Law Council
OF AUSTRALIA

Legal Practice Section

Exposure Draft Regulations to support Treasury Laws Amendment (Your Future, Your Super)

Treasury

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About the Law Council of Australia

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The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

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- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
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About the Section

The Legal Practice Section of the Law Council of Australia was established in March 1980, initially as the 'Legal Practice Management Section', with a focus principally on legal practice management issues. In September 1986 the Section's name was changed to the 'General Practice Section', and its focus broadened to include areas of specialist practices including Superannuation, Property Law, and Consumer Law.

On 7 December 2002 the Section's name was again changed, to 'Legal Practice Section', to reflect the Section's focus on a broad range of areas of specialist legal practices, as well as practice management.

The Section's objectives are to:

- Contribute to the development of the legal profession;
- Maintain high standards in the legal profession;
- Offer assistance in the development of legal and management expertise in its members through training, conferences, publications, meetings, and other activities.
- Provide policy advice to the Law Council, and prepare submissions on behalf of the Law Council, in the areas relating to its specialist committees.

Members of the Section Executive are:

- Ms Maureen Peatman, Chair
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- Dr Leonie Kelleher OAM, Treasurer
- Ms Tanya Berlis
- Mr Mark Cerche
- Ms Peggy Cheong
- Mr Philip Jackson SC
- Ms Christine Smyth

Acknowledgement

The Law Council is particularly grateful for the expertise of the Superannuation Law Committee of its Legal Practice Section in leading the development of this submission.

Introduction

1. The Superannuation Law Committee of the Law Council's Legal Practice Section (**the Committee**) makes this submission in relation to the package of materials released as the Exposure Draft of the Treasury Laws Amendment (Your Future, Your Super) Regulations 2021. The materials support the Government's 'Your Future, Your Super' package and associated measures. The submission is presented in three separate parts to reflect the three components of the key documents released by Treasury on 28 April 2021.

Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021

Annual Performance Test – introduction should be on a true prospective basis

2. The Committee has a number of observations regarding the Treasury Laws Amendment (Your Future, Your Super—Addressing Underperformance in Superannuation) Regulations 2021 (**Addressing Underperformance Regulations**) that also touch on the proposed features of the accompanying Bill, recognising that the final terms of the Bill may be amended in order to secure its passage. These points are not to take issue with the policy of the reforms, rather, the Committee wishes to ensure that any such changes are legally sound and consistent with what would be regarded as fair and objective implementation measures that may affect existing Registrable Superannuation Entity (**RSE**) licensee rights to offer MySuper and 'trustee directed' products.

3. Fundamentally, in the Committee's view, such measures (which represent new laws impacting licensee rights) should be introduced on a clear prospective basis, by which participants are informed of the rules against which they will be held to account and expected to behave for the purposes of the 'annual performance test'. That necessarily requires that historical performance data taken into account for the performance assessment should <u>not</u> pre-date the introduction of the legislation and regulations in the absence of some overwhelming necessity to do so.

4. The Committee notes that RSE licensees with MySuper licences are already (and have been since the advent of MySuper in 2013) required to construct and implement MySuper product investment objectives and strategies consistent with the relevant investment and MySuper specific statutory covenants of SIS and prescribed licence conditions, in addition to the standing requirement to exercise such powers in members' best interests. Members receive periodic reporting on investment performance including clear prescribed reporting of average returns over a 10 year period against benchmarks. In addition, RSE licensees already face regular and exhaustive supervision by Australian Prudential Regulation Authority (**APRA**) and are required to observe and perform detailed member outcome assessments annually.

5. Introduction of the new annual performance test effectively introduces a new MySuper requirement for a provider to maintain their licence, so that they may continue to offer MySuper product to new members.

   The Committee is not aware of a clear and overwhelming case for the need to introduce measures based on annual performance assessment which will use retrospective data over the preceding 7 years at point of introduction of that legislation.

6. Furthermore, the Committee is concerned that as the historical data to be used in the initial annual performance test has not been gathered for the intended purpose, it may well prove unreliable in whole or part for that purpose. Recent data collection initiatives by APRA recognise some of these limitations. Accordingly, given the significance of the data being used and the adverse implications for a RSE licensee, this may introduce a new area of potential dispute with APRA quite unnecessarily and without providing any benefit to beneficiaries.

