The Law
Reform
Commission

Report No 59

The Companies
and Securities
Advisory Committee

Report

COLLECTIVE INVESTMENTS: SUPERANNUATION

This Report reflects the law as at 31 March 1992

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The Law Reform Commission was established by the *Law Reform Commission Act 1973*, section 5, to review, modernise and simplify the law. It started operation in 1975. The office of the Commission is at 99 Elizabeth Street, Sydney, NSW, Australia (tel (02) 231 1733; fax (02) 223 1203).

The Companies and Securities Advisory Committee was established by the *Australian Securities Commission Act 1989* to monitor and advise on the operation of national scheme laws. It started operation in 1989. The office of the Committee is at 4 Bligh Street, Sydney, NSW, Australia (tel (02) 221 1988; fax (02) 223 4296).

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Terms of reference

COMMONWEALTH OF AUSTRALIA

Law Reform Commission Act 1973
Australian Securities Commission Act 1989

1. I, Michael Duffy, Attorney-General of Australia noting:
   - the report of the Companies and Securities Law Review Committee to the Ministerial Council for Companies and Securities titled 'Prescribed Interests'; and
   - the need to ensure that there is a proper legal framework for prescribed interests and like collective investment schemes (collective investment schemes) that:
     - — promotes commercial stability, and efficiency in capital raising and capital formation; and
     - — provides an appropriate level of regulation that adequately and effectively protects the interest of investors,

refer to the Law Reform Commission for review and report under the *Law Reform Commission Act 1973* section 6:

(1) Whether the present legal framework for collective investment schemes provides for the most efficient and effective legal framework for the operation of the various kinds of such schemes and, in particular, whether a different operating structure should be provided for such schemes, including whether separate structures should apply to different kinds of schemes;

(2) Whether there is a proper level of regulation of the various kinds of collective investment schemes, and in particular:
   - whether different systems of regulation should be provided for different kinds of such schemes;
   - what disclosures should be made to the public;
   - whether scheme documents, such as trust deeds, can be simplified or standardised;
   - what should be the powers, duties and responsibilities of the persons who promote, manage, or supervise the operation of collective investment schemes, such as managers and trustees, including whether, and the extent to which, such duties and responsibilities should be codified;
   - whether any form of self-regulation would be appropriate;
   - what prudential requirements, if any, should be imposed on such persons as promoters, managers or trustees of such schemes, including requirements as to availability of capital;
   - whether a special framework for the liquidity of collective investment schemes, and for the secondary sale or trading of collective investment scheme interests, is desirable, including whether buy-back arrangements are appropriate and, if so, whether there is a need for particular buy-back provisions for particular kinds of such schemes; and

(3) any related matter;

and, under the *Australian Securities Commission Act 1989* section 148, request the Companies and Securities Advisory Committee to advise me about those matters.

2. In carrying out their functions, the Commission and the Committee are to consult the Australian Securities Commission, the Commonwealth Attorney-General's Department, relevant Commonwealth, State, and Territory authorities, the securities industry and any other person or body they think appropriate, having special regard to the Commonwealth's Access and Equity policy.

3. The report and advice should include draft legislation and an explanatory memorandum.

4. The report is to be delivered by 1 November 1992.

DATED: 24 May 1991

Michael Duffy
Attorney-General

Participants

Australian Law Reform Commission

The Division of the Commission for the purpose of this report comprised:

President
Justice Elizabeth Evatt AO
Deputy President
John Greenwell
Members
Jim Armitage (from 22 October 1991)
Leigh Hall (from 12 December 1991)[1]
Stephen Mason (from 27 February 1992)

The Companies and Securities Advisory Committee

Convenor
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Mr Don Argus
Mr John Barner
Mr Reg Barrett
Professor Philip Brown
Mr David Crawford
Mr Kevin Driscoll CBE
Mr William Gurry
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Mr Wayne Lonergan
Ms Ann McCallum
Mr Alan McGregor AO
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Russell Agnew
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1. Mr Hall is also a member of the Advisory Committee.
2. By agreement, the ALRC project team had responsibility for preparing this report.

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3. The recommendations, statements of opinion and conclusions in this report are those of the members of the ALRC and the Advisory Committee. They do not necessarily represent the views of consultants or of the organisations with which they are associated.

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Mr Malcolm Starr, Director Companies and Securities, Australian Merchant Bankers Association
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Summary of abbreviations

ACTU	Australian Council of Trade Unions
ADF	Approved deposit fund
Advisory Committee	Companies and Securities Advisory Committee
AFIC	Australian Financial Institutions Commission. A body proposed to be established under co-operative legislation to oversight the prudential regulation of NBFIs under State and Territory law
ALRC	Australian Law Reform Commission
ASFA	Association of Superannuation Funds of Australia
ASIFA	Australian Society of Investment and Financial Advisers
ASC	Australian Securities Commission
ASX	Australian Stock Exchange Limited
ATO	Australian Taxation Office
CSLRC	Companies and Securities Law Review Committee established under the *Companies Act 1981* (Cth) (now abolished and replaced by the Advisory Committee)
Corporations Law	The Corporations Law, set out in the *Corporations Act 1989* (Cth) s 82
DA	Deferred annuity
DSS	Department of Social Security
DTI	Deposit taking institution (principally banks, building societies and credit unions)
EC	European Community
ERISA	*Employee Retirement Income Security Act 1974* (US)
ETP	Eligible termination payment
GDP	Gross domestic product
IAFP	International Association of Financial Planners
IFA	Investment Funds Association of Australia (formerly the UTAA)
IOSCO	International Organisation of Securities Commissions
IRC	Industrial Relations Commission
ISC	Insurance and Superannuation Commission
ISRO	Industry self regulating organisation
ITAA	*Income Tax Assessment Act 1936* (Cth)
LIA	*Life Insurance Act 1945* (Cth)
LIFA	Life Insurance Federation of Australia
National Mutual	National Mutual Life Association of Australasia Limited
NBFI	Non-bank financial institution
NCA	National Crime Authority
NWC	National wage case

OECD	Organisation for Economic Co-operation and Development
OSSA, OSS Regulations	*Occupational Superannuation Standards Act 1987* (Cth) and Regulations
PBGC	Pension Benefit Guarantee Corporation
PST	Pooled superannuation trust
RBA	Reserve Bank of Australia
RBL	Reasonable benefits limit — the maximum lump sum (expressed in terms of average weekly earnings) after which tax concessions on lump sums diminish
Release 126 (etc)	Numbered release of policy guidelines by the ASC
Senate Committee	Senate Select Committee on Superannuation (Chairman, Senator Nick Sherry)
SGL	Superannuation Guarantee Levy
TCA	Trustee Companies Association
TPC	Trade Practices Commission
UTAA	The Unit Trust Association of Australia (now the IFAA).

Summary of recommendations

3. Superannuation regulation: basic issues

3.1: *Indemnification of members of boards*
1. The law should provide that the responsible entity, and the members of the board of management of the responsible entity, for a superannuation fund, an ADF or a PST may not be indemnified out of the fund, ADF or PST for any liability incurred by it or them while acting as responsible entity or member. Failure to comply should be an offence as well as a breach of fiduciary obligation.

2. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must ensure that the annual report for the scheme include a statement whether the responsible entity or the members of the board of management of the responsible entity are insured in respect of their liability to members of the scheme for loss caused by fraud or negligence and, if they are, of the prescribed particulars of that insurance.

3. Nothing should prevent the payment out of the fund of the costs associated with obtaining insurance for the responsible entity for the fund, ADF or PST or for a member of the board of management of the responsible entity against liability for loss caused by fraud or negligence.

7. The constitutional basis for Commonwealth regulation

7.1. *Constitutional framework*

The law should provide that the conditions under which a superannuation fund, an ADF or a PST attract taxation concessions include a condition that, at all times during the relevant year of income, there was a responsible entity for the fund, ADF or PST and that:

- the responsible entity was a foreign corporation within the meaning of the Constitution s 51(xx) or a trading or financial corporation within the meaning of that paragraph or
- in the case of a superannuation fund, the substantial or dominant purpose of the fund was to provide old-age pensions within the meaning of the Constitution s 51(xiii).

8. Regulating the players: standards for operators

8.1. *Appointment of responsible entity*

The law should provide that the conditions under which a superannuation fund, an ADF or a PST attracts a tax concession include a condition that the deed or other instrument establishing the fund, ADF or PST must appoint a person as the responsible entity for the fund, ADF or PST.

8.2. ***Acceptance of appointment by responsible entity***

The appointment (including an appointment by election) of a person as responsible entity, or as a member of the board of management of a responsible entity, for a superannuation fund, ADF or PST should not be effective unless the person concerned accepts it in writing.

8.3. ***Pre-vetting of responsible entities***

There should be no change to the law to require any further pre-vetting of responsible entities for superannuation funds, ADFs or PSTs or for the providers of DAs.

8.4. ***What are bodies, and who are persons, unsuitable to act as responsible entity***

1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as the responsible entity for a superannuation fund, an ADF or a PST if

- it is an externally administered body corporate as defined in the Corporations Law or
- it, or one of its responsible officers as defined in the Corporations Law
  - has been convicted of serious fraud as defined in the Corporations Law
  - has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or
- one of its officers is an insolvent under administration

2. The law should provide that an individual is not suitable to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST if he or she

- is an insolvent under administration as defined in the Corporations Law or
- has been convicted of serious fraud as defined in the Corporations Law or
- has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty

8.5. ***Spent convictions***

The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of recommendation 8.4. The court should not be able to make such an order unless it is satisfied that

- the person is or proposes to become the responsible entity, or a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST and
- it is necessary to make the order to protect the interests of the members of the scheme.

8.6. *Persons etc. not to act as responsible entity while unsuitable*
1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

3. The law should provide that a purported appointment of an unsuitable body corporate or an unsuitable person as a responsible entity for a superannuation fund, an ADF or a PST, or of an unsuitable person as a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST, is of no effect.

4. The law should provide that, if a responsible entity, or a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or an unsuitable person

- the matter must be reported to the regulator without delay — the body corporate or person commits an offence if the matter is not so reported and
- the body corporate's or person's appointment as responsible entity, or as member of the board of management of a responsible entity, thereupon ceases.

8.7. *Declaration as to suitability*
1. The law should provide that it is an offence for a person to offer himself or herself for appointment or election as the responsible entity, or as a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST without first making a written declaration stating that he or she is not an unsuitable person. The declaration is to be given to

- in the case of an election — the returning officer for the election
- in the case of an appointment — the person making the appointment.

2. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to offer itself for appointment or election as the responsible entity for a superannuation fund, an ADF or a PST unless it, and each of the members of its board of management, have made written declarations stating that it, he or she is not unsuitable. The declarations are to be given to

- in the case of an election — the returning officer for the election
- in the case of an appointment — the person making the appointment.

3. It should be an offence knowingly to make a false declaration.

8.8. *Unsuitability to act as investment manager*

1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST, if

- it is an externally administered body corporate as defined in the Corporations Law or
- it, or one of its responsible officers as defined in the Corporations Law
  - — has been convicted of serious fraud as defined in the Corporations Law
  - — has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or
- one of its responsible officers is an insolvent under administration

2. The law should provide that an individual is not suitable to act as an investment manager for the responsible entity for a superannuation fund, an ADF or a PST if he or she

- is an insolvent under administration as defined in the Corporations Law or
- has been convicted of serious fraud as defined in the Corporations Law or
- has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.

3. The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator, declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of this recommendation. The court should not be able to make such an order unless it is satisfied that

- the person is acting or proposes to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST and
- it is necessary to make the order to protect the interests of the members of the fund, ADF or PST.

8.9. *Persons etc. not to act as investment managers while unsuitable*

1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

3. The law should provide that a purported engagement by the responsible entity for a superannuation fund, an ADF or a PST of an unsuitable body corporate or an unsuitable person as investment manager is of no effect.

4. The law should provide that, if a foreign corporation or a trading or financial corporation or a person is acting as investment manager for the responsible entity for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or person:

- the matter must be reported to the responsible entity without delay — the body corporate or person commits an offence if the matter is not so reported and
- the body corporate's or person's engagement as investment manager thereupon ceases.

5. The law should provide that it is an offence for an investment manager for the responsible entity for a superannuation fund, an ADF or a PST who becomes unsuitable to charge the responsible entity a fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

6. 'Acting as investment manager' means dealing with the assets of the fund, ADF or PST by exercising a judgment as to their investment that is independent of the judgment of the responsible entity, but is authorised by the responsible entity.

8.10. ***Dealing in securities***

The Corporations Regulations reg 7.3.13 should be amended by omitting subregulation (1).

8.11. ***Investment managers who do not carry on the business of dealing in securities***

Investment managers for responsible entities for superannuation funds, ADFs or PSTs should not have to hold a dealers licence under the Corporations Law if they do not carry on the business of dealing in securities within the meaning of the Corporations Law s 93.

8.12. ***Investment managers not to hold assets***

The law should provide that, if

- the responsible entity for a superannuation fund, an ADF or a PST enters into an agreement or arrangement with a person or with a body corporate under which the person or body corporate is to act an investment manager for the responsible entity and
- under the agreement or arrangement, the person or body is to hold or have custody of some or all of the assets of the fund, ADF or PST and
- at the time of entering into the agreement or arrangement and at all times while the agreement or arrangement is in effect, the person or body corporate had less than $5m in net tangible assets

the responsible entity and the investment manager should each be guilty of an offence. The responsible entity should have a defence that it made reasonable inquiries, and exercised due diligence, in relation to the matter. There should be no similar defence for the investment manager.

8.13. ***Contracts for investment managers***
1. The Federal Court or the Supreme Court of a State or Territory should be able, on application by the responsible entity for a superannuation fund, an ADF or a PST, to vary, by order, a contract between the entity and another person under which the other person is to act as investment manager for the entity so as to ensure that the contract does not unreasonably exclude or limit, or unreasonably provide for indemnity in relation to, the manager's liability for negligence or breach of contract.

2. The *Trade Practices Act 1974* (Cth) s 52A should extend to such contracts.

3. The responsible entity for a superannuation fund, ADF or PST should have to be a foreign corporation or a trading or financial corporation formed within the limits of the Commonwealth, or the fund should have, as its substantial or dominant purpose, the provision of old-age pensions.

8.14. ***Standards for insurance intermediaries***
1. Amend the *Insurance (Agents and Brokers) Act 1984* s 10 to provide that an insurer must not enter into an agreement for the purposes of s 10 under which the insurance intermediary is authorised to offer membership of a superannuation fund or DA for which the insurer is the responsible entity or provider, as agent of the insurer unless the insurer is satisfied, after proper inquiry, that the intermediary

- is of good fame and character[1] and
- will be able to act as agent honestly and
- has adequate educational qualifications and expertise and
- is not an undischarged bankrupt.

Failure to comply should be an offence by the life insurance company.

8.15. ***Know your client rule***
The law should apply the Corporations Law s 851 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of the insurer, membership of a scheme for which the insurer is the responsible entity or provider. The provision should require the person to make reasonable inquiries as to the client's circumstances.

8.16. ***Disclosure of interests etc.***
The law should apply the Corporations Law s 849 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of an insurer, membership of a scheme for which the insurer is the responsible entity or provider.

1. Although this is the formulation appearing the Corporations Law, it may be more precise to express it as 'unlikely to contravene, or cause a contravention of, the law'.

8.17. ***Continuing professional education for dealers and life agents***
1. The law should provide that it is a condition of holding a dealers licence that authorises the dealer to offer membership of a superannuation fund, an ADF or a PST that the dealer satisfactorily complete courses or other training prescribed in the regulations.

2. The law should provide that each agreement for the purposes of the *Insurance (Agents and Brokers) Act 1984* s 10 under which an insurance intermediary is authorised to offer, as agent of an insurer, membership of a superannuation fund, ADF, PST or DA for which the insurer is the responsible entity or provider, that the intermediary will satisfactorily complete courses or other training prescribed in the regulations.

8.18. ***Preserving acts done***
The law should provide that a third party who acts in good faith and without notice of the unsuitability of
- the responsible entity for a superannuation fund, ADF or PST
- a member of the board of management of a responsible entity of a superannuation fund, ADF or PST
- an investment manager for a superannuation fund, ADF or PST

is not affected by the unsuitability.

9. Duties of the responsible entity

9.1. ***Fiduciary obligations of responsible entities to be set out in legislation***
The law should set out the basic fiduciary obligations owed by responsible entities of superannuation funds, ADFs and PSTs to members. This provision should not affect any other duty that may be imposed on the responsible entity by the deed or other instrument constituting the fund, ADF or PST, or by some other law, if the other duty is not inconsistent with the basic obligations set out. Any provision of a deed or other agreement that purports to modify or exclude these basic obligations should be of no effect.

9.2. ***Basic fiduciary obligations of the responsible entity***
1. The law should specify the following obligations as basic fiduciary obligations of a responsible entity that cannot be excluded or modified:
- to hold the property of the fund not for the use or benefit of itself or the members of the responsible entity, but for the use and benefit of the members of the fund, including non-contributing members
- to become familiar with and to observe the provisions of the deed or other instrument constituting the superannuation fund or ADF and to apply them fairly as between the members of the scheme
- to act honestly in all matters concerning the fund or ADF

- to avoid any conflict between the interests of the members and the interests of the responsible entity and, if such a conflict arises, to disclose it to the members
- to exercise its powers, and perform its duties, as responsible entity in the best interests of the members
- to act, in relation to all matters affecting the fund or ADF with the care, skill and diligence with which a person of ordinary prudence would act when dealing with property of another for whom he or she was morally bound to provide
- to keep the money and other assets of the fund or ADF separate from the money and other assets of itself, of the members of its board of management and, in the case of an employer sponsored or industry superannuation fund, of any employer involved in the fund
- to exercise a discretion or a power vested in the responsible entity, either by law or by the deed or other instrument constituting the scheme, only after proper consideration
- if it invests the money, or deals with the other assets, of the fund or ADF — to seek advice from an appropriately qualified person before doing so; however, nothing prevents that person from being a member of the board of management of the responsible entity
- not to delegate trustee responsibility in relation to a matter affecting the fund or ADF
- not to profit from acting as responsible entity; this duty should not prevent an individual who is the responsible entity or a member of the board of management of a responsible entity from receiving reasonable remuneration for work done in that capacity
- to monitor regularly the relationship between the realisable assets of the fund or ADF and its liabilities and prospective liabilities to members to ensure that the scheme is able to pay benefits to which members become entitled as they fall due
- in determining whether to make a particular investment, to have regard to the whole of the circumstances of the fund or ADF including, but not limited to, the following:
  - its other investments
  - its obligations, both existing and prospective
  - the nature of its membership
  - the desirability of diversifying investments to minimise risk
- to allow a member access to any information or document in the possession or under the control of the responsible entity that relates to the fund or ADF, except a document the disclosure of which to the member who seeks it
  - would unreasonably disclose another person's private affairs or

— would disclose trade secrets or other information that has a commercial value that would be destroyed or lessened by the disclosure, and in relation to which the responsible entity is under a duty of confidence to another person not to disclose.

2. Parallel obligations should be imposed on responsible entities of PSTs.

9.3. ***Fiduciary obligations of members of boards of management of incorporated responsible entities***

The law should provide that each member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST owes to the members of the fund, ADF or PST the obligations set out in recommendation 9.2, changing what needs to be changed. In the case of a responsible entity that is a body corporate, this is in addition to any other obligation that he or she owes as director or officer of the body corporate.

10. Disclosure: a critical obligation

10.1. ***Inconsistencies in disclosure requirements***

The law should impose on all superannuation funds, ADFs, PSTs and DAs disclosure requirements conforming to those imposed by the Corporations Law. Where requirements do not meet this criteria, they should be changed.

10.2. ***Disclosure to single member schemes***

No disclosure requirements should apply to a superannuation scheme if the responsible entity is the only member.

10.3. ***Plain language***

1. The law should provide that all documents issued by
   - the responsible entity of a superannuation fund or ADF or
   - the provider of a DA

and given to members or prospective members to inform them about the scheme are to be written in clear and simple language. Failure to comply should not be an offence, but the regulator may give a written direction to the responsible entity or provider not to issue, or to take reasonable steps to recall from circulation, a particular document on the grounds that it is not written in clear and simple language. Failure to comply with the direction should be an offence.

2. The regulator, in conjunction with ASFA, other industry bodies and other experts, should develop guidelines for plain language in superannuation and related documents.

10.4. ***Information to persons not fluent in English***

1. The law should provide that the responsible entity for a superannuation fund or ADF, and the provider of a DA, must ensure that, as soon as practicable after a person becomes a contributing member of the scheme or starts to receive a pension

from the scheme, the person is given an opportunity to indicate whether he or she is not fluent in English. If the person indicates that he or she is not fluent in English but is fluent in one of the prescribed languages, the responsible entity or provider must

- forthwith give the person a copy of the statement prepared by the regulator for the scheme, or for schemes of the relevant kind, in that language and
- send, with each benefit statement or annual report sent or given to the person, a copy of the statement prepared by the regulator in that language.

Failure to comply should be an offence.

2. Regulations under the law should prescribe such a statement, which should include words to the following effect:

> This is an important document. It tells you about your superannuation scheme and the money you have in the scheme at the moment. You cannot get the money out of the scheme now, but you should take an interest in the scheme and how it is run.
>
> If you cannot understand the document, you should seek help to have it interpreted for you. If you do not know anyone who can help you, contact the Superannuation Advisory Service.

10.5. ***Information about benefits***

1. The law should provide that it is an offence for the responsible entity for a superannuation fund to publish information to members or prospective members of the scheme about the benefits available under the scheme, being information that does not comply with the following requirements:

- if the fund is a defined benefits superannuation fund under which the amount of the benefit for a member on ceasing employment is worked out by reference only to the amount of the member's remuneration during the year, or during 2 or more of the years, immediately before the member ceased the employment — the amount of the benefit must be expressed as a fraction or multiple of the amount of the member's remuneration during the year immediately before the member ceased the employment
- in any case
  - if the amount of the benefit is expressed in the information in dollars, the amount must be expressed in both present day dollars and in nominal dollar values
  - the information must include a statement of the assumptions about the rate of inflation, the rate of earnings of the fund and the rate of wages growth used to work out the amount of the benefits

— the information must include a statement to the effect that the amounts of benefits stated are not to be taken to be the actual amounts to which the member or prospective member will be entitled, and that there is no guarantee that the amounts stated will be paid.

