



29 March 2018

Ms Heidi Richards
General Manager, Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW

By email: superannuation.policy@apra.gov.au

Dear Ms Richards,

DISCUSSION PAPER: STRENGTHENING SUPERANNUATION MEMBER OUTCOMES

1. This submission has been prepared by the Law Council of Australia's Superannuation Committee (**the Committee**),¹ which is a committee of the Legal Practice Section of the Law Council of Australia.
2. The Committee's response to the Australian Prudential Regulation Authority's (**APRA**) *Discussion Paper: Strengthening Superannuation member outcomes (Discussion Paper)* is guided by its objective to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee has only made comments below where the Committee has identified issues within its remit.

Executive Summary

3. The Committee appreciates the intent behind the proposals and notes that the implementation approach evidenced in the consultation package has responded to feedback given in response to early consultation. In particular:
 - The proposals have been implemented largely through changes to existing prudential standards and prudential guidance,² rather than by overlaying an entirely new 'operational governance' framework. An opportunity has also been taken to consolidate APRA's guidance;³ and
 - There is less reliance on the 'best interests' covenant in s 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth) to justify the imposition of APRA's new member outcomes standard, draft *Prudential Standard SPS 225 Outcomes Assessment (SPS 225)*, consistent with what the Committee

¹ The Law Council of Australia is a peak national representative body of the Australian legal profession. It represents the Australian legal profession on national and international issues, on federal law and the operation of federal courts and tribunals. The Law Council represents 60,000 Australian lawyers through state and territory bar associations and law societies, as well as Law Firms Australia.

² For example by including its proposals relating to strategic and business planning and fund expenditure in *Prudential Standard SPS 220 Risk Management (SPS 220)*.

³ Relating to the adequacy of resources and the management of reserves.

considers to be the correct legal approach to the covenant.⁴ That said, there remains a reference to the 'best interests' covenant in paragraph 2 of *Prudential Practice Guide SPG 221 Strategic and Business Planning (SPG 221)*, which the Committee does not consider to be a true statement of the law.

4. The Committee has some concerns with:

- the prescriptive nature of the new requirements and the proliferation of compliance-driven documentation that will result; and
- the requirement for outcomes assessments to be comparative, rather than linked to what the trustee seeks to achieve for its own fund's members.

5. This submission does not seek to respond to each of the consultation questions, since some raise issues of practice or policy. Rather the Committee has responded to specific questions and make some general observations relating to the Committee's objective of ensuring that the law relating to superannuation in Australia is sound, equitable and demonstrably clear.

Changes to SPS 220

Strategic and business planning

6. The Committee makes no comment on the proposal to require a written business plan for implementing a trustee's strategic objectives, other than to note that the requirements for the business plan in Attachment A to *Prudential Standard SPS 220 Risk Management (SPS 220)* are very prescriptive and are not reflected in *Prudential Standard CPS 220 Risk Management (CPS 220)* for other industries regulated by APRA. The Committee queries whether even ASX listed companies would have business plans with that level of detail. Our concern is that business plans may become compliance driven and that a prescriptive approach may therefore inhibit rather than facilitate strategic and business planning.
7. *It may be more appropriate to move Attachment A to SPG 221 so that the listed items to be contained in business plans form guidance as to APRA's expectations, rather than absolute legal requirements.*

Expense management

8. The requirement to have a Board-approved expenditure policy that is consistent with the trustee's strategic objectives is not controversial, but it does create an additional policy for the trustee to maintain and monitor.
9. Feedback has been sought about whether the concept of 'significant expenditure' is consistent with how superannuation trustees currently undertake delegated expenditure decisions.⁵ The Committee does not consider that the proposed requirement to 'define' significant expenditure and to require a detailed business case

⁴ As noted in previous submissions and supported by case law, the Committee does not believe that the 'best interests' covenant requires a trustee to secure the 'best outcome' for members, but rather represents a trustee's obligation to place paramount importance on the members' interests when exercising its powers and duties.

⁵ Discussion Paper, Chapter 2, Consultation Question 3.

for each significant expenditure is consistent with the way financial delegations currently work.