Period of past performance

7. The period of past average performance and form of disclosure ought to align with that required of RSE licensees in their MySuper product dashboard and periodic statement requirements. In the absence of a change to existing requirements, average performance should be measured over the long-term period envisaged for a MySuper default investment in the accumulation phase, being 10 years rather than 7 years.

Prescribed notice to members of failure to meet annual performance test - Schedule 2A – s60E(2)

8. The Committee suggests several changes to the prescribed notice to members where a RSE licensee is determined to have failed to meet the annual performance test in the first year. These changes are to ensure that the notice is:

- factual and objective, rather than being overtly judgemental, subjective or alarmist; and
- alerts members to relevant risks in moving their superannuation to another product, consistent with Australian Securities and Investments Commission (**ASIC)** required disclosures on insurance implications before exercising portability and prominent recognition that past performance is not a guarantee of future performance.

9. For example, those changes would be along the following lines:

- replace reference to ‘poorly perform’ with ‘has not met the Australian Government’s annual average performance test for your fund’s investments’; and
- change reference to ‘switching to a different super product is easy and there are no fees involved’ so it reads ‘You should consider the Fund’s rectification plan to address this underperformance. You also have the right to switch to a different super product if you prefer without any exit fees. However, if you consider changing to another product/fund note:
  - past performance is not a guarantee of future performance;
  - you should consider any adverse impact of loss of death and disablement insurance cover you currently have in your existing product; and
  - you should consider your own objectives, circumstances and needs and ensure that any new product is suitable for you’.

10. The Committee would be pleased to provide further input on a revised form of notice prepared in accordance with the above principles.

Rectification plan requirement if fail under performance test – additional RSE licence condition

11. If a fund fails the performance test, the Committee suggests that the following should be considered consistent with the existing Superannuation Industry Supervision (**SIS**) approach to a fund being in an 'unsatisfactory financial position':

- the RSE licensee should be required to formulate a rectification plan, to address the underperformance and restore performance within a three-year period. The plan must be lodged with APRA; and
- the RSE must report to APRA and members via periodic statement and website as to annual progress against the plan.

12. In light of the above action, consideration could be given so that the successive annual performance test failure would have an additional overlay of a failure to comply with the rectification plan as agreed with APRA before the fund would be required to cease acceptance of new beneficiaries for investment in MySuper/trustee-directed product.

General comment on the concept of "trustee-directed product" in regulation 9AB.2

13. The Committee queries whether it would create less regulatory complexity to use a concept of 'member-directed product' rather than 'trustee-directed product' to define the scope of what products are covered by Part 6A; that is, to exclude 'member-directed products' rather than include 'trustee-directed products'. The corporations and SIS legislation already have concepts of member-directed investment choice, 'platform' and 'custodial arrangement'. The Committee suggests that building on these concepts rather than creating the obverse concept of a 'trustee-directed product' may be a clearer, simpler and more harmonious way of achieving the desired objectives. However, if the concept of 'trustee-directed product' is maintained, the following section of our submission contains some technical commentary on the existing proposals.

Technical comments on the drafting of sub-regulation 9AB.2(6)

14. The definition of 'trustee-directed product' at regulation 9AB.2 of the Addressing Underperformance Regulations contains exceptions to the definition in sub-regulations (4), (5) and (6).

15. The Committee observes that sub-regulation (6) may be largely redundant in practice given the exclusionary condition in sub-regulation 9AB.2(2)(c). This is because (2)(c) says (in effect) that an interest is not trustee-directed if a member can require the trustee to switch investments between covered asset classes. In fact, most if not all superannuation products offering member-directed investment choice in the Australian market will offer choices in more than one of the asset classes specified in sub-regulation 9AB.17(7). In such a case, it seems there would be no need to rely on sub-regulation (6). However, it is possible that a superannuation trustee might offer broad investment choice within only a single asset class, for example 'Australian Equities'.

16. So as a matter of principle the Committee considers it is relevant to comment on the drafting of sub-regulation (6), as follows.

17. It appears from the draft Explanatory Statement (**ES**) that the objective of sub-regulation (6) is to exclude from the 'trustee-directed product' definition products:

> *"where the only control the trustee has over the product is to either offer or not offer the product to members … These products include where the trustee offers for a third party to manage the investment strategy for the member's superannuation interest. This exclusion does not apply where the trustee is an associate of or has influence over the third party managing the interest."*

18. The Committee infers that this exclusion is intended to cover superannuation interests that offer member-directed investment choice (for example, choice of discrete underlying managed investment scheme products issued by separate product issuers but made available through a superannuation wrap platform).