10.6. ***Regulator to publish standard rates***

1. The law should provide that the regulator may, by notice in the *Gazette*, specify estimates for factors to be used in working out amounts of benefits. The estimates may include estimates as to the rate of inflation and the rate of wages growth.

2. The law should provide that it is an offence for a responsible entity for a superannuation scheme or an ADF, or the provider of a DA, to publish, as mentioned in recommendation 10.5, estimates of benefits worked out using, for a factor for which an estimate has been specified by such a notice, an estimate other than that specified unless the regulator has given written approval to the publications.

10.7. ***Free look***

1. The law should provide that a member of a personal superannuation fund, or of an ADF or DA, has a right, exercisable at any time before the end of 14 days after being first notified of his or her membership, to withdraw from the fund, ADF or DA. The right must be exercised by notice in writing given to the responsible entity of the fund or ADF or the provider of the DA.

2. The law should provide that, on withdrawal of an investment within 14 days of the investment being made, the responsible entity or provider is liable to repay to the member the amount due to the member under the terms of the scheme, worked out as at the date of the withdrawal notice. No exit fees are to be charged to the member in this instance.

10.8. ***Misleading and deceptive conduct in advertising superannuation***

The *Insurance Contracts Act 1984* (Cth) s 15 should be amended to ensure that it does not prevent the *Trade Practices Act 1974* (Cth) s 52 and 52A or the Corporations Law s 995 from applying in relation to insurance contracts issued in connection with a superannuation fund, an ADF, a PST or a DA. However, the effect of the *Insurance Contracts Act 1984* (Cth) s 33 and 55 should be preserved.

10.9. ***State government superannuation schemes***

The law should provide that the provisions of the *Trade Practices Act 1974* (Cth) relating to fair trading, that is, Pt V, extend to State government superannuation schemes.

10.10. *Warranty of care and skill in superannuation*

The *Trade Practices Act 1974* (Cth) s 74 should be amended to ensure that it applies to insurance contracts issued in connection with a superannuation fund, an ADF, a PST or a DA.

10.11. ***Power to require production of advertisements***

The law should make provision analogous to the *Life Insurance Act 1945* (Cth) s 77, and that recommended by the ALRC in its report *Insurance Contracts* (ALRC 20) giving the regulator a power to require production of any advertising matter used or proposed to be used by or on behalf of the responsible entity of a superannuation fund, an ADF or a PST or by the provider of a DA, and to stop the use or further use of the matter as advertising on the ground that it is misleading or deceptive.

10.12. ***Applications for membership of schemes***

The law should provide that it is an offence for the responsible entity for a superannuation fund, an ADF or a PST, or the provider of a DA, to accept an application by a person to become a contributing member of the scheme unless the application is made in writing on a form attached to a copy of the most recently issued prospectus or member booklet or, in the case of a DA, the most recently issued offer document, for the scheme.

10.13. ***Information to accompany prospectuses etc.***

The law should provide that it is an offence for

- a responsible entity for a superannuation fund, an ADF or a PST, or the provider of a DA, to give a prospectus, member booklet or offer document to a person with a view to the person's becoming a contributing member of the scheme or
- a responsible entity for a superannuation fund to give a member booklet to a person who has become a member of the fund

unless the responsible entity or provider also gives to the person

- a copy of the most recent annual report for the scheme relating to the investments of the scheme and
- a copy of any statement of material adverse change notified to members since the most recent annual report was issued.

10.14. ***Advertisements, brochures etc.***

The law should provide that the cover of (or, if it does not have a cover, the front page of the document) a brochure, pamphlet or other document about a superannuation fund, ADF, PST or DA (including an annual report, member booklet, offer document or prospectus) published by the responsible entity for the scheme or the provider of the DA may only display the name of the responsible entity for the scheme or of the provider of the DA and the name of the scheme. A contravention should be an offence by the responsible entity or provider.

10.15. ***Further information: member booklets etc.***

1. The law should provide that it is an offence if a prospectus, member booklet or offer document published by the responsible entity for a superannuation fund, ADF, PST or by the provider of a DA does not include, on the inside cover, the following information:
   - the name and address of the responsible entity
   - if the responsible entity or provider is a body corporate or unincorporated — the names of the members of the board of management of the responsible entity
   - the name of each investment manager engaged by the responsible entity or by the provider during the 12 months immediately before the booklet, prospectus or offer document was issued
   - whether there is institutional backing for the responsible entity, for the provider or for an investment manager and, if there is, the prescribed particulars of that backing.

2. 'Institutional backing' means whether any return to the member of capital or interest is guaranteed by the responsible entity or a related corporation.

10.16. ***Contents pages***

Member booklets, prospectuses and offer documents for superannuation funds, ADFs, PSTs and DAs should include a comprehensive contents page or index, but failure to comply should not be an offence.

10.17. ***Disclosure of adverse changes***

1. The law should provide that the responsible entity for a superannuation fund, ADF or PST must take reasonable steps to notify the members of the scheme of any significant adverse change in the circumstances of the scheme. Non-compliance should be an offence.

2. If there are more than 200 members of the fund, the law should provide that the responsible entity must, within 14 days after becoming aware of the existence of such a change, notify the ASC. Failure to comply should be an offence.

3. The responsible entity for the scheme and the members of the board of management of the responsible entity should be subject to the same criminal and civil liability as will apply in respect of enhanced disclosure obligations under proposed amendments to the Corporations Law.

4. A 'significant adverse change in the circumstances of a scheme' should be defined as
   - in the case of a defined benefit superannuation fund — a change in the circumstances of the scheme that would reasonably be likely to be taken into account by a person in determining whether the scheme will be able to meet its obligations to members as and when they fall due

- in other cases — a change in, or re-assessment of, the circumstances of the scheme that members or prospective members would reasonably require to make an informed assessment of the assets and liabilities, financial position, profits, losses and prospects of the scheme

being a change that tends to show that the scheme will not able so to meet its obligations to members as and when they fall due.

10.18. ***Information about financial performance***

The law should provide that a prospectus, member booklet or offer document published by the responsible entity for a superannuation fund or ADF, being a fund or ADF that has 5 or more members, must include the prescribed particulars of the scheme's financial performance over

- each of the 5 financial years immediately before the booklet or prospectus was issued or
- if the scheme has been in existence for less than 5 years, over all the years during which the scheme has been in existence.

Failure to comply should be an offence. The prescribed particulars should include particulars about the arithmetic average performance of the scheme over the relevant period.

10.19. ***Establishing, and reporting performance against, investment targets***

1. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must, before the start of each financial year, determine financial performance goals for the fund, ADF or PST. The goals must relate to the next 5 years (that is, a 5 year rolling investment plan). The goals are to be expressed in terms of the financial performance expected to be achieve by investments of the fund, ADF or PST when compared with

- an appropriate index (such as the CPI) or
- a specified portfolio of investments.

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must include in the annual report for the scheme the following information:

- a statement of the goals determined in respect of the year to which the report relates (which will be the goals for the present 5 year investment plan)
- a statement of the financial performance of the scheme during that year measured against those goals, and how that performance relates to achievement of the relevant 5 year goals
- if the responsible entity has determined that the 5 year goals should be altered — a statement of those goals as altered and of the nature of the alterations.

Failure to comply should be an offence.

10.20. ***Reserving***

The law should provide that the responsible entity for a superannuation fund must include in the annual report for the fund the following information:

- whether amounts in the fund are credited to reserves and
- if amounts are credited to reserves
    - — how the amount to be credited to reserves is worked out
    - — the amount credited to reserves during the period to which the report relates
    - — the source of the money credited in reserves during that time and
- what amounts, if any, have been transferred from reserves during the relevant year.

10.21. ***Timing of annual reports***

The law should provide that the responsible entity of a superannuation fund and the provider of a DA, must give an annual report to each member of the scheme not later than 6 months after the end of the period to which the report relates. Failure to comply should be an offence.

10.22. ***Reporting associated third parties***

1. The law should provide that the responsible entity for a superannuation fund must include in the annual report for the fund

- a statement whether, during the period to which the report relates, the responsible entity or provider engaged or retained an associate, as defined in the Corporations Law, of the responsible entity or, if the fund is constituted by a deed or other agreement between parties, of 1 or more of the parties to the deed or other agreement, as investment manager, adviser, consultant or in any other capacity and
- if it did — the prescribed particulars of the engagement or retainer and of the association.

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund must, within 14 days after so engaging such an associate, report the matter to the regulator. Failure to comply should be an offence.

10.23. ***SGL certification in benefit statements***

1. The law should provide that, in the case of employer related superannuation funds, each employer must, within 2 weeks after receiving a written request from the responsible entity, certify to the responsible entity whether the employer has made all payments required to be made to the scheme (including those to be required under the SGL). Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund must include in each benefit statement sent to a member of the fund

- a statement whether the employer has given a certificate in relation to the period since the last previous benefit statement was given to the member and
- if any of the payments required to be made have not been made — what steps the responsible entity is taking to recover the amounts due but unpaid.

Failure to comply should be an offence.

10.24. *Advice of SGL vesting etc.*

The law should provide that the responsible entity for a superannuation fund must include in each benefit statement sent to a member of the fund

- if the fund is an accumulation fund — the proportion of the gross SGL payment made to the responsible entity for the fund by an employer of the member that has been credited to the member's account in the fund
- in other cases — what percentage of the gross SGL payment during the period covered by the benefit statement has vested in the member.

Failure to comply should be an offence.

10.25. *Employers not to divert superannuation payments*

To ensure that the responsible entities concerned receive the amounts due to them, the law should provide that it is an offence for an employer to deduct an amount from an employee's remuneration on account of superannuation contributions to a superannuation scheme the responsible entity for which is a foreign corporation or a trading or financial corporation, or the substantial or dominant purpose of which is to provide old- age pensions, without immediately giving the amount to the responsible entity of the relevant eligible superannuation fund.

10.26. *Disclosure of fees and charges*

1. The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members of the fund a statement whether any of the following payments were made by the responsible entity on account of the fund or ADF during the year to which the report relates and, if so, the amount of that payment:

- payments of fees or charges to each investment manager
- payments of administration fees
- payments of commission not included in those amounts.

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members of the fund a statement of

- the amounts received from the fund by the responsible entity on account of its fees and charges

- the total of the amounts paid by the scheme directly to, and of the value of benefits given by the scheme directly to, the members of the board of management of the responsible entity because of their membership of the board of management of the responsible entity.

Failure to comply should be an offence.

3. The law should provide that, if at least 5% of the members of a superannuation fund so require in writing given to the responsible entity, the annual reports for the scheme must also include a statement of amounts of the salaries and other emoluments paid by the responsible entity to, and the value of the benefits given by the responsible entity to, each member of the board of management of the responsible entity. Failure to comply should be an offence.

10.27. ***Disclosure of significant holdings***

The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members the prescribed particulars of each asset the value of which, at the end of the period to which the report relates, was equal to 5% or more of the total value of all the assets of the fund. 'Value' means market value.

10.28. ***Disclosure to lost member***

The law should provide that the responsible entity for a superannuation fund or ADF does not have to comply with any requirements to report to members in relation to a member who is 'lost' to the scheme. A member is lost if six months have passed since the prescribed procedures were followed and the responsible entity has not located the member.

10.29. ***Information to beneficiaries***

The law should provide that disclosure and notification requirements imposed by law apply for the benefit of non-contributing members of the fund concerned.

10.30. ***Reconcilable information***

The law should provide that the reporting requirements and requirements to lodge returns imposed on life insurance companies are such that the ISC is easily able to reconcile the information provided in respect of superannuation business and in respect of life business.

10.31. ***Consequences of breach of disclosure requirements***

A contravention of the disclosure requirements recommended in this report should attract criminal liability except where otherwise indicated. Except in the case of disclosure by the responsible entity of an employer related superannuation fund, it should also attract civil liability to the same extent as provided for in the Corporations Law.

11. Investment controls

11.1. *No rule requiring the use of external investment managers*

There should be no rule apart from the responsible entity's fiduciary obligations to members of the fund that requires the responsible entity for a superannuation fund, an ADF or a PST to engage an investment manager.

11.2. *Asset allocation*

There should be no prescription of specific asset allocation for superannuation funds, ADFs or PSTs.

11.3. *PSTs subject to the same investment controls*

The law should provide that the prudential regulations applying to the use of superannuation scheme funds should apply to PSTs and to any other vehicle that may only accept investments from superannuation schemes and other tax preferred investment schemes.

11.4. *In-house investments*

1. The law should provide that the responsible entity for a superannuation fund must not knowingly lend to, or make an investment in, an employer sponsor of the fund or an associate of the employer within the meaning of the Income Tax Assessment Act of an employer sponsor of the fund if the amount of the loan and the value of the investment (worked out at cost in the prescribed way) is more than the prescribed percentage of the total of the value of the assets of the scheme.

2. The law should provide that the responsible entity of an industry fund must not knowingly lend to, or make an investment in, 2 or more of the employer sponsors of the fund or in an associate of such an employer within the meaning of the Income Tax Assessment Act if the total amount of the loans and value of the investments is more than the prescribed percentage of the total of the value of the assets of the scheme.

3. Contravention of this provision should be an offence on the part of the responsible entity.

4. Values should be worked out as provided in OSS Regulations reg 16A.

5. The prescribed percentage should be such that, by 30 June 1998, it is 5%.

11.5. *Borrowing by superannuation funds etc.*

1. The law should provide that the responsible entity for a superannuation fund or an ADF must not borrow, or maintain a borrowing of, money, whether on security

or not. Non-compliance should be an offence. There should be a defence that the borrowing was temporary and made only to enable the scheme or ADF to pay benefits due to its members.

2. The law should provide that the responsible entity for a PST must not borrow, or maintain a borrowing of, money. Failure to comply should be an offence. There should be a defence that the borrowing was temporary and made only to enable the PST to meet its buy-back obligations.

11.6. ***Use of futures etc.***

1. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must not invest in a futures contract or a derivative instrument except

- for hedging purposes or
- for risk management or
- for duration management of fixed interest portfolios or
- as a substitute for the outright purchase of other assets.

Failure to comply should be an offence.

2. The law should provide that, if, because of an investment in a futures contract or a derivative instrument, the fund, ADF or PST becomes geared, the responsible entity is guilty of an offence.

11.7. ***Certifying solvency***

The law should provide that the responsible entity for a superannuation scheme, an ADF or a PST must, within 2 months after the beginning of a financial year, certify in writing to the regulator whether the expected liabilities of the fund, ADF or PST for that year can be met as they fall due without recourse to borrowing. Non-compliance should be an offence.

11.8. ***Redemption periods for personal schemes***

The law should provide that personal schemes must have assets appropriate to their redemption periods. No specific sanction is required as the question is dealt with under recommendation 9.2.

12. Members' rights

12.1. ***Personal superannuation funds: transferability restrictions***

There should be no change to the law in relation to the ability of members of personal superannuation funds to transfer or withdraw their benefits.

12.2. *Employer sponsored and industry schemes: transferability restrictions*

1. There should be no change to the law in relation to the ability of members of employer related superannuation funds to transfer or withdraw their benefits: these should continue to be governed by the provisions of the deed or other instrument constituting the fund.

2. The law should provide that, despite any provision in the deed or other instrument constituting the fund, the date as at which the amount of a payment to which a member of an employer related superannuation fund is entitled on withdrawing from the fund otherwise than on ceasing the employment to which his or her membership relates is to be worked out is the date on which the member completes all that is required of him or her to withdraw from the fund. If payment is made after that date, interest, at a rate to be prescribed, should be payable on the amount outstanding.

12.3. *Outlawing victimisation*

The law should make provision similar to the *Industrial Relations Act 1988* (Cth) s 301 protecting persons who are members of the board of management of a responsible entity for a superannuation fund by making it an offence to threaten, coerce or intimidate, or prejudice in connection with their employment or otherwise, such a person on account of the exercise by the person in good faith of a power or duty as member of the board of management.

12.4. *Employee representation*

The law should provide that the conditions under which a employer related superannuation fund that has 50 or more members attracts a tax concession include a condition that the deed or other instrument constituting the fund makes appropriate provision to ensure that

- the responsible entity for the fund not be an individual and
- the board of management of the responsible entity for the fund have at least one half of its members appointed (whether by election or otherwise) by the members of the fund.

This provision should take effect from 1998.

12.5. *Members' power to replace responsible entity*

The law should provide that the responsible entity for a superannuation scheme may be replaced as follows:

- 10% or more of the members of the fund, may, by notice in writing given to the responsible entity, require a ballot to be held for the removal of the responsible entity and the appointment of another person as responsible entity; the other person must consent to appointment as the responsible entity and give the declaration required by recommendation 8.7

- the responsible entity must then arrange for a postal ballot to be held on the question; if all members of the fund will have a reasonable opportunity to attend a meeting at which the question can be put, the responsible entity may arrange for such a meeting instead
- the responsible entity must, if it arranges such a meeting, also include in the notice of meeting a statement of the procedure to be put to the meeting as the procedure to be adopted by the meeting for conducting the meeting and for taking votes
- the question is not to be taken as having been agreed to unless at least 25% of the members cast a vote and the votes in favour of it amount to at least 75% of the members voting.

The law should provide that this provision does not prevent other business being transacted at the meeting.

12.6. *Mergers*
1. The law should provide that the conditions under which a superannuation fund attracts a tax concession include a condition that the deed or other instrument constituting the fund not prevent or restrict a merger of the fund with another fund, restrictions implied by the responsible entity's fiduciary obligations to the members of the fund apart.

2. The law should provide that the responsible entity of a superannuation fund must not put into effect a merger of the fund with another superannuation fund unless the entity has given written notice of the proposed merger
- to the regulator and
- to the members of the fund.

The period of notice is to be not less than 3 months. Failure to comply should be an offence.

3. The law should provide that if 10% or more of the members of either fund, by notice in writing given to the responsible entity before the end of the 3 months, require a ballot to be held on the motion that the merger not proceed
- the responsible entities must then arrange for a postal ballot to be held on the question; if all members of a fund will have a reasonable opportunity to attend a meeting at which the question can be put, the responsible entity may arrange for such a meeting instead
- the responsible entity must, if it arranges such a meeting, also include in the notice of meeting a statement of the procedure to be put to the meeting as the procedure to be adopted by the meeting for conducting the meeting and for taking votes
- the question to be taken as having been agreed to by the members, unless at least 25% of the members of a fund cast a vote and the votes against the merger amount to at least 75% of the members voting in a scheme in which 25% of the members cast a vote.

The law should provide that this provision does not prevent other business being transacted at the meeting.

4. If the motion is passed, the merger is not to proceed.

12.7. *Superannuation Advisory Service*

1. A Superannuation Advisory Service should be established with the function of providing education and information to members of superannuation schemes about the operation of schemes and their entitlements as members.

2. The Superannuation Advisory Service should establish a panel of conciliators, able to provide conciliation services to assist in resolving disputes between members of superannuation funds, ADFs and DAs and the responsible entities for, or providers of, the schemes.

12.8. *Internal dispute resolution*

1. Responsible entities for superannuation funds and ADFs and providers of DAs should be strongly encouraged to maintain a fair, easily accessible internal dispute resolution mechanism that is free to members.

2. The law should provide that the responsible entity for a superannuation fund, or an ADF and the provider of a DA, must include in each prospectus, member booklet or offer document issued to members or prospective members the prescribed particulars of the internal dispute resolution mechanism, if any.

12.9. *Superannuation Review Panel*

1. The law should establish a Superannuation Review Panel, with the function of adjudicating disputes between members of superannuation funds or ADFs and the responsible entities of the funds.

2. The Panel should have no more than 3 members, appointed by the Minister on the nomination of interested groups. At least one member should have to have experience and knowledge of superannuation matters.

3. The Panel should be able to review any decision in relation to the member made by the responsible entity for the fund in the exercise or purported exercise of a power it has as responsible entity.

4. The Panel should only be able to make orders as follows:

- if the Panel finds that the power has been not been exercised improperly — an order affirming the decision
- if the Panel finds that the power has been exercised improperly
  - — an order referring the matter back to the responsible entity to reconsider the matter and make a fresh decision in accordance with directions given by the Panel

— an order varying the decision
— an order substituting for the decision its own decision.

Without limiting the circumstances in which the Panel may find that the exercise of a power by a responsible entity was improper, the Panel should so find if it finds that the responsible entity, in making the decision

- failed to take a relevant consideration or matter into account or
- took an irrelevant consideration or matter into account or
- acted in bad faith or with malice.

5. A member of a scheme should not be able to apply to the Panel unless
   - he or she agrees not to take proceedings in equity in relation to the subject matter of the application, but the Constitution (that is, the prerogative writs (Constitution s 75(v)) and the ability to seek judicial review under the *Administrative Decisions (Judicial Review) Act 1975* (Cth) of the Panel's decision on the application, should not be affected
   - either
     - there is no internal review mechanism established for the scheme
     - the decision concerned has been reconsidered in accordance with the internal review mechanism established for the scheme or
     - the Panel determines that the internal review mechanism is unlikely to assist or there are special circumstances that justify the application being made.

6. The law should provide that the conditions under which a superannuation scheme or an ADF attracts a tax concession include that the responsible entity must agree to be bound by any decision of the Superannuation Review Panel, but without prejudice to its
rights to take proceedings under the Constitution (that is, the prerogative writs (Constitution s 75(v)) or *Administrative Decisions (Judicial Review) Act 1975* (Cth) in relation to the Panel's decision on the application.

12.10. ***Qualifying and vesting periods***

1. The law should provide that the conditions under which a superannuation fund attracts a tax concession include that the qualifying period for access to benefits under the scheme be no more than 3 months. This should be phased in over 3 years.

2. The law should provide that the conditions under which a single employer sponsored or industry superannuation fund attracts a tax concession include that employer contributions to the fund in excess of those to be required under the Superannuation Guarantee Levy Bill 1992 vest in the employee at the rate of 20% each year. This requirement should be introduced in 3 years.

