>112</sup> in the case of a director of an RSE licensee it is to act as a prudent person whose

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<sup>109</sup> *Ying Mui Pty Ltd v Hoh (No 3)* (2017) 349 ALR 296; (2017) 119 ACSR 577; [2017] VSC 29 at [387] - [391] (Vickery J), and the cases referred to therein.

<sup>110</sup> The statutory duty to give priority to the members’ interests overrides the director’s duties under *Corporations Act 2001* (Cth) Part 2D.1. *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A(3)(a).

<sup>111</sup> *Australasian Annuities Pty Ltd (in liq) v Rowley Super Fund Pty Ltd* (2015) 318 ALR 302; 104 ACSR 312; [2015] VSCA 9 at [225] (Garde AJA) (citations omitted).

<sup>112</sup> In *Australian Securities Commission v AS Nominees Ltd* (1995) (1995) 62 FCR 504; (1995) 133 ALR 1; (1995) 18 ACSR 459; (1995) 13 ACLC 1822; [1995] FCA 1663 at ALR 13, Finn J held that ‘at least when, and to the extent that, directors of a trustee company are themselves “concerned in” the breaches of trust of their company, they are liable to the company according to the same standard of care and caution as is expected of the

profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity.<sup>113</sup>

The SIS Act allows for the directors to be indemnified out of the fund for certain liabilities incurred in acting as directors; it has effect despite s 241 of the Corporations Act. Section 57 permits the governing rules of a superannuation entity to provide for a director of the trustee to be indemnified out of the assets of the entity in respect of a liability incurred while acting as a director of the trustee, otherwise than against:

- (a) a liability that arises because the director:
  - (i) fails to act honestly in a matter concerning the entity; or
  - (ii) intentionally or recklessly fails to exercise, in relation to a matter affecting the entity, the degree of care and diligence that the director is required to exercise; or
- (b) liability for a monetary penalty under a civil penalty order; or
- (c) the payment of any amount payable under an infringement notice; or
- (d) liability for the costs of undertaking a course of education in compliance with an education direction; or
- (e) liability for an administrative penalty imposed by section 166.

## 2.5 Conflicts management arrangements

RSE licensees are trustees, and therefore fiduciaries. In addition to their fiduciary obligations they are subject to regulatory controls in relation to conflicts of interest, under *APRA Prudential Standard SPS 521* and s 912A(1)(aa) of the Corporations Act. These requirements are explained in *APRA Prudential Practice Guide SPG 521 – Conflicts of Interest* (July 2013) and *ASIC Regulatory Guide 181 – Licensing: Managing conflicts of interest* (August 2004).

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company itself'. See also *Australian Securities and Investments Commission v Parker* (2003) 21 ACLC 888; [2003] FCA 262 at [114]; *Australian Securities and Investments Commission v Australian Property Custodian Holdings Limited (No 3)* [2013] FCA 1324 at [541] – [543]; *Trilogy Funds Management Ltd v Sullivan (No 2)* (2015) 331 ALR 185; [2015] FCA 1452.

<sup>113</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(4).

The Productivity Commission has said that, ‘Conflicts of interest are managed differently depending on whether the trustees operate under a not-for-profit or for-profit structure’, because it considers that governance arrangements for not-for-profit trustees are concerned with managing conflicts between the trustee and the member, while for-profit trustee arrangements must also manage the interests of shareholders.<sup>114</sup> While this is true to an extent, it possibly understates the importance of other conflicts that can arise across the system.

Under *APRA Prudential Standard SPS 521* the RSE licensee’s board must approve the conflicts management framework. It covers both conflicts at the trustee level, and conflicts arising for any ‘responsible person’.<sup>115</sup> The RSE licensee must develop, implement and review a conflicts management policy that is approved by the board; identify all relevant duties and relevant interests; and develop registers of relevant duties and relevant interests.<sup>116</sup> It covers conflicts:

- between the duties owed by an RSE licensee, or a responsible person of an RSE licensee, to beneficiaries and the duties owed by them to any other person;
- between the interests of beneficiaries and the duties owed by an RSE licensee, or a responsible person of the RSE licensee, to any other person;
- between an interest of an RSE licensee, an associate of an RSE licensee or a responsible person or an employee of an RSE licensee, and the RSE licensee’s duties to beneficiaries; and
- between an interest of an RSE licensee, an associate of an RSE licensee or a responsible person or an employee of an RSE licensee and the interests of beneficiaries.

The RSE licensee’s conflicts management policy must include ‘controls and processes applying to all responsible persons and all employees of the RSE licensee’ for, among other things, identifying and recording relevant conflicts, ‘avoiding conflicts where required to do so’ and ‘where there is a conflict, managing that conflict, or ensuring that the conflict is managed in accordance with the requirements to give priority to the duties to, and

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<sup>114</sup> Productivity Commission 2016, above n 4, 285.

<sup>115</sup> Defined in *APRA Prudential Standard SPS 520 Fit and Proper* (28 June 2013).

<sup>116</sup> *APRA Prudential Standard SPS 521 – Conflicts of Interest* (15 November 2012) 1.

interests of, beneficiaries in sections 52(2)(d) and 52A(2)(d) of the SIS Act'. A footnote to the requirement states that 'Nothing in this Prudential Standard authorises a person to manage a conflict if the general law requires the person to avoid it'.<sup>117</sup>

The operation of s 912A(1)(aa) of the Corporations Act, as applied by ASIC pursuant to ASIC Regulatory Guide 181, is discussed in Background Paper 7 provided to the Royal Commission in April 2018. It is worth repeating ASIC's observation that 'many [AFS] licensees have fiduciary obligations to their clients to whom they provide advice or for whom they act in a trustee capacity. These obligations operate in addition to the statutory requirements and should be taken into account when formulating conflicts management arrangements'.<sup>118</sup>

Potential conflicts of interest can arise in a range of situations, including where the RSE licensee is outsourcing functions to a related entity. The particular issues raised by outsourcing are discussed in Chapter 5 below. In late May 2018, APRA provided further guidance to RSE licensees on conflicts management arrangements in relation to outsourcing to related parties.<sup>119</sup>

## 2.6 Relationship with service providers

It has recently been observed that 'the typical modern institutional superannuation fund is a virtual institution'.<sup>120</sup> This reflects the fact that many trustees outsource functions to, or acquire products and services from, related-party or third-party service providers. These may include fund administration, investment management and asset consulting, custodial services, insurance and advice for members.

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<sup>117</sup> Ibid, fn 6. The general law does not apply if the conflict arises in circumstances covered by *Superannuation Industry (Supervision) Act 1993* (Cth) s 58B, discussed below.

<sup>118</sup> Australian Securities and Investments Commission, *Regulatory Guide 181 – Licensing: Managing conflicts of interest* (August 2004), [RG181.19].

<sup>119</sup> Australian Prudential Regulation Authority, Letter to RSE Licensees from Deputy Chairman Helen Rowell dated 29 May 2018. The recommendations were that RSE licensees: undertake rigorous market-based benchmarking of pricing and services prior to engaging a related party service provider, including utilising independent advice and assessment where appropriate; that decision-making by RSE licensees on the use of related party providers is documented, including assessing materiality and demonstrating that the arrangement is in the best interests of members; that RSE licensees review their conflicts management frameworks to ensure they are current and appropriately reflect existing related party arrangements; and that RSE licensees review their processes for ensuring that arrangements with related party service providers are accurately reported as 'associates' on the relevant reporting forms and consistent with the reporting form guidance.

<sup>120</sup> ASFA, above n 9, 12.

Because of this, an important aspect of fund governance is how responsibility is allocated between trustees and the entities to which they outsource functions related to the operation of the fund. *APRA Prudential Standard SPS 231 Outsourcing* requires that an outsourcing agreement must, at a minimum, address designated matters, including liability and indemnity, sub-contracting and insurance. APRA's view is that whilst SPS 231 requires the outsourcing agreement to cover 'any liability', this provision does not prohibit the RSE licensee and the service provider agreeing to a limit on the service provider's liability and indemnities. Limitations in the liability and indemnity provided under the contract must be considered within the RSE licensee's risk management framework and when considering a suitable level for the operational risk financial requirement target amount and tolerance limit.

Some entities that provide financial services to superannuation fund trustees and their members will be AFS licensees; this includes investment managers, asset managers, custodians,<sup>121</sup> insurers and financial advisers. Part 15, Division 2 of the SIS Act contains standards relating to the appointment of investment managers and custodians. These include that 'an investment manager of a superannuation entity must not appoint or engage a custodian of the entity without the written consent of the trustee, or the trustees, of the entity',<sup>122</sup> that custodians have adequate financial resources,<sup>123</sup> that investment managers must be appointed in writing,<sup>124</sup> and that investment managers must be bodies corporate.<sup>125</sup> Section 102 of the SIS Act requires that the trustee include in any investment management agreement 'adequate provision to enable the trustee ... to require the investment manager ... to provide appropriate information as to the making of, and return on, the investments; and to provide such information as is necessary to enable the trustee, or the trustees, of the entity to assess the capability of the investment manager to manage the investments of the entity' and to require the investment manager to provide the information 'whenever it is necessary or desirable to do so'.

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<sup>121</sup> A custodian is an appropriately licensed entity appointed by the trustee to hold superannuation assets for the benefit of fund members.

<sup>122</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 122(1).

<sup>123</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 123.

<sup>124</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 124.

<sup>125</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 125.

### 3. MANDATORY DISCLOSURE

The regulatory system for superannuation relies heavily on mandatory disclosure in various forms to correct the information asymmetries that exist between trustees and members. The policy intention underlying mandatory disclosure is to ensure that trustees' actions can be scrutinised effectively by regulators and by members, potential members and the intermediaries who advise or assist them. This is intended to ensure greater accountability within funds, enhance member engagement and informed decision-making during membership, and expose poorly performing funds to competitive pressure.

Despite the very significant information burden placed on trustees by legislation, including in Part 7.9, Division 3 of the Corporations Act and Part 2B, Division 5 of the SIS Act, it is arguable that the current mandatory disclosure framework is not particularly effective in achieving its policy goals. Much of the information that must be disclosed to members or potential members is not meaningful to them. Comparison between funds is almost impossible and choice can be illusory. Members seeking specific information on which to base their decisions may find it difficult to obtain. Even at the level of reporting to regulators, the Productivity Commission's recent draft findings point to significant shortcomings,<sup>126</sup> including with information provided to APRA in accordance with reporting standards under the *Financial Sector (Collection of Data) Act 2001* (Cth).

This Chapter explains briefly the various forms of mandatory disclosure<sup>127</sup> required of RSE licensees.

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<sup>126</sup> The Productivity Commission concluded that: 'APRA, as the system's prudential guardian and main data custodian, should enhance its data reporting framework to collect more data on actual member outcomes on an ongoing basis. This should include collecting and publishing data at the product level (rather than the fund level), similar to what is collected for MySuper products. Work is also overdue on dealing with inconsistencies between funds in how they report data to the regulator — most importantly for outsourcing arrangements (where related parties are involved or investment costs are being netted off member returns) and the costs of administering insurance. APRA relies heavily on the goodwill of funds to accurately report on these areas in the spirit of the reporting framework, but this alone has proved inadequate — as has now been the experience of the Commission. More broadly, the regulators can do more to improve their data analytics capabilities and to coordinate their efforts on data collection and reporting. There should be a joint exercise by APRA, ASIC, the ATO, the ABS and the Commonwealth Treasury to improve data collection and analysis across the whole super system, with a strong focus on collecting and publishing consistent data.' Productivity Commission 2018, above n 16, 42.

<sup>127</sup> Trustees must provide certain member-specific information in certain circumstances, including where benefits are being dealt with in family law proceedings; see eg *Corporations Act 2001* (Cth) Pt 7.9, Div 11. Those disclosure requirements are not addressed here.

### 3.1 Product Disclosure Statements

The pattern of Part 7.9 of the Corporations Act is to require that a PDS be given to new members before or when they join a fund. PDSs are discussed in Background Paper 7 provided to the Royal Commission in April 2018. The content of PDSs for superannuation funds is prescribed by Pt 7.9, Div 4, Subdiv 4.2B and Schedule 10A, Pt 5B and Schedule 10D of the Corporations Regulations. The PDS for these products must not exceed a prescribed page length (although they can incorporate additional material by reference<sup>128</sup>) and must provide specified information under prescribed headings. These are:

1. About [name of superannuation product]
2. How super works
3. Benefits of investing with [name of superannuation product]
4. Risks of super
5. How we invest your money
6. Fees and costs
7. How super is taxed
8. Insurance in your super
9. How to open an account.

The Corporations Regulations prescribe the manner in which fees and charges must be disclosed in PDS and in the periodic statement given under s 1017D of the Corporations Act (discussed below), by reg 7.9.16O. The information required must be set out in the manner specified in and using the terminology in Part 3 of Schedule 10 to the Corporations Regulations as modified by ASIC Class Order [CO 14/252]. In 2017, ASIC amended its guidance on fees and charges disclosure in ASIC Regulatory Guide 97.<sup>129</sup> However that guidance attracted what ASIC described as ‘strong feedback from across industry around challenges with the implementation of ASIC Class Order CO 14/1252 and RG 97’, prompting ASIC to instigate an external review of the policy. That review, conducted by Mr Darren

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<sup>128</sup> The shorter PDS regime allows for “a matter contained in writing” to be “applied, adopted or incorporated” in a PDS. This is permitted under the modified s 1013C contained in sub-item 5C.1 of Pt 5C in Schedule 10A to the *Corporations Regulations 2001* (Cth), so long as it is done in the manner set out in reg 7.9.11X. Regulation 7.9.11X sets out detailed requirements applying to information incorporated by reference.

<sup>129</sup> Australian Securities and Investments Commission, *Regulatory Guide 97 – Disclosing fees and costs in PDSs and periodic statements* (29 March 2017).

McShane, delivered its report on 24 July 2018. It included 34 recommendations to change the existing approach to disclosure; tellingly the first recommendation was that ‘ASIC undertake a feasibility study into whether it, or another government agency could provide, or sponsor, the development of: (1) a publicly accessible, consumer facing facility providing fee and cost information extracted from PDSs that can be searched and compared on a range of criteria; and/or (2) data about average “Cost of Product” figures for specific investment option types that can be included as a reference figure in Fee Examples’.<sup>130</sup> For now, ASIC has ‘decided to extend its facilitative compliance approach to the fees and costs disclosure requirements until the review is completed and ASIC has considered the expert's recommendations. This means that ASIC will not look to take action against a trustee ... if they are making reasonable endeavours to comply with the fees and costs disclosure requirements’.<sup>131</sup>

In his report, Mr McShane noted that:

... considerations in this Report do not, on the whole, extend into broader framework questions such as the extent to which disclosure, and in particular PDS-based disclosure, can actually play an effective role in consumer decision-making and whether there are better approaches than segregated fee disclosure based primarily on point-of-sale documentation.

