FSC FINANCIAL SERVICES COUNCIL

RSE licence condition – no other duty (FSRC Rec 3.1) and ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5)

FSC Submission – Exposure Draft legislation

February 2020

FSC FINANCIAL SERVICES COUNCIL

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC welcomes the opportunity to provide comment on Exposure Draft (**ED**) legislation relating to:

- RSE licence condition – no other duty (FSRC Rec 3.1) and
- ASIC regulation of superannuation (FSRC Rec 3.8, 6.3, 6.4, 6.5)

The FSC supports the intent of both pieces of legislation. However, we have identified several issues where short timeframes and a lack of clarity in drafting may make it difficult for superannuation funds to comply in a manner that creates the best possible outcome for consumers.

In particular, FSC members have concerns with the short timeframes and narrow relief contemplated in relation to separating RSE and RE functions.

The significant practical and legal issues involved in this process mean that, without additional clarity and transition time, FSC members may not be able to complete these transactions in an optimal manner which ensures the best possible consumer outcomes.

The FSC has recommended amendments that will ensure these measures can be implemented effectively without compromising policy intent.

3. FSC recommendations

1. Extend commencement date to allow 24 months from Royal Assent for full compliance, with an interim requirement for transition plans to be provided to APRA.

2. Expedite additional relief for licensees transferring RE or RSE functions to another entity within the same corporate group, including simplifying the requirement of license applications.

3. Make it clear in the EM that the body corporate can either transfer the superannuation business to a new entity or the non-superannuation businesses to a new entity or entities, and this decision rest with the body corporate

4. Ensure any structural changes required as a result of this policy are tax neutral, with all necessary tax relief provided as necessary to achieve this aim.

5. Clarify that, in the context of this legislation, “duty” refers to fiduciary duty of the RSE licensee to the members of the fund and does not include other duties or obligations which may arise in the course of an RSE’s business operations.

6. Amend s29E(5A) to:

- include an express exemption for duties not conflicting with the RSE licensee’s duties to superannuation fund members

- clarify that a single body corporate may hold only one RSE license, but one licensee may act as trustee of multiple registrable superannuation entities.

7. Clarify licence and authorisation requirements for external service providers, including administrators.

4. RSE licence condition – no other duty (Recommendation 3.1)

4.1. Commencement timing

The ED provides for a commencement date of 1 July 2020 for the restrictions on RSE activities.

While impacted funds have already commenced work to implement this recommendation, it will not be possible to comply within this timeframe, due to uncertainty about how entities may be structured (see section 4.3 below) and the volume of activity required to undertake significant structural change and ensure compliance.

Additional uncertainty, including concerns about requiring APRA approval of extensions of time to comply and the need for additional relief from Corporations Act requirements as flagged in the EM, are also delaying the ability of entities to make firm decisions regarding implementation.

FSC members are concerned that a rushed implementation may limit their ability to undertake the transition and restructure businesses without compromising their business and consumer outcomes. Rushed or poorly considered structural changes may have immediate or future impacts on members and unitholders. Rushed implementation may also make it difficult for directors to following due process and fulfil their duties.

Essentially organisations should have two options - either the superannuation business (and trusteeship) is transferred to a new entity or the non-superannuation businesses (and trusteeship) are transferred to a new entity. Under each of these options additional time will be needed to deal with the issues associated with separation.

Whilst investigations are continuing, initial work completed by FSC members highlights that, as non-superannuation businesses are typically diverse, have a large number of funds, and are reasonably complex, they would require a high degree of unravelling leading to a greater time period to implement the proposed regulation.

Examples highlighting why additional time will be needed to deal with issues include:

- The work involved in setting up new entities, appointing new boards, designing organisational structures, entering new employment contracts, updating and adopting policies, communicating to members/unitholders and migrating assets is complex and immense;
- tax and transaction costs may be incurred by unitholders and superannuation members as a result of structural changes, and businesses require adequate opportunity to identify and address these;
- ASIC approvals
    - according to correspondence FSC members have received from ASIC, when applying for or varying an Australian financial services (**AFS**) licence, ASIC aim to decide whether to grant or vary an AFS licence within 150 days of receiving a complete application (target: 70%). Further, ASIC aim to decide

90% of complete applications within 240 days. These applications may take longer.
    - in the absence of changes to the Corporations Act granting relief from calling and holding a unitholder meeting, ASIC also needing time to approve applications for relief under RG 136
- APRA approvals – it is our understanding that if a body corporate choose to move its superannuation business to a new entity, APRA will treat this a new RSE license application. APRA has 90 business days to make a decision on an application, with the power to extend that notice period by another 30 business days with notice to the applicant;
- End of Financial Year requirements, which could slow or halt many activities between mid-June to mid-August due to blackout periods for financial reporting etc.;
- Separation of co-mingled assets where underlying funds contain both superannuation and non-superannuation assets – if CGT relief is not legislated (see below), trustees will need to consider applying for ex gratia CGT relief for impacted managed investment schemes and investors.
- In many cases the assets of the superannuation funds are held in the Trustees name and consequently there will be significant work involved in novating or transferring assets to new entities.