12.11. ***Unclaimed benefits procedure***

1. The law should provide that the responsible entity for a superannuation fund or ADF, and the provider of a DA, must establish a procedure, conforming to guide-

lines published by the regulator by notice in the *Gazette*, for finding members of the scheme who do not claim benefits that are due to them, or whom the responsible entity or provider cannot locate.

2. The law should provide that the responsible entity for a superannuation scheme must ensure that the each member booklet, prospectus or offer document for the scheme include particulars of this procedure.

12.12. ***Unclaimed benefits***

An arrangement for an unclaimed benefits scheme (UBS) should be established as an ADF. However, disclosure requirements, reporting to member requirements and member representation requirements should not apply to the UBS. The law should provide for a UBS as follows:

- the regulator should keep a register of 'lost' members notified to it by responsible entities
- the regulator should not manage or administer the money covered by the UBS and should regularly put these functions out to competitive tender
- the UBS, or its agents, should be able to accept money from any scheme
- the administration costs of the UBS should be paid out of the gross earnings of the funds in the UBS
- the responsible entity for an eligible superannuation scheme or eligible ADF
  - — may transfer unclaimed benefits to the UBS after the member has been lost (to their scheme) for six months and
  - — must transfer unclaimed benefits to the UBS as soon as practicable after the member has been lost (to their scheme) for a total of two years.

12.13. ***Unclaimed benefits not to be put to reserves***

The law should provide that it is an offence for the responsible entity for a superannuation fund to transfer the amount of benefits not claimed by the members entitled to them to the reserve established for the fund.

12.14. ***Hardship cases***

The law should provide that a provision in the deed or other instrument constituting a superannuation fund that permits a member to withdraw money from the fund, on the ground of hardship is of no effect.

12.15 ***Bankruptcy of scheme member***

1. The law should provide that, except as recommended below, on bankruptcy of a member of a superannuation fund or an ADF, none of the amount standing to a person's account in the fund or ADF is capable of being taken by the trustee in bankruptcy as part of the person's estate.

2. The law should provide that, on becoming aware that a member of the superannuation fund is bankrupt, the responsible entity for the fund must apply so much of

the amount standing to a person's account in the fund as represents the contributions required to be made under SGL, and the earnings thereon, to buy an annuity for the member, either immediate or deferred (depending on the member's age).

3. The law should provide that the income from the annuity is protected income under the *Bankruptcy Act 1966* (Cth) and that the deferred annuity is not property of the member divisible among the creditors.

4. A court having jurisdiction in bankruptcy should be able, on application by the trustee in bankruptcy or the Official Receiver of a bankrupt's estate, to declare, by order, that some or all of the amounts standing to a bankrupt's account in a superannuation fund or ADF that is

- more than the amount referred to in 2 and
- represents contributions made within the previous 2 years, and the earnings thereon,

is property divisible among creditors.

12.16. *Bankruptcy of employer*

The law should provide that the regulator, on becoming aware that the employer in a single employer sponsored superannuation fund has become bankrupt or, in the case of a company, become an externally administered body corporate, must, by written instrument, remove the responsible entity from office and appoint another responsible entity in its stead.

12.17. *Superannuation on divorce or separation*

1. The *Family Law Act 1975* (Cth) should be amended to empower a court exercising jurisdiction in proceedings with respect to the property of parties to a marriage to direct the responsible entity of an accumulation scheme of which one of the parties is a member to split the account of the contributing spouse and roll the amount (if any) awarded to the non-contributory spouse into an ADF. The proportion of the fund allocated to the non-contributory spouse should, unless the court orders otherwise, be half the value of that part of the fund accumulated during cohabitation. The ADF must be fully preserved. The order should have to be obeyed despite anything in the deed or other instrument establishing the scheme.

2. The *Family Law Act 1975* (Cth) should be amended to empower a court exercising jurisdiction in proceedings with respect to the property of parties to a marriage to direct the responsible entity of a defined benefit scheme of which one of the parties is a member to pay the entitlement of the non-contributing spouse, determined by the court, into an ADF. The entitlement of the member should be divided between the parties according to a prescribed formula.

3. The court should be able to depart from the prescribed shares (that is, 50/50 for accumulation schemes, as prescribed for defined benefit schemes) in limited circumstances. The parties should be able to vary the shares by agreement, subject to the protection recommended in the ALRC's report *Matrimonial Property* (ALRC 39) and subject to court approval. In deciding whether to depart from the prescribed shares, or to approve an agreement to that effect, the superannuation position of the non-contributing spouse should be considered.

4. The transfer should not be subject to any tax or duty.

12.18. ***Superannuation and breakdown of de facto relationships***

The law should provide that, on the breakdown of a de facto relationship, the superannuation entitlements of the parties to the relationship should be re-allocated on the same basis as provided for in recommendation 13.15. Jurisdiction in respect of proceedings under this recommendation should be conferred on the Family Court, the Family Court of Western Australia and on the Supreme Courts of the States and Territories.

13. Power of the regulator

13.1. ***Random audits***

The regulator should conduct a program of random audits of responsible entities and investment managers for superannuation funds, ADFs and PSTs and the providers of DAs. Enough resources should be provided to the regulator to ensure that such a program can be established and maintained.

13.2. ***Investigation powers***

In addition to any powers of investigation the regulator may have at present, the law should provide that the regulator has the power to

- require from a responsible entity's external auditors information obtained by them in the course of the audit
- require from any person the production and explanation of documents relating to the affairs of a superannuation scheme and take copies or extracts of them
- enter upon and obtain full and free access within premises for the purpose of obtaining relevant information
- obtain and execute search warrants
- conduct examinations of relevant persons.

13.3. ***Privileges***

The privileges from disclosure, the immunities from use in evidence and the liabilities for non-compliance should be similar to those applicable under the Corporations Law and the *Australian Securities Commission Act 1989* (Cth), as proposed to be amended by the *Corporations Legislation (Evidence) Amendment Bill 1992* (Cth).

13.4. ***Auditors to report suspected breaches etc.***

1. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation fund, an ADF or a PST, suspects on reasonable grounds that the responsible entity, or an investment manager engaged by the responsible entity, has contravened the laws governing superannuation, a prescribed law or the deed or other instrument constituting the scheme must report the matter without delay to the regulator. Failure to comply should be an offence.

2. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation scheme, ADF or PST, forms the opinion that the steps taken by the responsible entity to limit the risk of loss to prudent levels are not achieving their apparent objectives must report the matter without delay to the regulator. Failure to comply should be an offence.

3. The law should provide that an auditor who makes either such report has protection similar to that provided under the Corporations Law s 332(9)-(10) and s 1289.

13.5. ***Qualified auditors***

1. The law should provide that a person who does not have the proper qualifications must not

- act or purport to act as auditor of a superannuation fund, an ADF, a PST or
- hold himself or herself out as willing or able so to act.

Non-compliance should be an offence. A person should be taken to have the proper qualifications only if the person

- has satisfactorily completed a course of instruction approved by the regulator by notice in the *Gazette* or
- has experience of a kind, gained over a period, specified by the regulator by notice in the *Gazette*

or if the regulator is satisfied that the person has enough knowledge and experience to conduct such audits competently and so certifies in writing; the regulator may give a person such a certificate, with or without an application.

2. An application for a certificate should have to be in accordance with a form approved by the regulator. If an application does not contain enough information to allow the regulator to consider the application properly, the regulator should be able, by notice in writing given to the applicant, request the applicant

- to give further information or
- to produce to the regulator a specified document.

Non-compliance with a request should not be an offence, but the regulator should be able to decline to deal further with the application.

3. On an application, the regulator should grant or refuse to grant the certificate. The decision should be reviewable by the AAT.

4. The regulator should notify the applicant in writing without delay after making the decision on the application. If the decision is unfavourable to the applicant, the notice should state the reasons for the decision. If the regulator has not notified the applicant in writing of the decision on an application

- within 28 days after the application was received or
- if the regulator has given the applicant a notice under paragraph 2 — within 28 days after the notice is complied with

the application should be taken to have been refused.

5. The regulator should be able to direct a qualified auditor not to act or to offer or hold himself or herself out as able to act as auditor of a particular superannuation scheme, ADF or PST. The direction should be in writing and should only be given if the regulator is satisfied that, because of the risk of a contravention of the law imposing prudential control over the scheme, ADF or PST, or the Corporations Law, the *Life Insurance Act 1945* (Cth) or a prescribed law, the direction ought to be given. A decision to give the direction should be reviewable by the AAT.

13.6. *Actuarial certificates*

1. The law should provide that the responsible entity for a superannuation fund that is a defined benefit fund must have a current actuarial certificate no more than 3 years old. Failure to comply should be an offence.

2. The law should provide that the regulator may, by notice in writing given to a responsible entity for a defined benefit superannuation fund, require the responsible entity to obtain another actuarial certificate within such time as is specified in the notice, or such longer time as the regulator allows. Failure to comply with the requirement should be an offence.

3. The law should provide that a certificate is not effective for the purposes of this recommendation unless it includes or has attached to it a statement of the assumptions on which the actuarial calculations to which it relates are based.

13.7. *Preservation remedies*

The law should provide that the regulator have preservation powers, including the power to seek injunctions, similar to those now available to the ASC.

13.8. *Temporary responsible entity*

1. The law should provide that the Federal Court, or the Supreme Court of a State or Territory, may, by order, on application by the regulator, the responsible entity for or a member of a superannuation fund, an ADF or a PST, appoint a temporary responsible entity for the scheme. The order should specify the powers of the responsible entity and be subject to such terms and conditions, including as to period of appointment, as are specified in the order.

2. Such an order should not be made unless the court finds that the responsible entity is not able to fulfil, or has not fulfilled, its obligations as responsible entity.

13.9. ***Regulator may enforce members' rights***

The law should provide that the regulator may, without the consent of the members of a superannuation fund, an ADF or a PST, take the same proceedings for relief against the responsible entity that a member of the scheme may take. "Relief" does not include damages or compensation.

13.10. ***Regulator may enforce contracts against investment managers***

1. The law should provide that the regulator may, without the consent of the responsible entity for, or members of, a superannuation fund, take, in the name and on behalf of the responsible entity, the same proceedings for relief against an investment manager engaged by the responsible entity as the responsible entity may take. 'Relief' includes damages and compensation.

2. The law should provide that the regulator is to be bound, in taking such proceedings, by the same obligations to the members as bind the responsible entity.

3. The law should provide that the regulator's taking those proceedings is not to affect any liability of the responsible entity for a breach of fiduciary obligation in failing to act.

13.11. ***Regulator may sue for compensation for members***

1. The law should provide that the regulator has the power to take proceedings on behalf of a member of a superannuation fund, an ADF or a PST for compensation for loss or damage suffered by the member by conduct of the responsible entity that constitutes a contravention of the law regulating superannuation funds, ADFs and PSTs or the deed or other instrument constituting the scheme.

2. The law should provide that such an action may not be taken on behalf of a member except with the written consent of the member.

3. The law should provide that such a proceeding may be commenced in respect of an alleged contravention even though another proceeding has been commenced against the responsible entity in respect of the alleged contravention.

4. The law should provide that the court may find on the balance of probabilities, for the purposes of the proceeding, that a contravention has occurred.

13.12. ***Removal and banning orders***

The law should give the regulator powers to ban or remove a responsible entity, a member of an unincorporated responsible entity or a director of an incorporated responsible entity. The law should provide that the regulator is able to suspend, indefinitely or for such period as it may specify, a person who is a director or member of a responsible entity of a superannuation scheme from the board of the responsible entity. This power should be exercisable if, in the regulator's opinion

- the person ought to be removed having regard to the risk posed of non-compliance with the relevant law, either by the director or the member of the responsible entity or
- the person is unable to fulfil, or has failed to fulfil, his or her duties or functions under the law or under the deed or other instrument constituting the scheme.

13.13. ***Regulator may direct investment managers not to act***

1. The law should provide that the regulator may, by notice in writing served on a person, direct the person not to act or to continue to act as investment manager for the responsible entity for a superannuation fund. Non-compliance with the direction should be an offence. The direction should be reviewable by the AAT.

2. The law should provide that the regulator is not to serve such a notice unless it is of the opinion that

- having regard to the risk of non-compliance with the law, the regulations or the deed or other instrument constituting the fund, the person ought not to act as investment manager for the fund or
- the investment manager has not fulfilled or cannot fulfil its duties and functions as investment manager.

3. The law should provide that, if such a notice is served, the person on whom it is served is not to charge the responsible entity any fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

13.14. ***Stop orders***

The law should provide that the regulator may issue a stop order preventing the responsible entity for as personal superannuation scheme or an ADF or the provider of a DA from issuing further units or interests in the scheme. Subject to a hearing requirement, the regulator should be able to issue a final stop order. The provision should be modelled on the Corporations Law s 1033.

13.15. ***Stop orders: life agents***

The law should provide that the regulator may issue a stop order to a life insurance company preventing the company from continuing to use a particular life insurance agent in so far as the agent is involved in selling superannuation. If the regulator does not seek to confirm the order within a specified period the order should lapse.

13.16. ***Instituting prosecutions***

An information, charge, complaint or application in relation to any proceedings for an offence against a superannuation law may be laid or made by the regulator or a delegate of the regulator.

13.17. ***Issues of criminal liability***

The criteria for criminal liability of individuals, or directors of bodies corporate or members of the board of the responsible entity for breach of duty should, in principle, be the same as is proposed in the *Corporate Law Reform Bill 1992*. An act or omission of an individual, a director or member of a responsible entity that would, if done or omitted by a director of a company, attract the civil penalty orders provisions proposed to be inserted in the Corporations Law by the *Corporate Law Reform Bill 1992* (proposed Pt 9.4AA, Div 2) should attract similar liability under the proposed new law.

13.18. ***Merger of superannuation schemes***

1. The law should not require the prior approval of a court or the regulator for mergers of superannuation schemes.

2. The law should provide that a proposed merger should have to be notified to the regulator, who should be able to issue, within 21 days, an interim stop order to prevent the merger proceeding. The regulator should be required to initiate court proceedings within 14 days of issue to have the order confirmed.

13.19. ***Funding the regulator***

The regulator should be funded solely from Consolidated Revenue. The funding should be fully independent of any levy that government may choose to impose on the superannuation industry.

14. Surpluses and reserves

14.1. ***Surpluses not to be repatriated***

The law should provide that it is an offence for the responsible entity for a superannuation fund pay to a person who is liable to make contributions to the fund, except a member, any amount representing the whole or some of a surplus in the fund except as follows:

- an actuary has certified that there is a surplus in the fund
- the amount, or the sum of the amounts paid since the certificate was given, must not be more than 50% of the amount certified by the actuary as the amount of the surplus unless the regulator, subject to review by the AAT, has given written approval to making the payment
- the responsible entity must have given to the members of the fund written notice of its intention to make the payment not less than 2 months before the payment is made.

14.2. ***Deeds etc. to make provision for surpluses***

The law should provide that a provision in the deed or other instrument constituting a superannuation fund that makes provision inconsistent with Recommendation 14.1 is void to the extent of the inconsistency.

14.3. *Employers to disclose intention about deficits in defined benefits schemes*

The law should provide that, if an actuary certifies, in relation to a single employer defined benefit superannuation scheme, that the employer must make a particular contribution, or a contribution of not less than a particular amount, to the fund to ensure that benefits reasonably likely to become payable by the scheme will be able to be paid

- the responsible entity for the scheme must, without delay, request in writing from the employer advice as to whether the employer proposes to make such payments
- the employer must give a written reply containing that advice within 3 months after the request is given
- the next annual report to members must include a statement of the effect of the actuary's certificate, and a copy of the employer's response.

Failure to comply should be an offence.

14.4. *Deficits in defined benefits fund to be reported*

The law should provide that, if an actuary certifies to the responsible entity for a defined benefit fund that there will be a deficit in the fund, the matter must be reported without the delay to the regulator, and the responsible entity must inform the regulator how it proposes to deal with the matter. Failure to comply should be an offence.

14.5. *Reserving not to be a breach of trust*

The law should provide that a responsible entity for an eligible scheme does not contravene their fiduciary obligation to the members imposed by law, merely because the responsible entity credits amounts to reserves in the scheme in accordance with a policy that itself is prudent.

Summary

Introduction

The report arises out of a joint reference to the ALRC and the Companies and Securities Advisory Committee (the Review) to examine prudential supervision and other regulatory issues associated with prescribed interests and other 'collective investments'. On 4 September 1991, the Attorney-General wrote to the Review requesting an interim report on superannuation, which is a kind of collective investment. The report covers a range of issues relating to the prudential supervision of superannuation and the rights and interests of members of superannuation schemes.

Collective investments and superannuation

'Superannuation' generally refers to the payment of a benefit to a person upon retirement from employment. Superannuation schemes may be classified as personal schemes or employer related schemes. Schemes may also be divided on the basis of the benefits provided: defined benefit schemes (where the benefit to be received by the member is fixed, usually as a multiple of average salary over the last few years of employment) and accumulation schemes (where the amount of benefit depends on the investment performance of the scheme). Superannuation also includes specialised rollover funds such as Approved Deposit Funds (ADFs) and Deferred Annuities (DAs) which enable employees who receive a payment on termination of employment prior to retirement to defer any tax liability.

Making superannuation safe

With the introduction of the Superannuation Guarantee Levy legislation and the gradual increase in compulsory employer funded superannuation contributions from 3% to 9% of employee earnings, the government will transform superannuation from a voluntary collective investment used by a minority of the workforce to an almost universal, compulsory retirement savings policy. Because of the element of compulsion, the government and the community have a strong interest in ensuring that the investment of those funds is secure and successful. The Commonwealth has recognised the need to provide an appropriate prudential framework to back up its official encouragement of superannuation. This framework will need to take into account the need

- to protect retirement savings and maintain public confidence in superannuation schemes
- to take account of the importance of superannuation funds to the long-term development and stability of the economy

- to resolve the issue of how to deal equitably with schemes that collapse through dishonest or inefficient management
- to ensure that the highest degree of integrity is maintained by the operators of schemes that enjoy the privilege of tax concessions.

Should superannuation schemes be insured?

An alternative to prudential supervision to minimise the risk of superannuation schemes failing is to require them to insure themselves against failure. The report found that mandatory insurance of superannuation benefits would not be practicable in the Australian context. Instead, it recommends that those who operate superannuation schemes be encouraged to insure against loss due to negligence and fraud.

Achieving consistency in regulating superannuation

Different regulations apply to different kinds of superannuation schemes. Which regulations apply depend on the way the scheme is funded (defined benefit or defined contribution) and on which institution is offering it (for example, life insurance companies or employers). These differences mean that some schemes which appear to be conceptually similar are subject to different regulatory regimes and in some cases to quite different requirements. The five most important areas in which there are differences in regulation are

- solvency requirements
- investment controls
- reporting requirements
- liability
- standards for participants.

These differences are compounded by the fact that the industry is administered by a variety of agencies. The report outlines these differences in the regulation of superannuation schemes and considers whether they are justified. The report's recommendations overcome the inconsistencies between the regulatory regimes covering superannuation schemes. They will ensure that the regulator has effective and appropriate powers.

Who is the regulator

The report recommends that there be an appropriately funded regulator with power to enforce compliance with legal standards by the use of sanctions, and with the aim of protecting and enforcing the interests of scheme members. The regulator should have extensive powers of investigation and audit. The report does not recommend that a particular government agency should have responsibility for regulating superannuation. The focus of this report, and of the collective investment review as a whole, is to make recommendations about the appropriate law and regulatory policies to ensure the stability and security of superannuation schemes. The recommendations in the report can be administered by whatever agency or agencies the government decides should be responsible.

The constitutional basis for Commonwealth regulation

The report deals with the extent of Commonwealth legislative power to impose prudential and other controls on superannuation and other related schemes. The report notes that the principal defect of current controls is that trustees who fail to comply are not directly subject to any penalties or sanctions. The removal of the tax concession penalises members rather than a non-complying trustee. The report concludes that no Commonwealth legislative power, taken alone or in combination with other powers, will completely cover the areas for which provision needs to be made. The report recommends that the regulatory framework for superannuation schemes be strengthened by new enforcement mechanisms, backed up by effective sanctions. It recommends that this be achieved by using taxation incentives to ensure that all superannuation schemes which have more than one member

- are incorporated or otherwise fall within the corporations power or
- offer old-age pensions, within the meaning of the Constitution, as their dominant purpose.

Regulating the players: standards for operators

The success of the Commonwealth's retirement incomes policy will depend to a large degree on the quality and integrity of the participants in the industry. The Review considers that the party which bears primary responsibility to the members of a superannuation scheme should be able to be easily identified in all circumstances. Because of the important position of the responsible entity, the report recommends that individuals and corporations be declared unsuitable to act as responsible entities in certain circumstances, for example, being an undischarged bankrupt, having a receiver appointed or being convicted within the previous ten years of an offence involving dishonesty. A breach should result in immediate disqualification.

Standards for investment managers of superannuation funds

The report does not recommend that investment managers be subject to any prevetting in addition to the vetting that they may be subject to in relation to their actually dealing with funds. However, the report does recommend that an investment manager be considered unsuitable to act for a superannuation scheme on the same grounds as those on which a responsible entity is unsuitable to act. The report does not recommend a minimum capital requirement for investment managers unless they have custody of a superannuation scheme's assets. The report also makes recommendations to ensure that contracts between investment managers and responsible entities of superannuation schemes are fair to the responsible entity and hence do not prejudice the interests of members of the scheme.

Superannuation intermediaries

The quality of advice given to people who are contemplating joining personal superannuation schemes, investing in a single contribution superannuation scheme or rolling over superannuation benefits is an important factor in an individual's choice. The regulation of people who give such advice and sell these products will also be an important element in the success of the Commonwealth's retirement incomes policy. The report is concerned primarily to ensure that standards for superannuation intermediaries, whether they be securities dealers, financial planners or life agents, are adequate and uniform. It recommends changes to achieve this objective.

