Your Future, Your Super draft legislation

FSC Submission

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FSC FINANCIAL SERVICES COUNCIL

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1. About the Financial Services Council

The Financial Services Council (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 advice licensees 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 feedback on the Your Future, Your Super draft legislation package.

The FSC has consistently advocated for reforms that will improve the efficiency of superannuation and improve outcomes for members, and we support the overall intent of the draft legislation.

The package will significantly alter the trajectory and purpose of the superannuation system. On balance the FSC supports the reforms, and whilst this submission only addresses technical detail arising from the draft Bill, we note in the broader the context it is important for the Government to continue to work through issues raised by the industry and ensure the measures align with the objective of our retirement system.

The FSC particularly welcomes the introduction of measures to implement the recommendations of the Royal Commission and Productivity Commission that individuals should hold a single default superannuation account. This will be particularly important as the COVID-19 economic recovery continues and people return to work. FSC analysis prepared for this submission shows that the introduction of a single default account could save individuals switching jobs up to $1.8 billion in additional fees on unintended duplicate accounts over the first three years of the reforms.

The FSC also notes that a substantial portion of the detail of this reform package has been delegated to regulations, and we look forward to consultation on these in due course. However, we note that this has caused difficulty in assessing the draft legislation in some instances.

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3. FSC Recommendations

1. Clarify the application of stapling in common Successor Fund Transfer (SFT) scenarios.
2. Clarify arrangements for providing updated account information to funds when a member's stapled account details change.
3. Ensure the ATO Your Super comparison tool provides appropriate information to support consumer decision-making, including nudges in relation to insurance coverage.
4. Provide appropriate education and support to employers to ensure a smooth implementation of stapling changes.
5. Develop an appropriate methodology for applying the performance assessment to lifecycle products, in a way that reflects member experience.
6. Ensure lifecycle products are displayed on the Your Super comparison tool in a way that provides useful information about performance to individuals.
7. Undertake further consultation on the definition of a Trustee Directed Product.
8. Specifically exclude fund mergers and other SFT processes from having performance data stitched together where one product is wound up as part of the SFT.
9. Amend legislation to incorporate funds that do not have a 7-year or longer performance history into the performance benchmarking process.
10. Ensure the Your Super portal is designed to include new entrants to the superannuation market, with appropriate notations where necessary.
11. Ensure appropriate time for APRA to complete performance benchmarking and assessment after receipt of relevant data, to ensure high-quality results.
12. Provide an appropriate mechanism for review or re-issuance of a determination where genuine errors have occurred.
13. Specify timeframes in legislation which provide sufficient time for activities to be undertaken, including notification of beneficiaries and closure of products to new members.
14. Clarify the process for employers where their existing default fund is unable to accept new members.
15. Clarify the intended scope of new resolution powers, and how they differ from APRA's existing direction powers.
16. Clarify the application of the best financial interests duty in relation to third party expenses.

17. Clarify that existing contracts and arrangements are not captured by new requirements, unless they are reviewed after the commencement date.

18. Clarify that expense approvals may continue to be delegated, where the Board is ultimately accountable for expenses.

19. Clarify that long-term investment decisions, including those which incorporate ESG factors, are not in conflict with the best financial interests duty.

4. Single default account

The FSC strongly supports the introduction of measures to prevent the creation of unwanted duplicate accounts, and we agree that stapling members to a single, high quality fund is the most appropriate approach.

To support the implementation of the policy the FSC has conducted analysis to assess the likely fee savings that will occur as a result of stapling consumers to their accounts.

The FSC analysis uses recent data from the 2020-21 Budget forecasts to estimate the higher than usual potential savings on fees that could arise in the unique circumstances post the COVID-19 induced downturn. Not only will there continue to be Australians starting new jobs, but there will be an additional, substantial cohort of Australian's re-entering the workforce in new employment after having lost their job during shutdowns.

These two scenarios combined will likely result in a higher than usual creation of new duplicate accounts and the charging of excess superannuation fees.

The FSC's analysis shows that implementing the stapling recommendation in 2021 as scheduled should be a priority for Parliament as it is estimated to save consumers almost $1.8 billion in excess superannuation fees in the next three years.

Table 1. Estimate of fee savings from the single default account reform

	FY21-22	FY22-23	FY23-24
Number of Australians forecast to change employment	1,071,700	986,700	1,100,800
Estimated fee savings	$409.8m	$601.8m	$778.6m
		Total fee savings	**$1790.2m**

4.1. Clarifying practical application of stapling

The FSC supports the stapling approach outlined in the draft legislation and explanatory materials, which establishes a single stapled product which a member can carry with them until they make an active choice to change.

Determining a stapled account

In general, the FSC supports the use of the tie-breaker rules that form part of existing rules which are currently used by the ATO to enable pro-active consolidation of ATO-held super to a member's active account in instances where an individual holds multiple superannuation accounts.