Specific examples that illustrate some of the complexities, and hence time, involved in transferring the non-superannuation business include:

- retiring and appointing a replacement RE under the existing constitutions for managed investment schemes and trustee under the trust deeds for other trusts is typically not straightforward. In addition to the statutory regime, the RE is required to comply with the terms of the constitutions for the schemes. In some cases they do not contain a power to retire so REs will need to investigate available courses of action. The default position however is that a trustee in that instance will need to apply to the relevant Supreme Court exercising equitable jurisdiction to authorise the appointment of a replacement trustee.
- In many cases, third party consents will be required to novate a contract to a new entity, particularly for RE businesses and other trustee roles.
- Some managed investment schemes hold assets, such as loans, where contracts do not provide a unilateral power of novation or assignment, and consequently individual consent would be required to transfer the RE.
- Where a business holds an Australian Credit Licence as part of their RE business, this licence would also be required to be transferred to the new entity.
- The volume of assets requiring to be transferred to the new entity is likely significant given the high number of funds for which impacted FSC members act as RE.

FSC members have estimated that between 12-24 months will be required to fully implement the required changes to their business structure, particularly as some activities will be dependent on pre-requisite steps being completed.

APRA extensions

The EM anticipates APRA using its powers under Part 29 of the SIS Act to allow businesses additional time to comply with the changes where appropriate.

The FSC welcomes this flexibility in implementation, however impacted businesses remain concerned about the ability to have this relief in place by 1 July 2020.

We would welcome early engagement with APRA to understand exactly what would be required to approve extensions of time, and to ensure that these are in place within the necessary timeframe – particularly in the event of delayed passage of the relevant legislation.

We recommend that any such extensions also consider products and services that are scheduled to be terminated within the next 24 months to avoid any unnecessary impacts to members.

Recommendation

1. Extend commencement date to allow 24 months from Royal Assent for full compliance, with an interim requirement for transition plans to be provided to APRA.

4.2. Application and transitional provisions

Additional relief

The EM at 1.43 contemplates additional relief for entities transferring the RE function to another entity within the corporate group.

The FSC urges Government to move quickly to develop and implement this important relief to support businesses in their decision-making processes. The form of this relief may materially impact the decisions made in relation to the final structure of entities.

In addition, it will be important that this relief extend to the requirements to:

- call and hold a member meeting;
- subject the outcome of a change in RE to a member vote;
- notify members of the change in RE in writing but rather allow for digital or online disclosure; and
- update disclosure documents including PDSs (both short form and long form) but rather allow for an updating item disclosed digitally or online until the next disclosure roll takes place.

We also recommend broadening the relief to include circumstances where it is more appropriate to transfer the RSE to another entity within the group, rather than the RE function.

Essentially impacted organisations should have two options - either the superannuation business is transferred to a new entity or the non-superannuation businesses are transferred to one or more entities.

In some circumstances it may be a more efficient and less disruptive to transfer to RSE functions to a new entity, whereas for other entities a better result may be transferring the non-superannuation business to one or more new entities.

Importantly the decision should be rest with the body corporate in terms of which option it chooses (i.e. to transfer the superannuation business to a new entity or the transfer to the non-superannuation businesses to one or more new entities). We recommend that a provision is inserted in the EM that makes it clear that the decision of which business to transfer rests with the body corporate.

Regardless of which option is chosen, we recommend that consideration be given to streamlining the licensing application processes by both APRA and ASIC where there is a transfer to a related body corporate. As an example, if the superannuation business was transferred to a new related body corporate, it triggers a brand new RSE licence application which is quite onerous. Relief should be given so that an existing licence holder, across all licenses held (e.g. RSE, RE, AFSL) is only required to undertake limited steps to transfer licence(s) from one corporate group to another.

Consideration should also be given to relief for products which are in the process of being wound up. For example, in some instances an RSE may also be a responsible entity of a registered managed investment scheme which is in the process of being terminated. Due to activities being undertaken to wind up the MIS, it may not be practicable for the RE to retire and in fact be to the client's detriment to impose a change in RE where the termination is in process (by delaying the wind up process or increased costs leading to a diminution of the value of the asset).