Distinguishing features of superannuation trusts

While employer related superannuation schemes are structured as trusts, they have some features which differ from traditional trusts. The key differences, most of which have been introduced by Commonwealth policy, are

- beneficiaries are not always volunteers (that is, recipients of a gift)
- there is often an associated contract of employment
- employers have obligations to fund schemes
- employers have a continuing financial interest
- beneficiaries are entitled to representation on trustee boards
- the size of the trust fund is variable
- employers have the power to veto amendments to the terms of the trust

Duties of the responsible entity to be included in legislation

The report focuses on the principal fiduciary duties owed by responsible entities to members of superannuation schemes. The report recommends that they be expressly included in statute as obligations from which a responsible entity cannot be excused by the governing document of the scheme. All employees require the full protection of the fiduciary duties imposed upon superannuation scheme responsible entities. The report recommends that the law include a set of fiduciary obligations for responsible entities of superannuation schemes, ADFs and PSTs. The duties should be paramount — if they conflict with other conditions of the governing document, the other provisions should be void. The report recommends that the following duties of a responsible entity should be included in legislation

- duty to hold property for the benefit of members
- duty to become familiar with the deed and interpret the deed or other rules fairly
- duty to act honestly
- duty to avoid conflicts of interest and to fully disclose such conflicts
- duty to act always in the best interests of the members of the scheme
- duty to exercise care, diligence and skill
- duty to keep trust money separate from the employer's assets
- duty to exercise discretion only after proper consideration
- duty to act on advice
- duty to act personally and not to delegate
- duty not to profit from the trust
- duty to monitor the cash flow of the scheme
- duty to take a portfolio approach to investment
- duty to permit access to trust documents.

Duty of directors of incorporated responsible entities

The incorporation of a responsible entity will mean that trustees will become company directors. Technically, the company will replace them as trustee. Directors' duties are traditionally owed to the company as a separate legal entity. The establishment of such a corporation should not, however, mean that the directors of that corporation no longer stand in a fiduciary relationship to the beneficiaries of the scheme. Because the responsible entity's sole function is to manage the superannuation scheme on behalf of the members, the directors of a corporate responsible entity should be personally liable to the beneficiaries of the scheme, as they would be if the responsible entity was not incorporated.

Importance of disclosure

In the context of superannuation schemes, disclosure is important in three respects

- to prospective members, particularly of personal schemes
- to existing members of all schemes during membership of the scheme and on exit from the scheme
- to the regulator to enable it to monitor compliance with the law.

Consistency of disclosure requirements

The report sees the requirement for adequate disclosure as the fundamental requirement of any system of prudential supervision. The report endorses the disclosure requirements under the Corporations Law s 1022 as an appropriate standard to apply to disclosure for all superannuation schemes. The report recommends that all superannuation schemes should conform to that standard of disclosure.

Comprehensible information

Information must be comprehensible as well as consistent. There is little point in disclosure which uses technical jargon or sophisticated concepts not readily understood by the community. Consequently, the report recommends that information about prospective benefits should be reported to members in real terms, that is, in present day dollar values, and in clear, easily understandable language.

Advertising

The Review is strongly of the view that it is important to regulate advertising to ensure that a product or service provider does not mislead prospective investors and that the information provided is truthful and realistic. In the case of superannuation schemes this includes the information about the likely payments to be made to members. Advertisements should also clearly identify the responsible entity.

Disclosure to existing members

The Treasurer's statement of 20 August 1991 contained extensive disclosure requirements. The report endorses the need for requirements such as a comprehensive annual report and full disclosure of fees and charges. In addition to the Treasurer's proposals, the report recommends the following:

- disclosure to members of single investments of more than 5% (instead of 10%)
- reporting the superannuation scheme's performance over the past five years (instead of three)
- reporting the scheme's investment strategy over the next five years and performance against that strategy.

Investment controls

The report recommends that there should be no rule requiring specific asset allocation by superannuation schemes. In addition to the current investment controls, the report recommends that

- the limit on in-house investments be reduced from 10% to 5%
- the use of futures, options and derivative instruments should be restricted

- the responsible entity should be required to monitor the realisable assets of the scheme and report annually to the regulator on whether the expected liabilities of the scheme in the year ahead can be met without recourse to borrowing
- the same investment controls that apply to superannuation schemes should apply to PSTs.

In addition to these investment controls, the report recommends that the current restrictive approach by the courts in assessing the riskiness of investment activities of superannuation schemes should be changed to take into account the risk profile of the whole portfolio of investments.

Members' rights

The report recommends that scheme members have access to information held by their superannuation scheme. The report also enhances the rights of members to participate in the management of superannuation schemes by recommending that all schemes with 50 or more members should have equal employer and employee representation on the responsible entity. Members should also have the right to dismiss the responsible entity in certain circumstances. The report recommends that access to superannuation should be improved by reducing qualifying periods and vesting scales for superannuation contributions in excess of the level to be required under the proposed SGL legislation.

Advice and internal dispute resolution systems

As superannuation coverage increases, more and more people will be dealing with superannuation for the first time. The report recommends the establishment of an advisory service to ensure that members have access to accurate information regarding superannuation. The report also recommends that superannuation schemes be encouraged to establish internal dispute resolution mechanisms.

External dispute resolution mechanism

The report notes the Treasurer's reference to the need for a low cost alternative dispute resolution mechanism for superannuation. It recommends that a Review Panel be established, with powers equivalent to those of a court to hear disputes between members and responsible entities of superannuation schemes. The Review Panel should provide a cheaper alternative to review by the courts.

'Lost' members

The report recommends that procedures be established by each superannuation scheme to identify members it has lost contact with. It recommends that funds credited to the accounts of such members should be transferred to an Unclaimed

Benefits Scheme (UBS) two years after it is established that the member cannot be located. The UBS will be a group of privately administered, privately invested funds with a central register. This will ensure that members can easily reclaim their entitlements.

Superannuation on divorce

The report recommends that the Family Court should be given the power to order the re-allocation of superannuation entitlements of parties applying for divorce to ensure that the financial resources of the parties to a marriage can be more equitably divided between them. The orders should be binding on the responsible entity.

Powers of the regulator

The regulator will play a crucial role in ensuring the adherence to the prudential standards recommended in the report. The regulator will need to be adequately funded and have extensive powers of investigation and audit. The report recommends that the regulator have the power to take action (including representative action on behalf of scheme members) against the responsible entity.

The role of auditors

Even with an effective regulator, it is not possible to closely supervise the activities of all superannuation schemes. The report recommends that auditors should play a much greater role in the prudential supervision of superannuation schemes. It recommends that auditors be required to report to the regulator on the compliance with prudential standards by superannuation schemes. Only auditors that have undertaken special courses should be permitted to audit superannuation schemes.

Surpluses and reserves

The report includes recommendations to clarify the current confusion relating to surpluses. It recommends that no more than 50% of a surplus may be returned to an employer at any time. The report notes that there is some uncertainty about the ability of superannuation schemes to establish reserves without committing a breach of trust. The report recommends that reserving be allowed.

1. Introduction

The reference

1.1. On 24 May 1991 the federal Attorney-General, Mr Michael Duffy MP, asked the Law Reform Commission and the Companies and Securities Advisory Committee (the Review) to carry out a thorough review of the regulatory framework for prescribed interests and 'like collective investment schemes'. The terms of reference are set out at the front of this report. They require the Review to report by 1 November 1992.

The issues paper

1.2. In September 1991 the Review published a comprehensive issues paper on the area.[1] That paper identified the scope of the collective investments industry and discussed the importance of the industry for both national retirement incomes policies and capital formation in Australia. It set out the issues, so far as the Review saw them, and called for submissions.

Superannuation — interim report requested

1.3. In September 1991, just before IP 10 was published, the Attorney-General wrote to the Review asking for an interim report on superannuation issues. Specifically, he asked that the report

> traverse the regulation of superannuation investments products under the Corporations Law. As part of that report it would also be desirable, where appropriate, to consider the regulatory arrangements applying to comparable investment products which are not currently regulated by the Corporations Law.

Background to the superannuation inquiry

Superannuation guarantee levy legislation

1.4. The background to the request for the interim report on superannuation is the Commonwealth's retirement incomes policy, including the superannuation guarantee levy legislation, and the increasing awareness of the need to ensure that the regulation of superannuation schemes provides a proper level of protection for scheme members. The implications of these developments for the regulation of superannuation schemes are further considered in chapter 3.

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1. ALRC IP 10.

Collective investments and superannuation

1.5. The term 'collective investments' covers any type of investment scheme in which a number of investors hand over their money to professional managers who manage the total fund to produce a return. A common form of collective investment is the unit trust, but there are many others.[2] They do not necessarily take a corporate form, but they often involve issues and interests similar to those that arise in relation to capital formation through corporations. Some are subject to regulation under the Corporations Law as 'prescribed interests'.[3] Superannuation is a form of collective investment.

Superannuation and retirement income policy

1.6. The Commonwealth's retirement incomes policy involves two major components: privately funded superannuation and the old age pension. Recently, there has been an increasing emphasis on the privately funded superannuation component of retirement income. The Commonwealth's policy now looks to long term savings by individuals to provide a capital base from which they can generate income. In conjunction with the publicly funded pension, this will provide a higher level of retirement income than would otherwise be the case. Superannuation is also an increasingly important source of financial intermediation in the Australian economy. As a result of increased participation by the workforce in superannuation schemes, total superannuation assets have quadrupled in the last decade to $139 billion. Given the focus on compulsory participation in superannuation schemes contained in the Commonwealth's retirement incomes policy, the value of these assets may quadruple again by the turn of the century.

Discussion Paper 50

1.7. In January 1992, the Review published a discussion paper setting out preliminary proposals for the regulation of superannuation.[4] The discussion paper was widely circulated and over 100 submissions were received from a wide range of individuals and organisations. The Review gratefully acknowledges their interest. A list of those who made formal submissions is in Appendix 2.

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2. eg trustee common funds, shares, Friendly Society bonds and investment linked insurance products.
3. ALRC IP 10 para 1.1–1.5. For a further discussion of the regulation of prescribed interests under the Corporations Law see ch 4.
4. ALRC DP 50.

The Review's work

Assistance and acknowledgments

1.8. Soon after the Attorney-General's request to report on superannuation was received, the ALRC engaged Mr Paul Klumpes, Lecturer, Faculty of Commerce, Australian National University, to provide the Review with an overview of the superannuation industry, its existing regulatory framework and the inconsistencies within that framework. The material prepared by Mr Klumpes formed the basis for parts of DP 50 and of this report. The Review will soon publish a Research Paper setting out in more detail this overview. The ALRC also engaged Mr Ian Ramsay, Lecturer, Faculty of Law, University of New South Wales, to prepare a paper on trustees' duties, company directors' duties and the issues involved in the incorporation of trustees.

Consultants

1.9. In accordance with its usual practice, the ALRC appointed a number of honorary consultants from the superannuation industry, the legal profession, academia and the community to help the Review. The names of the consultants are listed at the beginning of this report. The Review acknowledges, with appreciation, their contribution. They attended several lengthy meetings to discuss the Review's preliminary proposals and gave valuable assistance in other ways. The Review wishes to express its particular appreciation for the extensive contribution made by Mr Robert Ferguson, Managing Director, Bankers' Trust Australia, to the Review's work.

Consultations

1.10. In addition to formal meetings with consultants, the Review held extensive consultations with the staff of the Insurance and Superannuation Commission (ISC) and the federal Treasury. The Review wishes to acknowledge in particular the helpful advice and assistance provided by Richard Beetham, Ron Deane, Bob Glading, Frank Keenan, Nick Stuparich and Mike O'Neill from the ISC, by Donald Duval, Australian Government Actuary, and by Ian Robinson from Treasury. The Review also met on a number of occasions with the Superannuation Committee of the Law Council of Australia. It acknowledges the helpful comments and advice received from the Committee. It particularly wishes to thank the Convenor of the Committee, Andrew Fairley, for providing the Review with the opportunity to participate in the Superannuation 1992 Conference. The Review also wishes to express its appreciation to Lord Browne-Wilkinson, a Lord of Appeal in Ordinary, for his thoughtful comments on the appropriate legal framework for superannuation schemes, the distinctive features of superannuation scheme trusts and their implications for the duties of superannuation scheme trustees. In addition, the Review would like to acknowledge the material provided by Baker & McKenzie on supervision of superannuation schemes overseas.

Further work

1.11. The Review's work on a number of matters that were raised in DP 50, and which are important for superannuation, has not been concluded. These matters, which include the regulation of financial advisers and the licensing of fund managers, will be covered further in the Review's final report on collective investments.

Form of recommendations

1.12. This report, despite the terms of reference of the Review, has been completed in too short a time to allow the Review to draft legislation to implement the recommendations. Later chapters set out the differences and inconsistencies between parts of the legislation that presently governs superannuation. The principal differences are in the areas of disclosure requirements and the powers of the regulators. One option would be to enact a comprehensive federal law covering all aspects of superannuation regulation, including those presently found in the Corporations Law. The question of the relationship between the Corporations Law and other laws that regulate superannuation will need to be addressed in drawing the legislation to implement the recommendations in this report. The Review has not addressed this matter.

Other reports, studies and reviews

1.13. The Review has had regard to a number of other government statements and agency reports dealing with specific issues relating to superannuation or to closely related areas. These include the Treasurer's statement of 20 August 1991 about prudential supervision of the superannuation industry and disclosure requirements and the Advisory Committee's Report *Enhanced Statutory Disclosure System* (1991). In view of the substantial common interests, the Review has maintained contact with the Senate Select Committee on Superannuation, chaired by Senator Nick Sherry.[5] The Review has also maintained a close working relationship with the Special Premiers' Conference Working Party on Non-Bank Financial Institutions sub-committee on Trustee Companies, through its Convenor, Dr Paul Moy, Assistant Secretary, NSW Treasury.

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5. The report of this Committee is due in May 1992.

Major issues

1.14. This report covers the following issues

- the constitutional power to regulate superannuation
- the policy implications of the changed nature of superannuation from a voluntary to a compulsory system
- standards of probity and competence for those who administer superannuation schemes
- duties of superannuation scheme trustees should be identified and included in legislation
- disclosure — to members and prospective members of superannuation schemes and to the regulator
- what, if any, investment controls should be imposed on superannuation schemes
- issues regarding the role and powers of the regulator
- problems regarding the relationship between superannuation schemes and their members, including inexpensive, non-judicial resolution of disputes
- problems concerning surpluses and reserves.

2. What is superannuation?

Introduction

Definitions

2.1. 'Superannuation' generally refers to the payment of a benefit to a person upon retirement from employment. The term 'superannuation fund' is defined in the *Occupational Superannuation Standards Act 1987* (Cth) (OSSA) as a fund that

(a) is an indefinitely continuing fund; and
(b) is maintained solely for one or more of the following purposes:
   (i) the provision of benefits for each member of the fund in the event of the retirement of the member from any business, trade, profession, vocation, calling, occupation or employment in which the member is engaged;
   (ii) the provision of benefits for each member of the fund in the event of the member attaining a particular age (being an age not less than the age prescribed by the regulations) without having retired from any business, trade, profession, vocation, calling, occupation or employment in which the member is engaged;
   (iii) the provision of benefits for dependants of each member of the fund in the event of the death of the member, being a death occurring before
      (A) the member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member is engaged; or
      (B) the member attains a particular age (being an age not less than the age prescribed for the purposes of subparagraph (ii)) without having retired from any business, trade, profession, vocation, calling, occupation or employment in which the member is engaged;
   whichever is earlier;
or for one or more of those purposes and for such ancillary purposes as the Commissioner approves in writing.[1]

Classifications

2.2. Each of these funds can be classified into one of a number of different types of 'superannuation schemes'. One classification relates to whether the scheme is a personal scheme or an employer related scheme. Another classification relates to the basis of the benefits provided: 'defined benefit' schemes or 'defined contribution' (or accumulation) schemes. Accumulation schemes are those in which the amount of contributions payable to the scheme

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1. OSSA s 3(1).

are specified, but the amount of benefit depends primarily upon the future investment income of the scheme. Defined benefit schemes, usually single employer sponsored[2] schemes, are those in which the benefit to be received by members, or the way in which it is to be worked out, is specified. The level of employee contribution (if any) is also fixed and is often expressed as a percentage of salary. The amount of employer contributions necessary to provide such benefits is not fixed, however, and depends upon future investment income, taxes and charges and, in part, upon actuarial determinations.

Industry structure

2.3. *Value of assets.* At the end of September 1991 the total value of assets in superannuation schemes and ADFs was $139 billion. This consisted of $62 billion in the statutory funds of life insurance companies, $69 billion in superannuation schemes outside life offices and $8 billion in approved deposit funds.[3] Superannuation scheme assets are concentrated in the larger schemes. The largest 462 schemes in 1988 had an average level of assets of approximately $60 million. The majority of schemes, some 99%, had average assets of $150 000.[4]

2.4. *Competition.* Promotion of competition is a policy objective of the current federal Government and the Opposition. Employer related superannuation schemes do not compete with each other to any great degree because currently the employee has no choice of schemes. Thus one company's or industry's scheme does not compete against that of another, although it is recognised that the quality of superannuation is used by employers to attract employees. Therefore, only in an indirect manner are there any competition incentives placed on superannuation schemes. In New South Wales as at 31 March 1992,[5] the employees, with employer approval, will be permitted to nominate their superannuation scheme. To the extent that these type of arrangements promote competition between schemes without unduly increasing the administration costs, this form of limited transferability will reduce the existing situation of mini-monopolies.

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2. See para 2.7 for explanation of this term.
3. Australian Bureau of Statistics, *Assets of Superannuation Funds and Approved Deposit Funds*, September Quarter 1991. In addition, it should be noted that these statistics exclude arrangements where the employee makes no contribution and all benefits are met entirely from employer's resources as they become payable.
4. ISC *Annual Report* 1990–91.
5. *Industrial Relations Act 1991* (NSW) s 180.

Employer related and personal superannuation schemes

Classification

2.5. The substantial growth in the assets of the superannuation industry has been accompanied by significant changes and continuing financial innovation in the design of superannuation schemes. Currently, two major categories of superannuation schemes may be identified: schemes related to a specific employer or group of employers (employer related schemes) and personal schemes. Many employer related schemes are defined benefit schemes, while the remaining schemes, including personal and rollover schemes, are typically accumulation schemes. The following sections elaborate on the different types of schemes.

Employer related schemes

2.6. ***Introduction.*** Employer related schemes may involve both employer and employee contributions (contributory schemes) or employer contributions only (non-contributory schemes). These schemes are not available, or marketed, to people who are not employed by the relevant employer or group of employers. There are three types of schemes in this category, single employer schemes, multi-employer schemes and industry schemes. Single employer schemes are sponsored by only one employer. Multi-employer schemes are typically schemes sponsored by single employers using a master trust arrangement of the type described in paragraph 2.12. Industry schemes are a special example of multi-employer schemes where more than one employer in an industry contributes to a scheme sponsored by the industry.

2.7. ***Single employer sponsored schemes.*** As the name suggests, these schemes are promoted by individual employers. Membership is available only to employees of the sponsoring employer, and may or may not be a condition of employment with the employer. They can be either defined benefit schemes or accumulation schemes. Most defined benefit schemes are unallocated, that is, the contributions by employees (if any) and the employer are pooled, and the benefits are determined by a formula in the trust deed or other instrument constituting the scheme, generally on the basis of salary and length of service. Actuarial calculations are used to determine the level of employer contributions necessary to ensure that there will be sufficient funds available to meet the scheme's expected liability for benefits. The distinguishing feature of defined benefit schemes is that the employer generally bears the investment risk of the scheme. The employees' contributions (if any) are fixed (for example, 2% of current salary), while the employer's contribution varies with changes in salaries, interest rates and resignations.[6] The benefit paid by a defined benefit scheme is most frequently paid as a lump sum but may also, or alternatively, be paid as a pension. However, the entitlement of the employee is based on the accumulated value of contributions made on his or her behalf by the employer as well as those made by the employee and the investment income of the scheme.

2.8. *Industry schemes.* As part of the Accord, the ACTU and the federal Labor Government each made a submission to the Industrial Relations Commission (IRC) in the 1986 National Wage Case. The IRC decided that, while it would not arbitrate to provide for superannuation, it would certify agreements or make consent awards covering superannuation in certain circumstances. The ACTU, in conjunction with employers, has established a number of schemes open to all employees of particular industries and, in certain cases, the 3% superannuation awarded by the IRC has been directed into these schemes.[7] These industry schemes are virtually all accumulation schemes.

Personal schemes

2.9. Personal schemes provide a means for individuals to make contributions towards retirement savings independently of their current employer. Tax concessions act as an incentive to invest in superannuation rather than in other forms of investment. Personal schemes are marketed to the public by a range of institutions, although the market is dominated by life offices. Retirement benefits are calculated as a lump sum based on the total accumulated contributions and investment income earned by the scheme. Personal superannuation schemes are the principal means of accumulating retirement savings for those in the workforce who cannot make contributions to an employer sponsored superannuation scheme, for example, the self employed. They are also useful for people in employment (whether regular, irregular part-time, casual or itinerant) to supplement their employer sponsored superannuation.[8] Regular or, in some cases, irregular contributions can be made to these schemes. Life companies, and only life companies, also market single premium personal superannuation schemes to cater specifically for those who wish to supplement on an irregular basis whatever other superannuation arrangements they may have.

6. For the purposes of AAS25, a defined benefit scheme includes all superannuation schemes other than defined contribution schemes.
7. There were a number of important industry schemes before the 1986 Wage Case (eg, SERF (1960's) Seafarers (1973), Pulp and Paper Workers (1974), LUCRF (1978), BUS (1984), TWU (1984)). The number and size of industry schemes has since increased.
8. Sometimes employers will make contributions to a personal superannuation scheme nominated by an employee to supplement contributions made by the employee.

Rollover arrangements

2.10. Rollover arrangements permit retirement related payments known as 'eligible termination payments' (ETPs) to be invested to defer tax liability until retirement age. There are currently two main types of rollover arrangements available: Approved Deposit Funds (ADFs) and Deferred Annuities (DAs). A distinguishing feature of rollover arrangements is that ETPs are the only money which may be contributed to them.[9] All money invested in ADFs is either repaid on death or on retirement after age 55, whichever occurs first. With DAs the money is repaid at or before the age of 65 if the investor elects to commute his or her income stream to a lump sum. Otherwise, the DA becomes an immediate annuity and the money is returned to the investor over a period of years in the form of regular annuity payments.