However, some variations from these existing rules may be necessary to ensure a sensible approach to determining a stapled fund. For instance:

- including the presence of active insurance cover, potentially below other signs of account activity such as contributions or rollovers in the list of factors to be considered, but above the size of the account;
- prioritising accounts with recent contributions over the most recent account to receive an ATO rollover;
- considering recently opened accounts (and ensuring there is the opportunity for a member to designate a new account as their stapled account);
- ensuring accounts unable to accept contributions, such as Eligible Rollover Funds and risk-only accounts, are not able to be designated as a stapled fund.

Where ATO discretion may apply, the ATO approach for exercising discretion should be transparent, and ideally subject to consultation before being finalised.

The FSC also recommends clarifying how it is intended stapling be managed in several common scenarios, including in the event of a Successor Fund Transfer (SFT) as a result of a fund merger.

Lack of clarity in relation to how SFT processes should be managed caused significant disruption and confusion following the commencement of *Protecting Your Super* and *Putting Members Interests First* reforms, and a legislative amendment was required to resolve the issues relating to insurance elections continuing.

Legislation or regulations should provide that where a member's benefits are transferred to another super fund as a result of a SFT and the original fund was the stapled fund for a member, then following the transfer, the successor fund automatically becomes the stapled fund for that member (unless the member has elected a different stapled account).

In some of these scenarios, it will be important that the ATO is able to proactively push updates to stapled fund information to employers to ensure that SG payments are made into the correct stapled account. For example, if a member closes an existing stapled account but does not notify their employer of this change, or leaves an employer and is unable to remain in an employer's default fund, it would be preferable for the employer to be notified before they attempted to make an SG contribution into the closed account.

Recommendation

1. Clarify the application of stapling in common SFT scenarios.
2. Clarify arrangements for providing updated account information to funds when a member's stapled account details change.

4.2. Role of ATO comparison tool

Stapling members to a single default account must also be supported by a robust online tool to empower members reviewing and engaging with their superannuation. The ATO Your Super comparison tool will play a central role in assisting superannuation members to exercise choice, particularly within the MySuper market.

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Stapling could be successful in engaging members with their super, including reviewing the ongoing appropriateness of insurance benefits, but only if members are provided with the opportunity to review their superannuation arrangements regularly and at appropriate times, especially when they are changing jobs (for example through the ATO's Single Touch Payroll onboarding process). An online solution that has universal participation, as recommended by the Productivity Commission, is necessary.

The Your Super tool should provide information about all fees, as well as investment returns, in a format that is meaningful to consumers, allows them to assess products against their needs, and identifies factors which are not included but which they may need to consider (such as fee discounts available to them, insurance cover etc).

Regular, appropriate nudges will also need to be provided to support decision-making and ensure good outcomes for individuals making use of the tool.

These nudges should include specific reference to insurance cover, to ensure that Australians are aware of the cover they hold, are prompted to check whether it is appropriate for their circumstances (particularly for those in high-risk occupations) and understand how their cover might be impacted if they switch between products.

Recommendation

3. Ensure the ATO Your Super comparison tool provides appropriate information to support consumer decision-making, including nudges in relation to insurance coverage.

Extension of the ATO tool to choice products

While we continue to support the introduction of a simple online comparison tool for MySuper products, the FSC also has concerns about including the broad range of choice products in a consumer-facing tool without appropriate guidance as this may facilitate consumers entering into products they do not fully understand.

Not all products are suitable for all individuals, and complex choice products are generally designed for use by a financial adviser who build a portfolio of investments for their client, often combining more than one choice investment option to meets their specific goals.

For most individuals who would be likely to utilise an online comparison tool, a MySuper product or a vanilla choice product (with similar features to a MySuper product) would be the most appropriate for their needs.

4.3. Employer transition

Given the role of employers in implementing the changes in this amendment for new employees from 1 July 2021, it will be vital that appropriate awareness and education programs are in place to ensure compliance.

Employers will need to be familiar with their obligations and the appropriate processes and timeframes associated with new requirements including having the ATO verify stapled fund details for new employees. If employers are not prepared for these changes then there is a significant risk of non-compliance with Superannuation Guarantee payment obligations, particularly in the first year of operation before an automated process is in place for obtaining stapled account details from the ATO

Support for impacted employers may also be required at the point where an underperforming superannuation fund is required to cease accepting new members (see section 0 below).

We recommend that specific timeframes are included in the legislation defining when an employer is required to verify stapled fund details with the ATO following the onboarding of a new employee, as well as the timeframes by which the ATO is required to respond to an employer's request.

Recommendation

4. Provide appropriate education and support to employers to ensure a smooth implementation of stapling changes.

5. Addressing underperformance in superannuation

5.1. Measuring superannuation product performance

The FSC supports the introduction of objective performance testing for MySuper products.

Given the detail of the performance test is delegated to regulations, this submission does not include detailed views on the performance testing methodology. However, we note the flexibility provided in the legislation for the regulations to specify multiple metrics and benchmarks, and welcome this flexibility to ensure the performance assessment approach remains fit-for-purpose over the long term.

Lifecycle products

The underperformance measures in the Bill as drafted specify application of the underperformance test at a product level. While this is appropriate for a MySuper product with a single investment approach (e.g. a Balanced investment option), it does not provide a meaningful outcome for individuals in lifecycle of lifestage products.

