

13 September 2017

Mrs Helen Rowell  
Deputy Chairman  
Australian Prudential Regulation Authority (APRA)  
Level 12, 1 Martin Place  
SYDNEY NSW 2000

By email: [superannuation.policy@apra.gov.au](mailto:superannuation.policy@apra.gov.au)

Dear Mrs Rowell

## **SUBMISSION ON CONSULTATION ON STRENGTHENING OPERATIONAL GOVERNANCE OF RSE LICENSEES**

This submission has been prepared by the Superannuation Committee of the Law Council's Legal Practice Section (**the Committee**).<sup>1</sup> The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee makes submissions and provides comments on the legal aspects of the majority of all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

### **Introduction**

The Committee is pleased to have the opportunity to respond to APRA's Consultation on Strengthening Operational Governance of Registrable Superannuation Entities (RSE) Licensees. The Committee is guided by its objectives identified above and has only made comments below where the Committee has identified issues within its remit.

### **Consultation on Strengthening Operational Governance of RSE Licensees**

The Committee notes the letter dated 11 August 2017 sent by APRA to all RSE licensees regarding proposed enhancements to the prudential and reporting standards with regard to operational governance, strategic and business planning and member outcomes.

The Committee also refers to recent 'round-table consultation' convened by APRA in Melbourne on 23 August 2017 to discuss these proposals, where the Law Council of Australia was represented by Mr Luke Barrett and Ms Heather Gray in their capacity as members of the Committee.

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<sup>1</sup> 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.

The Committee wishes to make the following submissions in relation to certain of the key elements of the proposals that have been outlined by APRA:

### **Prudential standard on Operational Governance**

1. The Committee understands APRA is proposing to introduce a new prudential standard to 'lift' operational governance practices of RSE licensees. It is understood that APRA's focus will be to ensure that an RSE licensee governs its business in a manner that has at its core the 'long-term sustainability of the business operations, and the delivery of quality, value for money outcomes for beneficiaries'.
2. APRA has indicated that the new standard would be developed in a way that will support RSE licensees in meeting the operational covenants under s 52(2) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) (trustee covenants). The Committee understands that APRA's expectation is that the new standard would merely reflect what RSE licensees should currently have in place for their business operations, particularly for 'strategic and business planning processes, and measures to ensure rigour in decision-making regarding expenditure and reserving'.
3. The particular details upon which APRA proposes to undertake further consultation are proposed requirements:
  - to ensure that RSE licensees have policies and procedures to establish, implement, monitor and review their business plan, and the achievement of strategic objectives; and
  - for RSE licensees to meet minimum expectations when making decisions which require the use of fund assets, whether these decisions relate to expenditure incurred in running the fund, setting aside money in reserves or the setting of fees and costs policies to fund these decisions (including implementing appropriate policies and procedures to ensure there is adequate rigour in decision-making, monitoring and transparency related to the use of members' money).
4. The Committee considers that the existing requirements under the SIS Act are already adequate to address the concerns that APRA has raised in relation to operational governance. In particular, s 29E of the SIS Act imposes conditions on all RSE licences that:
  - the RSE licensee complies with 'RSE licensee law' (s 29E(1)(a)); and
  - the duties of a trustee in respect of each registrable superannuation entity of which it is an RSE licensee must be properly performed (s 29E(1)(b)).
5. The concept of 'RSE licensee law' is a broad one encompassing the SIS Act and regulations as well as the prudential standards and certain other legislative requirements. In addition, the concept of the 'duties of a trustee' under s 29E(1)(b) would extend to encompass all general trust law obligations of trustees.
6. APRA already has extensive powers to require RSE licensees to comply with their licence conditions if APRA considers there has been a breach (ss 29EB, 29G of the SIS Act). APRA has specifically referred to compliance with the statutory covenants under ss 52

and 52A of the SIS Act as being underpinned by the (new) operational governance framework.