Rationalisation of administration and investment of superannuation schemes

Introduction

2.11. Superannuation schemes involve three basic functions — administration, investment and, in most cases, the provision of life insurance cover for scheme members. A number of arrangements are available to trustees of superannuation schemes to streamline the administration procedures or to facilitate the tax effective investment of their funds. Life insurance can only be provided to a superannuation scheme by a life insurance company. It takes the form of a policy for each scheme member or a 'group life' policy.[10]

Master trusts

2.12. Master trusts allow employers to participate in a common master trust rather than under their own unique deed. Since there is only one scheme, the master trust completes only one ISC return and one income tax return and is subject to only one audit, thus minimising the costs of legislative compliance. They may pool funds for all participating employers, as is usually the case under industry schemes, or may keep separate sub funds for each employer. The trustee may perform the investment and administration functions itself or it may

9. In addition, money from an ETP may also be invested into a superannuation scheme or an immediate annuity.
10. A group life policy is a single life insurance policy which covers a group of individuals, such as all the members, for the time being, of a superannuation scheme.

contract these out to professional managers. Master trusts are available for both employer sponsored and personal superannuation schemes. They are typically marketed by life offices, banks and other fund managers and superannuation advisers.

'Fund of funds' arrangements

2.13. This term refers to arrangements under which small superannuation schemes place their superannuation contributions into the statutory fund of a life company. These deposits are not required to be identified separately in the life insurance company's statutory fund return. The Review understands there are arrangements which are referred to as 'fund of funds' arrangements that do not invest wholly in life office funds. Those arrangements do not fall within the Review's definition of a 'fund of funds' arrangement. Rather they are a special example of a master trust.

Professional administration organisations

2.14. These are commercial organisations which undertake the administration of superannuation schemes. The tasks they perform for the schemes include maintaining member accounts, distribution of member statements and collection of contributions.

Pooled superannuation trusts (PSTs)

2.15. PSTs help provide superannuation schemes with greater economies of scale when investing. They are unit trusts that can only accept funds from superannuation schemes which comply with OSSA, or from ADFs, other PSTs and some other tax preferred institutions.[11] OSS Regulations contain rules to ensure that only complying funds are able to invest in PSTs.[12] However, to date they do not impose prudential standards or investment controls on PSTs.[13] The issue of whether the same prudential standards applying to superannuation schemes ought apply to PSTs is addressed in chapter 11.

Professional investment managers

2.16. Many superannuation schemes contract out the investment of the scheme's funds to one or more professional investment managers. These managers may be contracted to invest the funds in specific asset classes or generally.

11. OSS Regulations reg 3A, 23C, 23E.
12. OSS Regulations reg 23A.
13. However, OSSA s 8A allows a wide range of prudential requirements to be imposed upon PSTs.

New types of rationalisation arrangements

2.17. It is possible that other ways of rationalising the administration and investment activities of superannuation schemes will be developed in the future. The Review is concerned to ensure that relevant recommendations in this report extend to such arrangements so that organisations providing the same product or service are subject to the same regulatory framework.

Legal structure of superannuation schemes

2.18. All of the different types of superannuation schemes outlined above, including PSTs and ADFs, are structured as trusts or are established by or under an Act of a parliament. In much of the current debate surrounding the reform of superannuation it is assumed that the trust structure is the most appropriate for superannuation. The recommendations contained in chapter 3 onwards of this report are made on the assumption that the trust structure is retained for superannuation,[14] but that the trustee will, in most cases, be incorporated.[15]

Institutions offering superannuation schemes

Introduction

2.19. The superannuation schemes outlined above are offered by a growing variety of institutions. For the purposes of this report, offering institutions have been divided into two categories, employer offerors and other institutions. The types of scheme offered by each institution are outlined below and summarised in Table 1 at the end of this chapter.

Offerors of employer related schemes

2.20. ***Public sector employers.***[16] Superannuation has for many years been a feature of employment in the public sector. Until recently, superannuation schemes offered by public sector employers have been considerably more generous than those offered by private sector employers. Public sector schemes have also been characteristically offered as defined benefit schemes, although some public sector employers now offer accumulation schemes. Most public

14. The exception is a DA, which is not structured as a trust but as a life policy.
15. In the US, UK and Canada, the trust structure is used extensively. Although in certain instances each of these countries either requires or permits a corporate trustee, unincorporated trustees are also allowed: Baker & McKenzie *Submission* February 1992.
16. Public sector schemes are schemes established by a law of the Commonwealth or of a State or Territory or under the authority of the Commonwealth or the government of a State or Territory: OSS Regulations reg 3.

sector schemes operate on a 'pay as you go' basis, that is, the employer makes no contribution to the fund but meets any unfunded retirement benefit either from the current income of the fund or from consolidated revenue. The cash flow difficulties associated with unfunded schemes have, in the past, been overcome by providing retiring members with the choice of a less generous lump sum payment or a more generous pension. Under the pension option, resigning members forgo immediate access to their benefits by leaving them in the scheme and receive instead an increased entitlement to benefits. Unfortunately, this mechanism has not been entirely successful in reducing the cash flow difficulties, especially during periods of high inflation, retirements and retrenchments. Particularly in state schemes, there has been a recent shift to providing lump sums rather than pensions. Until 1990 the regulations applying to private sector schemes did not apply to public sector schemes. These schemes are now subject to the same regulatory regime as private sector schemes, including the same taxation liability.

2.21. *Private sector — single employer.* Historically, superannuation has not been as important a component of the employment contract in the private sector as it has in the public sector. Where superannuation has been available in the private sector, it has taken the form of both defined benefit schemes and, increasingly, accumulation schemes. Whereas in the public sector schemes defined benefits are typically unfunded, private employer sponsored defined benefits schemes are invariably fully funded.

2.22. *Private sector — multiple employers.* Trade unions have been closely involved in the establishment and administration of industry schemes following the 1986 National Wage Case decision.[17] Since that time these schemes have grown quite rapidly. As at April 1991, the eight largest industry funds had a total of $1.2 billion in assets under management.[18] Although the involvement of trade unions in superannuation schemes is quite recent, trade unions have historically had a role in the provision of retirement incomes through their capacity to provide pensions. This capacity arises through their historical connection with the friendly society movement.[19] However, with the introduction of government pensions funded from Consolidated Revenue, the power to pay pensions that many unions possess under their rules has fallen into disuse. The increasing involvement of unions in the retirement incomes debate may, however, see a revival of this function.

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17. See para 2.8.
18. Examples of such funds include HESTA (for the Health Industry), BUSS (for the building unions and construction industry), STA (Superannuation Trust of Australia-Metal Industry), REST (Retail), HOST-PLUS (Hotels), CARE (Clerical and Retail) and ARF (Australian Chamber of Manufactures and ACTU).
19. Some trade unions began as friendly societies.

Offerors of personal schemes and rollover arrangements

2.23. *Introduction.* Certain institutions offer superannuation schemes directly to the public at large. The range and type of such products available varies considerably across different types of offering institutions. There are four major groups of institutions offering these superannuation schemes: companies subject to the Corporations Law, life insurance companies, State government insurance offices and friendly societies.

2.24. *Offerors subject to the Corporations Law.* These include corporations which promote trust arrangements that enable them to provide a wide range of superannuation schemes in addition to the other collective investment schemes they promote to the public. They promote personal accumulation schemes and ADFs. They also promote master trusts and PSTs to employers, unions and other superannuation scheme promoters.

2.25. *Life insurance companies.* Life insurance companies are registered under the *Life Insurance Act 1945* (Cth). They can be structured either as mutuals or as companies limited by shares. Traditionally, personal superannuation schemes promoted by life insurance companies were offered in the form of risk based life insurance policies, particularly whole of life endowment policies. This key difference is reflected in Table 1. For example, life companies offer DAs instead of ADFs. In recent years life companies have begun offering investment linked superannuation policies. These policies now account for a significant proportion of their total premium income.

2.26. *State government insurance offices.* These institutions offer a range of schemes similar to those offered by life insurance companies. Only the life insurance activities of State government owned insurance companies that occur outside the State concerned are subject to the requirements of the *Life Insurance Act 1945* (Cth).[20]

2.27. *Friendly societies.* These State or Territory based financial institutions are similar to mutual insurance companies. They have traditionally offered social welfare related services, such as health care facilities and sickness insurance, to their members. However, as governments have taken over responsibility in these areas, friendly societies have branched out to offer a range of superannuation schemes similar to those offered by life companies and government insurance offices.

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20. *Life Insurance Act 1945* (Cth) s 5. The Constitution exempts State insurance within the State concerned from Commonwealth legislative control: Constitution s 51(xiv).

Proposed superannuation schemes

2.28. Several banks are proposing to create 'superannuation savings accounts' which will compete directly with other superannuation schemes currently offered by other types of institutions. The ANZ Bank is currently developing a product which will be marketed by ANZ Life. The money received will be invested in an account with the ANZ bank. This is merely a superannuation scheme which is no different from the others offered by ANZ Life. The only bank element is the fact that the money will be held in a bank account instead of being invested in other vehicles by the life company. It is possible, however, that in the near future other banks will develop proposals for 'superannuation accounts' which would be able to receive deposits direct from individuals on condition that the money would not be able to be withdrawn until the depositor had retired. Currently, it is not clear whether these accounts, if offered, will form part of the bank's main business or whether those funds will be held on trust or outright by a subsidiary. If the banks offer superannuation schemes which are not part of their banking business, the funds should be regulated in accordance with the recommendations in this report.

Retirement incomes — lump sums and annuities

2.29. All of the schemes and arrangements outlined above are designed to facilitate the process of saving for retirement. The Commonwealth grants them tax concessions designed to make them a more attractive alternative of saving for retirement. These tax concessions are subject to certain conditions.[21] Retirement income may either be provided by a pension offered by the scheme or by the retiree investing the lump sum he or she receives to produce an income stream or by purchasing an annuity. While annuities are not strictly 'superannuation' within the definition adopted by the Review, they play an important role in retirement incomes. Annuities may either be for a fixed period (a term certain) or whole of life. Currently, whole of life annuities are only available from life insurance companies.[22] In return for the payment of a lump sum by the retiree to the life insurance company, the retiree receives a regular (often indexed) pension payment until his or her death.[23] The income earned by the life insurance company from the investment of the lump sum is exempt from taxation.[24] That part of the income received by the retiree which represents a return of his or her capital is also exempt from income tax. The risk borne by the

21. See para 5.4.
22. Friendly societies only offer term certain annuities.
23. Often an annuity plan includes provision for payment of a reduced pension to the retiree's surviving spouse for the remainder of his or her life.
24. ITAA Pt III s 112A.

life insurance company is that the capital sum will be exhausted before the retiree, or his or her spouse, dies. An alternative to an annuity is a cash back or allocated pension. These pensions differ from annuities in that the pension received by the retiree can be varied at the retiree's discretion. Consequently, the capital sum invested to generate the pension may be exhausted quite quickly. Unlike an annuity, when the capital is exhausted the pension ceases. Thus an allocated pension may be distinguished from an annuity on the basis of who bears the risk that the capital will be exhausted before the death of the retiree. Allocated pensions are treated in the same way as life annuities for income tax purposes.[25]

25. They receive concessions for undeducted purchase price and post 1983 rebate. The lump sum used to purchase an allocated pension is currently limited to the lower lump sum reasonable benefit limit (RBL). The ISC is reviewing whether the higher RBL should be allowed. Currently, if a benefit is greater than the lower lump sum RBL, the excess does not receive a tax concession but is taxed at marginal rates.

Table 1
Superannuation Schemes
and their Offering Institutions

	Type of Offering Institution						
	Employment related sponsors			Offerors of other schemes			
Type of Superannuation Scheme	Public Sector Employer Sponsors	Private Sector Employer Sponsors	Unions/ Employers	Management Companies[1]	Life Insurance Companies[2]	Government Insurance Offices	Friendly Societies
REGULAR CONTRIBUTION SUPERANNUATION SCHEMES							
• Accumulation	X	X	X[3]	X	X	X	X
• Defined benefit	X	X					
SINGLE CONTRIBUTION SUPERANNUATION SCHEMES							
• Superannuation schemes				X			
• Superannuation bonds					X	X	X
ROLLOVER SCHEMES[4]							
• Approved deposit funds	X			X		X	X
• Deferred annuities					X	X	X
SIMPLIFICATION SERVICES							
• Master trusts				X	X		
• Pooled super trusts				X			
• Fund of fund arrangements					X		

1. Fund management companies include the wholly owned subsidiaries of banks, building societies, life insurance companies and credit unions.
2. Life insurance companies now also include wholly owned subsidiaries of banks.
3. One submission suggested that at least one industry plan (sponsored by employers and unions) offers a defined benefit for apprentices.
4. Employees often 'rollover' superannuation entitlements into their next employer's superannuation scheme.

3. Superannuation regulation: basic issues

Introduction

3.1. This chapter considers what regulatory controls are necessary for superannuation schemes. It outlines the main arguments for and against regulatory intervention in the financial system, and explains how those arguments are relevant to superannuation. It discusses the increased reliance on privately funded superannuation, which is a feature of the Commonwealth's retirement incomes policy, and why this requires a greater level of prudential supervision than currently exists. It outlines the essential elements and objectives of the proposed regulatory regime and considers whether there are other options to protect the interests of members, such as insurance to guarantee benefits, or to protect against negligence or fraud.

Government intervention in the financial system — Campbell Committee

3.2. The case for government intervention in the financial system in general was thoroughly investigated by the Committee of Inquiry into the Australian Financial System.[1] It identified six possible reasons for intervention

- to promote efficiency
- to promote diversity of choice
- to ensure competitive neutrality
- to promote stability of the financial system
- to promote the macroeconomic stability
- to achieve social objectives.[2]

The Committee concluded that there is a clear justification for government intervention where it is necessary to ensure free, fair and competitive markets.[3] It also endorsed a limited role for government intervention to safeguard the underlying stability of the financial system. It did not support intervention in the financial sector to achieve economic policy purposes, nor did it support intervention for the purpose of achieving social objectives.

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1. See Campbell Committee *Report*.
2. Campbell Committee *Report* para 1.8.
3. Campbell Committee *Report* para 1.80.

Government intervention — superannuation

Background — new superannuation policy

3.3. *Voluntary superannuation.* Until the announcement in the 1991–92 Budget speech that superannuation would form a 'vital part' of the Commonwealth's retirement incomes policy, superannuation was simply a voluntary form of saving for retirement. The funds invested came principally from the discretionary savings of investors. The only features distinguishing superannuation from other collective investments were that a contribution to a superannuation scheme could not be withdrawn at will[4] and that substantial tax concessions were available.[5] Superannuation was encouraged as a form of saving by tax concessions, but these were of benefit only to those who could afford to save in this way. They did not have the effect of bringing everyone into superannuation schemes.

3.4. *Award-enforced superannuation.* In the 1986 National Wage Case the (then) Conciliation and Arbitration Commission made provision in the National Wage Case principles allowing for agreed superannuation improvements not exceeding the equivalent of 3% of ordinary time earnings of employees. In 1987 the Commission determined that it would continue to certify agreements or make consent awards concerning superannuation, and would also be prepared to arbitrate on superannuation where negotiations and conciliation were exhausted. Award superannuation has been implemented progressively since the 1986 and 1987 National Wage Case decisions and many more people have become members of superannuation schemes.

3.5. *Superannuation and retirement incomes policy.* The decision by the federal Government in 1991 to introduce the Superannuation Guarantee Levy (SGL), and to increase gradually the level of compulsory employer funded superannuation contributions from 3% to 9% of employee earnings, has transformed superannuation. Instead of depending on the implementation of awards, employer contributions will be enforced through the levy. Superannuation will

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4. Although prior to the introduction of standards relating to preservation, many superannuation benefits were more easily accessible.
5. The earnings of complying superannuation schemes are now taxed at 15%. Until 1 July 1988 they were tax free. For most other collective investment schemes, earnings are taxed in the hands of the investor at the investor's marginal tax rate. It is acknowledged that other collective investments, for example, insurance bonds, also attract tax concessions. In general these concessions are not as large as those applying to superannuation schemes, although capital gains and profits of gold produces were tax free, like the earnings of superannuation schemes.

no longer be a voluntary collective investment used by a minority of the workforce to supplement their publicly provided tax financed pension. It will now be an integral part of retirement incomes policy, a policy which aims to

> encourage people to save for their retirement so that they can enjoy a higher standard of living than would be possible by reliance on the age pension alone.[6]

It is not intended, however, to replace entirely the tax funded pension with employer or employee financed superannuation. Unless the level of compulsory employer contributions under the SGL legislation is increased, superannuation will remain a supplement (albeit a significant one) to the pension.

Should there be greater intervention in the provision of superannuation?

3.6. Retirement incomes policy is intended to achieve a public purpose — higher retirement incomes — by requiring the use of a private delivery system — investment in superannuation schemes. The compulsory nature of the investment gives government a special interest in the success of those schemes. The more successful superannuation investments are, the less resort there will be to publicly funded old age pensions. Conversely, if the returns on superannuation investments are diminished, through incompetence, negligence or fraud, people may have to be provided for unexpectedly from tax revenue. So long as superannuation remained a voluntary private investment decision, there was no need for the prudential supervision of superannuation to be any greater than that applying to collective investments generally. The question for the Review is whether, and if so, to what extent, these policy changes should result in a greater degree of government intervention in the operation of superannuation schemes.

Failure of superannuation schemes

3.7. ***Nature of the risk.*** Investors in superannuation schemes generally face three types of risks: liquidity risk, institutional risk[7] and investment risk. The first two types of risks are firm specific. Liquidity risk relates to the ability of a scheme to meet its short-term financial obligations. Institutional risk concerns the risks faced by members of a scheme that their scheme will fail, that is, its assets will be insufficient to meet its obligations.[8] These risks operate in particu-

6. Treasurer's press release No 73, 20 August 1991.
7. It is recognised that the term institutional risk is more commonly used to refer to the probability that a firm in which an investor has invested cannot meet its financial obligations, or that its assets are insufficient to meet those obligations, even after liquidation. It is not used in that sense in this chapter.
8. This is particularly relevant for members of defined benefit schemes.

lar ways for superannuation. The fact that all employers are liable to contribute for their employees reduces significantly the liquidity risk of superannuation schemes. The regular contributions by employers (and employees) should provide a constant cash flow for superannuation schemes. On the other hand, there is an increased institutional risk faced by most members of superannuation schemes because they generally have no choice as to which scheme they join and are generally a member of one scheme at a time. Investment risk is the risk taken by members of superannuation schemes that the investments made by their scheme will fluctuate in value.[9]

3.8. *Risk of failure — non-diversification.* Most employees are only able to join one scheme. This exposes them to a significant degree of institutional risk (that is, the risk that the scheme of which they are a member will fail). This risk is more significant for them because it is their only scheme.[10] The lack of choice of superannuation scheme facing most superannuation scheme members is considered further in chapter 12.

3.9. *Effect of failure — impact on federal budget outlays.* If a scheme's assets are dissipated by dishonest, negligent or simply inefficient management, a future generation of taxpayers, who will already have paid once through tax revenue foregone due to tax concessions granted to superannuation schemes, will have to pay again through the social security system to provide pensions and other support for the members of the depleted scheme. Such an unexpected increase in social security outlays would have serious long term implications for the Commonwealth. Unlike an unexpected increase in unemployment, where the number of recipients will recede as the level of employment improves, these beneficiaries would require social security for the rest of their lives, as they will have no opportunity to rebuild their retirement savings.

3.10. *Effects of failure — political impacts.* The former members of a depleted superannuation scheme may have expectations (however unrealistic) that the Commonwealth, having forced them into a superannuation scheme, is responsible for their retirement savings and, consequently, should be required to make good the loss. The reaction of depositors in the Farrow group of building societies and the OST Friendly Society in Victoria indicate the kind of expectations people may have and their likely reaction should their superannuation schemes suffer a similar fate. The risk that members of a depleted superannuation scheme may demand recompense from the Commonwealth is heightened by two factors

9. This is particularly important for members of accumulation schemes.
10. It is acknowledged that an employee who changes jobs will have a series of ETPs which may be held in a variety of ADFs or DAs, thus reducing the degree of his or her institutional risk.

- it will have effectively endorsed superannuation as the preferred mechanism for retirement savings and forced people into superannuation schemes
- most individuals will only be members of one scheme at a time which denies them the protection available to other investors through diversification of their portfolio across institutions.[11]

Conclusion

3.11. ***Intervention justified.*** The Review is satisfied that government intervention in the provision of superannuation services is justified, not only for the general reasons endorsed by the Campbell Committee but also to ensure that scheme members are offered an adequate and appropriate level of protection for what may be a significant component of their post-retirement income. In IP 10 the Review identified the following three goals for regulatory intervention in collective investments.[12]

- To promote commercial stability and efficiency in capital raising and in long term investments. This involves establishing competitive neutrality between similar investments. It aims to ensure that the regulations imposed enable collective investment schemes to operate efficiently and effectively.

- To ensure that the legal framework harmonises with the regulation of similar investment vehicles. This goal is closely allied to the first. It is designed to ensure consistency in the regulation of conceptually similar investment opportunities. In the case of superannuation it is important that, subject to the special policy considerations flowing from the compulsory nature of superannuation and its role in the retirement incomes policy, its regulation be consistent with the regulation of collective investments generally.

- To ensure that there is appropriate protection for investors and beneficiaries. This involves adequate information being made available to investors and potential investors so they can make realistic assessments about their investment opportunities. It also involves ensuring that promoters, trustees and investment advisers meet minimum standards

11. This issue must be distinguished from the issue of diversification of investment across asset classes, but see fn 10.
12. IP 10 para 2.21.

> of competence and integrity. It requires that investors have an appropriate input into the conduct of collective investment schemes. This is particularly important in the case of employer related superannuation.

These goals are equally applicable in the context of superannuation.