While there has been discussion that a weighting approach may be used to apply the performance test to lifecycle products, it is not clear how this will be accurately applied.

Further work will also be needed to ensure that MySuper products with lifecycle investment strategies are presented on the ATO comparison tool in a way that is useful and meaningful for individuals comparing funds.

Recommendation

5. Develop an appropriate methodology for applying the performance assessment to lifecycle products, in a way that reflects member experience.
6. Ensure lifecycle products are displayed on the Your Super comparison tool in a way that provides useful information about performance to individuals.

Trustee directed products (TDPs)

The draft Bill notes that the APRA performance assessment process will apply to classes of beneficial interest other than MySuper, as identified in regulations (s60B(5)(b)).

The information paper released on 6 October 2020 indicates that the Government intends to extend the performance test to ‘trustee directed products’ in 2022, and defines these as choice superannuation products where the investment strategy is designed and controlled by the trustee, and where the investment strategy covers multiple asset classes.

The FSC welcomes acknowledgement that performance assessment is not suitable for all choice products. Products such as wraps and master trusts, which allow members to combine investments to construct their own superannuation portfolio, cannot be meaningfully performance tested.

Importantly, though, these more complex products are generally accessed by individuals through a financial adviser, who is required to act in the best interests of their client and make appropriate investment decisions which align with their retirement goals. These products are also subject to the incoming Design and Distribution Obligations (DDO) regime, so will be required to identify the appropriate target market for the investment options offered.

It should also be noted that the SIS Act definition of 'choice' products includes not just accumulation products but all products which do not meet the definition of MySuper or Defined Benefit products. This includes retirement, risk-only insurance and transition-to-retirement products, which are unlikely to be suitable for performance testing.

The FSC recommends the Government undertake further consultation on the definition of TDPs to be included in the performance assessment.

Recommendation

7. Undertake further consultation on the definition of a Trustee Directed Product.

Merging performance

Section 60F of the draft bill specifies that, in certain circumstances, two or more products may be treated as one and have their performance 'stitched together' for the purpose of the performance test.

While we understand that this section is intended as an anti-avoidance measure, stitching together performance histories of products could have an impact on potential product simplification and merger activity where trustees have concerns about historical underperformance.

The current drafting of proposed section 60F is quite broad, and allows APRA to exercise its discretion in terms of the circumstances in which multiple products may be treated as one product for the purposes of the annual performance test.

This means that following a merger of funds, or products, the investment performance history of both products may be considered for the purposes of the annual performance test. It will be important that the approach taken to merging historical performance provides appropriate and meaningful outcomes, including in scenarios where:

- a new MySuper has been established for the purposes of facilitating a merger;
- a MySuper product is wound up as part of an SFT process; or
- internal fund consolidation results in MySuper products being merged or wound up.

High performing funds are less likely to absorb poor performers if there is a possibility that the underperforming product may be taken into account in the high performing fund's next assessment. Under these circumstances, it would be difficult to justify merging with an underperforming fund as being in the best interests of current members.

To send a clear signal to trustees that consolidating with a poor performing product will not affect investment performance, the legislation should specifically exclude such cases for the purposes of proposed section 60F.

The application of the test should also ensure that, where a fund makes improvements to one or more existing products in response to a performance benchmark result, this would not constitute an attempt to by-pass the consequences of future performance benchmark tests.

Recommendation

8. Specifically exclude fund mergers and other SFT processes from having performance data stitched together where one product is wound up as part of the SFT.

New market entrants

A key consideration for the promotion of healthy competition within the Superannuation system is the application of the proposed performance test to new and recent industry entrants.

This will be particularly important if the ATO comparison tool is only open to funds which have been subject to the performance assessment process.

For new (and recent) market entrants, the key risk is not that they may be reported as an "under-performer" but rather that they will simply not be visible if the Your Super portal is solely comprised of funds that have the requisite performance history.

This would cause considerable commercial detriment to new entrants, in particular those that have not previously competed for the right to act as a default product in the workplace default market and attract all their members based on positive switching decisions by consumers.

From a competition policy perspective, not allowing new or recent market entrants to participate on a reasonably equal footing could be anti-competitive, and in effect lock new entrants out of the large-scale superannuation market for up to the next 7 years. Accordingly, the legislation should incorporate an appropriate mechanism to include them in the performance testing regime and Your Super portal.

One possible solution for new entrants would be to include them in the portal with a shorter performance history, subject to an acceptable minimum (such as 3 years), and noted as being a new entrant as of the applicable date.

Importantly though, prior to that minimum threshold, all registered MySuper products should still appear on the Your Super portal, with appropriate notations as to commencement dates where applicable.

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Recommendation

9. Amend legislation to incorporate funds that do not have a 7-year or longer performance history into the performance benchmarking process
10. Ensure the Your Super portal is designed to include new entrants to the superannuation market, with appropriate notations where necessary.