Noting the complexities faced by consumers in factoring cost impacts into decision-making, the complexity of information they have available to them and the limitations of supporting tools, it is difficult to be confident that the current regime is an optimal approach. It does however have to be acknowledged that the current regime, based on the toolset of a standardised fee table supported by a worked example set out in a point-of-sale document, is consistent with international approaches.<sup>132</sup>

The Productivity Commission has concluded that, ‘Analysing fees is bedevilled by significant gaps and inconsistencies in how funds report data on fees and costs, despite regulator endeavour to fix this. This lack of fee transparency harms members by making fee comparability difficult at best, and thus renders cost-based competition largely elusive.’<sup>133</sup>

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<sup>130</sup> Darren McShane, *Review of ASIC Regulatory Guide 97: Disclosing fees and costs in PDSs and periodic statements - Report to the Australian Securities and Investments Commission* (ASIC Report 581, July 2018) 150.

<sup>131</sup> See <https://asic.gov.au/regulatory-resources/superannuation-funds/fees-and-costs-disclosure/rg-97-review/>.

<sup>132</sup> McShane, above n 130, 157.

<sup>133</sup> Productivity Commission 2018, above n 16, 16-17.

### 3.2 Product dashboards

Product dashboards are intended to provide key information about MySuper products, which is useful to both new and existing members. The information is presented in a standardised manner to allow consumers to compare products and make informed choices.<sup>134</sup> The MySuper product dashboard must be publicly available on the superannuation fund's website, updated as required and contain the prescribed information about past returns, return targets, risk and fees and costs.<sup>135</sup>

Detailed requirements about the content and presentation of the information in the product dashboard are set out in the Part 7.9, Division 2E of the Corporations Regulations and in APRA's Reporting Standard SRS 700.0 Product dashboard. In December 2013, ASIC issued guidance on the product dashboard requirements in ASIC Information Sheet 170.<sup>136</sup>

The Productivity Commission's draft findings, released in May 2018, include that 'While there is no shortage of information available to members, it is often overwhelming and complex. Dashboards should be a prime mechanism to allow for product comparison and need to be salient, simple and accessible to be effective — but most are not'.<sup>137</sup>

### 3.3 Transparency information

Under s 29QB of the SIS Act, an RSE licensee must disclose and keep current specified information on a website. This information comprises remuneration, governance and other information related to the fund; it includes trustee directors' remuneration for the last two financial years, fund trust deeds and product disclosure statements, a summary of significant event notices sent to fund members in the last two years and a summary of the trustee's voting actions in the last financial year in relation to listed shares held by the fund.<sup>138</sup>

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<sup>134</sup> See Explanatory Memorandum of the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 [3.40].

<sup>135</sup> *Corporations Act 2001* (Cth) s 1017BA.

<sup>136</sup> Australian Securities and Investments Commission, *Information Sheet 170 MySuper product dashboard requirements for superannuation trustees* (December 2013).

<sup>137</sup> Productivity Commission 2018, above n 16, 50. The draft report makes recommendations to improve and extend the use of dashboards.

<sup>138</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 2.37 and 2.38.

### **3.4 Accounts, audit and financial reporting**

Part 4 of the SIS Act includes the reporting standards for RSEs. The objects of the part are to set out rules about the accounts, statements and audits of superannuation entities, and to require certain reports and returns relating to superannuation entities to be given to the Regulator.<sup>139</sup> The Part also includes requirements relating to the appointment of actuaries to the fund. Auditors and actuaries are also subject to the requirements in Part 16 of the SIS Act.

### **3.5 Corporations Act ongoing and periodic disclosure**

Part 7.9 of the Corporations Act requires the provision of information to members and others. The disclosure obligations imposed on trustees are in ss 1017A (obligation to give additional information on request), 1017B (ongoing disclosure of material changes and significant events), 1017BA (trustees of regulated superannuation funds—obligation to make product dashboard publicly available), 1017BB (trustees of registrable superannuation entities—obligation to make information relating to investment of assets publicly available), 1017BC (obligations relating to investment of assets of registrable superannuation entities—general rule about giving notice and providing information), 1017BD (obligations relating to investment of assets of registrable superannuation entities—giving notice to providers under custodial arrangements), 1017BE (obligations relating to investment of assets of registrable superannuation entities—giving notice to acquirers under custodial arrangements), 1017C (information for existing holders of superannuation products and RSA products), 1017D (periodic statements for retail clients for financial products that have an investment component), and 1017DA (trustees of superannuation entities—regulations may specify additional obligations to provide information). These are augmented by additional disclosure requirements in Part 7.9, Division 5 of the Corporations Regulations.

### **3.6 Reporting to APRA**

Superannuation entities are required, under the *Financial Sector (Collection of Data) Act 2001* (Cth) and its reporting standards, to provide data to APRA. This includes extensive data about the profile of the RSE licensee and the RSE, its membership, its investments, its asset allocation, governance and risk management arrangements, fees and financial position.

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<sup>139</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 35.

The data is defined in the (numerous) set of reporting forms and instructions. Some forms are subject to audit requirements.<sup>140</sup>

Except in certain prescribed circumstances, if an RSE licensee is required to give information to APRA under a reporting standard and the information is required to be calculated in a particular way under that standard, it must ensure that if the same or equivalent information is given by the RSE licensee to a person other than an agency of the Commonwealth or of a State or Territory it is calculated in the same way as the information given to APRA.<sup>141</sup> This includes information provided, for example, in the product dashboard.

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<sup>140</sup> See <https://www.apra.gov.au/superannuation-standards-and-guidance>.

<sup>141</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29QC.

#### 4. LEGAL PRINCIPLES GOVERNING USE OF MEMBERS' FUNDS

This Chapter summarises the legal rules that govern what the trustee may do with the money an RSE collects for or from members.

Money in a superannuation fund is given to the trustee to be held on trust for the benefit of the members. The expectation is that it will be invested in accordance with the investment strategy devised by the trustee and (in the case of Choice members) agreed by the member. Necessarily, in the hands of the trustee, it is put to a variety of uses – it is invested to produce returns, used to pay insurance premiums and taxes, applied to pay or reimburse the trustees' fees and expenses, and on occasions paid out in other ways – until eventually the balance is distributed to the member in retirement.<sup>142</sup>

Like all collective investment vehicles, RSEs exhibit the classic 'agency problem' that arises when (beneficial) ownership of assets is separated from their control. To reduce the risk of shirking or self-dealing by the trustee or its officers, the law imposes a range of controls on the use of members' funds in the form of permissions, requirements and prohibitions. As noted, these include 'hard law' controls in the general law of trusts, the applicable legislation and prudential standards and 'soft law' controls in the form of regulatory guidance and self-regulatory codes. In practice, the question of whether a trustee has acted lawfully in relation to the use of members' funds often depends on whether that use:

- is permitted under the terms of the trust
- does not cause the fund to fail the 'sole purpose' test
- is consistent with the RSE licensee's obligation to act in the best interests of members
- does not contravene the 'no conflicts' or 'no profits' fiduciary proscriptions (to the extent they are not excluded by legislation)
- is not negligent, and
- meets any relevant requirements or restrictions for the particular use contained in legislation or prudential standards (for example, for related party transactions).

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<sup>142</sup> The money may be paid out either a lump sum or an income stream in the form of an account-based pension and an annuity, or as a combination of those options. If the member dies before retirement, the fund may provide benefits to the member's dependants or heirs.

What follows is a brief summary of how those (complex) legal principles play out in practice.

#### 4.1 Terms of the trust

When it is registered with APRA, each RSE must lodge a copy of its ‘governing rules’, defined in s 10 of the SIS Act as: ‘(a) any rules contained in a trust instrument, other document or legislation, or combination of them; or (b) any unwritten rules; governing the establishment or operation of the fund, scheme or trust’.

Governing rules are not standard across the sector. However typically they will include provision for the RSE licensee to be paid fees<sup>143</sup> and to recover its costs and expenses, give it wide discretions in relation to the management of the trust fund, and provide for the fullest possible indemnities. There are two constraints on the terms that can be included. The first is that the rules cannot allow the RSE licensee to treat the trust property as if it were beneficially entitled to it; to do so would negate the existence of the trust. The second is that, to the extent the rules do not include covenants required by, or are inconsistent with, Part 6 and (for MySuper) ss 29VN and 29VO<sup>144</sup> of the SIS Act, those statutory provisions prevail.

The objective of Part 6 of the SIS Act is ‘to set out rules about the content of the governing rules of superannuation entities’.<sup>145</sup> Section 52 and 52A of the SIS Act contain covenants to be (or taken to be) included in the governing rules of a regulated superannuation fund that bind, respectively, the RSE licensee and its directors. The covenants in s 52(2) apply to the trustee and are:

- (a) to act honestly in all matters concerning the entity;
- (b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation trustee would exercise in relation to an entity of which it is trustee and on behalf of the beneficiaries of which it makes investments;
- (c) to perform the trustee’s duties and exercise the trustee’s powers in the best interests of the beneficiaries;

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<sup>143</sup> The fees that can be charged in relation to MySuper products are restricted by *Superannuation Industry (Supervision) Act 1993* (Cth) Pt 2C, Div 5 and in relation to funds generally in Pt 11A.

<sup>144</sup> These relate to the scale obligation, discussed below.

<sup>145</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 51.

- (d) where there is a conflict between the duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee:
- (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
  - (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
  - (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
  - (iv) to comply with the prudential standards in relation to conflicts;
- (e) to act fairly in dealing with classes of beneficiaries within the entity;
- (f) to act fairly in dealing with beneficiaries within a class;
- (g) to keep the money and other assets of the entity separate from any money and assets, respectively:
- (i) that are held by the trustee personally; or
  - (ii) that are money or assets, as the case may be, of a standard employer-sponsor, or an associate of a standard employer-sponsor, of the entity;
- (h) not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;
- (i) if there are any reserves of the entity—to formulate, review regularly and give effect to a strategy for their prudential management, consistent with the entity's investment strategies and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due;
- (j) to allow a beneficiary of the entity access to any prescribed information or any prescribed documents.

Section 52 also contains investment covenants, insurance covenants and covenants related to risk<sup>146</sup> that bind the RSE licensee. The investment covenants and insurance covenants are discussed in Chapter 4 below. These are supported by relevant APRA Prudential Standards including *SPS 530 Investment Governance*, *SPS 250 Insurance in Superannuation* and *SPS 220 Risk Management*.

The covenants in s 52A, which apply to RSE licensee directors, are:

- (a) to act honestly in all matters concerning the entity;
- (b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as a prudent superannuation entity director would exercise in relation to an entity where he or she is a director of the trustee of the entity and that trustee makes investments on behalf of the entity's beneficiaries;
- (c) to perform the director's duties and exercise the director's powers as director of the corporate trustee in the best interests of the beneficiaries;
- (d) where there is a conflict between the duties of the director to the beneficiaries, or the interests of the beneficiaries, and the duties of the director to any other person or the interests of the director, the corporate trustee or an associate of the director or corporate trustee:
  - (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
  - (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and
  - (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
  - (iv) to comply with the prudential standards in relation to conflicts;
- (e) not to enter into any contract, or do anything else, that would:

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<sup>146</sup> These are: (a) to formulate, review regularly and give effect to a risk management strategy that relates to: (i) the activities, or proposed activities, of the trustee, to the extent that they are relevant to the exercise of the trustee's powers, or the performance of the trustee's duties and functions, as trustee of the entity; and (ii) the risks that arise in operating the entity; (b) to maintain and manage in accordance with the prudential standards financial resources (whether capital of the trustee, a reserve of the entity or both) to cover the operational risk that relates to the entity.

(i) prevent the director from, or hinder the director in, properly performing or exercising the director's functions and powers as director of the corporate trustee; or

(ii) prevent the corporate trustee from, or hinder the corporate trustee in, properly performing or exercising the corporate trustee's functions and powers as trustee of the entity;

(f) to exercise a reasonable degree of care and diligence for the purposes of ensuring that the corporate trustee carries out the covenants referred to in section 52.

Sections 56 and 57 deal with, respectively, indemnification of the trustee and its directors from the fund assets. Sections 58 and 59 deal with the retention of discretions. Sections 58A and 58B are relevant to the use of members funds. Section 58A is headed 'Service providers and investments cannot be limited to particular persons or associates' and includes the following:

*Service providers*

(2) A provision in the governing rules of a regulated superannuation fund is void to the extent that 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.

*Investments in entities*

(3) A provision in the governing rules of a regulated superannuation fund is void to the extent that it specifies an entity or entities (whether by name or in any other way, directly or indirectly) in or through which one or more of the assets of the fund may or must be invested.

*Financial products*

(4) A provision in the governing rules of a regulated superannuation fund is void to the extent that it specifies (whether by name or by reference to an entity) a financial product or financial products:

(a) in or through which one or more of the assets of the fund may or must be invested; or

(b) that may or must be purchased using assets of the fund; or

(c) in relation to which one or more assets of the fund may or must be used to make payments.<sup>147</sup>

Section 58B is headed ‘Service providers and investments’. It is important because it excludes the application of the fiduciary prohibition to certain transactions entered into by the trustee. It applies if a trustee of a regulated superannuation fund ‘does one or more of the following: (a) acquires a service from an entity; (b) invests assets of the fund in or through an entity; (c) invests assets of the fund in or through a financial product; (d) purchases a financial product using assets of the fund; (e) uses assets of the fund to make payments in relation to a financial product’.

Subsection 58B(2) is to the effect that ‘the general law relating to conflict of interest does not apply to the extent that it would prohibit the trustee, or the trustees, from doing’ any of those things, as long as the trustee does not contravene the SIS Act or any other Act; a legislative instrument made under or any other Act; the prudential standards; the operating standards; the governing rules of the fund; or the SIS Act statutory covenants. Section 58B is discussed in Chapter 4 below.

## 4.2 Sole purpose test

The trustee cannot operate the fund in a manner that is inconsistent with the ‘sole purpose’ test contained in s 62(1) of the SIS Act. It provides that the trustee of a regulated superannuation fund must ensure that the fund is maintained solely for one or more of what are called the core purposes, or alternatively one or more of the core purposes and ancillary purposes.<sup>148</sup> A core purpose is to maintain the fund to provide benefits for each member of the fund on or after:

- the member’s retirement from any business, trade, occupation or employment;
- the member’s attainment of a prescribed age;
- the earlier of the member’s retirement from any business, trade, occupation or employment or the attainment of a prescribed age, or

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<sup>147</sup> Subsections (2), (3) and (4) do not apply ‘if the relevant person, entity or financial product is specified in a law of the Commonwealth or of a State or Territory, or is required to be specified under such a law’: *Superannuation Industry (Supervision) Act 1993* (Cth) s 58A(5).

<sup>148</sup> For a useful discussion of the sole purpose test, see Australian Taxation Office, *Self Managed Superannuation Funds Ruling SMSFR 2008/2*, Appendix 2.

- the member's death, if the death occurred before they attained a prescribed age or retirement, where benefits are provided to the member's dependants or legal representative.

An ancillary purpose is to provide benefits for each member on or after:

- the termination of the member's employment with an employer who, at any time, had made contributions to the fund for that member;
- cessation of employment due to ill health;
- death of the member after retirement where benefits are paid to the member's dependants or legal representative;
- death of the member after attaining a prescribed age where the benefits are paid to the member's dependants or legal representative, or
- other ancillary benefits approved in writing by the Regulator.