10. Typically, the CEO would be given delegated authority to manage the fund's operations consistent with an annual budget (usually formulated in conjunction with an annual business plan) and to seek Board approval for expenditure that materially exceeds the budget. Each fund is likely to have its own materiality threshold.
11. APRA's proposal seems to envisage that the CEO would also need to prepare a business case and seek approval for each 'significant' expenditure even if it is within budget. Typically, some items of significant expenditure (eg a major project) may be represented by separate 'line items' in the budget and would have already had a business case prepared before being included as separate line items. However, other significant expenditures may simply be incorporated in a general category within the budget, with the intention that the CEO may occur up to the budgeted amount without a separate business case.
12. Further, in SPG 221, APRA states its expectation that the trustee should be able to demonstrate how significant fund expenditure decisions are consistent with its 'best interests' duty, even where they are already contemplated by the fund's business plan (which itself would have been formulated with regard to members' interests).
13. The Committee is concerned that APRA's 'one size fits all' proposal for managing 'significant expenditure' risks proliferating paperwork and a 'tick a box' compliance approach without necessarily improving financial governance.
14. *If APRA has concerns with particular types of fund expenditure,⁶ it might be preferable to impose more detailed requirements by reference to the character of those expenditures, rather than by reference to their 'significance'.*

Sole purpose test

15. APRA has asked for feedback on whether *Circular No. III.A.4 The Sole Purpose Test (Circular III.A.4)* remains relevant.⁷
16. Proposed SPG 221 contains APRA's expectations for there to be a strong link between an expenditure decision and the trustee's strategic objectives. At paragraph 31, APRA states that the more indirect or tangential is the linkage, the less likely that an expenditure decision would comply with the sole purpose test. APRA then states that expenditure on member education, member recruitment and member retention may be appropriate where the trustee can demonstrate that these actions deliver tangible outputs consistent with the outcomes being sought.
17. On a similar topic, Circular III.A.4 states:

It is open to trustees to develop features of their fund which add value to, or differentiate it from, other funds. For example, fund sponsored member awareness, education and financial advice programs, targeted at fund specific issues such as benefit features (including insurance options, the making of binding death benefit nominations etc) or investment choices offered in the fund, may be appropriate. However, fund sponsored

⁶ Such as payments to fund sponsors, payments to related parties, advertising campaigns

⁷ Discussion Paper, Chapter 2, Consultation Question 8.

programs, including financial planning services, which are targeted at broader, non-superannuation savings and investment opportunities, products or services, such as investment or tax advice and health insurance, are inappropriate.

As a guiding principle, there should always be a reasonable, direct and transparent connection between a particular scheme feature or trustee action, and the core or ancillary purposes. The more tenuous the linkage between a service or activity and the retirement savings objective, the greater will be the difficulty in the fund meeting the sole purpose test.⁸

18. Proposed SPG 221 reflects APRA's current thinking on educational and promotional activities and might therefore be considered to supersede the Circular in this respect. However, the Committee notes that the Circular also traverses topics such as the retirement purpose for investments⁹ and the provision of financial planning services¹⁰ and so remains relevant to industry in those areas.
19. *Therefore, Circular III.A.4 remains relevant, but APRA should consider how to resolve the potential ambiguity that may ensue where proposed SPG221 covers the same topics.*

Outcomes Assessment

20. SPS 225 will impose a new requirement for superannuation trustees to conduct an annual outcomes assessment and to have the outcomes assessment approved by the Board.
21. Since this is a matter of policy for APRA, the Committee does not seek to comment, other than to query whether it is appropriate for the trustee's assessment to include outcomes provided to beneficiaries of other Registrable Superannuation Entities (RSEs). The Committee is concerned that this comparative focus will inhibit trustees from seeking to differentiate their fund's offering and will drive an even greater focus on peer comparisons (for example investment performance) than on achieving the best retirement outcomes for a fund's particular membership demographic. While a comparative approach may be appropriate for *MySuper* 'default' products (that are legislatively designed to be more 'plain vanilla') the Committee submits that the marketplace for 'choice' and 'pension' products will not benefit from such an approach.
22. As APRA has signalled at paragraph 27 of proposed SPG 225, there is also a risk that the self-selection of 'peer' funds will suffer from comparison bias. In the Committee's view, outcomes assessments would be most effective if focussed on what the trustee intends to achieve for its own fund's members, rather than requiring funds to spend time and money designing a methodology for comparing their funds with others.
23. *The Committee notes that, as the regulator of the superannuation industry, APRA itself is best placed to draw its own comparisons between funds. If APRA then has concerns that certain funds are operating outside of accepted industry practice, it could use its regulatory powers to bring them into line.*

⁸ Australian prudential Regulation Authority, *Circular No. III.A.4 The Sole Purpose Test*, [41]-[42].

⁹ *Ibid* [30]-[33].

¹⁰ *Ibid* [43]-[45].

Look through reporting

24. APRA has sought feedback on whether 'look through' reporting should extend to the first non-associated entity in the chain of service providers.¹¹ The example relates to the engagement of an advertising firm by a related party administrator, rather than by the trustee itself. The example assumes that the trustee has control of the related party entity, which is not necessarily the case.
25. *The Committee queries whether APRA's powers to require information would extend to third party expenses of a related party entity.*

Contact

26. The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:
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 - Ms Lisa Butler Beatty, Deputy Chair, Superannuation Committee
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Yours sincerely



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Chief Executive Officer

¹¹ Discussion Paper, 21 [3.2].