5.2. Performance test timing

While we understand the importance of efficiently identifying and responding to poor performance in superannuation funds, we have concerns about the proposed timeframes for the activities associated with the performance test and consequences for underperformance.

APRA assessment timing

The timing for APRA to complete performance assessments is not specified in the legislation, however the roadmap in the Your Future, Your Super Treasury paper indicates that APRA will complete the first performance test in September 2021 and trustees of underperforming products must notify members by 1 October 2021.

Asset allocation and net return data for the quarter ended 30 June 2021 is required to be reported to APRA by 28 July 2021. This means the proposed timeline provides only 9 weeks for APRA to construct SAA benchmark portfolios and complete performance tests for all MySuper products and for trustees of underperforming products to prepare and issue notices to members. If APRA is intending to use the new, more granular data to be collected as part of the Superannuation Data Transformation project, this will not be available until 30 September 2021, likely making it difficult to complete the first performance tests on time.

It currently takes almost 4-5 months for APRA to construct benchmark portfolios and publish results in the MySuper Heatmap.

Further consultation with industry and APRA should be undertaken to determine a more reasonable timeframe for completing the performance tests and notifying members.

Recommendation

11. Ensure appropriate time for APRA to complete performance benchmarking and assessment after receipt of relevant data, to ensure high-quality results.

Review of decisions

The EM is clear that an APRA determination in relation to failing an underperformance test is not a reviewable decision, and as such there does not appear to be a mechanism for review or correction of performance test results.

The FSC is concerned that there is no mechanism to correct or re-issue a determination, even where there is a data error. Given the short timeframes involved in the data collection

and assessment process, it is likely that some errors will occur which may not be identified or rectified before a determination is made, particularly in the initial assessment periods.

Recommendation

12. Provide an appropriate mechanism for review or re-issuance of a determination where genuine errors have occurred.

Consequences of underperformance

The legislation notes that funds have 28 days to notify members of the product from the time APRA notifies a fund that they have failed the performance test.

Particularly if paper communications are required, this is a short timeframe to prepare and provide communications to every member of the product, particularly as the wording of 60D(2) currently appears to require the notification to be received, rather than sent, within 28 days

Section 60E also requires a fund to cease accepting new members on the day APRA notifies the fund of a second failed assessment.

While we note that funds at risk of a second failed assessment may be able to prepare in advance for these processes, it is still not possible to make changes on the same day a notice is provided, particularly given that new members are created automatically via online switches and applications on a daily basis.

In addition, if a fund that is prevented from accepting new members is a default fund for one or more employers, then these employers will need to make arrangements for an alternative default fund to be put in place for any new employees without an existing stapled fund. This generally requires a tender to be undertaken. It is not clear how employees would meet their SG obligations for a new employee without an existing stapled account in the interim period until the tender is complete.

To resolve these timing concerns, it would be preferable to link the timing of these actions to the date the determination comes into force, which can be specified by APRA under section 60E(5)(b). This would allow APRA to allow sufficient time for the consequences to be applied without creating adverse outcomes.

Recommendation

13. Specify timeframes in legislation which provide sufficient time for activities to be undertaken, including notification of beneficiaries and closure of products to new members.

Employer impact

Appropriate processes, timeframes and support will need to be in place to ensure the impact on employers and individuals is minimised in circumstances where a fund is required to cease accepting new members.

Legislation needs to address circumstances where a provider fails the performance test in two consecutive years and the employer is required to change default providers. Changing default service providers is a long process which includes tender. While the number of new entrants into an employer default will be very small for most employers going forward, the SG Act requires employers to pay default contributions to a fund within a specified timeframe, which may not be possible for new employees without a stapled fund if a tender is underway.

We also note that the legislation prevents funds from accepting new members, it does not prevent these underperforming products from continuing to be listed as default products in particular Awards.

Recommendation

14. Clarify process for employers where their existing default fund is unable to accept new members.

5.3. APRA resolution powers

The draft amendments provide APRA with power to make prudential standards in relation to resolution planning.

The FSC supports this amendment in principle, however this would benefit from additional context to clarify the intended scope of these standards and the situations where this power would be used. It is also difficult to understand how these powers differ from APRA's existing trustee direction powers.

The draft proposes a definition of Resolution in s10(1) that covers situations where the fund is:

> (a) being unable to meet its obligations; or
> (b) being considered likely to be unable, or being considered 16 likely to become unable, to meet its obligations; or
> (c) suspending payment, or being considered likely to suspend payment;
> including through the exercise of powers and functions under this Act or another law.

For example, we assume these provisions would allow APRA to create a framework to allow APRA to facilitate an orderly transition of members from underperforming funds through mechanisms such as Successor Fund Transfers. This would mitigate potential poor outcomes for disengaged members who do not proactively move from an underperforming fund.

However, the broad drafting of these definitions means it is not clear which other situations may meet the criteria in s10(1), including:

- Defined benefit funds may from time to time be in an unsatisfactory financial position and as result may pay out less than the full defined benefit, which may meet the definition of being “unable to meet its obligations”. A defined benefit fund could also be in an unsatisfactory financial position but continue to pay benefits and have a rectification plan, yet still be considered “unable to meet its obligations” under the current drafting.
- The definition of resolution also covers suspending payment or being considered likely to suspend payments. It would be helpful to clarify that temporary suspension of payments from a single investment option for liquidity reasons would not be sufficient to lead to resolution.