19. However, the Committee submits that the current wording of sub-regulation (6) could never achieve the intended objective. In addition, the draft ES and sub-regulation (6) seem to perhaps inadvertently conflate or confuse several distinct concepts. To explain further:

    (a) Sub-regulation (6)(a) requires that the trustee '*not engage in <u>any</u> activity* in relation to the class of beneficial interest other than' offering the class and 'engaging in activities necessary to make such offers' (emphasis added). Given the numerous ongoing regulatory obligations of a superannuation trustee, this condition could never be met in relation to any class of superannuation interest even if the class offered the highest possible degree of member autonomy in relation to investment choice. The wording of sub-regulation (6)(a) seems to give unwarranted focus on activities relating to the class of *superannuation interest itself* rather than activities relating to the *underlying investments* that might be offered in relation to the class. It therefore appears that this requirement is drafted much more widely than is necessary to achieve the objective.

    (b) Sub-regulation (6)(b) refers to an entity that 'manages investments' but it is unclear what kind of 'management' is being referred to. The Committee submits that it is important to distinguish between:

        (i) a true 'investment manager' in the sense used in the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**), meaning a person contracted by a superannuation trustee to make investment decisions as agent for the trustee; and
        (ii) a 'fund manager' with whom a trustee might invest.

    The latter term is commonly used to refer to an entity that is in fact the responsible entity (**RE**) and issuer of separate managed investment scheme products (**MIS**) in which a superannuation trustee may invest. Although often referred to colloquially (but confusingly) as 'fund managers', such REs are not agents of the trustee and are not 'investment managers' in the SIS Act sense; they are arms' length investment issuers. Many superannuation trustees offer MISs as member-directed investment choices. While an RE in this situation will be managing the investment that the trustee has made, the RE is not a trustee-appointed investment manager. On the assumption that (6) is intended to exclude member-directed investment choice, the Committee submits that the appointment by a trustee of a true investment manager should not be allowed to attract the sub-regulation (6) exception, whether the investment manager is associated with the trustee or not; this is because a trustee should be responsible for the performance of its agents. Conversely, investment by a trustee in a bona fide discrete MIS product (or other discrete financial products) pursuant to a member direction, should attract the sub-regulation (6) exemption, whether the RE or other product issuer is associated with the trustee or not.

(c) It seems to be clear that the reference in sub-regulation (6)(b) to a 'connected entity' is intended to be an anti-avoidance mechanism to prevent trustees from using related parties to escape coverage of the performance reporting provisions. However, the Committee submits that investments by a trustee in a discrete financial product issued by a related company should not necessarily be treated any differently for this purpose from investments by a trustee in a discrete financial product issued by an unrelated company. Differential treatment would lead to anomalous outcomes; for example, investment by a financial services group entity super trustee in its own group's MIS pursuant to a member direction might be treated as trustee-directed but investment by an external group trustee in that other group's MIS pursuant to a member direction would not be. The RE of an MIS will have its own Australian Financial Services Licence and set of fiduciary and other regulatory obligations. An exception to this equal treatment might be if the trustee did have rights to substantially influence the investment decisions of the RE (or other product issuer).

Technical query on the drafting of sub-regulation 9AB.7 and 9AB.8

20. The Committee submits that the proposed exception relating to regulations 9AB.7 and 9AB.8 (and the application of specified classes of Part 6A products) seems unclear. In particular, the Committee submits that there is a lack of clarity in drafting between the various sub-regulations. It perhaps appears that an entity could rely on the 5-year exemption where a fund changes from a single standard investment strategy to a lifecycle investment strategy (or vice versa) within an existing MySuper product. This view could arise from an interpretation based on the interaction of sub-regulation (1) and (2) of regulation 9AB.8. Sub-regulation (1) states that sub-regulation (2) specifies a requirement for all specified classes of Part 6A products (specified classes being lifecycle and standard). However, then (2) references only 'Part 6A products' not classes of Part 6A products. The argument may be that due to (1) one could read (2) as referencing classes of Part 6A products. But this is perhaps not the legislative intent; is, the exception should apply to the MySuper product as a whole (not the class of product - lifecycle or standard).