Relief should also be provided in instances where a trustee entity has legacy products containing a small number of investors, where it would not be in the best interests of members to set up a separate trustee entity for these members. In many cases, superannuation funds would prefer to close these products but have kept them open due to potential adverse consequences for members of closure. In some instances these entities may have fewer than 100 members, and would generally have no pooling of underlying assets.

We suggest that a scale test be applied to ensure that new entities are not required for small legacy entities, where it would not be in the best interests of members to separate them from the existing trustee structure.

Taxation implications

Where a trust changes its trustee, the issue of resettlement arises which could result in all assets being disposed of for tax purposes and reacquired. The consequence of this may be the crystallisation of tax liabilities for the trust's beneficiaries and arguably tax losses being trapped in the "original" trust. The FSC recommends legislative clarity should be provided

ensuring that the change in trustee as a consequence of this proposal would not result in a resettlement of the trust for any tax purpose. Any rollover relief would need to include assets held on capital and revenue account and rollover treatment under TOFA, i.e., there needs to be "whole of Act" relief. This issue arises irrespective of whether an entity ceases to be an RE or RSE.

The above resettlement issues could also apply to the assets of a superannuation fund.

Where an RSE licensee is also RE of managed investment schemes which contain both superannuation and non-superannuation investments (co-mingled), a potential outcome of the new legislation is that superannuation and non-superannuation investments will have to be separated out from the co-mingled MISs to enable the RSE licensee to retain control over the superannuation assets. The restructure or rationalisation of MISs will be subject to significant tax impediments which include crystallisation of capital gains tax, non-transferability and/or forfeiture of tax losses and capital losses and other implications in relation to CGT discount and franking credit offsets.

These adverse tax consequences, if any, will likely be borne by superannuation funds' members and other investors in the co-mingled MISs. This outcome is not desirable and is clearly contrary to the Government's policy objective of protecting consumers.

The existing CGT rollover relief provisions will not be sufficient to remove the tax impediments to the restructure of co-mingled MISs which will be necessarily implemented for the predominant purposes of complying with the new legislation.

Any changes in structure as a result of this policy are not discretionary, but are mandated by Government. As such, there are strong grounds for providing general tax relief for any changes in structure as a result of this policy. This policy approach would be consistent with the rollover relief provided for Accrued Default Amounts (**ADAs**) transferred to new MySuper accounts, as this was relief provided for changes that were mandated by Government policy. The relief provided could be modelled on the relief provided to ADAs or contemplated for the Corporate Collective Investment Vehicle.

We note that resettlement may also mean assets are disposed of and reacquired for state stamp duty purposes, or more specifically a transfer of legal title to trust property occurs, from an existing entity to a new entity (being a new RE or RSE), and this transfer could be subject to stamp duty. A stamp duty liability could exist if the trust holds any dutiable property (e.g. land interests, certain rights or other business assets etc).

We urge the Federal Government to liaise with State Governments to ensure that duty does not apply to transactions required as a result of this policy.

Recommendations

2. Expedite additional relief for licensees transferring RE or RSE functions to another entity within the same corporate group, including simplifying the requirement of license applications.

3. Make it clear in the EM that the body corporate can either transfer the superannuation business to a new entity or the non-superannuation businesses to a new entity or entities, and this decision rest with the body corporate

4. Ensure any structural changes required as a result of this policy are tax neutral, with all necessary tax relief provided as necessary to achieve this aim.

4.3. Structure of the RSE entity

Defining duties

We note that the intent of the legislation is to limit the provision to circumstances where an RSE has another conflicting fiduciary duty to another person. We suggest that this is clarified so that the opening part of the provision be amended to read as follows:

*…The condition is that the RSE licensee must not have a **fiduciary duty** to act in the interests of another person…*

The draft EM (at 1.21) already expressly recognises that "the new licence condition would not prohibit an RSE licensee from having a duty that does not involve acting in the interests of another person" and uses as an example, allowing an RSE licensee to provide "trustee administration services to other entities in exchange for fees as this would likely involve a contractual duty to provide a service to the entity, rather than a duty to act in the interests of the entity."

The drafting change suggested above would ensure the drafting is closely aligned with the policy intent, to allow an RSE to carry out activities which don't conflict with their duty to RSE members.

For example, an RSE acting in its corporate capacity may provide administration or other non-fiduciary, contractual services to other entities or clients. This does not give rise to a conflict of interest or duty as the RSE is acting in its corporate, non-fiduciary role and nor is the RSE faced with a conflict of competing interests or duties.

Recommendation

5. Clarify that, in the context of this legislation, "duty" refers to fiduciary duty of the RSE licensee to the members of the fund and does not include other duties or obligations which may arise in the course of an RSE's business operations.