Recommendation

15. Clarify the intended scope of new resolution powers, and how they differ from APRA’s existing trustee direction powers

6. Best financial interests duty

6.1. General comments

The FSC supports the proposed changes to sections 52(2)(c) and 52A(2)(c) of the SIS Act, to clarify the duty of a trustee of a superannuation fund, and its directors, is to exercise their powers and perform their duties in the best financial interests of beneficiaries.

The impact of this provision has been subject to considerable debate, so to inform this debate and provide a neutral basis to interpret the provisions the FSC sought advice from leading financial services lawyer, Michael Vrisakis, Partner at Herbert Smith Freehills.

Based on the legal advice attached to the FSC's submission, the amendments are less contentious and material than they appear, as the amendments do not change the substance of the law. Conduct that was previously unlawful will remain unlawful, but the wording of the primary legislation is being clarified to make this explicit. The FSC supports this approach.

These amendments are in the best interests of consumers and will help ensure retirement savings are better protected from misuse.

Overall, the combined effect of these changes is to provide clarity and certainty to trustees on what activities are permissible under the law. These changes should also encourage the regulator to take action in relation to breaches of these provisions as the reversal of the evidentiary burden addresses information asymmetries, where a trustee knows the basis for a decision whilst the regulator may not have access to that information.

6.2. Application of the best financial interests duty

The advice received by the FSC explains that expenditure by a trustee on a campaign that is unrelated to the financial interests of beneficiaries, or where the trustee has gone to no effort to determine whether a campaign is in the financial interests of beneficiaries, is likely to have been unlawful prior to this amendment. Under the proposed amendment this conduct will continue to be unlawful, and as such the amendment is not material.

It is important to note that, while the EM considers the activities of third parties receiving payments from trustees, Sections 52(3A) and 52A(3A) as drafted do not explicitly provide for look-through of expenses and investments. Amendments to the Bill or further detail in the regulations will be required to understand how the Government intends the measures to apply to third-party payments outside the scope of the SIS Act as discussed in the EM.

The FSC also submits that the reforms are clearly agnostic to different corporate structures and apply evenly to all superannuation funds. This will ensure consumers across the industry are protected from misuse of their savings.

There is some ambiguity, however, in relation to the commencement of the new requirements. It would be helpful for the legislation to clarify whether the amendments apply to existing expenses and investments at commencement, or to decisions made from that

date. A transition period should apply if existing contracts are captured, to allow time for existing arrangements to be unwound without adverse financial consequences for members.

Recommendations

16. Clarify the application of the best financial interests duty in relation to third party expenses.
17. Clarify that existing contracts and arrangements are not captured by new requirements, unless they are reviewed after the commencement date.

6.3. Reverse onus of proof

There is a more substantive change arising from the proposed reversal of the evidential burden, however the impact of this amendment is also less material than suggested by some stakeholders.

Based on the attached advice the FSC understands that, provided a trustee and a fund's directors can provide evidence that they have exercised their powers in the best financial interests of fund members the onus still falls on the regulator to then prove that they did not.

Requiring a trustee to retain evidence to demonstrate that expenditure is in the best financial interests of its members is a reasonable expectation in the context of our mandatory superannuation system, particularly given the high level of member disengagement.

The amendment also imposes strict liability for directors as a result of a breach. Notwithstanding the strength of these provisions outlined in the attached advice, given the consumer protection focus of these reforms the FSC considers this an appropriate and proportionate approach.

It is not clear, however, whether the amendments require the trustee board to explicitly approve all expenditure. Given the Board will ultimately be accountable for all expenses (and consistent with existing practice) it would be appropriate for expense approvals to continue to be approved through delegations.

Recommendation

18. Clarify that expense approvals may continue to be delegated, where the Board is ultimately accountable for expenses.

6.4. Prohibition on certain payments and investments

The FSC is concerned about the proposed power for the Treasurer to prohibit certain types of payments, given the broad nature of the power and the ability to apply it to any type of expense or investment.

Given the impact of the change, however, is dependent on the regulations that are yet to be made, the FSC reserves judgment on this issue.

6.5. ESG investing

There has been some discussion of the impact of the Best Financial Interests duty and the reversal of the onus of proof on the ability of trustees to invest with regard to environmental, social and governance (ESG) risks and opportunities.

While the FSC and our members consider that considering ESG factors is an important aspect of long-term investing, there are some concerns that the impact of the best financial interests duty will be to discourage trustee engagement in this space due to a perception that there is a conflict between incorporating ESG factors and the duties of the trustee.

In addition to clear evidence that incorporating ESG considerations into investment decisions has led to stronger long-term financial performance over most asset classes and most investment horizons, we also note the increasing focus from financial regulators on the need for superannuation trustees to consider systemic risks of climate change.