Whether a fund complies will depend on the facts of each case and will be assessed by the objective facts, not the subjective views of trustees or, in the case of the corporate trustees, the directors.<sup>149</sup> The test has been explained in the following terms:

... it may be that there are isolated incidents which, viewed in the overall context of the way in which a superannuation fund is being maintained, are so incidental, remote or insignificant, that they cannot, having regard to the objects sought to be achieved by the Act, be regarded as constituting a breach of the sole purpose test. Such incidents will be rare. The legislature, by adopting the "sole purpose" test, has expressly determined that a strict standard of compliance should be adhered to. Under the Act, the test requires more than the presence of a dominant or principal purpose in the maintenance of a superannuation fund — it requires an exclusivity of purpose commensurate with that purpose being the "sole purpose".<sup>150</sup>

Enforcement action in respect of contraventions of the sole purpose requirement, which is a civil penalty provision, appear to be confined to smaller funds. There are several examples of the Deputy Commissioner of Taxation having brought proceedings against SMSF trustees for

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<sup>149</sup> *Montgomery Wools Pty Ltd as Trustee for Montgomery Wools Pty Ltd Super Fund v Cmr of Taxation* [2012] AATA 61 at [102] (Senior Member Redfern).

<sup>150</sup> *AAT Case 10,301* (1995) 95 ATC 374; 31 ATR 1067 at [24].

contraventions,<sup>151</sup> and there have been some enforcement actions by APRA in respect of smaller employer funds.<sup>152</sup>

It has been observed that the sole purpose test ‘makes it difficult for superannuation funds to diversify their services within the fund. For example, funds cannot provide banking products to members as this is not a core purpose. However, they can facilitate lending by providing introductions to their membership. An example of this is Members Equity Bank. This ADI is owned by many industry funds, which hold the asset as a ‘private equity’ investment within the overall pool of members’ investments’.<sup>153</sup> The impact of the restriction on the provision of services, including financial advice, to members is discussed below.

### 4.3 Best interest duty

Superannuation trustees are:

... obliged to act honestly and in good faith, to act in what they consider to be the interests of the members, and to act for proper purposes and upon relevant considerations. In *Metropolitan Gas Co v Federal Commissioner of Taxation* (1932) 47 CLR 621 at 633, Gavan Duffy CJ and Starke J said that the Trustees of a pension scheme “are, of course, in a fiduciary position under the trust instrument, and must exercise their powers honestly and reasonably in the interest of contributors. Otherwise, we apprehend, they would be controlled by a Court of competent jurisdiction”.<sup>154</sup>

Trustees have both a statutory and a general law duty to act in the best interests of members. The duty is expressed in s 52(2)(c) of the SIS Act as a duty ‘to perform the trustee’s duties and exercise the trustee’s powers in the best interests of the beneficiaries’. Much has been written on the nature of the best interests duty in financial services.<sup>155</sup> In the

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<sup>151</sup> For a recent example, see *Deputy Commissioner of Taxation v Rodriguez* (2016) 103 ATR 662; [2016] FCA 860.

<sup>152</sup> E.g., *Australian Prudential Regulation Authority v Derstepanian* [2005] FCA 1121.

<sup>153</sup> Rice Warner, Letter to Australian Prudential Regulation Authority concerning changes to prudential standards and guidance, 3 April 2018 available at [https://www.apra.gov.au/sites/default/files/Submission-Member-Outcomes\\_Rice-Warner.pdf](https://www.apra.gov.au/sites/default/files/Submission-Member-Outcomes_Rice-Warner.pdf).

<sup>154</sup> *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593 at 609 (Waddell CJ in Eq).

<sup>155</sup> For a discussion of the literature, see Pamela F Hanrahan, ‘The relationship between equitable and statutory “best interests” obligations in financial services law’ (2013) 7 *Journal of Equity* 46.

superannuation context, the members' interest are usually equated with their financial interests.<sup>156</sup>

The statutory duty does not expand the general law.<sup>157</sup> It is not to secure the best outcome for members, rather it is to exercise the relevant discretion having sole regard to what is in the best interests of members. This has been described as involving 'not just the pursuit of the best possible authorised end or outcome (as the trustee rationally conceives the matter) for the trust as a whole but also the observance of proper procedures and processes in decision-making'.<sup>158</sup> That s 52(2)(c) of the SIS Act does not add to the general law duty to act in the best interests of members of the fund was emphasised by the New South Wales Court of Appeal in 2011 in the following terms:

The respondent's general law obligation could be expressed, in the language of s 52(2)(c), as an obligation to perform and exercise its duties and powers in the best interests of the beneficiaries. The words "to ensure" add nothing; an obligation is an obligation. Again, the respondent was exercising a discretionary power, and "to ensure" does not turn the question of exercise of a discretionary power into one of strict liability. There is liability if the discretionary power is exercised improperly, but otherwise there is not.<sup>159</sup>

#### 4.4 Fiduciary proscriptions

As a fiduciary, the trustee is subject to the fiduciary proscriptions, generally described as the 'no conflicts' and 'no profits' rules. These have been stated as:

... two proscriptive obligations imposed by equity. Those obligations are, unless the fiduciary has the informed consent of the person to whom they are owed, first, not to obtain any unauthorised benefit from the relationship and, secondly, not to be in a position where the interests or duties of the

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<sup>156</sup> *Cowan v Scargill* [1985] Ch 270 at 287 ; [1984] 2 All ER 750 at 760; *Commonwealth Bank Officers Superannuation Corporation Pty Ltd v Beck* (2016) 334 ALR 692; [2106] NSWCA 218 (Bathurst CJ; Macfarlan and Gleeson JJA agreeing).

<sup>157</sup> *Commonwealth Bank Officers Superannuation Corporation Pty Ltd v Beck* (2016) 334 ALR 692; [2106] NSWCA 218 at [136]; *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 ; [2011] NSWCA 204.

<sup>158</sup> G W Thomas 'The duty of trustees to act in the "best interests" of their beneficiaries' (2008) 2 *Journal of Equity* 177, 202.

<sup>159</sup> *Manglicmot v Commonwealth Bank Officers Superannuation Corp Pty Ltd* (2011) 282 ALR 167; [2011] NSWCA 204 at [121] (Giles JA, Young and Whealy JA agreeing).

fiduciary conflict, or there is a real or substantial possibility they may conflict, with the interest of the person to whom the duty is owed.<sup>160</sup>

The effect of the prohibitions in the superannuation context is that the trustee cannot use its position to derive a benefit or advantage for itself or another person that is not expressly authorised by the governing rules unless it has the fully informed consent of all affected members. Further, it cannot act in circumstances where there is a real and sensible possibility of a conflict arising between its personal interest, or duty to another person, and its duty to act in the interests of the beneficiaries. However, this second proscription is modified by s 58B of the SIS Act, discussed below.

Of course, as Edelman J points out in *Australian Securities and Investments Commission v Drake (No 2)*:

Fiduciary duties are shaped, and can be modified, by the trust instrument or an underlying contract. For instance, in *Kelly v Cooper* [1993] AC 205 at 215, the Privy Council held that no breach occurred since the contract of agency envisaged that the fiduciary might have a conflict of interest. The decision in *Kelly v Cooper* was applied by Lord Browne-Wilkinson in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 at 206 where his Lordship said that “[a]lthough an agent is, in the absence of contractual provision, in breach of his fiduciary duties if he acts for another who is in competition with his principal, if the contract under which he is acting authorises him so to do, the normal fiduciary duties are modified accordingly”.<sup>161</sup>

#### 4.5 Duty of care

The trustee must act with care, skill and diligence in its administration of the trust, including in making use of the members’ money. The duty arises at common law, in equity and under statute. The required standard is that of a prudent superannuation trustee – that is, a prudent person whose profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity.<sup>162</sup>

<sup>160</sup> *Wingecarribee Shire Council v Lehman Bros Australia Ltd (In Liq)* [2012] FCA 1028 at [732] (Rares J) referring to *Pilmer v Duke Group Ltd (In Liq)* (2001) 207 CLR 165 at 197–8 [74], 199 [78] – [79].

<sup>161</sup> *Australian Securities and Investments Commission v Drake (No 2)* (2016) 340 ALR 75; (2016) 118 ACSR 189; [2016] FCA 1552 at [354].

<sup>162</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(4).

The duty of care imposed on trustees was altered following the recommendations of the Super System Review by the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth). Until 1 July 2013, the standard was that of ‘an ordinary prudent person would exercise in dealing with the property of another for whom the person felt morally bound to provide’. The changes made by the 2012 Act are explained in 1.3 above.

#### **4.6 Statutory restrictions on related party dealings**

The SIS Act and the Prudential Standards both contain specific requirements and restrictions that apply when trustees enter into particular transactions, including with related parties.

In the SIS Act, s 65 deals with lending to members and s 66 with acquisitions of assets from related parties. Sections 67 and 67A deal with borrowing, and Part 8 with in-house assets. An in-house asset is a related party loan or investment; the market value ratio of in-house assets cannot exceed 5%.

Section 109 requires that investments be on arm’s length terms. Section 109(1) provides that a trustee or investment manager of a superannuation entity must not invest in that capacity unless:

- (a) the trustee or investment manager, as the case may be, and the other party to the relevant transaction are dealing with each other at arm’s length in respect of the transaction; or
- (b) both:
  - (i) the trustee or investment manager, as the case may be, and the other party to the relevant transaction are not dealing with each other at arm’s length in respect of the transaction; and
  - (ii) the terms and conditions of the transaction are no more favourable to the other party than those which it is reasonable to expect would apply if the trustee or investment manager, as the case may be, were dealing with the other party at arm’s length in the same circumstances.

Section 109(1A) goes on to provide that if:

(a) a trustee or investment manager of a superannuation entity invests in that capacity; and

(b) at any time during the term of the investment the trustee or investment manager is required to deal in respect of the investment with another party that is not at arm's length with the trustee or investment manager;

the trustee or investment manager must deal with the other party in the same manner as if the other party were at arm's length with the trustee or investment manager.

As Weinberg J observed in *Australian Prudential Regulation Authority v Derstepanian*, the term at arm's length 'is not defined in the SIS Act. Nonetheless, it plainly implies a dealing that is carried out on commercial terms. ... [A] useful test to apply is whether a prudent person, acting with due regard to his or her own commercial interests, would have made such an investment'.<sup>163</sup>

#### 4.7 Scale

In managing superannuation funds, trustees ought to have regard to questions of scale. This is because, all other things being equal, larger funds ought to be able to operate more efficiently. In its submission to the Murray FSI in 2014, the Reserve Bank of Australia explained that:

According to the OECD, countries with privately managed DC systems and a large number of small funds typically have higher operating costs than countries with a few relatively large funds offering DB schemes (OECD 2013b). Larger superannuation funds can achieve economies of scale, reducing operating expenses as a share of total assets: larger not-for-profit superannuation funds in Australia tend to realise lower expense ratios compared with smaller comparable funds (Cummings 2012). The ongoing consolidation among superannuation funds should lead to greater economies of scale.<sup>164</sup>

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<sup>163</sup> *Australian Prudential Regulation Authority v Derstepanian* (2005) 60 ATR 518; [2005] FCA 1121 at [18] (Weinberg J).

<sup>164</sup> Reserve Bank of Australia, *Submission to the Financial System Inquiry* (March 2014) [7.3.1].

The Productivity Commission’s draft findings, released in May 2018, point to costs to members of remaining in sub-scale funds.<sup>165</sup> In its view, failed fund mergers are a contributing factor:

Evidence of unrealised economies of scale, persistent underperformance and an entrenched large number of small funds — about half of all APRA-regulated funds have less than \$1 billion in assets — raises the question of why there have not been more fund mergers, given the likely benefits for members. Membership of an underperforming fund imposes large costs — as noted earlier (in cameo 1), a typical full-time worker in the median bottom-quartile fund (on investment performance) can expect to retire with a balance less than half the size than if they were in the median top-quartile fund.<sup>166</sup>

In MySuper, trustees and their directors are subject to a specific requirement to address questions of scale. Section 29VN(b) of the SIS Act provides that:

Each trustee of a regulated superannuation fund that includes a MySuper product must:

...

(b) determine on an annual basis whether the beneficiaries of the fund who hold the MySuper product are disadvantaged, in comparison to the beneficiaries of other funds who hold a MySuper product within those other funds, because the financial interests of the beneficiaries of the fund who hold the MySuper product are affected:

(i) because the number of beneficiaries of the fund who hold the MySuper product is insufficient; or

(ii) because the number of beneficiaries of the fund is insufficient; or

(iii) where the assets of the fund that are attributed to the MySuper product are, or are to be, pooled with other assets of the fund or assets of another entity or other entities—because that pool of assets is insufficient; or

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<sup>165</sup> The Productivity Commission points to ‘the remaining large tail of small funds (with higher expenses) suggests unrealised scale economies remain, at much cost to members (figure 8)’: Productivity Commission 2018, above n 16, 24-5.

<sup>166</sup> Ibid, 28.

(iv) in a case to which subparagraph (iii) does not apply—because the assets of the fund that are attributed to the MySuper product are insufficient; and

This is supported by an obligation imposed directly on the directors of a corporate trustee in relation to a MySuper product by s 29VO of the SIS Act, to ‘exercise a reasonable degree of care and diligence for the purposes of ensuring that the corporate trustee carries out the obligations referred to in s 29VN’. This requires ‘the degree of care and diligence that a superannuation entity director would exercise in the corporate trustee’s circumstances’, and for this purpose a superannuation entity director is a person whose profession, business or employment is or includes acting as director of a corporate trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity’.

## 5. APPLICATION OF THE LEGAL PRINCIPLES

This Chapter explains the how legal principles governing to the use of members' funds, explained in Chapter 4, impact specifically on superannuation fund fees, trustee remuneration and expenses, investments, insurance and outsourcing.

### 5.1 Fees

Trustees may charge fees if this is provided for in the governing rules. Depending on their nature, fees will be deducted at the fund (or sub-fund) level or from a member's individual account.

The SIS Act restricts the types of fees that can be charged in connection with MySuper accounts<sup>167</sup> and imposes certain requirements relating to fees for other accounts.<sup>168</sup> The Productivity Commission found that fees paid exceed \$30 billion per year (excluding insurance premiums) and that reported fees in Australia are higher than in many OECD countries.<sup>169</sup> The government has recently introduced legislation to cap fees on certain low balance and inactive accounts,<sup>170</sup> but otherwise the level of fees is a matter for the market, except where the legislation specifically provides that the fee must be limited to cost recovery.

APRA collects and publishes information about fund level fees (by source of payment and type of fee) in its annual superannuation statistics.<sup>171</sup> However as the Productivity Commission has observed, there are real limitations in the data collected.<sup>172</sup> Part of the complexity lies in the fact that costs are incurred at various points in the investment chain that are hard to capture. Amendments to the disclosure requirements for superannuation funds from 2017 attempted to capture these other costs through disclosure of an 'indirect cost ratio' but this has proven difficult to implement.<sup>173</sup>

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<sup>167</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) Pt 2C, Div 5.