7. In addition to the covenants forming part of 'RSE licensee law' there is also the legislative underpinning of decision-making for RSE licensees via the existing 'sole purpose test' (s 62 of the SIS Act).
8. The Committee notes that RSE licensees who are already minded to breach the sole purpose test and ignore statutory covenants and other RSE licensee law would be unlikely to be deterred by any requirements of a new prudential standard seeking to elaborate or supplement existing RSE licensee law.
9. The Committee is concerned about the additional regulatory burden of a new prudential standard that seeks to elaborate on the statutory covenants. The Committee notes APRA's existing power to impose additional licence conditions on RSE licences pursuant to s 29EA and queries whether a more targeted approach to addressing concerns with individual RSE licensees (as appear to have already been identified by APRA) may be a sufficient and appropriate mechanism with a lesser regulatory burden for the entire industry.
10. The Committee also queries whether any officers of RSE licensees would continue to meet the 'fit and proper' criteria if they were involved in clear breaches around what might constitute good decision-making and a targeted approach to addressing this may be more effective.
11. Finally, the Committee is concerned that there is a potential for overlap and confusion between what might be incorporated under a new operational governance prudential standard and what might be required as a matter of law and pursuant to the statutory covenants. There is a risk that the new prudential standard will offer a limited range of approaches to how an RSE licensee might satisfy its duties under the statutory covenants and general trust law obligations, but in so doing may operate as preventing other means by which those duties might also be adequately satisfied. Ultimately any perceived inconsistency between the requirements of the prudential standard and the requirements of the SIS Act would expose the prudential standard to legal challenge having regard to s 34D of the SIS Act.

#### **Fund expenditure and reserving – Reporting Collection**

12. The Committee understands that APRA also proposes to amend the reporting collection standards to support greater accountability and transparency on RSE licensee expenditure in light of the Government's proposed reforms to allow APRA to collect more expense data on a look-through basis.
13. The Committee also wishes to flag its preliminary concerns about APRA's proposals mentioned at the recent 'round-table consultation' to require RSE licensees to seek to 'look through' unrelated entities to determine the application of fund expenditure. The Committee notes that the process required for RSE licensees would be much more difficult and different to the approach that has been taken to 'looking through' investments and investment vehicles for asset class exposures, currency exposures and like. The Committee is very interested in how APRA's proposals will be further developed and progressed in this regard. We also refer to the submission we made to Treasury in relation to the proposed legislative reforms behind this matter which are set

out in Schedule 7 of the exposure draft *Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017* concerning amendments to the *Financial Sector (Collection of Data) Act 2001*.

#### **Assessing outcomes for all beneficiaries**

14. The Committee understands APRA to be seeking to apply a best interests test on a 'member outcomes' basis by requiring RSE licensees to regularly assess whether they have provided and are likely to continue to provide 'quality value for money outcomes for beneficiaries in all of their RSEs and products'. In particular, it is understood that APRA would consider the assessment addressing: net investment returns (potentially over a past three-year period), expenses and costs, insurance and other benefits and services provided.
15. The Committee has long held a view consistent with case law (see *Manglicmot v Commonwealth Bank Officers Superannuation Corporation* [2010] NSWSC 363) that the 'best interests' covenant is 'concerned with process, not outcome'. APRA's proposal to require RSE licensees to develop a framework for assessment of member outcomes in a manner which suits their individual business operations has the potential to conflict with the RSE licensee's role as a trustee – for instance, requiring an RSE licensee to deal with a factor that is seen to be inhibiting better member outcomes may be at odds with a requirement imposed upon a trustee by its trust deed or otherwise by general trustee duties.
16. The Committee accepts that RSE licensees will typically have as their general overriding objective that there be positive and advantageous outcomes for members in all decisions that are made – however, there is a rich and more complex structure of general trust law that reinforces appropriate decision-making by RSE licensees and the application of an 'outcomes' test does not easily sit with trust law principles. There are many recent examples of the courts providing guidance to trustees regarding their decision-making processes drawing on the developed principles of trust law and applying them in the superannuation fund trustee context: see, for example, *Finch v Telstra Super* [2010] HCA 36 and more recently *Miljevic v Holden Employee Superannuation Fund Pty Ltd* [2016] FCA 718.
17. The Committee suggests that caution be applied to any proposed application of an 'outcomes' test on RSE decision-making as it may lead to all RSE licensee efforts being directed to satisfying a narrow set of shorter-term benchmarks and focus being taken away from the important inputs-based enquiry process for good decision making supported by the developed principles of trust law. Further, members may be wrongly guided by an outcomes-based approach to the effect that any underperformance against a benchmark is evidence of the RSE licensee not having fulfilled its duties.

## Contacts

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:

- Mr Luke Barrett, Chair, Superannuation Committee T: 03 9910 6145 or at (E) [luke.barrett@unisuper.com.au](mailto:luke.barrett@unisuper.com.au); or
- Ms Lisa Butler Beatty, Deputy Chair, Superannuation Committee on (T) 0477 753 941 or at (E) [BeattyLi@cba.com.au](mailto:BeattyLi@cba.com.au).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jonathan Smithers', with a long horizontal stroke extending to the right.

**Jonathan Smithers**  
**Chief Executive Officer**