It would be helpful for the scope of the duty to be clarified to ensure that long-term investment decisions, including those which incorporate ESG factors, are not in conflict with the best financial interests duty, particularly given the long-term nature of superannuation investments and the need to consider retirement outcomes for members in future decades.

Recommendation

19. Clarify that long-term investment decisions, including those which incorporate ESG factors, are not in conflict with the best financial interests duty.

7. Detailed feedback on draft legislation

Reference	Issue	Recommended solution
Single default account		
32R	No timeframe is specified for ATO compliance with employer requests for stapled fund information regarding an employee. Without clear timeframes for this information to be provided, there is a risk of employers struggling with SG payment timeframes.	Regulations should specify: • an appropriate timeframe for ATO notification to ensure employers can appropriately manage SG obligations, unless instant online verification is available for employers. • a timeline for employers to make a request, to ensure obligations to determine the correct stapled fund are met prior to the employer making the first SG contribution. • process for employers if they do not receive a response from the ATO before they are required to make contributions.
32Q EM 1.22	The legislation specifies that tie-breaker rules for establishing a stapled fund where a member has multiple active accounts will be similar to existing USM rules. While consistency with these existing rules is preferable, we note these rules do not consider active insurance policies within superannuation as one of the factors – if this is not used, then members could lose insurance cover as a result of the account they hold insurance through becoming inactive.	Consider varying existing ATO rules, by: • including the presence of active insurance cover, potentially below other signs of account activity such as contributions in the list of factors to be considered, but above the size of the account; • prioritising accounts with recent contributions over the most recent account to receive an ATO rollover; • considering recently opened accounts (and ensuring there is the opportunity for a member to designate a new account as their stapled account); • ensuring accounts unable to accept contributions, such as Eligible Rollover Funds and risk-only accounts, are not able to be designated a stapled fund.

Reference	Issue	Recommended solution
	It is currently unclear how stapled accounts would be treated in the event of an SFT. Industry requires clear guidance, supported by scenarios, of how stapling is to be applied, including what happens to a 'stapled' account when an SFT has occurred. This would include what to tell members and employers before and after the SFT has transacted. It would be beneficial if the ATO could update the employer of the employee's new stapled fund if required following an SFT.	Clarify impact of SFT on stapling arrangements. Generally, where a member's stapled account is transferred to another fund as a result of an SFT, the successor fund should automatically become the new stapled fund. Clarify process to ensure compliance where stapled fund details change due to SFT (or for another reason) and employee does not notify the employer.
	Changing jobs may impact an individual's default insurance cover which is connected to their stapled super account, particularly if they are moving to a higher risk occupation. This may result in loss of cover if the default insurer does not provide coverage for higher risk occupations.	Ensure appropriate prompts and nudges to support individuals to consider insurance cover when they are changing jobs.
Addressing Underperformance		
34C	The intent and application of new provisions around resolution is unclear.	Clarify in legislation or EM circumstances where APRA resolution powers are intended to apply.
	It is unclear how the proposed timings associated with the assessment will be achieved in practice, given: • APRA will receive data shortly before being required to issue determinations • Underperforming funds will have 28 days from APRA's determination to contact all impacted members • Underperforming funds will also cease to be able to take new members on the day APRA notifies of a second failed assessment, which will require employers to tender for a new default provider	Reconsider timeframes for undertaking test and implementing consequences for poor performance to ensure integrity of each stage of the process. Align 60E(2)(a) with 60E(5) to specify "the day the determination comes into force" rather than requiring the fund to stop accepting new members on the day the notification is given – this will allow determinations to be made with sufficient time available for employers to undertake a tender for a new default fund if required.
60F	It is not clear how products will be combined in order to derive an 8 year return, particularly in the case of an SFT.	Specify an alternative test in regulations to ensure new entrants are able to be assessed at an appropriate time, particularly in order to be represented in the ATO online tool.

Reference	Issue	Recommended solution
60F	It is not clear how performance will be assessed for new entrants where 8 years of data cannot be stitched together.	Specifically exclude performance of a fund that is being wound up as part of an SFT process, to avoid disincentivising mergers. Provide additional context for other scenarios where multiple products will be stitched together.
60B	This section refers to application to “other classes of beneficial interest” which are to be defined in regulations. Expanding to all choice products is not practical and would not provide a meaningful improvement to member outcomes, particularly given this includes retirement products and products where members (usually with the help of an adviser) control their own investments.	Ensure the definition of TDPs applies only to appropriate products.
EM 1.20	The EM is clear that a determination is not a reviewable decision, and as such there does not appear to allow for review or correction of performance test results, even where there is a data error – given the short timeframes involved in the data collection and assessment process, it is likely that some errors will occur.	Provide appropriate avenues for review or issuance of a new determination where appropriate.