<sup>168</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) Pt 11A.

<sup>169</sup> Productivity Commission 2018, above n 16, 15-17.

<sup>170</sup> Treasury Laws Amendment (2018 Superannuation Measures No 1) Bill 2018.

<sup>171</sup> See Australian Prudential Regulation Authority *Annual Fund-level Superannuation Statistics June 2017* available at <https://www.apra.gov.au/publications/annual-fund-level-superannuation-statistics>.

<sup>172</sup> See n 126 above.

<sup>173</sup> See Chapter 3 above. The indirect cost ratio (ICR), for a MySuper product or an investment option offered by a superannuation entity, is the ratio of the total of the indirect costs for the MySuper product or investment option, to the total average net assets of the superannuation entity attributed to the MySuper product or investment option. It is defined as any amount that the trustee 'knows, or reasonably ought to know, will

Usually there will be an administration fee charged to each member's account, which will be either a fixed dollar amount or a percentage of their account balance or a combination, sometimes capped. There will be an investment fee, generally expressed as a percentage, which is deducted at the fund (or sub-fund) level. There is likely to be a buy/sell spread that is reflected in the price at which members transact.<sup>174</sup> There may be switching fees when Choice members move between investment options. Entry fees are banned,<sup>175</sup> and exit fees may be.<sup>176</sup> Insurance premiums are recouped from the individual member's balance. A member who has sought and received personal financial advice to be paid for out of the fund will have that fee debited to their balance. Other fees payable by the individual member may relate to splitting contributions between spouses, and certain family law related actions.<sup>177</sup>

The rules relating to fees contained in Part 11A of the SIS Act apply to all RSEs. Section 99B prohibits entry fees.<sup>178</sup> Section 99C provides that if the trustee charges 'a buy-sell spread, a switching fee or an exit fee, the fee must be no more than it would be if it were charged on a cost recovery basis'.

Section 99D prohibits the trustee from including 'in any fee charged to any member of the fund an amount that relates to costs incurred by any person, directly or indirectly, in relation to personal advice provided by any person to an employer of one or more members of the fund'. Section 99F prohibits the trustee or the trustees of a regulated superannuation entity from directly or indirectly passing on the cost of providing [personal] financial product advice in relation to a member of the fund on to any other member of the fund, to the extent that the advice is provided by the trustee or another person acting as an employee of, or under an arrangement with, the trustee in prescribed circumstances.<sup>179</sup>

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directly or indirectly reduce the return on the investment of a member', and which is not charged to members as a fee.

<sup>174</sup> This generally represents an estimate of transaction costs, including brokerage fees and stamp duty, incurred when buying or selling underlying assets in relation to investment options.

<sup>175</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 99B.

<sup>176</sup> Treasury Laws Amendment (2018 Superannuation Measures No 1) Bill 2018.

<sup>177</sup> *Family Law (Superannuation) Regulations 2001* (Cth).

<sup>178</sup> An *entry fee* is a fee, other than a buy-sell spread, that relates, directly or indirectly, to the issuing of a beneficial interest in a superannuation entity to a person who is not already a member of the entity: *Superannuation Industry (Supervision) Act 1993* (Cth) s 99B(2).

<sup>179</sup> The circumstances are set out in *Superannuation Industry (Supervision) Act 1993* (Cth) s 99F(1)(c) and include where: (i) the subject member has not yet acquired a beneficial interest in the fund when the advice is given, and the advice relates to whether the subject member should acquire such an interest; (ii) the advice relates to a financial product that is not a beneficial interest in the fund, a related pension fund for the member and the fund, a related insurance product for the member and the fund or a cash management facility within the

Specific limitations apply to fees charged on MySuper accounts. Section 29V provides that a trustee of a regulated superannuation fund that offers a MySuper product may only charge fees of one or more of the following kinds in relation to that product:

- (a) an administration fee;<sup>180</sup>
- (b) an investment fee;<sup>181</sup>
- (c) a buy-sell spread;<sup>182</sup>
- (d) a switching fee;<sup>183</sup>
- (e) an exit fee;<sup>184</sup>
- (f) an activity fee;<sup>185</sup>

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fund; (iii) the advice relates to whether the subject member should consolidate that member's beneficial interests in 2 or more superannuation entities into a beneficial interest in a single superannuation entity; (iv) at the time the advice is provided, the subject member reasonably expects that a person mentioned in subparagraph (a)(i) or (ii) will periodically review the advice, provide further personal advice or monitor whether recommendations in the original or any later advice are implemented and the results of that implementation.

<sup>180</sup> An *administration fee* is a fee that relates to the administration or operation of a superannuation entity and includes costs incurred by the trustee, or the trustees, of the entity that: (a) relate to the administration or operation of the fund; and (b) are not otherwise charged as an investment fee, a buy-sell spread, a switching fee, an exit fee, an activity fee, an advice fee or an insurance fee: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(2).

<sup>181</sup> An *investment fee* is a fee that relates to the investment of the assets of a superannuation entity and includes: (a) fees in payment for the exercise of care and expertise in the investment of those assets (including performance fees); and (b) costs incurred by the trustee, or the trustees, of the entity that: (i) relate to the investment of assets of the entity; and (ii) are not otherwise charged as an administration fee, a buy-sell spread, a switching fee, an exit fee, an activity fee, an advice fee or an insurance fee: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(3).

<sup>182</sup> A *buy-sell spread* is a fee to recover transaction costs incurred by the trustee, or the trustees, of a superannuation entity in relation to the sale and purchase of assets of the entity: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(4).

<sup>183</sup> A *switching fee* is a fee to recover the costs of switching all or part of a member's interest in a superannuation entity from one class of beneficial interest in the entity to another: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(5).

<sup>184</sup> An *exit fee* is a fee to recover the costs of disposing of all or part of members' interests in a superannuation entity: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(6). Legislation has been introduced to prohibit trustees charging exit fees: see n 176 above.

<sup>185</sup> A fee is an *activity fee* if: (a) the fee relates to costs incurred by the trustee, or the trustees, of a superannuation entity that are directly related to an activity of the trustee, or the trustees: (i) that is engaged in at the request, or with the consent, of a member; or (ii) that relates to a member and is required by law; and (b) those costs are not otherwise charged as an administration fee, an investment fee, a buy-sell spread, a switching fee, an exit fee, an advice fee or an insurance fee: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(7).

(g) an advice fee;<sup>186</sup>

(h) an insurance fee.<sup>187</sup>

Under s 29VA of the SIS Act, a trustee of a regulated superannuation fund that offers a MySuper product ‘may only charge a fee in relation to the MySuper product during a period if it satisfies one of the charging rules set out in this section in relation to that period’. The charging rules are specific; in broad terms they are intended to ensure members are treated equally<sup>188</sup> while allowing for an administration fee exemption to be offered to employees of particular employer-sponsors;<sup>189</sup> for lifecycle differentiated investment fees;<sup>190</sup> and the recovery of advice fees<sup>191</sup> and insurance fees<sup>192</sup> from the individual members to which they relate.

If the trustee charges an activity fee or an insurance fee to a member in relation to a MySuper product, the fee must be no more than it would be if it were charged on a cost recovery basis.<sup>193</sup>

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<sup>186</sup> A fee is an *advice fee* if: (a) the fee relates directly to costs incurred by the trustee, or the trustees, of a superannuation entity because of the provision of financial product advice to a member by: (i) a trustee of the entity; or (ii) another person acting as an employee of, or under an arrangement with, a trustee or trustees of the entity; and (b) those costs are not otherwise charged as an administration fee, an investment fee, a switching fee, an exit fee, an activity fee or an insurance fee: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(8).

<sup>187</sup> A fee is an *insurance fee* if: (a) the fee relates directly to either or both of the following: (i) insurance premiums paid by the trustee, or the trustees, of a superannuation entity in relation to a member or members of the entity; (ii) costs incurred by the trustee, or the trustees, of a superannuation entity in relation to the provision of insurance for a member or members of the entity; and (b) the fee does not relate to any part of a premium paid or cost incurred in relation to a life policy or a contract of insurance that relates to a benefit to the member that is based on the performance of an investment rather than the realisation of a risk; and (c) the premiums and costs to which the fee relates are not otherwise charged as an administration fee, an investment fee, a switching fee, an exit fee, an activity fee or an advice fee: *Superannuation Industry (Supervision) Act 1993* (Cth) s 29V(9).

<sup>188</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VA(2) – (7). A percentage based administration fee may be capped, under *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VE.

<sup>189</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) ss 29VA(8) and 29VB. The note to the subsection says, ‘In some circumstances, the RSE licensee may wish to offer a MySuper product for the employees of a large employer or its associates (see sections 29T and 29TB). Any fee set for that MySuper product may differ from the equivalent fee set for another MySuper product within the fund. In other circumstances, a separate MySuper product may not be offered, but instead a lower administration fee charged to the employees of a particular employer-sponsor (see section 29VB)’.

<sup>190</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VA(9). This is determined under the governing rules, which may provide for up to four age cohorts and allow for differentiated investment fees between them. It may be charged only if it reflects a fair and reasonable attribution of the investment costs of the fund between the age cohorts.

<sup>191</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VA(9A).

<sup>192</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VA(10).

<sup>193</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 29VC(1).

The investment fee is typically calculated to cover the costs incurred by the trustee in managing the fund investments, including fees paid to investment managers. In the case of MySuper products, the legislation also controls the terms on which the trustee may enter into arrangements with investment managers that include performance fees. Section 29VD applies where a trustee enters into an arrangement with an investment manager ‘for the investment of an asset or assets of the fund attributed, in whole or in part, to the MySuper product, and under the arrangement, a fee payable to the investment manager is determined, in whole or in part, by reference to the performance of the investments made by the investment manager on behalf of the trustee’.

In these circumstances, the base fee must be set or adjusted to give an incentive to obtain the performance-based fee; the period over which it is determined must be appropriate to the kinds of investment to which the performance-based fee relates; the performance of investment must be measured against an appropriate benchmark; the performance-based fee is to be worked out on after-costs, after-tax basis; and the fee must be calculated in a way that includes disincentives for poorly performing investments.

However these requirements are qualified by s 29VD(8), which provides that the trustee ‘does not breach this section to the extent that the asset or assets of the fund invested under the arrangement are attributed by the trustee ... of the fund to a MySuper product if, despite the fact that the arrangement does not comply with one or more of the provisions of this section, the arrangement promotes the financial interests of the beneficiaries of the fund who hold the MySuper product’.

## **5.2 Trustee remuneration and expenses**

In not-for-profit funds, the governing rules will usually provide for the trustee to be paid an amount calculated by reference to the costs incurred by the trustee in running itself and the fund. This is separate from the direct investment expenses shown on the fund’s income statement. In for-profit funds, the governing rules will allow for the payment of remuneration at a level specified in the rules.

Part of the amount collected by the trustee will be paid to its directors. Director remuneration must be disclosed as part of the transparency information published on the fund website. In the case of funds with member and employer representatives on the board, the

directors' remuneration may be payable to the nominating organisation, rather than the individual director. In setting the framework for remunerating its directors and senior executives, a trustee must have regard to *APRA Prudential Standard 510 Governance* and *APRA Prudential Practice Guide 511 Remuneration*.

The governing rules of a fund will typically allow for expenses incurred by the trustee in relation to the fund or the administration of the trustee to be paid or reimbursed from the fund. Those expenses must be properly incurred.<sup>194</sup> Section 99E of the SIS Act provides that 'if there is more than one class of beneficial interest in a regulated superannuation fund, the trustee ... must attribute the costs of the fund between the classes fairly and reasonably'.

The decision to incur expenses that are paid out of the fund must be made in good faith, for a proper purpose and in the interests of the members. APRA has pointed to 'sponsorship, marketing or other payments for services (such as some of those highlighted by the Trade Union Royal Commission) where the value for money or underlying benefit for members has not been adequately demonstrated and the governance and oversight in relation to those payments is weak' as indicative of poor fund governance.<sup>195</sup>

### 5.3 Investments

As with its other discretions, the trustee must exercise its investment powers in the interests of the members of the fund. Section 52 of the SIS Act sets out a series of covenants relating to investments that are taken to be included in the governing rules. These require the trustee to:

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

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

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<sup>194</sup> See e.g. *Arena Management Pty Ltd (recs and mgr apptd) v Campbell Street Theatre Pty Ltd* (2011) 80 NSWLR 652; (2011) 281 ALR 304; (2011) 84 ACSR 33; [2011] NSWCA 128 at [64] (McColl, Campbell and Macfarlan JJA).

<sup>195</sup> Helen Rowell, Australian Prudential Regulation Authority, 'Governance and culture in superannuation' Speech to the AFR Banking and Wealth Summit, Sydney, 5 April 2016.

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

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

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

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

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

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

(viii) any other relevant matters;

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

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

*APRA Prudential Standard SPS 530 Investment Governance* requires that the trustee:

- formulate specific and measurable investment objectives for each investment option, including return and risk objectives;
- develop and implement an effective due diligence process for the selection of investments;
- determine appropriate measures to monitor the performance of investments on an ongoing basis;
- review the investment objectives and investment strategies on a periodic basis; and

- formulate a liquidity management plan.<sup>196</sup>

Section 29VN relates specifically to the investment of MySuper funds. It provides that the trustee must:

(c) include in the investment strategy for the MySuper product the details of the trustee's determination of the matters mentioned in paragraph 29VN(b) [relating to scale]; and

(d) include in the investment strategy for the MySuper product, and update each year:

(i) the investment return target over a period of 10 years for the assets of the fund that are attributed to the MySuper product; and

(ii) the level of risk appropriate to the investment of those assets.

In selecting and managing the fund's investments the trustee must have regard to the best interests of the members which, in the context of superannuation funds, has been held to equate to their best financial interests. The leading case is *Cowan v Scargill*, which concerned the pension scheme for the British coal industry. In 1982 the five trustees of the scheme appointed by the workers' union refused to approve an annual investment plan for the scheme unless it was amended to restrict overseas investments and investment in energy industries which were in direct competition with coal, to reflect union policy. At 286-7 Sir Robert Megarry V-C said:

I turn to the law. The starting point is the duty of trustees to exercise their powers in the best interests of the present and future beneficiaries of the trust, holding the scales impartially between different classes of beneficiaries. This duty of the trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that, they must put the interests of their beneficiaries first. When the purpose of the trust is to provide financial benefits for the beneficiaries, as is usually the case, the best interests of the beneficiaries are normally their best financial interests. In the case of a power of investment, as in the present case, the power must be exercised so as to yield the best return for the beneficiaries, judged in relation to the risks of the investments in question; and the prospects of the yield of income and capital appreciation both have to be considered in judging the return from the investment.

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<sup>196</sup> APRA Prudential Standard SPS 530 Investment Governance (15 November 2012) 1.

