



14 August 2017

General Manager
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The Treasury
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Delivery by email to superannuation@treasury.gov.au

Dear Sir/Madam

Thank you for the opportunity to provide a submission to The Treasury on the Exposure Draft of the:

Treasury Legislation Amendment (Improving Accountability and Member Outcomes in Superannuation) Bill 2017.

Preliminary

I am Deputy Director of the Centre for Law, Markets and Regulation at UNSW Law. I research in the areas of trust law, superannuation, managed investments and the regulation of financial markets. I am also retained on a part-time basis as an External Consultant by Herbert Smith Freehills. The views expressed in this submission are informed by my research but they are my own and ought not be taken to reflect the views of either UNSW nor Herbert Smith Freehills, nor any of their clients, employees or associates. I make this submission in my personal capacity and not on anyone's behalf or at anyone's instruction. I would also like to acknowledge the valuable contribution to this submission made by Ms Kylie Zih; noting again that all the views expressed are mine.

Submission

I am making a submission on three specific areas contained in the Bill. They are presented below.

1. Schedule 1 – Annual MySuper outcomes assessment

The Government is proposing, in substance, to elaborate on the annual 'scale' test required of the trustees of MySuper products. Anecdotal reports suggest that some in the industry are concerned that the amendments to section 29VN of the *SIS Act* intensify the obligation inappropriately. I can see merit in the suggestions that the requirement in section 29VN(3) for trustees to compare the tax position of their fund against competitors is infeasible in practice and should be removed (taxes not being disclosed publicly at a level of detail that would enable such a comparison) and that the timeframe for the return comparisons in section 29VN(3) should be expressly specified.

However, as I have written previously, I believe the main mischief in section 29VN lies elsewhere.¹ As I noted at that time:

“There may however be particular care required where the trustee comes to the conclusion that the MySuper product lacks critical mass. Public communication of the strategy that the trustee intends to employ (for instance to seek a merger or to re-negotiate the terms of some service provider contracts) could seriously compromise the interests of members. It may also attract adverse press and public comment, which itself may compromise the interests of members.”²

That is to say, the last thing that the trustee of a MySuper product ought to do when it becomes concerned about its lack of scale is publicise the fact and risk inspiring a run on the product. At best that would render the forecast a *fait accompli*. More likely it will see the better-informed or fleeter-of-foot redeem, leaving behind those who are disengaged or unable to understand the implications of the declaration to incur the costs of winding up the more illiquid parts of the investment portfolio.

It seems to me far preferable that the declaration be made to APRA, privately, than publicly. That would give the trustee and APRA an opportunity to decide an appropriate response, which may well take time to implement. It cannot be in the best interests of members (especially those in MySuper products) to be exposed to the risk of a run on the fund. The requirement that the assessment be included in the documented investment strategy is therefore, it seems to me, likely to harm those most vulnerable, for whom the MySuper regime was in large part designed to protect.

2. Schedule 5 – APRA directions power

APRA has played and will continue to play a key role in disciplining the financial sector. Its prudential approach to supervision and regulation is specifically designed to ensure that financial firms are in a position to make good on their promises to customers. The power to make appropriate directions is a key part of that. I do however have three concerns about the directions power contained in the Draft *Bill*:

- First, I believe the extent of the power granted to APRA under section 131D is considerably too extensive. Section 131D(1) is satisfied when APRA ‘has reason to believe’ that one of the criteria in (a) through (j) has been satisfied. This criterion would be satisfied by the presence of a single, perhaps not even compelling, reason. I believe it would be better if APRA was empowered to act when it ‘reasonably believes’ one of the criteria has been satisfied. This form of words contains both an objective element (was the belief reasonable) and a subjective element (~~did~~ APRA ~~did~~ actually believe it). In addition, a number of the criteria in (a) through (j) are diluted by phrasing such as the RSE being ‘likely to’ contravene, or that there ‘might be’ a material risk or material deterioration. The result is that there is no effective boundary to this jurisdiction: APRA will be able to exercise this power in almost any circumstances it sees fits. More

¹ M Scott Donald, ‘When Size Matters’ *Australian Superannuation Law Bulletin*, (Sept 2012), 41.