Treasury Laws Amendment (Your Future, Your Super—Improving Accountability and Member Outcomes) Regulations 2021

21. In proposed Regulation 2.10 of the Treasury Laws Amendment (Your Future, Your Super—Improving Accountability and Member Outcomes) Regulations 2021, there is a very large range of information which must be included with the notice of an annual members' meeting. Much of the information is already required to be given to or made available to members by other existing mechanisms in the law. However, there are some new elements. The Committee raises queries about the meaning and certainty of the wording for some of those elements, as follows:

(a) There is a requirement in sub-regulation 2.10(1)(e) to provide an itemised list showing each payment (if any) made, by or on behalf of the registrable superannuation entity during the year of income, for which the main purpose was promoting the entity. That wording is sufficiently clear, although the Committee suggests that the language should be about payments 'from' the registrable superannuation entity rather than payment 'by' the registrable superannuation entity, since the entity (as a superannuation fund) is not itself a legal person who can make payments.

(b) The next element is payments for which the main purpose was 'promoting a particular view on behalf of the entity'. The Committee queries whether the meaning of this is sufficiently clear. 'Entity' means the superannuation fund, and a fund is a pool of money which (arguably) cannot hold a view. Even if it means that the trustee (acting for purposes connected with running the fund) is the legal person doing the 'promoting', the Committee queries whether the words 'a particular view' are sufficiently clear. It is perhaps also not clear what 'on behalf of' means in terms of the relationship between the trustee as legal entity and the registrable superannuation entity as a trust fund. The Committee submits that some redrafting would be warranted.

(c) Similarly, the third element is payments for which the main purpose was 'sponsorship on behalf of the entity'. The Committee queries the use of the words 'on behalf of the entity', in particular, how can sponsorship be done *on behalf of* another, particularly when the legal circumstance involves a trustee vis a vis its trust fund?

(d) There is a requirement in sub-regulation 2.10(1)(h) to provide an itemised list showing each payment (if any) made by the entity during the year of income to entities variously described over six sub-paragraphs. There is quite some generality employed in the language of these sub-paragraphs, including a key term 'connected entity of the RSE licensee of the main entity'. The term 'connected entity' does not seem to be defined, and the Committee therefore queries whether the term has sufficient certainty.

(e) Also, as a general observation the Committee queries whether the notion of related party payments which is intended to be captured in this Regulation 2.10(1)(h) could be more succinctly described, or whether there would be existing notions of related party dealings which could be relied upon (much like the notion of 'associate' in the SIS Act refers to the applicable aspects of that term in the *Corporations Act 2001*). The Committee observes that regulation of superannuation funds is already very complex, and to prescribe additional new and detailed legal tests to concepts which are not novel tends to add to that complexity.

Treasury Laws Amendment (Your Future, Your Super—Single Default Account) Regulations 2021

Definitions of "selection period" and "tiebreaker requirements"

22. The proposed regulations provide for a definition of 'selection period' by reference to the new regulation 17A(4) of the Treasury Laws Amendment (Your Future, Your Super—Single Default Account) Regulations 2021 (**Single Default Account**

Regulations), being the period relevant for the Commissioner to identify the 'employee's stapled fund'. The period is relevant to the 'tiebreaker requirement' where the Commissioner identifies two or more existing funds that meet the basic eligibility requirements.

23. The selection period is the period which commences from the start of the previous financial year and runs through to the time that the tiebreaker decision is made by the Commissioner. Though such period ensures at least a 12-month period is considered for the purpose of the Commissioner selecting one of the eligible funds, it could never run beyond two years. The Superannuation Committee considers such period may not be sufficient to address all workforce hiatus periods. It is not readily apparent to the Committee as to why the period could not be extended beyond two years to ensure it covers, in particular, women who have left the workforce for a period of say, five years, to care for infant children.

24. The Committee also suggests that the fund that has received the most recent contribution may not be an appropriate tiebreaker rule under proposed regulation 17A(3)(b). It fails to give sufficient regard to the possibility of a single contribution being made in error or as part of an inconsequential casual employment arrangement. The Committee suggests that the tiebreaker rule at proposed sub-regulation 17A(3)(c) (relating to the fund with the higher account balance) should rank ahead of the tiebreaker rule at sub-regulation 17A(3)(b).