Later at 290 the Vice-Chancellor continued:

The large size of pension funds emphasises the need for diversification, rather than lessening it, and the fact that much of the fund has been contributed by members of the scheme seems to me to make it even more important that the trustees should exercise their powers in the best interests of the beneficiaries. In a private trust, most, if not all, of the beneficiaries are the recipients of the bounty of the settlor, whereas under the trusts of a pension fund many (though not all) of the beneficiaries are those who, as members, contributed to the funds so that in due time they would receive pensions. It is thus all the more important that the interests of the beneficiaries should be paramount, so that they may receive the benefits which in part they have paid for. I can see no justification for holding that the benefits to them should run the risk of being lessened because the trustees were pursuing an investment policy intended to assist the industry that the pensioners have left, or their union.<sup>197</sup>

In Choice funds, trustees may (and typically) do offer investment options that allow members to select a socially responsible investment option, for example that excludes certain industries from the investment portfolio. The long investment horizons for superannuation funds mean that it is generally appropriate for trustees to consider matters such as sustainability in the construction of the fund's investment portfolio as to do so is in the financial interests of the members. *APRA Prudential Practice Guide SPG 530 Investment Governance* says on this issue:

The SIS Act requires an RSE licensee, when formulating an investment strategy, to give regard to the risk and the likely return from the investments, diversification, liquidity, valuation and other relevant factors. An RSE licensee may take additional factors into account where there is no conflict with the requirements in the SIS Act, including the requirement to act in the best interests of the beneficiaries. This may result in an RSE licensee offering an 'ethical' investment option to beneficiaries to reflect this approach. An 'ethical' investment option is typically characterised by an added focus on environmental, sustainability, social and governance (ESG) considerations, or integrates such considerations into the formulation of the investment strategy and supporting analysis.

APRA expects that an RSE licensee would have a reasoned basis for determining that the investment strategy formulated for such an investment option is in the best interests of beneficiaries, and that it satisfies the requirements of s. 52 of the SIS Act for liquidity and diversification. While ESG considerations may not be readily quantifiable in financial terms,

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<sup>197</sup> *Cowan v Scargill* [1985] Ch. 270; [1985] 2 All ER 750. See also *Asea Brown Boveri Superannuation Fund No 1 Pty Ltd v Asea Brown Boveri Pty Ltd, McKeown, Gray & ABB Properties (Vic) Pty Ltd* [1999] 1 VR 144 at 160 (Beach J).

APRA expects an RSE licensee would be able to demonstrate appropriate analysis to support the formulation of an investment strategy that has an ESG focus.

In offering such investment options, a prudent RSE licensee would be mindful of exposing the interests of beneficiaries to undue risk stemming from matters such as a lack of diversification, where investment in some industries are excluded or a positive weighting is placed on certain nonfinancial factors as a result of ESG considerations.<sup>198</sup>

#### 5.4 Insurance

An important function of trustees is to provide death, total and permanent disablement and income protection insurance for members who elect to take it up. However, the operation of insurance in superannuation has not worked well for all members and is the subject of intensive regulatory and industry attention at present. The Productivity Commission's May 2018 draft findings include that 'in terms of premiums paid, default insurance in superannuation offers good value for many, but not for all, members. For some members, insurance in superannuation is of little or no value — either because it is ill-suited to their needs or because they are not able to claim against the policy. Income protection insurance and unintended multiple insurance policies are the main culprits for policies of low or no value to members'.<sup>199</sup>

Section 52 of the SIS Act contains covenants related to insurance that bind the trustee. They require the trustee:

(a) to formulate, review regularly and give effect to an insurance strategy for the benefit of beneficiaries of the entity that includes provisions addressing each of the following matters:

(i) the kinds of insurance that are to be offered to, or acquired for the benefit of, beneficiaries;

(ii) the level, or levels, of insurance cover to be offered to, or acquired for the benefit of, beneficiaries;

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<sup>198</sup> APRA *Prudential Practice Guide SPG 530 Investment Governance* (November 2013) [34] – [36].

<sup>199</sup> Productivity Commission 2018, above n 16, 53. See also Australian Securities and Investments Commission, *Report 529: Member experience of superannuation* (June 2017) and Peter Kell Deputy Chairman, Australian Securities and Investments Commission, 'Insurance in super: The regulators – What do they think?' Speech to Association of Superannuation Funds of Australia Spotlight on Insurance Conference, Sydney, 27 February 2018.

(iii) the basis for the decision to offer or acquire insurance of those kinds, with cover at that level or levels, having regard to the demographic composition of the beneficiaries of the entity;

(iv) the method by which the insurer is, or the insurers are, to be determined;

(b) to consider the cost to all beneficiaries of offering or acquiring insurance of a particular kind, or at a particular level;

(c) to only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries;

(d) to do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if the claim has a reasonable prospect of success.

*APRA Prudential Standard SPS 250 Insurance in Superannuation* notes that ‘the Board of an RSE licensee is ultimately responsible for having an insurance management framework that reflects the risks associated with making available insured benefits that is appropriate to the size, business mix and complexity of the RSE licensee’s business operations’. The insurance management framework must include the insurance strategies for each registrable superannuation entity required in the SIS Act. The key requirements include that the trustee must:

- ensure that insurance arrangements adequately address the minimum requirements set out in this Prudential Standard; and
- formulate and give effect to appropriate selection processes for, and due diligence of, insurers and monitor relationships with insurers on an ongoing basis.<sup>200</sup>

The legal rules have been supplemented by an industry *Insurance in Superannuation Voluntary Code of Practice*, which came into effect on 1 July 2018. The Code deals with a range of matters, including benefit design, claims handling and disclosure. However, ASIC has said of the Code that it:

... has some significant limitations. It’s voluntary, not enforceable and has a lengthy transition period out until 2021. The administration of the Code is unclear. There is a range of areas where trustees can exercise discretion and

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<sup>200</sup> *APRA Prudential Standard SPS 250 Insurance in Superannuation* (15 November 2012) 1.

utilise exceptions so that they do not have to meet Code standards. That is not a desirable feature of any code. We will be interested to observe in practice how widely these exceptions will be utilised. There are also key issues that didn't make it into this version of the Code, such as standardised definitions for TPD. In short, ASIC welcomes the work in this area, and we would encourage industry participants to look at how they can use the Code to raise standards. However, there is more to do. At present, the Code certainly falls short of the long-standing code approval standards that ASIC sets out in Regulatory Guide 183...<sup>201</sup>

## 5.5 Outsourcing

As noted, outsourcing is widespread in the superannuation industry. In a 2010 study of the outsourcing of eight functions - auditing, administrative services, legal services, asset allocation, sales and marketing, custody, actuarial services and investment management – by trustees, APRA found that:

- outsourcing is widespread, to the point that selecting and monitoring service providers constitutes one of the principal responsibilities of a superannuation fund trustee;
- not-for-profit funds (consisting of corporate, industry, and governmental funds) were more likely to outsource than retail funds, even more so when one looks through formal outsourcing arrangements with related service providers;
- for some services, on average, trustees of retail funds pay higher fees to related service providers, particularly for administration, compared to independent service providers; and
- in highly concentrated markets such as custody, actuarial services and auditing, dominant service providers charge higher fees.<sup>202</sup>

*APRA Prudential Standard SPS 231* deals with outsourcing. Its key requirements include that an RSE licensee must have a policy, approved by the Board, relating to outsourcing of material business activities; have sufficient monitoring processes in place to manage the outsourcing of material business activities; have a legally binding agreement in place for all outsourcing of material business activities; consult with APRA prior to entering into agreements to outsource material business activities to service providers that conduct

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<sup>201</sup> Kell, above n 199.

<sup>202</sup> Kevin Liu and Bruce R Arnold, Australian Prudential Regulation Authority, *Research Working Paper: Australian superannuation outsourcing – fees, related parties and concentrated markets* (12 July 2010).

their activities outside Australia; and notify APRA after entering into agreements to outsource material business activities.<sup>203</sup>

In 2017-18 APRA undertook a thematic review of outsourcing arrangements between superannuation trustees and related parties.<sup>204</sup> The review noted that:

The prevalence of outsourcing in the superannuation industry and its centrality to RSE licensees' business operations makes the management of service provider relationships critical in ensuring the delivery of appropriate member outcomes. This is particularly the case where an outsourced service provider is considered to be a related party of the RSE licensee.<sup>205</sup>

Transacting with related service providers occurs across all fund categories.<sup>206</sup> Following its review APRA made five recommendations to improve outcomes for members where services are outsourced to related parties, relating to contract management,<sup>207</sup> benchmarking,<sup>208</sup> materiality, documentation of decision-making and conflicts management,<sup>209</sup> and data reporting.<sup>210</sup>

## 5.6 Conflicts of interest and conflicts of duty

Within the superannuation system, trustees and trustee directors can face conflicts of interest or conflicts of duty. Trustees are in a fiduciary relationship with members, and directors with

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<sup>203</sup> APRA *Prudential Standard SPS 231 Outsourcing* (15 November 2012).

<sup>204</sup> Australian Prudential Regulation Authority letter to RSE Licensees, *Related Party Arrangements Thematic Review* 29 May 2018.

<sup>205</sup> Ibid.

<sup>206</sup> For example, the fund manager IFM Investors (Nominees) Limited is a wholly owned subsidiary of IFM Holdings Pty Ltd, which in turn is a wholly owned subsidiary of Industry Super Holdings Pty Ltd (ISH). ISH is directly owned by 27 industry superannuation funds.

<sup>207</sup> That RSE licensees ensure that related party arrangements are formalised, contain clear and objective performance measurements, and appropriate termination and penalty provisions, and a fixed term for review. Reporting against the relevant measures and triggers should be timely, rigorous and subject to appropriate review and oversight by the RSE licensee.

<sup>208</sup> That RSE licensees undertake rigorous market-based benchmarking of pricing and services prior to engaging a related party service provider, including utilising independent advice and assessment where appropriate.

<sup>209</sup> That decision-making by RSE licensees on the use of related party providers is documented, including assessing materiality and demonstrating that the arrangement is in the best interests of members. That RSE licensees review their conflicts management frameworks to ensure they are current and appropriately reflect existing related party arrangements.

<sup>210</sup> That RSE licensees review their processes for ensuring that arrangements with related party service providers are accurately reported as 'associates' on the relevant reporting forms and consistent with the reporting form guidance. See also Productivity Commission 2018, above n 16, 43 identifying a lack of transparency on related party outsourcing arrangements.

the trustee company and (perhaps) the members directly.<sup>211</sup> As noted in Chapter 4 above, the AFS and RSE licensing regimes require trustees to have in place arrangements for the management of conflicts. Directors must manage their conflicts in accordance with Part 2D.1 of the Corporations Act. The SIS Act also contains provisions that attempt to resolve some of those conflicts.

These rules apply when there is a real and sensible possibility of a conflict arising for a trustee or a director between:

- their personal interests and their duty to act in the interests of another, or
- their duty to act in the interests of one person and their duty to act in the interests of another.

In both cases the resolution of the conflicts is affected by the statutory covenants contained in the SIS Act.

In 2015 APRA conducted a thematic review of conflicts management in superannuation entities.<sup>212</sup> The review highlighted a range of matters in connection with identification of conflicts, governance structures, policies and procedures and roles and responsibilities, and related party transactions.

### ***Trustees***

Trustees are in a fiduciary relationship with members and therefore ordinary principles relating to conflicts apply except to the extent that they are effectively displaced by legislation. Of particular relevance are s 52(2)(c) and (d) and s 58B of the SIS Act, which were introduced by the *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (Cth). The statutory covenants that apply to the trustee are set out in 4.1 above. Section 52(2) includes in the governing rules of a superannuation fund a covenant requiring the trustee to ‘perform the trustee’s duties and exercise the trustee’s powers in the best interests of the beneficiaries’ and, where there is a conflict between the

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<sup>211</sup> Among other things the statutory covenants in *Superannuation Industry (Supervision) Act 1993* (Cth) s 52A require a director of trustee ‘to perform the director’s duties and exercise the director’s powers as director of the corporate trustee in the best interests of the beneficiaries’. A duty to exercise powers and discretions in the interests of another person is one of the hallmarks of a fiduciary relationship.

<sup>212</sup> APRA letter to RSE licensees, *Managing conflicts of interest in superannuation*, 19 March 2015.

duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee':

- to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
- to ensure that the duties to the beneficiaries are met despite the conflict; and
- to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
- to comply with the prudential standards in relation to conflicts.

Also important is s 58B of the SIS Act, which modifies the general law conflicts rules in relation to certain actions of the trustee that would attract the fiduciary proscriptions. It provides that:

(1) This section applies if a trustee, or the trustees, of a regulated superannuation fund does one or more of the following:

- (a) acquires a service from an entity;
- (b) invests assets of the fund in or through an entity;
- (c) invests assets of the fund in or through a financial product;
- (d) purchases a financial product using assets of the fund;
- (e) uses assets of the fund to make payments in relation to a financial product.

(2) If the trustee, or the trustees, would not breach:

- (a) a provision of any of the following:
  - (i) this or any other Act;
  - (ii) a legislative instrument made under this or any other Act;
  - (iii) the prudential standards;
  - (iv) the operating standards;

(v) the governing rules of the fund; or

(b) any covenant referred to in this Part or prescribed under this Part;

in doing one or more of the things mentioned in subsection (1), the general law relating to conflict of interest does not apply to the extent that it would prohibit the trustee, or the trustees, from doing the thing.

Section 58B was introduced into the SIS Act by the *Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Act 2013* with effect from 1 July 2013; it was a late amendment to the Bill. The Supplementary Explanatory Memorandum to the legislation<sup>213</sup> says:

Concerns have been raised that, as currently drafted, section 58A which is to be inserted into the [SIS Act] could inadvertently prohibit trustees from using related service providers, even where this is in the best interests of members. The basis for this concern is that, on one view, the general law on conflicts of interest may require a trustee to avoid dealing with a related party at all (even where the outcome is favourable to beneficiaries of the fund) if the trustee or its directors have a conflict of interest under general law. Some funds address this by including a provision in the trust deed authorising the trustee to deal with the related party, but there is concern that section 58A will render such a provision void.

The amendments insert a new section 58B into the SIS Act which will make it clear that, provided a trustee complies with all relevant Acts, legislative instruments, prudential and operational standards, governing rules and statutory covenants, the trustee may enter into service provider and investment arrangements (and undertake the preliminary dealings necessary to do so) even though this might otherwise breach general law conflict of interest prohibitions. It will not be necessary, therefore, for the trust deed to expressly authorise the trustee to engage in dealings with the related party. The words 'general law relating to conflict of interest' are intended to be construed broadly so as to cover general law relating to both trustees and directors and to cover conflicts between duties to beneficiaries and the interests of beneficiaries, on the one hand, and duties to other persons and the interests of other persons, on the other.

Where s 58B does not apply, the relationship between the covenant in s 52(2)(d) and the fiduciary 'no conflicts' rule is not clear.<sup>214</sup> Also, the way in which s 52(2)(d) applies in

<sup>213</sup> Supplementary Explanatory Memorandum to the Superannuation Legislation Amendment (Service Providers and Other Governance Measures) Bill 2012 [1.12] – [1.13].