² *Ibid*, 42.

problematically, the express statutory basis for the jurisdiction will mean that APRA's exercise of this power will in a great many circumstances be difficult to challenge before the AAT and the courts.

- Second, the range of directions that APRA can make is too wide. In particular, paragraph (n) which empowers APRA to make a direction 'to do, or refrain from doing, anything else in relation to the affairs of the Trustee or the Fund' is self-evidently without bound, but the extent of the powers denominated (j) through (m) are also very invasive of the trustee's right to manage its business affairs. It is even conceivable that this power would enable APRA to collect forcibly information for use in its enforcement activities that would ordinarily not even be available under the rules of discovery in curial proceedings.
- Finally, there appears to be no requirement that APRA's response to a situation be directed towards or be proportionate to the risks or potential costs of the situation. Relevance and proportionality are important qualities of any regulatory scheme.

These concerns ought not to be taken as criticism of APRA's past conduct nor of its personnel. However the powers contemplated in this *Bill* will be available to APRA and its officers for decades hence, when economic and political pressures may be very different. The very low likelihood that current personnel operating in the current economic and political milieu would abuse such far-reaching powers should not obscure the fact that the extent of the directions power contained in the Draft *Bill* is far greater than is required and may, if taken to an extreme, encroach upon the rule of law itself.

3. *Schedule 6 – Annual members' meetings*

The Government is proposing that the trustees of all superannuation funds with more than 5 members hold Annual Meetings of Members (AMMs). Those meetings are intended to ensure 'greater accountability and transparency' by providing members with 'a forum to ask questions about all areas of the fund's performance and operations.'

At some level the idea has merit. Giving members the opportunity to engage interactively with their superannuation fund may engender confidence and enhance the legitimacy of the system. Even if members don't attend, or don't ask questions themselves, the mere opportunity may inspire confidence.

Considerable weight is placed in some quarters on the desirability of member engagement with their superannuation fund providers. I believe it is possible, and common, for this enthusiasm to be misdirected. It is crucial that individuals can ascertain the state of their superannuation accounts efficiently. They should be able to have such enquiries as they may have about the administration of the fund or funds to which they have contributed answered accurately and quickly. I agree that generic disclosure documents, however voluminous, cannot ever fully satisfy all the questions which a fund member may have. However there are existing mechanisms for these types of enquiry. Section 1017C of the *Corporations Act*, in concert with Section 101 of the *SIS Act*, gives members a right to have their questions answered. Whether

such mechanisms are effective in practice is, as far as I know, empirically untested and reliable research into this question would seem to be a priority.

However, close attention to the content of the proposal suggests that it may in fact be aimed in a slightly different direction. In many respects the Exposure Draft of the *Bill* emulates provisions found in the *Corporations Act* in respect of the Annual General Meetings held by corporations. As such it appears to be aimed at instituting a more developed form of participative democracy in the institution that is a superannuation fund. That objective was expressed early in the policy development of compulsory superannuation³ and, arguably, found its way into the ultimate design of the compulsory system in a diluted form in the requirement for equal representation on the boards of all standard employer-sponsored funds.

It does not seem to me that that objective will be satisfied by an AMM on its own. The AGM plays an important role in the corporate context specifically because it is a deliberative forum; it makes decisions on key governance matters such as the appointment of directors and the auditor, adoption of financial accounts and, in listed companies, the approval of executive remuneration. The superannuation fund AMM, as invoked in the Exposure Draft of the *Bill*, has no such decision-making role. It could play such a role. In another submission to Treasury on the subject of independence on superannuation fund boards, Dr Suzanne Le Mire and I argued that having 'independent' directors elected by the members would enhance markedly the effectiveness of the Government's initiative to require all APRA-regulated superannuation funds to have a minimum percentage of directors satisfy a statutory definition of independence from relevant external affiliations.⁴ The AMM could play a valuable role in this election process were that proposal in respect of independent directors resuscitated at some point by the Government. Of course, the elevation of the AMM to such a role would require additional provisions, such as those provided by the *Corporations Act* and the general law in the contexts of AGMs, to buttress and protect the process from abuse.