Scope of RSE licensee role

The EM describes the intention of the Bill as allowing "duties arising from the RSE licensee operating investment vehicles, such as managed investment schemes, special purpose vehicles and pooled superannuation trusts, that are only open to members of the registrable superannuation entity"[1]

While we agree with this intention, there is uncertainty as to whether it has been achieved based on the drafting of Section 29E(5A), which does not allow trustees to undertake any duty not directly linked to their role as an RSE licensee.

This would appear to prevent a corporate entity also acting as trustee of a managed investment scheme (registered or unregistered) or trustee of a trust, even where the only duties arising would be to fund members. Further, we believe that circumstances may arise that require the RSE to also be a member of managed investment scheme (along with RSE members), such as to provide seed capital of a newly created investment fund, and provision should be made to allow for this.

Additional clarity is required in the drafting to achieve the stated intent.

The ED also appears to indicate that one corporation could hold multiple RSE licenses, which we do not believe to be the intent. However, an RSE licensee may be the trustee for multiple RSEs, as contemplated at 1.27 in the EM. Clarifying the wording of s29E(5A) would assist

> (5A) An additional condition is imposed on ~~each~~ the RSE licence held by an RSE licensee that is a body corporate. The condition is that the RSE licensee must not have a fiduciary duty ~~duty~~ to act in the interests of another person, other than a duty that arises in the course of:
>
> (a) performing the RSE licensee's duties, or exercising the RSE licensee's powers, as a trustee of ~~a~~ registrable superannuation entity(ies); or

Recommendation

6. Amend s29E(5A) to:

- include an express exemption for duties not conflicting with the RSE licensee's duties to superannuation fund members

- clarify that a single body corporate may hold only one RSE license, but one licensee may act as trustee of multiple registrable superannuation entities.

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Personal advice

The ED specifically contemplates an exemption for the provision of personal advice at Section 29E(5A)(b). The EM notes that while the majority of advice provided would be covered under 29E(5A)(a), some personal advice may not be captured by this exemption but should still be able to be provided.

While it is not the role of this legislation to resolve broader issues with the provision of advice, it is important to ensure that a consistent regulatory framework, with a focus on the best interests of members, governs the delivery of advice to superannuation members.

For superannuation trustees, acting in the best interests of members may mean a requirement for advisors to understand and consider alternative products outside the trustee's offering, in line with the expectations of an independent financial advisor.

5. ASIC regulation of superannuation (Recommendations 3.8, 6.3, 6.4, 6.5)

5.1. Commencement

Commencement of licensing requirements

The application and transition provisions, (eg, section 1675A) contemplate that if an RSE licensee immediately before 1 July 2020 holds an AFSL to deal in a superannuation product then the relevant AFSL is taken from 1 July 2020 to be subject to a condition authorising the licensee to provide a *superannuation trustee service* (as defined).

We support this implementation process, which should ensure that RSEs do not need to apply for a variations to an AFSL.

However, given the short lead time to the proposed commencement, it would be helpful for ASIC to engage closely with industry to ensure no unintended consequences arise.

Commencement of regulator roles

The proposed adjustment of Regulator roles is significant. However, the ED contemplates a commencement date of 1 July 2020. In a practical sense, this is a very short period within which each Regulator must refocus on its proposed core activities in the superannuation context and allocate staff to various areas.

Nevertheless, in a practical sense, there is likely to be overlap in the matters falling within the jurisdiction of each Regulator. We also note that the ED contemplates that ASIC must obtain APRA consent before it can take AFSL administrative action against a superannuation trustee licensee.

This is an area where, more than ever, there will need to be cooperation and communication between each Regulator, as contemplated by the recent *Financial Regulator Reform (No. 2) Bill 2019: Governance (FSRC Recommendations 6.9 and 6.11).* Indeed, this may well be an area where each Regulator needs to revise its internal protocols in relation to the other. Indeed, it would be appropriate in our view for the Memorandum of Understanding between the Regulators to be revised to accommodate the refocus of roles.

5.2. Application to external service providers

The FSC understands that it is not intended that superannuation administrators need to be authorised as representatives of the RSE in order to provide services that would fall within the services identified as superannuation trustee services – like transfer, payment or rollover of member accounts.

However, this is not reflected in the EM. For clarity, it would be helpful for a statement to this effect to be included in paragraph 1.126 of the EM.

It has also not been clear whether superannuation administrators would be required to obtain a separate authorisation for insurance claims handling done for superannuation funds.

The FSC considers that this should not be necessary. However, if the intent of the changes is to require superannuation administrators to obtain a claims handling authorisation, the FSC requests that the Corporations Act contain a provision to automatically grant that authorisation to superannuation administrators in the same manner contemplated by proposed section 1675A of the Corporations Act in relation to RSEs.

Recommendation

7. Clarify licence and authorisation requirements for external service providers, including administrators.