3.12. *Prudential supervision.* Prudential supervision is a series of measures directed at redressing market imperfections in a particular industry. A major way that it does this is by prescribing standards that participants in the industry must observe. It is not a substitute for the assessment of risk by individual investors. Rather, it aims to make it easier for investors to make accurate assessments of the risks involved. For example, by establishing minimum disclosure requirements, a system of prudential supervision can avoid the need for excessive duplication of basic information search costs and provide investors with a proper and reasonable opportunity to measure and assess risk. There is already a level of prudential supervision in operation, and the Review is satisfied that it represents an appropriate way of intervening.

Insurance

Why consider insurance?

3.13. *Requiring insurance.* Another way of intervening is to arrange for the risk of loss, which regulation is designed to prevent or minimise, to be insured. The Review notes that the Commonwealth has indicated that, in intervening, it does not propose to control investment generally, or to guarantee superannuation benefits to scheme members against the impact of adverse market movements or poor commercial decisions.[13] The risk of failure will continue to lie with the superannuation scheme members.[14]

3.14. *Structure of the industry.* There are over 120,000 superannuation schemes. Close prudential supervision of the superannuation industry by the regulator alone is prohibitively expensive. Even if supervision were tightened up and a regulator established with the full powers and the right approach to its functions, there would still be gaps, and there would still be potential for failure. The Review gave consideration to whether, given the importance of superannuation for public policy, the risk of failure should be insured. Two kinds of insurance were considered. The Review explored whether it is feasible to establish an insurance system to guarantee the benefits provided by superan-

13. Treasurer's press release No 73, 20 August 1991; Treasurer's statement, paper 1 para 10.
14. Treasurer's press release No 73, 20 August 1991; Treasurer's statement, paper 1 para 7.

nuation schemes to their members against loss caused by failure of the scheme, however the failure arose. The second option is more limited. It may be possible to provide insurance against loss due to fraud or negligence. The cost of either option is a key consideration.

3.15. ***Retirement income insurance systems overseas — ERISA.*** Some countries have voluntary supplementary pension schemes with an associated safety net,[15] whereas others have mandatory pension schemes with an associated safety net.[16] The best known example of voluntary supplementary funds pensions combined with an insurance scheme is in the USA, where many schemes are insured by the Pension Benefits Guarantee Corporation (PBGC), an independent corporation established under the *Employee Retirement Income Security Act 1974* (USA) (ERISA).[17] ERISA only provides a safety net for defined benefit schemes.[18] In return for the payment by a superannuation scheme of a variable fee of between $US16 and $US50 for each member, the PBGC guarantees the payment to members of their basic benefit, that is, the normal retirement benefit which would have become vested in the employee under the terms of the scheme, up to a maximum monthly pension payment.[19] The PBGC will pay a benefit to members of a single employer sponsored scheme only if the scheme has been terminated on one of a number of specified grounds including that the employer sponsor is placed in liquidation.[20] In the event of such a termination the employer is liable to the PBGC for the unfunded liability of the scheme and special rules apply if the amount owed exceeds 30% of the net worth of the employer sponsor.[21] It was necessary to amend the original legislation[22] to provide for specific instances where a superannuation scheme could 'terminate', because of the presence of moral hazard. Employers were deliberately underfunding superannuation schemes and then voluntarily winding up the schemes, thereby requiring the PBGC to pay the difference to the members. Interestingly, this problem has not been as predominant where the employers contributed to a multi-employer plan.[23] In a multi-employer plan, several employers combine to offer a multi-employer superannuation scheme. These schemes pay a lower, flat, insurance premium of $US2.60 a member.[24] The conditions under which the

15. US, Canada, Germany.
16. In Sweden, supplementary contributions are required by collective agreements between the employee's union and the employer's union not by legislation.
17. ERISA s 4002
18. The PBGC does not insure accumulation schemes.
19. In 1990 this was $US2164.77. The rate is adjusted each year in line with inflation.
20. ERISA s 4041(c)(2)(B)(i).
21. ERISA s 4062(b)(2)(B).
22. *Omnibus Budget Reconciliation Act, 1987* (USA).
23. Multi-employer plans are administered separately from the single-employer plans: Ippolito *The Economics of Pension Insurance* 14.
24. Coleman *Primer on ERISA* 57.

PBGC will pay a benefit are also restricted. It will only act in the event that all the assets of the scheme have been depleted[25] or all the employers have withdrawn from the scheme.[26] This form of co-insurance reduces the moral hazard problems that are associated with single employer schemes. In addition, the level of benefit guaranteed by the PBGC to employees covered by multi-employer schemes is relatively low. No portion of the benefits under these schemes is guaranteed until the scheme has been in effect for five years and the maximum benefit paid by the PBGC is $US20 a month for each year of service.[27] Thus an employee with 30 years service would only receive $US600 a month.[28]

Arguments in favour of insurance

3.16. *Lower cost.* No matter how extensive the supervisory framework, losses will occur. The importance of superannuation for retirement incomes policy means that the impact of such losses must be minimised. A universal insurance scheme would spread the burden of these losses across the industry. It is argued that an insurance scheme is the most cost effective way of protecting the interests of the members of the schemes, decreasing the total cost of supervision and increasing the profitability of funds. This is because it is argued that the lower cost of reduced prudential controls more than offset the cost of the insurance scheme.

3.17. *Protection for poorly diversified investors.* Insurance can also provide protection for poorly diversified investors.[29] This is particularly important in the context of superannuation, where most employees are only a member of one superannuation scheme at a time.

3.18. *Protection against runs.* If contributors are entitled to transfer their membership from scheme to scheme, the chance of a run increases. Investor confidence in schemes, therefore, becomes more important. The fact that a scheme has insurance will promote investor confidence. This will reduce the likelihood of runs.

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25. Formally the employer's liability ceases upon the plan's adoption of an amendment to the effect that no further credit may be given to participants in the fund: ERISA s 4041A(a). Under the *Multiemployer Pension Plan Amendment Act 1980* (USA) the employer is liable to meet unfunded liabilities, so the PGBC is not liable until the fund has exhausted this source of funds. See Coleman *Primer on ERISA* 60.
26. ERISA s 4041A(a)(2).
27. Domone *ERISA The Law and the Code* 58–59.
28. cf $US2164.77 for members of single employer sponsored schemes.
29. Again, diversification is here used to mean diversification across institutions, rather than diversification of investments across asset classes and risks.

Arguments against insurance

3.19. *Cross subsidisation.* It is said that a compulsory insurance scheme may be inequitable for some schemes. First, those who behave in a responsible manner will be subsidising those engaging in excessive risk taking. Furthermore, those members who are willing to accept more risk for a higher return will be paying an implicit insurance premium (in the form of a lower earnings rate) for insurance they don't want. This argument needs to be weighed against other public policy purposes in relation to superannuation.

3.20. *Encourages risk taking.* A more significant objection is that insurance may tend to encourage excessive risk taking by members or by the scheme. This is known as the 'moral hazard' problem. It is argued that those who are insured against a certain risk have less incentive to use optimal care to avoid those risks. In the case of insurance against investment risk in particular, this argument suggests that such superannuation schemes would be encouraged to engage in the highest yielding investments, as this is the most economically rational option for the scheme. Given the direct inverse relationship between rates of return and risk, members will therefore have incentives to place their funds in the riskiest investments, that is, the ones most likely to fail. There would be little incentive for members to stop trustees from engaging in such investment strategies, because, if the strategy succeeds, they reap the benefits and, if it fails, the insurer bears the costs, not them.

3.21. *Leads to underfunding.* An additional moral hazard in the case of defined benefit superannuation schemes is the incentive for employers to underfund the scheme. This has been a problem in the USA and was recently addressed by tightening the funding requirements in the 1987 amendments. Underfunding occurs because the insurer, rather than the employer sponsor, is ultimately responsible for any underfunding of such schemes.[30]

3.22. *Insurance less cost effective.* The proponents of prudential supervision argue that it is generally more cost effective in achieving a given level of protection for investors than are systems of insurance, principally because there is a much smaller 'moral hazard' problem. Investors know that return of their investment is not guaranteed. They must, therefore, make use of the information provided to them as a consequence of the prudential supervision undertaken by the regulator to monitor their investment. Promoters too, know that taking excessive risks will cost them in loss of capital.

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30. Holland & Sutton 'The Liability Nature of Unfunded Pension Obligations Since ERISA' (1988) 55 *Journal of Risk and Insurance*, 32–58.

DP 50 proposal

3.23. In DP 50 the ALRC proposed that a privately funded comprehensive insurance system be established.[31] Comment was sought. The majority of the submissions rejected this proposal.[32] Many focused on the unknown and potentially prohibitive cost of such a scheme. Aside from the cost of funding a scheme such as that established under ERISA, there are additional complications in the Australian context, such as the lack of experience with this type of insurance and an increasing number of accumulation schemes. In order to reduce the moral hazard problem, each premium would need to be based on the riskiness of the fund's own portfolio. This has been very difficult to assess. This was one of the reasons for the development in the United States of a government backed insurance fund associated with ERISA,[33] the PBGC, instead of a private insurance scheme. There is the further limitation that, in Australia, an insurer like the PBGC could only provide cover for defined benefit funds and not accumulation schemes.[34]

An alternative — negligence and fraud insurance

3.24. *Introduction.* As superannuation schemes are structured as trusts, there are no capital adequacy provisions like there are in the banking[35] and insurance[36] industries. Capital adequacy requirements can act as a buffer in the event of fraud or negligence on the part of the management to reduce the likelihood of loss to investors. Prudential supervision alone does not provide a guarantee against negligence or fraud. It may be possible to supplement prudential control with insurance to protect funds simply against fraud or negligence. Although there was no specific proposal to this effect in DP 50, it received support during the Review's consultations.

3.25. *Insurance can cover breach of duty.* Negligence insurance provides cover in the event that the scheme operators fail to perform their duty.[37] As the trustees of superannuation schemes are often not remunerated for their work, the deed or other instrument constituting the scheme typically provides that the

31. DP 50 proposal 11.1.
32. eg, National Mutual *Submission* February 1992; Institute of Actuaries *Submission* February 1992; Department of Social Security *Submission* February 1992; BT Asset Management *Submission* February 1992.
33. Ippolito *The Economics of Pension Insurance* 3–5.
34. Although it may be possible to provide cover for accumulation schemes provided the interest to be insured is determinable, such as members contributions in real terms or members contributions plus a minimum earnings rate.
35. *Banking Act 1959* (Cth) s 16.
36. *Life Insurance Act 1945* (Cth) s 19A.
37. This type of cover is presently available through ASFA and one of the major life companies.

fund will indemnify the trustee or a member of the trustee board for any loss resulting from negligence. The fund is required to pay for any successful claim made against the trustee.[38] If instead the scheme took out a third party indemnity policy, the insurance company would be responsible for paying any successful negligence claim against the trustee, thus preserving the remaining assets of the scheme.[39]

3.26. *Would there be a moral hazard problem?* The Review has concluded that such insurance is appropriate in the context of superannuation schemes. It could be argued that just as there is a moral hazard problem when insuring against any loss, there is also a moral hazard problem with insuring for negligence, because it provides an incentive for trustees not to perform their duties properly, knowing that neither they nor the fund will suffer financially.[40] After consultations with industry practitioners, however, the Review is convinced that such a problem is not significant. The prudential system can place clear obligations on responsible entities, and insurers are likely to have fewer difficulties in pricing the risks for insurance purposes. The likelihood that a single employer sponsored or industry superannuation scheme will be defrauded by its trustees is not high.[41]

3.27. *Premium calculation.* Negligence insurance is now available commercially. The premiums of such insurance are based on the riskiness of each fund. The evaluation of riskiness includes, among other factors, an evaluation of the size of the fund, the number of members, whether the funds are externally managed and whether prior claims have been lodged. There should be no difficulty with fixing premiums.[42]

3.28. *Recommendation.* It would be desirable to have all single employer sponsored and industry schemes insured against loss due to fraud or negligence. However, the Review accepts that there may be practical difficulties, particularly for the small funds, in meeting such a requirement. The Review strongly recommends that such insurance be obtained by all funds. There should be an obligation on the trustees to disclose to the members whether or not the scheme has this kind of insurance.

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38. This means that often times the fund will have to pay twice: for example, when the trustee negligently pays money out of the fund assets to the wrong beneficiary and then to the correct beneficiary.
39. See Companies & Securities Law Review Committee *Company Directors: Indemnification, Relief and Insurance*. The CSLRC proposed similar reforms to the Corporations Law s 241.
40. Except to the extent of increased premiums.
41. Only if the fraud involved all the trustees would the loss be uninsurable on the basic public policy rule that one's own fraud is uninsurable. Usually the fraud of one trustee will involve the negligence of other trustees and, consequently, be recoverable under a policy covering loss due to negligence.
42. The Review understands that such insurance is available relatively cheaply with $1m in cover costing approximately $500 each year.

3.29. ***Liability and indemnity.*** Indemnities for trustees against liability for breach of trust are often included in deeds, particularly where the trustee is not remunerated (as is the case with most superannuation schemes) to reduce what would otherwise be too heavy a burden of responsibility upon them. The trustees of superannuation schemes are often insured against liability. The premium on the insurance policy can be paid out of the assets of the scheme. However, the Corporations Law provides that any attempt to indemnify an officer of a body corporate against a liability that by law would otherwise attach to the officer for negligence, default, breach of duty or breach of trust is void.[43] This may prevent superannuation schemes from paying the premium for trustees from the assets of the fund merely because they are directors of a company. As a result, trustees may be reluctant to incorporate. The Review recommends that the law should make it clear that premiums for negligence and fraud insurance may properly be paid out of the fund.

Recommendation 3.1: Indemnification of members of boards

1. The law should provide that the responsible entity, and the members of the board of management of the responsible entity, for a superannuation fund, an ADF or a PST may not be indemnified out of the fund, ADF or PST for any liability incurred by it or them while acting as responsible entity or member. Failure to comply should be an offence as well as a breach of fiduciary obligations.

2. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must ensure that the annual report for the scheme include a statement whether the responsible entity or the members of the board of management of the responsible entity are insured in respect of their liability to members of the scheme for loss caused by fraud or negligence and, if they are, the prescribed particulars of that insurance.

3. Nothing should prevent the payment out of the fund of the costs associated with obtaining insurance for the responsible entity for the fund, ADF or PST or for a member of the board of management of the responsible entity against fraud or negligence.

43. Corporations Law s 241.

4. Regulation under the Corporations Law

Introduction

Scope of chapter

4.1. This chapter traverses the existing regulation imposed on superannuation schemes by the Corporations Law. Later chapters deal with the way other laws, such as the *Life Insurance Act 1945* (Cth) and *OSSA*, regulate superannuation, and draw out the differences and gaps between them. This chapter discusses the principles underlying the Corporations Law controls, and the details of controls imposed on investments, prospectuses, dealers and fund-raising activity.

Overview

4.2. The Corporations Law does not apply to all superannuation schemes. Nor does it regulate those to which it does apply in a uniform way. Depending upon the nature and structure of the particular superannuation scheme, all or only some of the following provisions may apply:

- Pt 7.3: licensing of dealers and investment advisers
- Pt 7.11: conduct in relation to securities
- Pt 7.12 Div 2: prospectuses
- Pt 7.12 Div 5: prescribed interests
- general provisions governing public management companies and any incorporated trustees.

Pt 7.3 prohibits persons from carrying on a securities or investment advice business except with a statutory licence; Pt 7.11 imposes civil and criminal liability for breach of the prospectus provisions; Pt 7.12 Div 2 prohibits any offer or invitation to subscribe for or buy securities except under a prospectus and Pt 7.12 Div 5 places similar restrictions on prescribed interests.

Corporations Law principles

4.3. Before the Corporations Law, the view was that, in most cases, offers or invitations to contribute to superannuation schemes or ADFs, or for these schemes to subscribe for units in PSTs, did not constitute offers or invitations 'to the public.' The prospectus and prescribed interest requirements in the now superseded Companies Act and Codes, which only regulated 'offers to the public', therefore had only limited application. Under the Corporations Law, regulation is no longer based on the concept of 'offer to the public'. Instead, s 1065 provides that no person shall 'issue, offer for subscription or purchase or issue invitations to subscribe for or buy any prescribed interest', except in compliance with the Pt 7.12 Div 5 (prescribed interests). A 'prescribed interest' is defined to include a 'participation interest'. Superannuation schemes, ADFs and PSTs fall within the definition of 'participation interests' and thus are prescribed interests, unless the exceptions for life insurance policies apply.[1] Prescribed interests are 'securities' and an offer or invitation to subscribe for or acquire securities can only be made pursuant to a prospectus.[2] The statutory requirements concerning prospectuses and prescribed interests, and other provisions in Pt 7 regulating securities, therefore apply to these superannuation arrangements. In all cases these requirements are subject to specific exceptions, either statutory or because of the exercise of the ASC's discretionary powers.

Schemes outside the Corporations Law

4.4. Superannuation schemes in which the rights of scheme members constitute an 'interest in, or arising out of, a policy of life insurance' are excluded from the definition of 'participation interest', and consequently from the definition of 'prescribed interest', in s 9.[3] They fall outside the ambit of the Corporations Law and are regulated principally under the *Life Insurance Act 1945* (Cth) and OSSA.[4]

Schemes subject to the Corporations Law

Investments in superannuation funds and ADFs

4.5. The prospectus and prescribed interest provisions in the Corporations Law Pt 7.12 apply to offers or invitations to contribute to superannuation schemes and ADFs, except those excluded under the Corporations Law[5] and those that the ASC exempts as a matter of discretion. The main categories that are excluded are offers or invitations by

1. Superannuation schemes, ADFs and PSTs involve investment arrangements that constitute 'investment contracts' as defined in s 9, or otherwise fall within para (a)-(c) of the definition of 'participation interests' and, consequently, 'prescribed interests' in s 9.
2. Corporations Law s 1018, s 92 apply to 'securities of a corporation'. 'Corporation' is defined in s 9 to include any body corporate. Section 92(4) provides that 'a provision of Pt 7.12 that applies in relation to securities of a body corporate also applies in relation to prescribed interests made available by a person or body other than a body corporate'.
3. For what is 'a policy of life insurance', see, eg, *Marac Life Assurance Ltd v Commissioner of Inland Revenue* [1986] 1 NZLR 694; *Cutten & Harvey v Sun Alliance Life Assurance Ltd* (1986) 4 ANZ Insurance Cases 60-742.
4. See further ch 5.
5. s 66.

- public sector or foreign superannuation funds
- superannuation funds operated by or on behalf of an employer, a group of employers or a trade union (that is, employer sponsored and industry schemes)
- superannuation funds or ADFs of not more than 10 members, and not promoted by or on behalf of a person whose business includes the promotion of similar funds.[6]

The ASC has a general power under s 1084 to exempt or limit the obligations of compliance with the prospectus and prescribed interest requirements. It has rejected applications for exemption from the prospectus provisions in relation to some superannuation schemes, such as schemes for self employed persons and employer sponsored superannuation schemes containing 'unsupported' members.[7] However the ASC has provided for extended life prospectuses in these cases.[8]

Investment of superannuation funds or ADFs in PSTs

4.6. Offers to superannuation funds or ADFs to invest in PSTs fall within the prospectus requirements. The main exemptions that are relevant to investment invitations by PSTs to superannuation schemes and ADFs are

- offers to invest amounts in excess of $500 000[9]
- offers to trustees of public sector or foreign superannuation schemes, that is, those constituted by or under a law of the Commonwealth or of a State, Territory or foreign country[10]
- offers to trustees of superannuation schemes or ADFs that have net assets, or control an amount, of not less than $10 million.[11]

Under the Corporations Law s 1084, the ASC has relieved PSTs from the prospectus requirements in respect of offers to existing investors, only if the relevant offer, if accepted, would result in the investor holding at least $500 000 worth of units in the trust and the offer is not capable of being accepted in

6. Corporations Regulations reg 7.12.05, 7.12.06.
7. ASC Policy Statement 12 (November 1991).
8. ASC Policy Statement 18 (March 1992) para 45, 50.
9. Corporations Law 66(2)(a); s 66(3)(a)(ba). Each amount payable must be of $500 000 or more for the exemption to apply; it does not suffice that an account balance exceeds $500 000: see also Corporations Regulations reg 7.12.06 (b).
10. Corporations Regulations reg 7.12.05(a)(iv), 7.12.06(a)(iv).
11. Corporations Regulations reg 7.12.05(a)(v),(e), 7.12.06(a)(v), (j).

respect of part only of the units offered.[12] In other circumstances, the ASC has declined to grant a total exemption for offers by PSTs.[13] Instead, it has modified the prospectus requirements for PSTs to

- relieve PSTs of the requirement to register, but not to lodge, prospectuses[14]
- allow multi-document prospectuses, incorporation by reference in rollover prospectuses and use of half-yearly and annual reports as prospectuses.[15]

Prospectus requirements

4.7. Non-exempt superannuation schemes are subject to the prospectus requirements in the Corporations Law Pt 7.12 Div 2, as modified for prescribed interest schemes.[16] They are also subject to the restrictions in s 1078 on securities hawking. A particularly significant power is that enabling the ASC to issue stop orders to prevent the further distribution of prospectuses that contravene the statutory requirements or are false or misleading. Extensive liability and recovery provisions are found in Pt 7.11 Div 2 and 4.[17]

Prescribed interest requirements

4.8. Pt 7.12 Div 5 regulates the internal structure of non-exempt superannuation schemes. It requires the division of functions between a trustee and a management company.[18] The trustee retains custody of the assets of the scheme while the management company makes the investment decisions and is usually responsible for the day to day administration of the scheme. The trustee must be approved by the ASC. The management company must be a public corporation and be licensed as a securities dealer. The trust is to be governed by a deed

12. ASC Instrument 761/91; see also ASC Policy Statement 18 para 12(i).
13. The reasons are set out in the ASC Report on the Public Hearing on Pooled Superannuation Trusts: *ASC Digest* 1992 vol 2 PH 25-30.
14. ASC Instrument 760/91; see also ASC Policy Statement 18 para 21.
15. ASC Instrument 760/91; see also ASC Policy Statement 18 para 35(b); para 37.
16. Corporations Regulations reg 7.12.12. However, the ASC will permit some modifications to the Pt 7.12 prospectus requirements for superannuation savings plans to allow for extended life prospectuses: ASC Policy Statement 18 (March 1992) para 45; 50.
17. s 1033.
18. The Review's recommendation 8.1, that a single responsible entity be appointed for each superannuation scheme, is a fundamental departure from the requirement for a separate trustee and management company for applicable superannuation schemes. However, 'the ASC experience has suggested that a regulatory regime which requires the appointment of both a manager and a supervisory trustee leads to uncertainty in the division of responsibilities, a duplication of functions, unnecessary costs and ineffective supervision': ASC *Submission* March 1992.

approved by the ASC.[19] There are extensive statutory covenants implied into these deeds. The ability of the trustee to limit its liability for breach of trust is restricted.[20] The trustee and management company are also restricted in the exercise of their functions and powers.[21] The ASC may give an exemption from some of these statutory covenants.[22] Subscription contracts may be rescinded where contraventions have taken place and proceedings may also be brought for breach of the statutory covenants.[23]

General Corporations Law

Introduction

4.9. Independently of the prospectus and prescribed interest requirements, the activities of various persons involved in the promotion or administration of superannuation funds are subject to regulation under the Corporations Law. They are controlled by licensing requirements and by prohibitions on misleading or deceptive conduct.