In addition there appear to me to be a variety of practical issues unaddressed by the current Draft *Bill*. For instance:

- All responsible officers of the fund are required to attend the meeting and to answer any and all questions put to them (other than those to which section 29PB(3) applies). It is unclear what attendance means in the context of an electronic meeting, and it is far from obvious that it would be appropriate for the obligation to answer the meeting to lie with the responsible officer. It would seem far more sensible that the obligation lie with the trustee (which may of course draw on the knowledge of one or more of its officers to answer any given question).
- Moreover, section 29PB(2) would seem to suggest that the responsible officer must answer all questions. As those experienced in wrangling corporate AGMs know well,

³ Diana Olsberg, *Ageing and Money, Australia's Retirement Revolution* (Allen & Unwin, 1997).

⁴ M Scott Donald and Suzanne Le Mire, submission to the Treasury on *Superannuation Legislation Amendment (Governance) Bill 2015* (23 July 2015).

management of the questioning process is crucial if the exercise is to have any value.⁵ Whether that involves questions being collected in advance, or somehow mediated through the Chair or some other body, ought to be a decision taken by the trustee in question, bearing in mind that the trustee (and directors of the trustee thanks to the covenants in section 52A of the *SIS Act*) is under an obligation to exercise its powers in the best interests of members. Any trustee who cherry-picks the questions so as to avoid difficult issues or unfavourable impressions would breach that covenant.

- Although minutes of the meeting are to be compiled and published by the trustee, there are no decisions to be taken at the meeting so the concept of ‘minutes’ does not seem appropriate. It would seem more appropriate to require the trustee to publish answers to all those questions (perhaps with the exception of those which pertain to individual circumstances). The *Bill* currently only envisages that the question be answered.
- Regard may need to be had for the possibility that the meeting occurs over a number of time slots. Few employers are likely to permit members to ‘attend’ an AMM during business hours, even if the AMM was virtual and connection was technically possible. On the other hand, shift-workers and those working outside normal business hours, such as many in the retail and hospitality industries, may find evening time-slots impossible.
- Quite why the Government wishes to specify the practicalities of the AMM in such detail in statutory form is also unclear. Although basic duties, including the duty to hold the meeting, certainly belong there, the *SIS Regulations* or *Operating Standards* would appear to be a better location for the detailed rule than the *SIS Act* itself. (They would also appear to be superior to having the rules appear in an APRA Prudential Standard given the substance of the requirement is most certainly not a ‘prudential matter’, upon which APRA’s power to determine such Standards depends).

Concluding Comments

It is hard to find fault with the Explanatory Memorandum when it says:

Having a modern, vibrant superannuation system, which is solely focused on delivering outcomes for members, culminating in the efficient delivery of income in retirement, is critical... A modern superannuation system empowers members; provides for transparency and accountability around funds’ activities and performance; enables regulators to hold trustees to high standards and take appropriate action where they fall short; and ensures members get their full entitlements.

⁵ See for instance Governance Institute, *Good Governance Guide: Policy to promote effective communication at general meetings (including question time at the AGM)*, available at <https://www.governanceinstitute.com.au/knowledge-resources/guidance-tools/good-governance-guides/?category=Rights+of+shareholders>. Also AICD, ‘AGMs’, *Company Director* (September 2007); available at <http://www.companydirectors.com.au/director-resource-centre/publications/company-director-magazine/2000-to-2009-back-editions/2007/september/agms>; ASX, ‘Ideas for better AGMs’ *Investor Update* (July 2014) available at <http://www.asx.com.au/education/investor-update-newsletter/201407-ideas-for-better-agms.htm>

Whether the amendments to the *SIS Act* and related legislation contemplated in this Draft *Bill* will bring about those ends in their current form is arguable. The Annual MySuper declaration and Annual Members' Meeting, in particular, appear ill-designed in certain respects. Further, I believe it is important to empower the regulator, but in my opinion the *Bill* extends too far in certain respects; threatening the rule of law on which Australia's regulatory environment relies. Finally, I am aware that other submissions to this consultation have identified serious shortcomings in the drafting of the *Bill*. It is important that those concerns be taken seriously: infelicitous drafting has the potential to cause much dysfunction in the regulatory scheme and the industry it seeks to regulate.

Please do not hesitate to contact me on s.donald@unsw.edu.au if you have any questions or require any further information or elaboration.

Yours sincerely



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