<sup>214</sup> See generally, Pamela F Hanrahan 'Conflicts of Duties in Statutory Contexts: Managed Investments, Superannuation and Financial Services' Presentation to the Supreme Court of New South Wales Annual

situations of conflicts of duty is not apparent. What if the ‘other person’ mentioned in the covenant is a member of another registered superannuation entity of which the company is also trustee, with a trust deed that is deemed to include an identical covenant? Which duty should be prioritised then?

### ***Directors***

The conflicts management obligations imposed by *Prudential Standard SPS 521 Conflicts of Interest* extend to conflicts faced by ‘responsible persons’, which includes directors.<sup>215</sup>

Directors must comply with the requirements of Part 2D.1 of the Corporations Act, including where they have a material personal interest in a matter being considered by the board. Directors have, since 2013, been bound by the covenants in s 52A of the SIS Act; these are extracted in 4.1 above. Among other things the covenants require the directors ‘to perform the director’s duties and exercise the director’s powers as director of the corporate trustee in the best interests of the beneficiaries’ and, ‘where there is a conflict between the duties of the director to the beneficiaries, or the interests of the beneficiaries, and the duties of the director to any other person or the interests of the director, the corporate trustee or an associate of the director or corporate trustee’:

- to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and
- to ensure that the duties to the beneficiaries are met despite the conflict; and
- to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and
- to comply with the prudential standards in relation to conflicts.

By operation of s 52A(4), the obligations of the director under paragraph (2)(d) override any conflicting obligations the director has under Part 2D.1 of the Corporations Act or

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Commercial and Corporate Law Conference, Sydney, 15 November 2017. Available at [http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Corporate%20and%20Commercial%20Law%20Conference/2017/2017\\_Hanrahan.pdf](http://www.supremecourt.justice.nsw.gov.au/Documents/Publications/Corporate%20and%20Commercial%20Law%20Conference/2017/2017_Hanrahan.pdf).

<sup>215</sup> A ‘responsible person’ is defined for this purpose in *APRA Prudential Standard SPS 520 Fit and Proper* [11] – [17]. It includes quite a wide group of people, including directors and ‘senior managers’, and ‘a person who performs activities for a connected entity of the RSE licensee where those activities could materially affect the whole, or a substantial part, of the RSE licensee’s business operations, or its financial standing, either directly or indirectly’.

Subdivision A, Division 3 of Part 2-2 of the *Public Governance, Performance and Accountability Act 2013* (which deals with general duties of officials) or any rules made for the purposes of that Subdivision.

## 6. ADVICE IN SUPERANNUATION

This Chapter provides an overview of the particular regulatory arrangements that cover the provision of financial product advice to superannuation fund members.

Participation in the superannuation system can require individuals to make complex decisions involving financial products. In the accumulation phase, these decisions may include whether to move from a MySuper fund to a Choice fund or to set up an SMSF; whether to change from one fund to another or consolidate existing accounts in one fund rather than another; whether to opt out of or increase insurance cover held within the fund; whether to choose one investment options or another in a Choice fund or SMSF; and whether to make additional contributions to the fund. In the transition-to-retirement and retirement phases the decisions become even more complex. Members are often encouraged to seek general or personal financial advice<sup>216</sup> in connection with these choices, either from a fund trustee (if they provide it) or another financial adviser.

The provision of financial product advice is discussed in Background Paper 7, provided to the Royal Commission in April 2018. Financial product advice is regulated by ASIC under Chapter 7 of the Corporations Act. Usually, personal financial product advice can only be provided to a retail client by a person who is or is a representative of an appropriately licensed AFS licensee and whose name appears in the ASIC Register of Relevant Providers.<sup>217</sup>

The mandatory disclosure requirements in Part 7.7 (including the requirements relating to Financial Services Guides and Statements of Advice) and the best interests process obligations and remuneration restrictions in Part 7.7A of the Corporations Act apply if advice is provided to a retail client. By operation of s 761G(6) of the Corporations Act, a person (including an individual, company or trustee) who is provided with advice in connection with

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<sup>216</sup> Financial product advice is defined in *Corporations Act 2001* (Cth) s 766B; it is a recommendation or statement of opinion, or a report of either those things, that is intended to influence a person or persons in making a decision in relation to a particular financial product or class of financial product, or an interest in a particular financial product or class of financial product, or could reasonably be regarded as being intended to have such an influence. Personal advice is defined in *Corporations Act 2001* (Cth) s 766B(3); it is financial product advice that is given or directed to a person in circumstances where the provider of the advice has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters.

<sup>217</sup> *Corporations Act 2001* (Cth) s 966Q.

a superannuation product or RSA product is a retail client.<sup>218</sup> Limited Class Order relief granted by ASIC in 2009 to facilitate the provision of ‘intra-fund’ advice<sup>219</sup> lapsed with the repeal of former s 945A of the Corporations Act as part of the Future of Financial Advice (FoFA) reforms.

An individual who wants information or advice in relation to their superannuation choices may approach the trustee of their existing fund or seek out another adviser. Most RSE licensees are also AFS licensees authorised to provide either general advice only or (in limited cases) general or personal advice to retail clients covering superannuation and insurance; otherwise they typically have arrangements with third-party AFS licensees to do so for members on a referral basis. Other financial advisers are also active in this space, as are accountants who advise clients in respect of the establishment and administration of SMSFs.<sup>220</sup>

Government and ASIC policy has attempted over the years to facilitate access to information and advice that is timely, relevant and affordable within the framework of Chapter 7 of the Corporations Act. Despite this, quality advice is rare and ASIC compliance reviews consistently reveal significant shortcomings.<sup>221</sup>

Five aspects of the advice laws as they apply to superannuation are worth noting here. They concern paying for advice, and the provision of: information, general advice and ‘scaled’ personal advice; non-ongoing personal intra-fund advice that is paid for out of the fund; switching advice; and advice in relation to SMSF.

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<sup>218</sup> This includes where a person is advised to contribute to an SMSF, but not when the trustee of an SMSF is advised on how the fund should be invested: see *Jamieson v Westpac Banking Corp* (2014) 283 FLR 286; (2014) 98 ACSR 63; [2014] QSC 32 at [250] – [260]. If the trustee has net assets of at least \$2.5 million it will qualify as a wholesale investor under the general test. See Australian Securities and Investments Commission, 14-191MR ‘Statement on wholesale and retail investors and SMSFs’ (8 August 2014)

<sup>219</sup> On 9 July 2009, the (then) Minister for Financial Services, Superannuation and Corporate Law, Chris Bowen and the Minister for Finance and Deregulation, Lindsay Tanner, ‘welcomed the release of Australian Securities and Investments Commission (ASIC) guidance and class order relief that will enable millions of Australians to access low-cost, simple advice on their superannuation investments’. See Media Release 006/2009 ‘Simple Superannuation Advice Launched’ (9 July 2009).

<sup>220</sup> For a summary of the regulation of accountants’ advice in connection with SMSFs, see Australian Securities and Investments Commission, *Information Sheet 216: AFS licensing requirements for accountants who provide SMSF services* (26 April 2018).

<sup>221</sup> Australian Securities and Investments Commission, *Report 562 - Financial advice: Vertically integrated institutions and conflicts of interest* (24 January 2018); Australian Securities and Investments Commission, *Report 337 - SMSFs: Improving the quality of advice given to investors* (18 April 2013); Australian Securities and Investments Commission, *Report 279 - Shadow shopping study of retirement advice* (27 March 2012).

## 6.1 Paying for advice

Market practice determines how individual members pay for personal advice in respect of their superannuation. Some advice can be provided on the basis that it is ‘collectively charged’ to the fund – that is, the cost of providing the advice to an individual member is borne by the members as a whole. This is expressly permitted by legislation and is discussed below. More complex personal advice will generally be charged on a retainer or fee-for-service basis. If the advice relates solely to the member’s interest in superannuation, it can be paid for from their superannuation fund account. There is a long-held view that paying for other advice from a member’s account would fall foul of the sole purpose test.<sup>222</sup>

Accordingly, APRA has previously expressed the view that where the costs of advice ‘are charged to the members’ balances in the fund, trustees must ensure that the services relate exclusively to fund matters’.<sup>223</sup>

## 6.2 Information, general advice and scaled advice

Members may seek information or general advice related to superannuation as a basis for making decisions. A person can provide information without holding an AFS licence, but a licence is required to provide general advice. *ASIC Regulatory Guide 244* provides guidance on this type of communication;<sup>224</sup> the guiding principles include that:

*Giving factual information:* You can provide factual information to a client even if you have personal information about the client and use that information to determine what factual information to provide.

*Giving general advice:* You can provide general advice to a client even if you have personal information about the client. We will not consider general advice to be personal advice if you clarify with the client when you give the advice that you are not giving personal advice, and you do not in fact consider the client’s relevant circumstances (i.e. their objectives, financial situation or needs). We will not take action where you give personal advice merely because you give general advice using personal

<sup>222</sup> This reflects APRA’s position as set out in Australian Prudential Regulation Authority, *Superannuation Circular No. III.A.4*, ‘The sole purpose test’ (February 2001) at [41] and [43].

<sup>223</sup> *Ibid*, [44]. The Parliamentary Joint Committee considered the cost and accessibility of superannuation advice in some detail. See Commonwealth of Australia, Parliamentary Joint Committee on Corporations and Financial Services, *The Structure and Operation of the Superannuation Industry* (August 2007) Ch 6

<sup>224</sup> Australian Securities and Investments Commission, *Regulatory Guide 244 - Giving information, general advice and scaled advice* (December 2012).

information about a client's relevant circumstances to choose general advice that is relevant and useful to them...<sup>225</sup>

Members may also seek 'scaled' personal advice; this is advice that is limited to particular issues or aspects of the client's financial affairs. ASIC says, of scaled advice, that:

Advice is provided along a continuous spectrum. You can scale all types of advice, including advice about complex issues. The inquiries you make, as an advice provider, will need to reflect the nature of the matters you are considering. Some points to consider when giving scaled advice are: the rules that apply to 'scaled advice' and 'comprehensive advice' are identical; scaled advice can include advice on a single topic or advice on multiple topics; scaled advice is not lesser quality advice; scaled advice does not mean that the advice provider who gives the advice can have lower training standards; and while processes can be used to help you provide scaled advice, you need to use your expertise and skills as an advice provider to deliver good quality scaled advice.<sup>226</sup>

### **6.3 Intra-fund advice that is 'collectively charged'**

The Stronger Super reforms made in 2012 provided for superannuation trustees and others to give and 'collectively charge for' certain types of simple superannuation advice.<sup>227</sup> The policy intention is that superannuation funds can provide a member with simple, non-ongoing personal advice on the member's interest in the fund and that this advice can be collectively charged across the fund's membership.

ASIC provides guidance 'about what may and may not be collectively charged, what the record keeping requirements are and to outline the other reforms that may affect the giving of advice'. It defines intra-fund advice for this purpose as 'the types of advice that a superannuation trustee can provide to members where the cost of the advice is borne by all members of the fund'.<sup>228</sup>

RSE licensees can offer intra-fund advice on any MySuper product or Choice product in a superannuation fund. If the RSE licensee offers a MySuper product, intra-fund advice must be available to all members on the same terms. The intra-fund advice may be provided

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<sup>225</sup> Ibid, Table 1.

<sup>226</sup> Ibid.

<sup>227</sup> *Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Act 2012* (Cth).

<sup>228</sup> Australian Securities and Investments Commission, *Information Sheet 168: Giving and collectively charging for intra-fund advice*.

by the RSE licensee directly or by another person 'acting as your employee or under an arrangement with you'.

The RSE licensee may collectively charge for personal advice where the advice is not ongoing and does not fall within one of the prohibitions in s 99F of the SIS Act. ASIC says that 'the types of advice for which a superannuation trustee is likely to be allowed to collectively charge, where the advice is not ongoing, include advice to a member about:

- the extent of cover provided by the insurance arrangements that apply to the member's interest in the fund and the types of cover that may be suitable for them
- increasing contributions, and
- changing investment options within a fund.

RSE licensees may not collectively charge members for various types of personal advice, including advice that is likely to be more complex and ongoing in nature, as set out in s 99F of the SIS Act. The cost of this advice must be borne directly by the recipient. This includes personal advice that is given in one or more of the following circumstances:

- The person to whom the advice is given has not acquired a beneficial interest in the fund, and the advice relates to whether the person should acquire such an interest.
- The advice relates to a financial product other than a beneficial interest in the fund, a related pension fund, a related insurance product or a cash management facility within the fund.
- The advice relates to whether the member should consolidate their superannuation holdings in two or more superannuation entities into one.
- The advice is ongoing personal advice, to the extent that there is a reasonable expectation that you or a person acting on your behalf as an employee or under an arrangement with you will periodically review the advice, provide further personal advice and monitor the implementation of recommendations or their results.

Personal advice that is provided to an employer of one or more members of the fund may not be charged through a fee charged to members of the fund. This prevents commissions and other costs being deducted from employee balances for advice that the

employer receives.<sup>229</sup> In limited circumstances, it may be possible to charge transition-to-retirement advice collectively if it is given for a related pension fund and is not ongoing.

#### 6.4 Super switching advice

Specific statutory requirements apply when a financial adviser recommends that a member change from one superannuation fund to another. Section 947D of the Corporations Act applies if personal advice is or includes a recommendation that:

- (a) the client dispose of, or reduce the client's interest in, all or part of a particular financial product and instead acquire all or part of, or increase the client's interest in, another financial product; or
- (b) the client dispose of, or reduce the client's interest in, a MySuper product offered by a regulated superannuation fund and instead acquire an interest, or increase the client's interest, in another MySuper product or a choice product offered by the fund.

Section 947D(2) requires that the following additional information must be included in the Statement of Advice provided to the client in these circumstances:

- (a) information about the following, to the extent that the information is known to, or could reasonably be found out by, the providing entity:
  - (i) any charges the client will or may incur in respect of the disposal or reduction;
  - (ii) any charges the client will or may incur in respect of the acquisition or increase;
  - (iii) any pecuniary or other benefits that the client will or may lose (temporarily or otherwise) as a result of taking the recommended action;
- (b) information about any other significant consequences for the client of taking the recommended action that the providing entity knows, or ought reasonably to know, are likely;
- (c) any other information required by regulations ...;

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<sup>229</sup> *Superannuation Industry (Supervision) Act 1993* (Cth) s 99C.

Subsection (3) goes on to provide that, if the providing entity knows that, or is reckless as to whether, the client will or may incur these charges, will or may lose the benefits, or that there will or may be these consequences for the client but ‘the providing entity does not know, and cannot reasonably find out, what those charges, losses or consequences are or will be’ the Statement of Advice ‘must include a statement to the effect that there will or may be such charges, losses or consequences but the providing entity does not know what they are’. ASIC provides guidance to advisers giving super switching advice.<sup>230</sup>

## 6.5 SMSF advice

SMSFs are outside the Royal Commission’s terms of reference. However, if an individual is advised to establish an SMSF this has significant implications for their financial security in retirement. Regrettably the quality of advice provided in connection with SMSF is also poor. In 2018, ASIC reported on a review of 250 advice files recommending that the client establish an SMSF. The files were reviewed for compliance with the statutory best interests duty and related obligations in Part 7.7A of the Corporations Act, and for compliance with the ‘switching advice’ requirements in s 947D of the Corporations Act. ASIC found that:

While it is difficult to assess the long-term financial impact of setting up an SMSF, we considered that, in 26 files (10%), the client risked being significantly worse off in retirement as a result of following the advice. Our concerns were based on the balance size of the SMSF, the age of members and the level of gearing within the fund—or a combination of these factors ...