Reference	Issue	Recommended solution
60E(2)	Underperforming funds are subject to a blanket prohibition on accepting new members, however there may be some situations where a new account is required – for example in the case of family law splitting, In these circumstances, trustees are often required to create new accounts for individuals who are typically not existing members of the fund. Where this occurs, investments are generally defaulted to the MySuper offering, where applicable.	Consider providing exemptions for the creation of new accounts in specified circumstances. While the Government has announced that it plans to introduce legislation to allow funds to transfer accounts to the ATO voluntarily where the trustee considers it is in the members best interests to do so, this would not address the above issues. Firstly, from a practical perspective, an account will need to be established on a fund's administration systems in order for any accounts to be transferred to the ATO. In the absence of a direction provided by the account holder, trustees will be required to specify a default investment allocation. Secondly, trustees may determine that transferring certain amounts to the ATO voluntarily may not be in the best interests of the beneficiaries in certain cases.
60D	The legislation does not specify the form of member communications in the event of the performance test not being met. The same issues that required relief to provide electronic transactions during the Protecting Your Super package implementation (exclusion of SIS Act comms from Electronic Transactions Regulations) will also apply in the case of underperformance	Ensure communications to members are able to be provided in electronic format
Best Financial Interests		
	The legislation does not make clear the level of look-through required on expenses, particularly in relation to corporate groups and expenses paid by parent companies rather than trustees. E.g. what happens when a service provider is paying for 'fund promotion' as it's an outsourced activity	Clarify the look-through requirements for expenses and investment decisions

Reference	Issue	Recommended solution
	It is not clear whether existing contractual arrangements will be grandfathered under these provisions. In the event contracts need to be changed to comply, this could take months to finalise.	Specify a transition period for existing contracts to allow time for trustees to ensure compliance
	Clarify application in relation to expenditure approved from 1 July 2021 (vs. paid from this date)	Clarify that only expenditure approved from 1 July 2021 is captured by the requirements
	It is not clear whether it is necessary for Board to approve all expenditures, or whether this can continue to be handled via delegations.	Clarify the level of approvals for expenditure, noting that the Board will be ultimately accountable for all expenses anyway per existing practice.

HERBERT SMITH FREEHILLS

Mr Blake Briggs
Deputy Chief Executive Officer
Financial Services Council

17 December 2020

By Email

Dear Blake

You have asked us to assess and comment on the provisions in the Exposure Draft of the *Treasury Laws Amendment (Measures 4 for a later sitting) Bill 2020* that relate to the imposition of a duty upon the trustees of registrable superannuation entities and their directors to exercise their powers and perform their duties in the best financial Interests of beneficiaries.

Our comments are divided into four elements of the provisions:

1 The insertion of the word 'financial' in sections 52(2)(c) and 52A(2)(c) to create the composite 'best financial interests.'

2 The introduction of a rebuttable presumption that a trustee or director did not act in the best financial interests of beneficiaries.

3 The introduction of a prohibition on the trustee making certain types of payments specified in the Regulations.

4 The extension of each of the changes to apply to the directors of the trustee companies.

We assess and comment on each below.

1 **Insertion of the word 'financial'.** We do not believe this change alters the substance of the law as it has been applied since the introduction of the *Superannuation Industry (Supervision) Act 1993* (Cth). In that time the courts have consistently held that the best interests of beneficiaries of a superannuation fund are their best financial interests.[1] The consequence of this change is thus entirely expressive – it clarifies in the wording of the statute the meaning that the courts have consistently applied to the provision, and to its general law antecedent. Respectfully, we therefore disagree with the statement in the Explanatory Memorandum that 'By requiring trustees and directors of corporate trustees to *only have regard to financial interests*, it eliminates the possibility that trustees and directors of corporate trustees can act in a manner that they judge improves the non-financial interests of members but not their financial interests.'[2] In our opinion there is nothing in the new wording that precludes trustees and their directors having regard to non-financial interests, so long as they exercise their powers and perform their duties in the best financial interests of beneficiaries. Importantly, our view is adopted in later parts of the Explanatory Memorandum where it says 'Subject to the trustees complying with the sole purpose test, this does not preclude trustees undertaking actions that also yield non-financial benefits to the beneficiaries, but the action cannot compromise the best financial interests of members.'[3] We are

1 See for instance *Commonwealth Bank Officers Superannuation Corporation v Beck* (2016) 334 ALR 692, [136]-[140] (Bathurst CJ); *Australian Prudential Regulatory Authority v Kelaher* (2019) 138 ACSR 459, [65] (Jagot J).

2 Explanatory Memorandum, [1.6].

3 Explanatory Memorandum, [1.27].

ANZ Tower 161 Castlereagh Street Sydney NSW 2000 Australia
GPO Box 4227 Sydney NSW 2001 Australia
T +61 2 9225 5000 **F** +61 2 9322 4000
herbertsmithfreehills.com DX 361 Sydney

also unsure of the statement in the Explanatory Memorandum that 'The identification of a quantifiable financial benefit to members is a threshold consideration for trustees in assessing whether the proposed exercise of their power will fulfil the requirements of the duty.'[4] The requirement for quantifiability appears nowhere in the draft legislation and would, were it present, create challenges where trustees were, for instance, required to have regard to a salient but unquantifiable risk to their investment portfolio or operational arrangements.