25. Alternatively, sub-regulation 17A(3)(d) which provides the Commissioner with discretion to select the 'most appropriate' of the eligible funds may be a preferable approach (in place of sub-regulations 17A(3)(b) and (c)) pursuant to which the Commissioner might then be directed to have regard to the kinds of factors currently set out in (b) and (c). This would enable the Commissioner to apply their own de minimis standards and to have regard to other relevant matters, without first having ruled out the criteria under sub-regulations 17A(3)(b) and (c) for which it may be apparent is clearly inappropriate. To the extent the Commissioner is aware that insurance is provided to a member, the Committee suggests that also be set out as a relevant matter for the Commissioner in selecting a fund.

26. The Committee also queries whether a fund which has failed the new performance test with respect to 'Part 6A products' should continue to satisfy the basic eligibility criteria for a "stapled fund". If such a fund is not in the legislature's view fit for new members, then by parity of reasoning it should also be unfit to operate as a default fund for existing members who have not made a choice of fund selection with a new employer.

Timing issues

27. If, as identified on page 4 of the draft Single Default Account Regulations, an employer is unable to make contributions to a stapled fund (selected by the Commissioner), the employer is able to request that the Commissioner identify another fund that could be the employee's stapled fund (regulation 17B).

28. However, the Explanatory Statement acknowledges that it is possible in these circumstances for an employer to essentially run out of time to make the contributions by the quarterly due date, in which case it is suggested by the Explanatory Statement that the employer might seek relief from the shortfall incurred from the Commissioner pursuant to proposed new sections 19(2E) and (2F) of the *Superannuation Guarantee (Administration) Act 1992 (Cth)* (**SGAA**). The Committee submits that the prospect of an employer being put in a position

where it must seek relief from the superannuation guarantee shortfall due to misinformation being provided by the Commissioner is not palatable. In those circumstances the employer should be relieved from any shortfall without having to make application for relief – which imposes an additional administrative burden upon the employer in circumstances where it has not been at fault. Further, the employer will not be entitled to a tax deduction for contributions made after the quarterly due date even if relief were to be provided under section 19(2E).

29. New regulation 17C permits the Commissioner to alter a notification given to an employer if the Commissioner has identified an error and the Commissioner is unaware of any contributions being made to the fund by the employer. The Committee is concerned that timing differences between paying contributions (including through clearing houses) and reporting contributions to the Commissioner, as well as administrative errors, could result in the Commissioner changing an earlier notification that adversely affects an employer who has already made a contribution. The Superannuation Committee submits that employers should not be subject to disadvantage in these circumstances.

30. Finally, it is unclear to the Committee how the selection process would operate in circumstances where a new employee joins an employer towards the end of an SG reporting period (say on or after 24 June 2022) – and is paid on 30 June 2022, with superannuation contributions then being paid to the employee's fund. In those circumstances, is it anticipated that the employer is permitted to proceed on the assumption that there is no stapled fund for the employee? The Committee is concerned about issues of timing that could make this determination/presumption by the employer problematic if it is made pending a response from the Commissioner. It is suggested this may be particularly problematic if the employee has multiple funds and the Commissioner has to apply the tiebreaker rules to determine the employee's stapled fund and there may be an unexpected delay. If the employer delays making the contributions until after 30 June 2022 (say to 28 July 2022), the employer will not be entitled to a tax deduction through no fault of the employer.

31. The Committee recommends that further consideration be given to these timing issues before the Single Default Account Regulations are finalised.

Employer liability

32. The Committee recommends that consideration be given to a transitional period for relief to be granted to employers where there has been an effort made to comply with the new single default fund requirements but where a failure has occurred due to administrative errors on the part of the Commissioner, the employer or a clearing house or payroll services provider. The Committee is concerned about these matters because there is limited scope for the Commissioner to provide relief under proposed section 19(2E) and the first twelve months of implementation is likely to be the most administratively problematic.

33. It also remains unclear to the Committee whether the so-called override provisions of Part 3A of the SGAA (by operation of the amendments to section 5B of the SGAA) will of themselves be sufficient to overcome an employer contravening a term of an enterprise agreement under section 50 of the *Fair Work Act 2009* (Cth) (**FW Act**) when it makes a contribution to a stapled fund which is not a fund specified by the terms of the relevant enterprise agreement. The consequences may be particularly problematic if the employee has insured benefits or superior insured benefits under the fund nominated by the relevant enterprise agreement.

There does not appear to have been any amendment proposed to the FW Act to address this aspect.