Licensing requirements

4.10. *Dealers.* The Corporations Law Pt 7.3 regulates participants in the securities industry, including trustees and management companies of superannuation schemes, and any external advisers. A person may not carry on a business of dealing in securities[24] unless the person holds a dealers licence or is an exempt dealer.[25] Under Pt 7.3 Div 3, representatives of dealers must hold a proper authority from their licensed principal. Pt 7.5 deals with the accounts that must be kept by the holder of a dealers licence, and with how they must be audited; Pt 7.6 regulates the manner in which licensed dealers are to manage money received; while Pt 7.7 requires licensees to maintain a register of their interests. Trustees of a superannuation scheme who deal in securities only in relation to the management and administration of that scheme are exempt from the licensing and consequential requirements of these provisions.[26] The manager of a prescribed interest scheme must hold a dealers licence. In addition, a

19. s 1065, 1066 1067(1)(2).
20. s 1076.
21. s 1069; Corporations Regulations reg 7.12.15. For instance, s 1069(1)(a), s 1069(1)(e)(i) and Corporations Regulations reg 7.12.15(1)(f) impose proper performance obligations on the manager and trustee in the exercise of their functions and powers, while s 1069(1)(g) imposes an absolute prohibition on investments in the trustee, the manager or an associate of either of them.
22. s 1069(3).
23. s 1073.
24. See s 9 "deal"; s 93 "securities business".
25. s 780-1.
26. Corporations Regulations reg 7.3.13(1).

person who, as part of a business, recommends to potential contributors that they subscribe to a superannuation scheme that is a prescribed interest scheme, is dealing in securities and accordingly also must hold a dealers licence.[27] The ASC may impose conditions on the licence[28] and require the licensee, at any time, to provide information to it.[29] This is in addition to the statutory reporting requirements.[30] The ASC's powers to suspend or revoke a licence, and impose banning orders, are found in Pt 7.3 Div 5.

4.11. *Investment advisers.* Any person who carries on a business of providing advice on securities must be licensed under s 781. The requirement applies to persons providing securities advice to superannuation funds, whether or not they are constituted as prescribed interests, and to persons giving securities advice to potential contributors.[31] Representatives of investment advisers must hold an appropriate authority. Investment advisers are subject to the licensing requirements in Pt 7.3 and the 'know your client' and disclosure of benefits rules in Pt 7.4 Div 3. The ASC may suspend or revoke a licence, and impose banning orders; these powers are found in Pt 7.3 Div 5.

4.12. *Misleading or deceptive conduct.* All superannuation schemes, whether or not exempt from the prospectus and prescribed interest requirements, are subject to s 995. This section, which is based on *Trade Practices Act 1974* (Cth) s 52, imposes a general prohibition on misleading or deceptive conduct in relation to any dealing in securities or any prospectus issued, or notice published, in relation to securities. In this context the term 'prospectus' may cover a wide range of promotional material issued in respect of superannuation funds.[32] Contravention of the provision imposes a civil liability but does not constitute a criminal offence.[33] Losses suffered in consequence of breach may be recovered against any person involved in the contravention.[34]

False or misleading statements

4.13. *False or misleading statements in prospectuses.* Superannuation schemes that are required to register or lodge a prospectus with the ASC are subject to the prohibition in s 996 on prospectuses containing material statements that are

27. The criteria for granting a licence are set out in s 783-4.
28. s 786.
29. s 788.
30. s 787, 790, 791.
31. For the definition of 'securities' see s 92; for the definition of 'investment advice business' see s 77.
32. "Prospectus" is defined in s 9 as a written notice or other instrument inviting applications or offers to subscribe for or buy the securities or offering the securities for subscription or purchase.
33. s 995(3). See generally ASC Practice Note 12: Offerings of Securities for Subscription or Purchase — Regulation of Conduct (July 1991) para 2.1 - 2.10.
34. ibid para 4; and see Corporations Law s 79 (involvement in contraventions).

false or misleading, or that contain material omissions. The section imposes criminal liability on all persons who 'authorise or cause' the issue of the prospectus, subject to stipulated defences.[35] The section does not apply to excluded offers or invitations, that is, superannuation schemes exempt from the prospectus and prescribed interest requirements.

4.14. *Misleading representations concerning future matters.* Section 765, which is based on *Trade Practices Act 1974* (Cth) s 51A, amplifies s 995 and s 996 by providing that, where a person makes a representation with respect to any future matter, and the person does not have reasonable grounds for making the representation, this shall be taken to be misleading. An onus rests on the defendant to show that he or she had such reasonable grounds.

Other provisions

4.15. Management companies and incorporated trustees of superannuation schemes are subject to the general provisions of the Corporations Law governing these bodies and their officers. For instance, directors of these companies are required to comply with applicable statutory obligations, including the fiduciary duties in s 232, while directors of corporate trustees have further potential liabilities under s 233. The ASC has extensive investigative and enforcement powers under the Corporations Law and the ASC Act in respect of these companies and their officers.

35. ibid para 3.1-3.6.

5. Regulation of superannuation under other laws

Introduction

5.1. Chapter 4 examined the extent to which the Corporations Law applies to superannuation activities. This chapter briefly outlines the general law and legislation (in addition to the Corporations Law) that governs the activities of superannuation schemes. The legislation discussed includes State and Territory legislation governing trustee companies,[1] the *Occupational Superannuation Standards Act 1987* (Cth) (OSSA), the *Income Tax Assessment Act 1936* (Cth) (ITAA) and the *Life Insurance Act 1945* (Cth). Table 2 (at the end of this chapter) summarises the laws that apply to each type of superannuation scheme. A detailed discussion of these laws is provided in later chapters. Accounting standards and actuarial issues are also considered.

Trust law

General principles

5.2. Superannuation schemes are, typically, trusts. The deed or other instrument establishing the scheme is either a trust deed or imposes trustee obligations on the persons in charge of the scheme. This is so even for statutory schemes, such as those for public servants. The trustee must not only comply with the provisions of the relevant trust deed or other instrument, but is subject to common law principles of trust law. The centre-piece of trust law is the fiduciary obligation to act honestly and in good faith and in the best interests of the members of the scheme. This finds expression in a number of quite specific duties for trustees.[2] Superannuation schemes sometimes employ a professional trustee such as a trust company. In performing its duties a professional trustee is subject to a higher standard of care than a non professional.

> [A] higher duty of care is plainly due from someone like a trust corporation which carries on the specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals . . . Just as, under the law of contract, a professional person possessed of a particular skill is liable for breach of contract if he neglects to use the skill and

1. *Trustee Companies Act 1964* (NSW); *Trustee Companies Act 1968-1984* (Qld); *Trustee Companies Act 1953* (Tas); *Trustee Companies Act 1987* (WA); *Companies (Trustees and Personal Representatives) Act 1981* (NT); *Trustee Companies Act 1984* (Vic); *Trustee Companies Act 1947* (ACT); *Trustee Companies Act 1988* (SA).
2. These are set out in ch 9.

> experience which he professes, so I think that a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.[3]

Trustee companies

5.3. Almost all superannuation schemes to which OSSA applies are trusts. Schemes that fall under the prescribed interest provisions of the Corporations Law often have a trustee company as trustee.[4] Trustee companies operate under State or Territory trustee companies Acts.[5] While these vary from jurisdiction to jurisdiction, they all set out the powers, responsibilities and accountability of trustee companies.[6] The concept of an 'approved trustee' is raised in OSSA only in relation to ADFs.[7] Statutory trustee companies are 'approved trustees' for the purposes of OSSA.[8]

Federal statutes

Income Tax Assessment Act

5.4. A major statute governing the operation of superannuation schemes is the ITAA. It specifies the income tax treatment of contributions to superannuation schemes, of the income of the schemes and of the benefits paid by schemes. Tax concessions are available if certain conditions are met. The Act was amended in 1989 to provide for tax on contributions and investment income, with effect from 1 July 1988. Currently, investment income of a 'complying superannuation fund' (discussed below) is taxed at a rate of only 15%,[9] instead of the

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3. *Bartlett v Barclays Bank Co Ltd* [1980] Ch 515, 534 (Brightman J).
4. These schemes must have a trustee approved by the ASC. They are more likely to appoint a trustee company as trustee.
5. *Trustee Companies Act 1964* (NSW); *Trustee Companies Act 1968-1984* (Qld); *Trustee Companies Act 1953* (Tas); *Trustee Companies Act 1987* (WA); *Companies (Trustees and Personal Representatives) Act 1981* (NT); *Trustee Companies Act 1984* (Vic); *Trustee Companies Act 1947* (ACT); *Trustee Companies Act 1988* (SA). As trustees, trustee companies are also subject to State and Territory Trustee Acts.
6. At the Special Premiers' Conference held in Canberra on 31 May 1991, Heads of Agreement were signed in which it was agreed that a working group on Non-Bank Financial Institutions (NBFIs) would be established to develop proposals for a system of supervision of building societies, credit unions, friendly societies, co-operative housing societies and trustee companies. The working group has established a sub-committee on trustee companies. The sub-committee is expected to report in 1992 on ways to achieve consistency between State and Territory Trustee Companies Acts.
7. See OSSA s 3(1), definition of ADF, which requires that it be a continuing fund maintained by an approved trustee.
8. OSS Regulations reg 19(e).
9. ITAA s 285; *Income Tax Rates Act 1986* (Cth) s 26(1)(a).

maximum tax rate applying to individuals.[10] The specific tax requirements that relate to superannuation are beyond the scope of this report.[11] The importance of tax law is that taxation concessions are the main vehicle for the exercise of Commonwealth power.[12] To obtain a tax concession, most superannuation schemes, ADFs and PSTs (but not deferred annuities) must advise the ATO that a notice stating that the scheme has complied with OSSA and its regulations during the relevant financial year has been received, or is expected to be received, from the ISC. The ISC gives such a notice when a scheme lodges a return containing the required statistical data and summary financial information for the scheme. Deferred annuities are automatically taxed at concessional rates as a specific class of life insurance business.[13]

Occupational Superannuation Standards Act (OSSA)

5.5. ***'Complying funds'.*** OSSA and the OSS Regulations specify a number of operating standards for superannuation schemes, ADFs and PSTs. A scheme must satisfy all standards and conditions imposed by OSSA if it is to qualify as a 'complying fund' for the purposes of the ITAA.

5.6. ***Standards imposed.*** The principal prudential standards imposed by OSSA and the OSS Regulations are

- equal numbers of member and employer representatives on trustee boards of schemes that have 200 or more members[14]
- a prohibition on borrowing by schemes other than for temporary finance for the purpose of paying member benefits (that is, a prohibition on gearing)[15]

10. Non complying funds are taxed at the maximum tax rate applying to individuals: ITAA s 286; *Income Tax Rates Act 1986* (Cth) s 26(2).
11. The Review notes that the Treasurer, Mr Dawkins, indicated recently in a speech to the Conference of Major Superannuation Funds in Wollongong that the simplification of the tax treatment of superannuation, in particular the taxation of lump sum benefits, would be undertaken only after consultation with the industry.
12. See ch 7.
13. ITAA Pt III Div 8.
14. OSS Regulations reg 13, 15. This rule applies to a scheme's management board or committee if it exercises actual control over the policies of the scheme. This regulation is subject to some transitional provisions. Exemptions are granted to personal schemes.
15. OSS Regulations reg 16(1)(b), 16(5).

- a requirement that investments other than investments in the sponsoring employer (so-called in-house assets) must be made at arm's length (that is, they must be made on commercial terms)[16]
- a restriction on investments in in-house assets, to 10% of the historic value of the scheme's total assets[17]
- a requirement that the rights of members to benefits be fully secured and not subject to lien[18]
- a prohibition on a scheme lending money to members[19]
- a requirement that the scheme's accounts be audited once a year by an independent auditor[20]
- in the case of defined benefit schemes, a requirement that actuarial reports be prepared at least once every three years[21]
- requirements for reporting to members when they join a scheme, annually during membership, on termination of membership and on request[22]
- a prohibition on reduction of accrued benefits, other than with the approval either of all members of the scheme or of the ISC.[23]

5.7. *Reporting requirements.* The existing requirements for the provision of information to members of superannuation schemes include the following

- when joining a fund, a written statement containing details of the kinds of benefits provided to members, the conditions relating to those benefits and the method of determining entitlements to members;
- once a year, subject to some variations depending on the type of fund
  - — the amount of benefit vested at the beginning of the year;
  - — the amount of benefit vested at the end of the year;
  - — the method of determining the latter amount;
  - — the amount of vested benefit required to be preserved;
  - — the amount of member contributions;
  - — the amount or rate of net earnings allotted to the member; and
  - — the amount of any current death benefits;

16. OSS Regulations reg 16(1)(c). In-house investments do not include policies of insurance covering employees (in the case where the employer sponsor is a life assurance company) or investments in securities issued by Commonwealth, State or Territory governments or investment in a public authority (where the employer sponsored scheme is a public sector scheme).
17. OSS Regulations reg 16A(17). This regulation is subject to some transitional provisions.
18. OSS Regulations reg 5, 5AB(2).
19. OSS Regulations reg 16(1)(a). This regulation is subject to some transitional provisions.
20. OSS Regulations reg 17(1)(c).
21. OSS Regulations reg 17(1)(a).
22. OSS Regulations reg 17.
23. OSS Regulations reg 17(d)(ii).

- on ceasing membership
  - the amount of benefit entitlements including any amounts which are required;
    to be preserved;
  - the method of determining those entitlements; and
  - except on death, disablement or retirement from the workforce, the information set out in the previous point;
- on request by the member
  - the information required by the standards to be included in any actuarial report;
  - a copy of the auditor's report;
  - a copy of any return to the ISC and any certificates or notices required to be provided under sections 12 and 13 of the OSS Act; and
- where the governing rules of the fund are altered, a statement explaining the nature and purpose of the alteration and effect (if any) on benefit entitlements.[24]

5.8. *Coverage and compliance mechanisms.* OSSA applies to all superannuation schemes constructed as trusts. It also applies to superannuation bonds offered by life insurance companies. Deferred annuities (DAs) do not come under OSSA's definition of 'superannuation fund',[25] although those parts of the Act and Regulations dealing with reasonable benefit limits, preservation and portability apply. The efficacy of OSSA controls depends upon the persuasive force of tax advantages. The only sanction that is available to the regulator in respect of a scheme which fails to comply with one or more of these standards is to disallow the tax concession. There are no civil and criminal sanctions that the regulator can impose on those who contravene the standards.

Life Insurance Act

5.9. *The Act.* The activities of all life insurance offices operating in Australia (other than State Government insurance offices conducting life insurance business within the limits of the State concerned) are governed by the *Life Insurance Act 1945* (Cth).[26] The Act extends to superannuation arrangements

24. OSS Regulations reg 17.
25. See further para 6.5–6.
26. *Life Insurance Act 1945* (Cth) s 4(1). The Act originally did not envisage 'superannuation policies' and was intended to apply to 'ordinary policies' such as whole of life endowment policies. This was amended following the introduction of 'investment linked' policies during the 1960s. The proposition that 'superannuation policies' are a form of life insurance business remains untested, although in *Cutten and Harvey v Sun Alliance Life Insurance Ltd* (1986) 4 ANZ Ins Cases 74461 it was decided that a 'money accumulator bond' was not a life insurance policy.

entered into by life offices that are based upon life insurance products (that is, it applies to life products that are primarily personal superannuation arrangements).[27] The ISC is responsible for administering the Act, subject to directions from the federal Treasurer.[28] The ISC is currently in the final stages of a major review of the Act. This review is focusing upon three main areas

- solvency and capital adequacy requirements for life offices
- the content of financial statements
- enhanced disclosure requirements to current and potential policyholders.

5.10. ***Controls imposed.*** Only a company can carry on a life insurance business.[29] To carry on a life insurance business, a company must be registered with the ISC.[30] Prerequisites for registration[31] include that a company

- has a paid up share capital, or paid up capital and share premium account, of not less than $10 million[32]
- satisfies the ISC that it is likely to be able to meet its obligations and comply with the requirements of the Act
- has at all times eligible assets in excess of liabilities of $5m.[33]

Life companies must lodge financial and statistical returns (including actuarial reports on their financial position) with the ISC at regular intervals. Additional powers of inquiry and investigation are available to the ISC. The formal requirements of the Act are supplemented by actuarial standards and practices, as well as by guidelines issued by the ISC.[34] These require life insurance companies to consider factors such as asset mix and reserve levels against their underlying liability profile and capacity to deal with market, credit and liquidity risks. The Act requires registered companies to establish and maintain one or more statutory funds which are subject to stringent actuarial and financial controls.

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27. The *Life Insurance Act 1945* (Cth) was amended by the *Life Insurance Act 1961* (Cth) s 3 to include specifically superannuation policies: s 4. A large proportion of the superannuation policies issued by life offices are in the form of contracts between the life office and the policy holder. These are subject to the requirements of the *Insurance Contracts Act 1984* (Cth) which imposes (among other things) a 14 day free look period: s 58(2).
28. *Life Insurance Act 1945* (Cth) s 9.
29. *Life Insurance Act 1945* (Cth) s 14.
30. As at 30 June 1991 there were 56 life insurers registered under the Act.
31. Required under the *Life Insurance Act 1945* (Cth) s 19(2).
32. This was raised recently from $2m: *Life Insurance Act 1945* (Cth) s 19. Life companies also have to maintain at all times net assets of $5m: s 19A(5).
33. s 19A(5). An eligible asset is defined as an asset of the company other than an asset invested in a related company: s 4B(1).
34. eg, circulars dealing with investment accounts business and the management of risk exposures.

All the premium income received in respect of superannuation schemes promoted by a life insurance company must be deposited in the company's statutory fund. Assets of these schemes must also be maintained in the statutory funds.[35] The ISC also issues circulars to life companies on particular issues as they arise. These have included guidelines for disclosure in 'promotional brochures' offering superannuation schemes.[36] The returns that life insurance companies furnish to the superannuation group of the ISC to obtain concessional tax certificates are difficult to reconcile with the annual returns they furnish to the life insurance group of the ISC. There is a need to revise these returns so that overlaps and shortfalls can be identified and a reconciliation achieved.[37]

Accounting and actuarial standards

Accounting standards

5.11. During August 1991 the Australian Accounting Research Foundation (AARF) issued an accounting standard which specifically relates to superannuation schemes.[38] The standard applies to superannuation schemes that are 'reporting entities' for reporting periods ending on or after 30 June 1992.[39] The standard deals with three main matters

- the way in which superannuation schemes should account for particular transactions and events
- the format of superannuation scheme financial statements
- information requiring disclosure in the financial report of superannuation schemes.

A feature of the standard is that it requires superannuation schemes to record all assets included in their annual accounts on a net market (selling) value basis. An exposure draft of a further standard affecting superannuation was issued by the AARF during August 1991.[40] The draft proposes specific standards for measuring and disclosing all employee entitlements in employer sponsored or industry superannuation schemes as liabilities in the financial reports of the employers. It also proposes that any excess of defined benefit superannuation scheme assets over employees' accrued entitlements should appear as an asset in the financial

35. *Life Insurance Act 1945* (Cth) s 37, 39(2).
36. ISC circulars 226, 290, 291. These circulars do not have the force of law.
37. See recommendation 10.31.
38. Australian Accounting Standard 25 (AAS25) *Financial Reporting by Superannuation Plans.*
39. Under AAS25 (para 17), a superannuation scheme is a reporting entity where 'Members, or other users with a legitimate interest in financial information about a superannuation plan, may be unable to command the disclosure of financial information specific to their own needs'.
40. Exposure draft 53, *Accounting for employee entitlements.*

statement of the employer sponsor. Conversely, any excess of employees' accrued entitlements over defined benefit superannuation scheme assets should appear as a sponsor liability. Although the accounting standards issued by the AARF are not imposed by statute, they are required to be observed by all members of the accounting profession and will, therefore, be applied to audited superannuation schemes.[41]

Actuarial investigations

5.12. Currently actuarial investigations are required under the OSS Regulations for defined benefit superannuation schemes[42] and under the *Life Insurance Act 1945* (Cth) for superannuation investment schemes offered by life insurance companies.[43] Actuaries assess whether the value of future contributions will be sufficient to cover the long term contingent liability to pay retirement benefits. This involves making assumptions about the value of, for example, future earnings and expenses, expected rates of exit from the scheme, interest rates and asset valuations, expected salary scales, the expected rate of growth and the distribution of new contributions made to the scheme over time. Using these assumptions, the actuary values the cash flow relationship of assets and liabilities over time and makes a recommendation about whether the current level and rate of contributions and benefits need to be adjusted over the next three years (in particular) and for the foreseeable future (in general). Actuarial investigations must comply with the professional standards issued by the Institute of Actuaries of Australia.[44]

41. An 'accounting standard' for life insurance companies has been issued by the ISC: circular 241, March 1986. This standard was developed in conjunction with the former NCSC but has not been accredited by the Australian accounting profession. It does not contain any specific requirements relating to the valuation or disclosure of superannuation schemes administered by life insurance companies. The general asset and liability valuation requirements contained in the circular would appear to be somewhat inconsistent with those contained in AAS25.
42. OSS Regulations reg 17.
43. *Life Insurance Act 1945* (Cth), s 48(1). Such investigations are only required in respect of the 'life insurance business' and not specifically for each superannuation investment product.
44. Professional Standard No 1 covers investigations into the financial condition of a life insurance company. Professional Standard No 2 covers investigations of defined benefit superannuation schemes.