2 **Introduction of the rebuttable presumption**. This change is described as a 'reversal of the evidential burden' but in substance functions more akin to a rebuttable presumption. This is because section 220(3)(b) provides that once the defendant has adduced evidence that it exercised its powers or performed its duty in the best financial interests of the beneficiaries, the onus returns to the regulator to prove, on a balance of probabilities, that it did not. That is to say, the defendant does not need to prove its case, it need only demonstrate a reasonable possibility that a matter existed or did not exist, in order for the onus to revert to the regulator initiating the action. The Explanatory Memorandum justifies this change in the following way: 'The reversal of the evidential burden should emphasise to trustees and directors of corporate trustees that they need to have strong systems and processes in place to ensure that all actions they take can be demonstrated to be in the best financial interests of beneficiaries. It should also highlight the need for trustees to keep clear records of the decision-making process.'[5] However we note that the requirement for strong systems and processes and for careful record keeping are already directly and specifically imposed on the trustees of registrable superannuation entities by the *SIS Act*, the *SIS Regulations* and relevant *Prudential Standards*. We therefore believe this change is designed to address the asymmetry of information between the trustee and the regulator, thereby encouraging relevant regulators to undertake court action. We note in that regard that recent extensions to the powers of both ASIC and APRA would appear to give them the power to require disclosure of a wide range of information from a trustee in the ordinary course of supervision. The effect of the change is moreover ameliorated by the requirement on ASIC and APRA to act as model litigants. We therefore believe this change is likely to have an effect only at the margin on the regulatory process.

3 **The prohibition of certain types of payments**. The effect of this change will depend on the content of the Regulations made. Specifically, section 117A speaks in terms of 'types of payments or investments' being prescribed in the Regulations. The Explanatory Memorandum does not provide concrete examples of these but talks rather in terms of the motives and processes associated with the decisions taken by trustees in respect of payments to third parties.[6] This appears to be intended to describe the combined effect of the proscription in section 117 and the changes to sections 52(2)(c) and 52A(2)(c) of the *SIS Act* described above. Respectfully, this combination is inconsistent with the structure of the provisions as currently drafted. Payments contrary to section 117A are prohibited so no consideration of whether they also breach the covenant in section 52(2)(c) arises. The best financial interests duties apply where the transaction is not prohibited under section 117A but the transaction can be demonstrated not to be in the best financial interests of members. We also note that the Explanatory Memorandum suggests that trustees ought to 'have oversight that monies paid are being used by third parties for the intended

4 Explanatory Memorandum, [1.28].

5 Explanatory Memorandum, [1.48].

6 Explanatory Memorandum, [1.42 – 1.44].

purpose.'[7] With respect this objective is not addressed in the provisions in the draft Bill nor in the regulatory scheme currently in place for the trustees of registrable superannuation entities.

4 **The imposition of liability on directors**. Sections 52A(2)(c), 52A(2A), 117B and 220A extend the provisions just considered to directors of the trustee company. The changes to section 52A do not appear to us to materially alter the substance of the law. It is however notable that section 117B is expressed in strict terms, employing the phrase 'must ensure'. Although the courts have historically tended to downplay the use of the verb 'ensure' in interpreting the *SIS Act*, [8] that may be dangerous in this instance given the presence of the imperative 'must'. This is exacerbated by the status of s117B as a civil penalty provision and the presumption arising from proposed section 220A. We further note in that respect the current move to restrict the directors' right of indemnity in respect of regulatory sanctions contained in the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* and the difficulty directors may face securing indemnity insurance in respect of regulatory sanctions imposed as a result of a contravention of civil penalty provision. In other relevant parts of the *SIS Act* directors are implicitly permitted to defend their actions if they can demonstrate that they have acted honestly and not in an intentionally or recklessly careless manner.[9]

You will see from these comments that we believe that the amendments to the *SIS Act* that would be brought about by the *Treasury Laws Amendment (Measures 4 for a later sitting) Bill 2020* are likely to be workable if enacted in their current form. Such concerns as we have relate primarily to the imposition of duties of strict liability on trustee directors. We have also noted that the descriptions provided in the Explanatory Memorandum appear in some respects to go beyond what is contained in the Bill. For the most part those descriptions will be relevant only in the event that the provisions ultimately enacted are ambiguous in some way, in which case a court may use them as extrinsic evidence of Parliament's intention. There remains the chance, however, that the description attached to the prohibition in respect of payments by trustees signals an intention on the part of the Government to craft Regulations more broadly than might be suggested by a strict reading of the wording of section 117A. Should that eventuate, we would need to review closely the precise wording of the Regulations to ascertain their full legal effect.

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7 Explanatory Memorandum, [1.42].

8 See for instance *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Limited* [2006] VSC 112, [103] – [105] (Byrne J), endorsed *in Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204, [104 – 121], (Giles JA, Young and Whealy JJA agreeing.)

9 See for instance section 57, *SIS Act*.

HERBERT
SMITH
FREEHILLS

Yours sincerely

Michael Vrisakis
Partner
Herbert Smith Freehills

+61 2 9322 4411
+61 418 491 360
michael.vrisakis@hsf.com

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