In a further 47 files (19%), we considered that clients were at increased risk of suffering financial detriment as a result of following the advice.

In an additional 155 files (62%), we found that the advice provider did not demonstrate compliance with the best interests duty and related obligations. The fact that these files were found to be non-compliant does not mean that clients were significantly worse off as a result of following the advice or that the advice, if implemented, would result in negative outcomes. However, these files did not demonstrate that the client would be in a better position following the advice.

The two main causes of files being assessed as non-compliant were: (a) the advice provider did not demonstrate that they had conducted sufficient

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<sup>230</sup> Australian Securities and Investments Commission, *Information Sheet 182: Super switching advice – complying with your obligations*.

research into, and properly considered, the client's existing superannuation products before recommending the establishment of an SMSF; and (b) the advice provider did not demonstrate that they had adequately considered the client's objectives, financial situation and needs before recommending the establishment of an SMSF.

We also found that: (a) in 227 files (91%), the advice provider did not demonstrate compliance with the requirement to provide appropriate advice under s961G; (b) in 214 files (86%), the advice provider did not demonstrate that they had prioritised the client's interests under s961J; and (c) where advice was provided to replace a superannuation product (234 files), information on the product replacement was inadequate or absent in 158 files (68%).<sup>231</sup>

This points to a significant and ongoing regulatory failure. However ASIC's findings are challenged by providers on the basis that an adviser can meet the 'best interests' requirement in s 961B(1) of the Corporations Act without being able to demonstrate that they took all of the steps in s 961B(2).

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<sup>231</sup> Australian Securities and Investments Commission, *Report 575 - SMSFs: Improving the quality of advice and member experiences* (June 2018) [241] – [245].

## 7. DISPUTE RESOLUTION

This Chapter explains the dispute resolution framework which applies to the Australian superannuation system<sup>232</sup> with particular reference to the features and operation of the Superannuation Complaints Tribunal (SCT) and the implications of the newly created Australian Financial Complaints Authority (AFCA).

Disputes in superannuation are typically dealt with through:

- internal complaints handling and dispute resolution arrangements
- external alternative dispute resolution arrangements
- the court system.<sup>233</sup>

All AFS licensees and unlicensed financial product issuers are required to have in place internal dispute resolution (IDR) arrangements that meet ASIC requirements.<sup>234</sup> These are explained in ASIC Regulatory Guide 165.<sup>235</sup> They are also required to participate in authorised external dispute resolution (EDR) schemes. The law relating to both IDR and EDR for superannuation has recently been amended by the *Treasury Laws Amendment (Putting Consumers First - Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth) (AFCA Act) and is currently operating in transitional phase.

Until 1 November 2018, the principal EDR schemes for superannuation is the SCT. The recent amendments<sup>236</sup> replace the SCT, the Financial Ombudsman Scheme (FOS) and

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<sup>232</sup> This does not include disputes relating to the internal administration of SMSFs. As trustees (or trustee company directors) of SMSFs are also the members of the fund (except in limited circumstances, such as children of adult SMSF members), these members are said to have no need to participate in the EDR process in the same way as clients of a financial firm. That said, members of SMSFs may participate in EDR processes as consumers; for example, as consumers of financial advice or other financial products: see Commonwealth of Australia, The Treasury, *Final Report: Review of the financial system external dispute resolution and complaints framework* (3 April 2017) (Ramsay Review) 19.

<sup>233</sup> The court system is important in the resolution of superannuation disputes both as an alternative to EDR and as the sole avenue for redress in circumstances not covered by EDR. The latter includes disputes related to the management of the superannuation fund as a whole, as distinct from disputes arising from trustees' decisions and actions related to the treatment of an individual member or claimant. As compulsory IDR and EDR arrangements do not apply to SMSFs, disputes between members of SMSFs are dealt with by courts.

<sup>234</sup> *Corporations Act 2001* (Cth) ss 912A(1)(g) and 912A(2) and s1017G and *Superannuation Industry (Supervision) Act 1993* (Cth) s 101.

<sup>235</sup> Australian Securities and Investments Commission, *Regulatory Guide 165 – Licensing: Internal and external dispute resolution* (February 2018).

<sup>236</sup> The *Treasury Laws Amendment (Putting Consumers First - Establishment of the Australian Financial Complaints Authority) Act 2018* (Cth) amended the *Corporations Act 2001* (Cth) and 12 other Acts to introduce a new external dispute resolution scheme, known AFCA, to resolve disputes about products and services provided by financial firms; and five Acts to: require firms that must participate in the enhanced IDR framework

Credit and Investments Ombudsman (CIO) with the Australian Financial Complaints Authority (AFCA), a single external dispute resolution body for the financial sector. Subject to grandfathering arrangements,<sup>237</sup> AFCA will commence operations on 1 November 2018.

The creation of AFCA followed the recommendations of the Ramsay Review of the financial system external dispute resolution and complaints framework, held in 2016-17.<sup>238</sup> Much of the commentary on the existing EDR arrangements in this Chapter draws on the work of the Ramsay Review.

## 7.1 Internal dispute resolution

As noted, all AFS licensees and financial product issuers must have an IDR procedure in place which complies with ASIC Regulatory Guide 165.<sup>239</sup> This includes trustees of regulated superannuation funds (other than SMSFs) and approved deposit funds; to the extent there is a gap in coverage it is addressed by s 101(1)(b) of the SIS Act.<sup>240</sup>

In formulating the requirements for IDR, ASIC is required to have regard to the Australian Standard for complaints handling.<sup>241</sup> As a minimum, any IDR procedure for financial service providers must be able to deal with complaints made by ‘retail clients’, as

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to report their IDR activities to the ASIC in accordance with ASIC requirements; provide ASIC with additional powers to determine the content and form of IDR reporting by IDR Firms and to publish this data at both the aggregate and firm level; and allow ASIC to specify, by legislative instrument, requirements for trustees and retirement savings account providers to provide written reasons for decisions in relation to complaints. It also repealed the *Superannuation (Resolution of Complaints) Act 1993* (Cth) and made consequential amendments to 11 Acts.

<sup>237</sup> SCT will remain operative to resolve disputes lodged with it up to and including 31 October 2018: see Australian Securities and Investments Commission *Media Release 18-123MR ASIC welcomes AFCA authorisation* 2 May 2018.

<sup>238</sup> Ramsay Review, above n 232.

<sup>239</sup> *Corporations Act 2001* (Cth) ss s912A(1)(g) and 912A(2) and s1017G. The requirements are contained in ASIC Regulatory Guide 165 – *Licensing: Internal and external dispute resolution* (February 2018) (ASIC RG 165) RG 165.1–RG 165.5, RG 165.32–RG 165.33 and Section B and ASIC Class Order [CO 09/339] *Internal dispute resolution procedures*.

<sup>240</sup> It provides that the trustee: must have an internal dispute resolution procedure that complies with the standards, and requirements, mentioned in subparagraph 912A(2)(a)(i) of the *Corporations Act 2001* in relation to financial services licensees.

<sup>241</sup> Under *Corporations Regulations 2001* (Cth) regs 7.6.02(1) and 7.9.77(1), ASIC must take into account: (a) Australian Standard AS ISO 10002–2006 *Customer satisfaction— Guidelines for complaints handling in organizations* (ISO 10002:2004 MOD), published by SAI Global Limited on 5 April 2006 (AS ISO 10002–2006); and (b) any other matter it considers relevant, in making or approving standards or requirements relating to IDR.

defined in s761G of the Corporations Act and its related regulations.<sup>242</sup> The key requirements imposed by ASIC are that the IDR procedure:

- (a) adopt the definition of ‘complaint’ in AS ISO 10002–2006 (see RG 165.78);
- (b) satisfy the Guiding Principles at Section 4 of AS ISO 10002–2006, and follow Section 5.1—Commitment, Section 6.4—Resources, Section 8.1—Collection of Information, and Section 8.2—Analysis and evaluation of complaints in AS ISO 10002–2006 (see RG 165.82–RG 165.85); and
- (c) have a system for informing complainants or disputants about the availability and accessibility of the relevant EDR scheme (see RG 165.130)...<sup>243</sup>

An important aspect of IDR is the timely resolution of disputes. ASIC Regulatory Guide 165 explains the required timeframe for the resolution of superannuation disputes in the following terms:

Prior to the [AFCA Act], provisions of the [SIS Act] and [RSA Act] imposed requirements in relation to the time within which complaints should be dealt with by the trustees of regulated superannuation funds and approved deposit funds, and by [RSA] providers. The SIS Act also imposed requirements in relation to the giving of reasons for decisions on complaints by the trustees of regulated superannuation funds. These requirements sat alongside the IDR arrangements for financial service providers under the Corporations Act. Schedule 2 of the AFCA Act has now:

- repealed s101(1) and (1A) of the SIS Act and s47(1) and (2) of the RSA Act, which set out the requirements for dealing with inquiries and complaints within 90 days and the requirements for the giving of reasons for decisions on complaints;
- amended the SIS Act and RSA Act to require trustees of a regulated superannuation fund (other than a self-managed superannuation fund) or of an approved deposit fund, or an RSA provider to have an IDR procedure that complies with the standards and

<sup>242</sup> ASIC RG 165, above n 239, RG165.72. The definition of ‘retail client’ is discussed in Background Paper 7 provided to the Royal Commission in April 2018. *Corporations Act 2001* (Cth) s 761G(6) deals with superannuation products and RSA products; it provides that a person (including an individual, company or trustee) who is provided with a superannuation product or RSA product is usually retail.

<sup>243</sup> Ibid, RG 165.62.

requirements made or approved by ASIC for s912A(2)(a)(i) of the Corporations Act in relation to AFS licensees; and

- amended the SIS Act and RSA Act to empower ASIC to make a legislative instrument setting out requirements for the giving of reasons for decisions on complaints.

As a transition measure, the IDR timeframe requirements for trustees of regulated superannuation funds and approved deposit funds, and RSA providers in s101(1) and (1A) of the SIS Act and s47(1) and (2) of the RSA Act will continue until we consult on and finalise updated IDR standards and requirements that are made or approved under s912(2)(a)(i) of the Corporations Act. The effect of the requirements in the SIS Act for trustees of regulated superannuation funds in relation to the giving of reasons for decisions on complaints is also retained until ASIC makes a legislative instrument setting out the requirements: Sch 2, item 10 of the AFCA Act.<sup>244</sup>

ASIC has reported that some trustees are taking longer than the prescribed timeframe to resolve disputes relating to insurance in superannuation.<sup>245</sup> The *Insurance in Superannuation Voluntary Code of Practice*, discussed in Chapter 4, includes a 45-day timeframe for the resolution of complaints.

Trustees of regulated superannuation funds (other than SMSFs) and approved deposit funds were required by former s 101 of the SIS Act to provide written reasons for decisions about complaints made by beneficiaries, former beneficiaries and other interested parties.<sup>246</sup> With the commencement of the enhanced IDR regime, the requirements relating to the giving of written reasons for complaints set out in s 101 of the SIS Act may be replaced with new requirements set out in a legislative instrument made by ASIC, to take effect from the date of the instrument. Until that time former s 101 of the SIS Act continues to apply.

The other main change to IDR made following the recommendations of the Ramsay Review is to give ASIC the power to impose a standardised reporting framework, requiring

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<sup>244</sup> Ibid, 22-23.

<sup>245</sup> Kell, above n 199, 4.

<sup>246</sup> Trustees are not always required to provide reasons for decisions under the general trust law. For a discussion of the adequacy of written reasons being provided by trustees in relation to insurance claims, see Australian Securities and Investments Commission, *Report 529: Member experience of superannuation* (June 2017) [97] – [106].

financial firms to report their IDR activity in accordance with ASIC requirements and allowing ASIC to publish information relating to that activity.<sup>247</sup>

## 7.2 External dispute resolution – current arrangements

Alternative dispute resolution arrangements have been a feature of the current superannuation system since its inception. The EDR body with jurisdiction over most consumer disputes relating to superannuation is the SCT, established by the *Superannuation (Resolution of Complaints) Act 1993* (Cth) (SRC Act) to provide dispute mechanisms that are ‘fair, economical, informal and quick’.<sup>248</sup> The service is free and there is a presumption against legal representation contained in the SRC Act, except where the complainant has a disability or where SCT considers it ‘necessary in all the circumstances’.<sup>249</sup>

The SCT is an independent statutory administrative tribunal, not an ombudsman scheme. The jurisdiction of the SCT covers certain decisions and conduct of trustees, insurers, RSA providers, and superannuation providers in relation to regulated funds (excluding SMSFs), approved deposit funds, life policy funds and annuity policies.<sup>250</sup> Access to EDR through the SCT is not available unless the applicant has first complained through the fund’s IDR; the matter may be brought to the SCT only if the applicant is dissatisfied with the fund’s response or if the fund fails to respond within 90 days.<sup>251</sup> It is also not available in relation to matters the subject of court proceedings. More generally, SCT cannot deal with complaints that relate to the management of a fund as a whole, such as investment performance or the general level of fees and charges.

The SCT’s statutory powers are outlined in the SRC Act. Broadly, the SCT stands in the shoes of the trustee and can exercise all the powers and discretions available to the trustee under its deed, superannuation and other relevant legislation, and trust law. In making a determination, the SCT must consider whether the trustee’s decision was ‘fair and reasonable’ in the circumstances. If the SCT determines that a decision was fair and

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<sup>247</sup> *Corporations Act 2001* (Cth) ss 912A(1)(g)(ii) and 1017G(1)(d). Section 912A(2A) provides that ‘ASIC may, by legislative instrument, specify information that financial services licensees must give ASIC relating to their internal dispute resolution procedures and the operation of their internal dispute resolution procedures’.

<sup>248</sup> *Superannuation (Resolution of Complaints) Act 1993* (Cth) s 11.

<sup>249</sup> *Superannuation (Resolution of Complaints) Act 1993* (Cth) s 23.

<sup>250</sup> *Superannuation (Resolution of Complaints) Act 1993*, Part 4. Section 5 of the Act excludes SMSFs from SCT’s jurisdiction.

<sup>251</sup> See Ramsay Review, above n 232, [4.160].

reasonable, it must affirm the decision; otherwise it may only exercise its powers to place the complainant, as nearly as practicably, back into the position they would have been before the decision was taken. As the Ramsay Review notes, the SCT cannot award costs or damages or provide a remedy where there has been no adverse practical outcome or financial loss.<sup>252</sup>

Appeals against a SCT determination can be made to the Federal Court on questions of law only.<sup>253</sup>

Recourse to the SCT is available to a range of individuals affected by the decision of a trustee, annuity provider or RSA provider. This includes:

- For superannuation complaints, a person who thinks the superannuation fund trustee's decision or conduct is or was unfair or unreasonable and who is one of the following: a current member or former member of a regulated superannuation fund which is not a self-managed superannuation fund; a beneficiary or former beneficiary of an approved deposit fund (ADF) which has more than one beneficiary; a person with an interest in, or who claims an entitlement to, a death benefit; or someone acting on behalf of the persons above or of their estate, such as a family member or legal personal representative.
- For annuity policy complaints, a person who thinks the decision or conduct in relation to the annuity policy is or was unfair or unreasonable and who: has or claims to have an interest in (i.e. has purchased) an annuity policy; is a person who is a potential beneficiary under an annuity policy in relation to a benefit payable following the death of the person who held the policy; or is a person acting for one of the above.
- For RSA complaints, a person who thinks the RSA provider's decision or conduct is or was unfair or unreasonable and who is: a current or former RSA holder; a person with an interest in, or who claims an entitlement to, a death benefit payable from an RSA; or someone acting on behalf of the persons above or of their estate, such as a family member or legal personal representative.<sup>254</sup>

The Ramsay Review found that:

... complaints lodged with SCT generally fall into one of the following categories:

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<sup>252</sup> Ramsay Review, above n 232, [4.164] – [4.165].

<sup>253</sup> *Superannuation (Resolution of Complaints) Act 1993* (Cth) s 46.

<sup>254</sup> See <http://www.sct.gov.au/pages/make-a-complaint/who-can-make-a-complaint>.

- death benefits claims (635 complaints (26.8 per cent) in 2015-16);
- total or permanent disability claims (519 complaints (21.9 per cent) in 2015-16); and
- fund administration claims (1214 complaints (51.3 per cent) in 2015-16).

SCT has no monetary limit for complaints, including in relation to disputes relating to life insurance. No time limits apply except in certain circumstances defined in the SRC Act such as death benefit distribution claims (generally 28 days) and total permanent disability claims (generally four years).<sup>255</sup>

Superannuation fund trustees agree to abide by SCT determinations as a condition of their RSE licence; they are legally required to comply with SCT determinations and may face enforcement action by APRA in the event of non-compliance.<sup>256</sup>

A matter raised with the SCT by a consumer moves through various stages in the dispute resolution process. The first is to separate out enquiries from complaints, and then to determine whether the complaint is within jurisdiction. If it is, the matter moves to the investigation stage, followed by conciliation. If the matter is not resolved at this level it progresses to formal review, followed by a determination. As the Ramsay Review notes:

Delays and dispute resolution backlogs have long been an issue for SCT. SCT has indicated that if a dispute is not withdrawn or resolved with the superannuation provider before review, it will take at least 12 months to get to review, at which time SCT will make a formal decision in relation to the complaint...

In 2010, the average time in days to resolve a dispute from lodgement to determination was 635 days. In 2015-16, this number had increased to 796 days. The time taken by SCT to make decisions regarding whether a dispute was outside its jurisdiction also increased from 17 days in 2010-11 to 26 days in 2015-16.<sup>257</sup>

Both funding and staffing levels at the SCT have fallen steadily since 2010.<sup>258</sup>

<sup>255</sup> Ramsay Review, above n 232, [4.157] – [4.158]. For a summary of time limits on death and TPD claims, see <http://www.sct.gov.au/pages/make-a-complaint/time-limits>.

<sup>256</sup> *Superannuation Industry (Supervision) Regulations 1994* (Cth), reg 13.17B.

<sup>257</sup> Ramsay Review, above n 232, [4.143], [4.145].

<sup>258</sup> *Ibid*, [4.180] – [4.183].

### 7.3 External dispute resolution – AFCA

From 1 November 2018, the SCT will be replaced<sup>259</sup> for new superannuation disputes by AFCA.<sup>260</sup> Unlike the SCT, AFCA is an ombudsman scheme, rather than a statutory tribunal.

AFCA is created under the new Part 7.10A of the Corporations Act which deals with ‘External Dispute Resolution’ for the financial sector. Division 1 of Part 7.10A establishes a new authorisation framework which provides for the Minister to authorise a single EDR scheme for the purposes of the Corporations Act, known as AFCA. Division 2 gives ASIC certain powers to regulate the AFCA scheme. Division 3 contains additional provisions relating to superannuation complaints, that are required because some superannuation complaints cannot be resolved by relying on contractual obligations between AFCA and the members of the AFCA scheme.<sup>261</sup>

All AFS licensees, unlicensed product issuers, unlicensed secondary sellers, Australian credit licensees and credit representatives, regulated superannuation funds (other than SMSFs), approved deposit funds, retirement savings account (RSA) providers, annuity providers, and life policy funds and insurers will be required to be members of AFCA. AFCA’s members will be contractually bound to comply with AFCA’s operating rules, which will be included in AFCA’s terms of reference (ToR). Accordingly, the operational aspects of the AFCA scheme will be based on private law (contractual) obligations between AFCA and the members.

The legislation provides the broad design principles for AFCA. They are:

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<sup>259</sup> The transitional arrangements are explained in the Revised Explanatory Memorandum to the Treasury Laws Amendment (Putting Consumers First - Establishment of the Australian Financial Complaints Authority) Bill (AFCA Bill EM) at [1.202] – [1.216].

<sup>260</sup> As with the SCT, AFCA does not have jurisdiction in relation to SMSF disputes. These include disputes relating to a decision made by the trustee of an SMSF; conduct engaged in by an insurer, or a representative of an insurer, in relation to the sale of an annuity policy maintained or to be maintained by the trustee of an SMSF on behalf of its members; or a decision made by an insurer, or a representative of an insurer, under an annuity policy maintained by the trustee of an SMSF on behalf of its members. However, members of an SMSF may still lodge non-superannuation complaints with AFCA. For example, an SMSF may, as a consumer of financial advice, be permitted to bring a non-superannuation complaint to AFCA regarding a financial adviser.

<sup>261</sup> The AFCA Bill EM gives the following example: ‘For example, superannuation complaints may involve third parties who are not members of the AFCA scheme but may have an interest in the outcome of a complaint (such as third parties to a complaint who have an interest in a death benefit)’: AFCA Bill EM, above n 259 at [1.26].

- the operations of the scheme must be financed by contributions made by members of the scheme;
- the scheme must have an independent assessor, to focus on reviewing the handling of complaints;
- consumers must be able to access the scheme cost-free;
- the complaints mechanism under the scheme must be accessible to people who are dissatisfied with the response of a member of the scheme to their complaint; and
- the scheme must resolve disputes in a way that is fair, efficient, timely and independent. ASIC will have regulatory oversight and undertake action where necessary to ensure that disputes are resolved in this way.

Within these parameters, the design of the AFCA scheme will be determined by AFCA's board and set out in its ToR. This is intended to 'allow the scheme to be flexible where operational improvements can be implemented more quickly than would otherwise be the case if a legislative change was required, which is a key benefit of an ombudsman model'.<sup>262</sup>

### *Superannuation disputes*

Division 3 of Part 7.10A deals specifically with the resolution of superannuation disputes by AFCA. It sets out certain statutory powers that assist in the resolution of superannuation disputes, and includes provisions that deal with how a determination about a superannuation complaint is made, how questions of law about a superannuation complaint can be referred to the Federal Court and how appeals about superannuation complaints can be made to the Federal Court on a question of law.

AFCA's statutory powers which can be used to assist in resolving a superannuation complaint are as follows:

- the power to join certain third parties to a superannuation complaint;
- the power to obtain information and documents which are relevant to a superannuation complaint;
- the power to require people to attend conciliation conferences to assist in the resolution of a superannuation complaint;

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<sup>262</sup> Ibid, [1.21]

- the power to issue directions to protect the confidentiality of information; and
- the power to refer a question of law arising in relation to a superannuation complaint to the Federal Court.

In relation to the making of a determination of a superannuation complaint, Division 3 also:

- sets out the powers, obligations and discretions of AFCA in making a determination;
- requires AFCA to give written reasons for a determination relating to a superannuation complaint; and
- explains that a determination comes into operation immediately upon the making of the determination unless otherwise specified by AFCA.

AFCA's determinations of superannuation complaints are subject to appeal to the Federal Court on a question of law. The Revised Explanatory Memorandum states that:

A right of appeal is maintained for superannuation complaints given the compulsory nature of superannuation and the obligation of trustees to act in the best interests of all beneficiaries of the fund. The outcome of a superannuation complaint may have wider implications on the future payment of benefits by a trustee to members. It is important that these types of decisions can be appealed where the law may have been incorrectly applied.<sup>263</sup>

### ***When superannuation complaints can be made***

A complaint relating to superannuation can be made under the AFCA scheme only if the complaint relates to one of the decisions or types of conduct outlined below and the complainant alleges that the decision or conduct was unfair or unreasonable. That conduct is:

- *Regulated superannuation fund*: a decision of a trustee of a regulated superannuation fund or approved deposit fund in relation to a particular member or former member, or a particular beneficiary or former beneficiary, of the fund: s 1053(1)(a) of the Corporations Act

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<sup>263</sup> Ibid, [1.102].

- *Life policy*: a decision by a trustee maintaining a life policy to admit a member to the fund (or a failure to admit the member to the fund): s 1053(1)(b) of the Corporations Act
- *Annuity policy*: the conduct of an insurer or a representative of an insurer in relation to the sale of an annuity policy or a decision of an insurer under an annuity policy: s 1053(1)(c) and (d) of the Corporations Act
- *Retirement savings account*: the conduct of an RSA provider or a representative of an RSA provider in relation to the opening of an RSA; a decision of an RSA provider in relation to a particular RSA holder or former RSA holder; the conduct of an insurer or a representative of an insurer, in relation to the sale of insurance benefits under a contract of insurance, where the premiums are paid from an RSA; or a decision of an insurer in relation to a contract of insurance where the premiums are paid from an RSA. s 1053(1)(f), (g), (h) and (i) of the Corporations Act
- *Death benefits*: a decision by a death benefit decision-maker relating to the payment of a death benefit: s 1053(1)(j) of the Corporations Act
- *Tax statements*: a decision of a superannuation provider to set out, in a statement given to the Commissioner of Taxation (as a result of certain legislative requirements), an amount or amounts in respect of a person: ss 1053(1)(e) and 1053(2) of the Corporations Act.

For this purpose, the making of a decision by a trustee, an insurer, an RSA provider or another decision-maker also includes making or failing to make a decision, or engaging in conduct or failing to engage in conduct which relates to making a decision. This is the case whether or not the decision or conduct involves the exercise of discretion.<sup>264</sup>

### ***Differences between the SCT and AFCA***

The following table, extracted from the Explanatory Memorandum to the AFCA Bill, explains the differences between the former and new EDR requirements:

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<sup>264</sup> *Corporations Act 2001* (Cth) s 1053(5).

## Comparison of key features of new law and current law<sup>265</sup>

<i>New law</i>	<i>Current law</i>
The Minister will have the power to authorise one EDR scheme after taking into account a range of considerations set out in the legislation and may take into account the general considerations and any other relevant matters when considering whether to authorise the EDR scheme. Once the EDR scheme has been authorised, it will be known as the AFCA scheme.	ASIC has the power to approve multiple EDR schemes.
There are a number of mandatory requirements which the Minister must be satisfied that the EDR scheme will meet at the time it is authorised. The Minister may include additional conditions for authorisation at the time of authorising the EDR scheme. The Minister will have the power to vary or revoke any additional conditions.	ASIC may make an approval of an EDR scheme subject to conditions specified in the approval.
The Minister will have the power to vary or revoke the authorisation at any time.	ASIC has the power to vary or revoke an EDR scheme's approval.
AFCA must comply with mandatory requirements for the AFCA scheme at all times during the scheme's authorisation.	No equivalent.
ASIC will have the power to issue regulatory requirements relating to compliance with the mandatory requirements and general considerations.	No equivalent.
All material changes to the AFCA scheme must first be approved by ASIC.	Schemes must consult with ASIC on all proposed changes to their ToR.
ASIC will have the power to issue directions to the scheme operator to increase limits on the value of claims or remedies that may be awarded, to ensure the scheme is sufficiently financed, or to undertake specific measures to comply with a mandatory requirement, a condition of authorisation specified by the Minister or regulatory requirements.	No equivalent.
AFCA will have the power to join certain persons to a superannuation complaint.	The SCT has the power to join certain persons to a complaint.
AFCA will have the power to obtain information and documents from people where the information or documents are relevant to a superannuation complaint.	The SCT has the power to obtain information and documents.
AFCA will have the power to require persons to attend conciliation conferences in relation to a superannuation complaint.	The SCT has the power to require attendance at conciliation conferences.
AFCA will have the power to issue directions to protect the confidentiality of information.	The SCT has the power to issue directions relating to certain meetings to protect the confidentiality of information.
AFCA may refer questions of law to the Federal Court in relation to a superannuation complaint.	The SCT may refer a question of law to the Federal Court.
When making a determination regarding a superannuation complaint, AFCA will have all the powers, obligations and discretions conferred upon the original decision-maker.	For the purpose of reviewing a decision, the SCT has all the powers, obligations and discretions conferred on the trustee or other decision-maker.

<sup>265</sup> AFCA Bill EM, above n 259, [1.37].

<b><i>New law</i></b>	<b><i>Current law</i></b>
A determination of AFCA in relation to a superannuation complaint comes into effect immediately unless otherwise specified.	A determination of the SCT comes into effect immediately, unless otherwise specified by the SCT determination.
A party to a superannuation complaint may appeal to the Federal Court about a determination of AFCA on a question of law.	A party to a superannuation complaint may appeal to the Federal Court about a ruling of the SCT on a question of law.

#### **7.4 Last resort compensation**

Part 23 of SIS Act makes provision for the grant of financial assistance to APRA-regulated superannuation funds that have suffered loss through fraudulent conduct or theft. The loss must also have caused a substantial diminution of the superannuation fund leading to difficulties in the payment of benefits. Compensation limits are at the Minister's discretion. If the Minister, after seeking the advice of APRA, is satisfied that the loss has caused a substantial diminution of the superannuation fund and that the public interest requires action, a financial grant may be made by government to the fund.

The scheme is industry funded through a levy on APRA-regulated superannuation funds and approved deposit funds.

For example, in 2011 and 2012 the Government provided grants of over \$70 million under Part 23 to compensate victims of fraud in the APRA-regulated superannuation industry resulting from the collapse of Trio Capital Limited. These grants were recouped via a levy imposed on the superannuation industry. SMSFs that had invested in registered and unregistered managed investment schemes operated by Trio Capital Limited that were not regulated superannuation funds were not entitled to compensation under this scheme.

The Ramsay Review's supplementary report, issued in September 2017, recommended the establishment of a more broadly based last resort compensation scheme for the financial sector, to deal with AFCA determinations that go unsatisfied because firms are insolvent or unavailable to pay.<sup>266</sup> If financial advice licensees exit the industry and go into liquidation, the demands on such a scheme are likely to increase substantially.

<sup>266</sup> Commonwealth of Australia, The Treasury, *Supplementary Final Report - Review of the financial system external dispute resolution and complaints framework* (September 2017).