Table 2
Institutional framework affecting Superannuation Schemes

Type of Superannuation Scheme	Type of institutional arrangement: Corporations Law	Life Insurance Act	OSSA	Specific accounting standards	Actuarial investigations	Tax related returns	State-based Trustee Acts
REGULAR CONTRIBUTION SUPERANNUATION SCHEMES							
• Publicly offered	X	X	X	X	X[1]	X	X[3]
• Employer sponsored			X	X	X[2]	X	X
• Industry			X	X		X	X
SINGLE CONTRIBUTION SUPERANNUATION SCHEMES							
• Superannuation schemes	X		X			X	X
• Superannuation bonds		X	X		X[1]	X	
ROLLOVER SCHEMES							
• Approved deposit funds	X		X			X	X
• Deferred annuities		X		X	X[1]	X[4]	
RETIREMENT INCOME SCHEMES							
• Allocated pensions	X					X[5]	X
• Immediate annuities		X			X[1]	X[4]	
SIMPLIFICATION SCHEMES							
• Master funds	X	X	X			X	X
• Pooled super trusts	X		X			X	X
• Fund of fund arrangements		X[6]			X[7]		

1. Only superannuation schemes offered by life companies are subject to actuarial investigation as part of their 'life insurance business'.
2. Actuarial investigations apply only to defined benefit schemes.
3. Trustee companies subject to the various Trustee Companies Acts are often appointed as trustee, but not always.
4. A specific form of return does not have to be prepared for annuities as they are a specific class of life insurance business which is taxed at a concessional rate under Part III Division 8 of ITAA.
5. Allocated pensions are not currently eligible for tax concessions. This is under review by the ISC, the ATO and the Department of Social Security.
6. These cover arrangements under which small superannuation schemes place the contributions they receive into the statutory fund of a life insurance company. They are currently not specifically identified as such in the returns of the company receiving the deposit.
7. These arrangements would be subject to actuarial assessment as part of the insurance company's statutory fund only. They are not subject to specific actuarial assessment.

6. Achieving consistency in regulating superannuation

Introduction

6.1. This chapter considers the differences in the regulation of different types of superannuation schemes and the possible justification for those differences. It examines the validity of applying different solvency, investment, disclosure and reporting requirements to schemes which appear to be conceptually similar. It stresses the importance for the efficiency of the financial system of achieving consistency in regulation of comparable financial services. The question of a single regulator is also considered.

Different regulation

6.2. There are two main reasons why different operating conditions apply to different superannuation schemes. First, because of the different ways that schemes are funded (defined benefit versus defined contribution) and secondly, because they are offered by institutions with different regulatory arrangements, for example, life insurance companies and trusts.[1] These differences mean that some schemes which appear to be conceptually similar are subject to different regulatory regimes and in some cases to quite different requirements. The five most important areas in which there are differences in regulation are:

- solvency requirements
- investment controls
- reporting requirements
- liability
- standards for participants.

These differences are compounded by the fact that the industry is administered by a variety of regulations administered by different agencies.

Solvency

6.3. *Personal schemes.* Life insurance companies are subject to minimum solvency ratio requirements determined by the ISC.[2] This is because their business includes schemes that involve mortality risks, for example, annuity products. Consequently, DAs offered by life companies are offered against a

1. Including employer related schemes.
2. A life insurance company must maintain $10M in capital and have net assets of $5M; see para 5.10.

background of solvency requirements imposed on the offering institution. Life insurance companies are also subject to an actuarial investigation every year. However, the offerors of personal superannuation schemes, PSTs and ADFs that are accumulation schemes providing a lump sum are not subject to any solvency or capital requirements under the Corporations Law or under OSSA. The Review accepts that solvency requirements are unnecessary for these schemes because they do not involve any sort of guarantee or insurance risk.[3]

6.4. *Employer related schemes.* Employer sponsored defined benefit schemes are subject to solvency-like requirements. Like life insurance companies, they are subject to actuarial investigation, but only every three years.[4] However, in the case of a defined benefit superannuation scheme, the actuarial report does not relate to the need to maintain minimum capital requirements. Rather it is designed to ensure that such schemes will have sufficient net cash flows over a period to meet future expected liabilities, as members resign or retire.[5] This difference in approach to the actuarial assessments of life insurance companies and defined benefit schemes is justifiable on the basis that a defined benefit scheme generally does not bear the mortality risk directly. Accordingly, the Review makes no further comment on this.

Investment controls

6.5. *Insurance companies.* Life insurance companies are also subject to investment controls for prudential reasons. However, they are different controls to those imposed by OSSA. The assets of a life insurance company's statutory fund (or funds) may not be invested in a related company (other than a subsidiary)[6] or under a trust scheme[7]. Nor may a life insurance company mortgage or charge any of the assets of any statutory fund otherwise than to secure a bank overdraft.[8] This restriction does not prevent a life insurance company from investing by way of loan to, or deposit with, shares in or debentures of, a bank[9] or by way of loan to, or deposit with, a prescribed dealer in the short term money market.[10] Consequently, superannuation offered through a trust operat-

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3. If a scheme like this did offer an annuity, it would probably be purchased from a life company, not provided by the scheme.
4. OSS Regulations reg 17(1).
5. The mortality risk of such a scheme, that is, the risk that the scheme will become liable for death benefits, is usually underwritten by a life insurance company through the purchase by the scheme of a group life policy.
6. *Life Insurance Act* 1945 (Cth) s 39(2)(a).
7. *Life Insurance Act* 1945 (Cth) s 39(2)(b). Up to 5% of the value of a statutory fund may be invested in trust schemes without breaching this requirement: s 39(4).
8. *Life Insurance Act 1945* (Cth) s 38(3).
9. *Life Insurance Act 1945* (Cth) s 39(3)(a).
10. *Life Insurance Act 1945* (Cth) s 39(3)(b).

ed by a life company and invested in the life company is subject to the investment controls imposed by OSSA (when the funds are invested in the superannuation scheme) and then those prescribed by the *Life Insurance Act 1945* (Cth) (when the funds are in the hands of the life insurance company). DAs, however, are only subject to controls under the *Life Insurance Act 1945* (Cth).

6.6. *Discussion.* To the extent that the personal superannuation schemes offered by life insurance companies compete with those offered by other providers, and DAs compete against ADFs for the same business, it is argued by some that they should be subject to identical controls. It may be argued that, if a life insurance company offers an investment linked superannuation scheme that does not bear mortality risk, there is little point in imposing on such a scheme investment controls designed primarily to apply to statutory funds that do bear such a risk, such as those containing premiums paid in respect of whole of life endowment policies. On the other hand, it is argued that the fact that the provider of a DA may be subject to mortality risk (because the DA may not be commuted to a lump sum) and the provider of an ADF is not (because the ADF is only available as a lump sum), justifies different investment controls. The Review is inclined to accept this justification for what appears to be an anomaly.

6.7. *OSSA.* All superannuation schemes subject to OSSA are also subject to a variety of investment controls imposed for the purpose of prudential supervision.[11] The controls extend to ADFs but not to PSTs, even though both PSTs and ADFs may only accept funds from tax preferred sources. As noted in chapter 3, the need for consistent legislation for like financial services is vital to the efficiency of the financial system. The issue of investment controls, in particular whether the apparent inconsistency means that there is a need for such prudential regulation of PSTs, is dealt with in chapter 11.

Disclosure and reporting requirements

6.8. *Areas of inconsistency.* There are two main areas of inconsistency in the disclosure requirements imposed on superannuation schemes

- inconsistency in disclosure requirements that apply to different personal schemes
- inconsistency in disclosure requirements between personal schemes on the one hand and employer related schemes on the other.

The sources of these inconsistencies and proposals to remove them are discussed below.

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11. These are listed in para 5.6.

6.9. ***Personal schemes.*** The inconsistency in disclosure requirements among personal schemes arises from the different approaches to disclosure taken by the *Life Insurance Act 1945* (Cth) (in relation to superannuation schemes marketed by life insurance companies) and the Corporations Law (in relation to schemes marketed by other corporations). A potential investor in a superannuation scheme covered by the prescribed interest provisions of the Corporations Law must be supplied with a prospectus containing

> all the information that investors and their professional advisers would reasonably expect to find in the prospectus, for the purpose of making an informed assessment of:
> (a) the assets and liabilities, financial position, profits and losses and prospects of the . . . scheme; and
> (b) the rights attaching to the securities; and
> (c) the merits of participating in that . . . scheme and the extent of the risks involved in the participation.[12]

A potential investor in a superannuation scheme marketed by a life company, on the other hand, is not provided with a prospectus. He or she will receive an offer document or 'promotional brochure' which may (but is not required to) adhere to standards determined by the ISC.[13] The Review understands that circulars 290 and 291, developed in consultation with the NCSC, contain a significantly higher standard of disclosure than life insurance companies had previously provided. They follow closely the former requirements for prospectuses under the Companies Code. However, to the extent that the Corporations Law established a new standard for disclosure in prospectuses, this comparability of disclosure requirements no longer exists.

6.10. ***Employer related schemes.*** Employer related schemes are exempt from the disclosure requirements of the Corporations Law.[14] It may be argued that these schemes should not be subject to the same information disclosure requirements as other superannuation schemes because the member often has no choice about being a member of the scheme. On the other hand, members of all superannuation schemes need adequate information to make an informed assessment as to the merits of their participation in the scheme. The Review does not accept that, because employer related schemes are in many cases compulsory and are open only to people who are connected to the particular employer or industry, the members of those schemes are not entitled to the same level of

12. Corporations Law s 1022; Corporations Regulations reg 7.12.12.
13. See ISC circulars 276, 290, 291.
14. Corporations Regulations reg 7.12. 06(c).

disclosure as potential members of personal schemes. However, the Government has announced that employer related schemes will be required to provide members with an annual report or notice containing

> all such information as members of superannuation funds would reasonably require, and reasonably expect to have provided, for the purpose of making an informed judgement as to the financial condition and administrative arrangements of the fund.[15]

The Review understands that this will make the disclosure requirements for employer related schemes virtually identical to those for personal schemes subject to the Corporations Law. The appropriate level of disclosure for superannuation schemes, ADFs, PSTs and DAs and the need for consistency between different offerors of superannuation schemes is discussed at length in chapter 10.

Liability

6.11. The Corporations Law provides criminal, civil and administrative penalties for breaches of its disclosure provisions. It also imposes liability directly on advisers and others who assist in the preparation of prospectuses.[16] Because the ISC guidelines issued to life insurance companies are not binding on them, there appears to be no sanction which can be imposed on a life insurance company that does not conform to the standards contained in circulars issued by the ISC other than perhaps to prosecute a company under the *Trade Practices Act 1974* (Cth) should it not only fail to comply, but also engage in misleading or deceptive conduct.[17] OSSA is also severely lacking when it comes to penalties for breach of its disclosure provisions. There are no criminal or civil penalties available. The removal of a scheme's tax concession is virtually the only means available to the ISC to enforce the disclosure requirements contained in the OSS Regulations. It has been acknowledged for some time that this situation is unsatisfactory. The Treasurer announced that the issue of a better targeted enforcement mechanism would be investigated.[18] This is a major issue for the Review.

Standards for operators

6.12. There are no requirements imposed by the ISC on the trustees of superannuation schemes that are regulated by OSSA. It does, however, impose

15. Treasurer's statement, paper 2 para 9.
16. Corporations Law s 1006.
17. *Trade Practices Act 1974* (Cth) s 52.
18. Treasurer's statement, paper 1 para 22.

controls on the trustees of ADFs.[19] Because ADFs are also prescribed interests, the ASC imposes its own requirements on the trustees of ADFs. PSTs are also prescribed interests and consequently must meet the standard required by the Corporations Law. No standards are imposed on them by OSSA. The Review considers the need for a set of consistent and appropriate standards in chapter 8.

Reconciling the differences

6.13. The Review accepts that solvency requirements are of special relevance to superannuation schemes that provide defined benefits. Differences in solvency requirements may also be justifiable for deferred annuities on the basis that there is a mortality risk attached to the DA. However, there are anomalies in the different regulation of investment controls, reporting requirements, standards for participants and the availability of sanctions which do not appear justifiable on the face of it, having regard to the essentially similar nature of the schemes. The Review makes recommendations throughout this report which aim to eliminate differences which it believes cannot be justified.

Different regulators

6.14. The differences in the regulatory regimes are partly linked to the fact that the legislative regimes governing superannuation schemes are administered by different agencies. The *Life Insurance Act 1945* (Cth), OSSA and OSS Regulations are administered by the ISC, whereas the Corporations Law is administered by the ASC. They have different powers of enforcement. They also have a different approach to financial regulation, derived from the circumstances in which they operate. The ISC is faced with a relatively small number of life insurance companies to regulate. They are represented by a single industry association. In the case of superannuation schemes, on the other hand, there are over 100 000 schemes, ranging in size from one or two members to many thousands of members.[20] They are not represented by a single industry voice. Clearly this must influence the way in which the industry members and the ISC interact. There are also a large number of ADFs and PSTs with whom the ASC and the ISC must deal. The fact that two regulators are involved with ADFs and PSTs also opens up the possibility of inconsistencies and regulatory overlaps. This is an issue that is of some importance for the Review.

19. OSS Regulations reg 19.
20. 87% of superannuation schemes have fewer than 5 members: ISC database for 1987-88.

Achieving consistency

6.15. The recommendations made by the Review in this report are intended to overcome the inconsistencies in these regulatory regimes and to establish appropriate powers for the regulator. The need for consistency in the approach to regulation of superannuation discussed in this chapter also has implications for the role of the regulator. Ideally, all the regulatory powers that are specific to superannuation schemes should be vested in a single regulator. Several submissions have suggested that the Review should recommend that a particular government agency have full responsibility for regulating superannuation schemes.[21] The Review is not disposed to do this. The agency or agencies to regulate superannuation schemes will be determined, ultimately, by Prime Ministerial decision on the allocation of portfolio responsibilities among Ministers. The focus of this report, and of the Review as a whole, is to make recommendations about the appropriate law and regulatory policies to ensure the stability and security of superannuation schemes. The recommendations in the report can be administered by whatever agency or agencies the Government decides should be responsible.[22] Nevertheless, in devising these recommendations, the Review has been guided by its perception of the goals that regulator should pursue. Chief among these should be to enhance their ability to exercise control over the scheme's operations. It will also be important for the regulator to make it clear that it does not regard its role merely as ensuring that schemes comply with the letter of the law. Several of the recommendations in the report are based on the notion that the regulator will be proactive, and act as a watchdog for members of schemes who will, in many cases, even with the enhanced prudential controls, still not be able fully to appreciate or enforce their rights.

21. eg LIFA *Submission* November 1991; IFA *Submission* November 1991; National Mutual *Submission* November 1991.

22. The Review notes that, in a statement on superannuation released with the 1991/92 Budget, the then Treasurer stated that the ISC was to be the 'lead regulator' in superannuation matters: Treasurer's statement, paper 1 para 23. The current Treasurer reaffirmed this in his speech to the conference of Major Superannuation Funds, Wollongong March 1992.

7. The constitutional basis for Commonwealth regulation

Introduction

Scope of chapter

7.1. This chapter deals with the extent of Commonwealth legislative power to impose prudential and other controls on superannuation and related schemes. It considers a number of possible sources of constitutional power for the Commonwealth to regulate superannuation scheme operations. The objective of the discussion is to identify a legislative framework that will allow the Commonwealth to exercise appropriate regulatory control over the kinds of superannuation schemes that are operating and those that may be established in the future.

The present regulatory framework

7.2. *The framework outlined.* The *Occupational Superannuation Standards Act 1987* (Cth) (OSSA) is, together with the *Income Tax Assessment Act 1936* (Cth) (ITAA), the mechanism by which the Commonwealth presently imposes regulatory control on superannuation schemes. Under ITAA the income earned by superannuation scheme trustees in their capacity as trustees is subject to a concessional rate of tax if the Insurance and Superannuation Commissioner (ISC) has certified that the scheme is a complying fund.[1] The certificate will be issued if the trustee applies for one and the ISC is satisfied that the superannuation fund conditions, or the ADF or PST conditions, set out in OSSA and the OSS Regulations have been complied with for the year of income to which the application relates. There is power to give a certificate even if the ISC is not satisfied that the conditions have been met if special circumstances exist that justify the scheme being treated as a complying fund. This power is used extensively.[2]

7.3. *No effective sanctions.* The principal defect of this approach is that trustees who fail to comply with the standards fixed under OSSA are not directly subject to any penalties or sanctions. This means

1. ITAA s 23FC, 23FD; OSSA s 12, 13 for certificates.
2. OSSA s 13. The Review understands from the ISC that approximately 4,000 schemes receive tax concessions each year even though they do not comply.

- the only penalty or sanction that can be imposed for a breach of the standards — the removal of the tax concession — is necessarily imposed on the fund members rather than on the non-complying trustees, as it is the fund members' entitlements, and therefore their retirement income support, that will be reduced if the scheme's income is subject to taxation at normal rates
- the Commonwealth has no effective means to ensure that its policy objectives in relation to superannuation will be met.

7.4. *Need for new enforcement mechanism.* Clearly, a more precise and sophisticated regulatory approach is needed to enable superannuation standards to be enforced directly. The federal Government has announced that it is examining options.[3] The regulator with responsibility for the implementation of Commonwealth policy in relation to superannuation needs power to penalise directly those who fail to comply with their legal obligations, rather than the members whom the regulator is, in the final analysis, working to protect. In DP 50 the Review noted that, apart from the taxation power presently used, the main alternative sources of constitutional power for the Commonwealth to legislate to regulate superannuation are

- the trade and commerce power
- the corporations power
- the pensions power.

In addition, there are a number of other relevant powers: the banking power, the insurance power, the power to make laws with respect to bankruptcy and insolvency and the Commonwealth's power in relation to its own employees and agencies and for the Territories.[4]

Sources of Commonwealth power to legislate to regulate superannuation

The taxation power

7.5. There is no doubt that the Commonwealth's use of the taxation power to regulate superannuation through the imposition of standards is constitutionally valid.[5] A law imposing a liability for taxation can properly make the application of that law depend on whether the taxpayer has complied with standards set out or determined by reference to that law. However, if the tax law is used to

3. Treasurer's statement, paper 1 para 22.
4. DP 50 para 1.5, 1.6.
5. Constitution s 51(ii): see *Fairfax v Federal Commissioner of Taxation* (1965) 114 CLR 1.

encourage compliance with standards, as it is with superannuation, failure to comply will usually mean that there is a liability to pay tax. This encouragement to comply voluntarily is not a satisfactory way to achieve the objectives underlying the standards.

The 'trade and commerce' power

7.6. The Constitution s 51(i) authorises the Parliament to make laws with respect to

> (i) Trade and commerce with other countries, and among the States:

The superannuation industry is a national industry. Some superannuation schemes are constructed so as to engage in trade or commerce across State lines. They could be regulated by legislation under this head of power. However, the question whether individual schemes can be subject to federal regulation based on this power will have to be answered separately for each scheme. It cannot be answered on a superannuation industry wide basis. Many schemes, particularly employer sponsored schemes where the employer does not operate outside his or her home State, could not validly be the subject of federal law based on this power. The Review has concluded that the range of superannuation schemes which could validly be covered by a law based on this power would not be adequate to ensure that the Commonwealth's policy objectives for the regulation of superannuation would be met.

The corporations power

7.7. *Scope of corporations power.* The Constitution s 51(xx) provides that Parliament has the power to make laws with respect to

> (xx) Foreign corporations, and trading and financial corporations formed within the limits of the Commonwealth:

This power has recently been held by the High Court not to extend to authorising the Parliament to make a law with respect to the formation or incorporation of corporations. It is a power that can be exercised only in respect of trading or financial corporations or foreign corporations that have already been formed.[6]

6. The Full High Court has held that the word 'formed' is a 'past participle used adjectivally', thus precluding the Commonwealth from legislating with respect to the formation or incorporation of companies in Australia except in the Territories: *New South Wales v the Commonwealth* (1989) 90 ALR 355, 358.

7.8. ***The national scheme for corporate regulation.*** The effect of this *lacuna* has been overcome, in relation to corporate regulation generally, by agreement between State and Territory Ministers, and the federal Attorney-General, in June 1990. Under the arrangement, the administration and policy control of corporate regulation rests primarily with the Commonwealth, although amendments must be negotiated with the States and the Northern Territory. The federal Parliament has legislated exhaustively in respect of all matters of corporate regulation, including incorporation, for the ACT.[7] Each State and the Northern Territory, under the agreement, has enacted legislation that applies the federally made law in its own jurisdiction. Amendments are enacted by the Commonwealth and take effect as a result of these State and Territory application laws. A uniform corporations law therefore applies, but as a law of each jurisdiction. The Constitutional restrictions on Commonwealth legislative power imposed by the High Court's analysis of s 51(xx) have thus been overcome in practical terms.

7.9. ***Assessment of the power.*** The corporations power is not adequate to allow the Commonwealth to legislate comprehensively to regulate superannuation. Principally, it does not authorise the Parliament to make a law requiring persons who run superannuation schemes to assume a corporate form. Some federal laws make it an offence to trade in particular industries otherwise than in corporate form; for example, only bodies corporate can carry on insurance business[8] or banking business. These laws have their constitutional basis, however, not in the power to legislate with respect to trading or financial corporations,[9] but in the powers to legislate with respect to banking and insurance.[10] A corporation that conducts a superannuation scheme either as the whole or as a part of its operation would fall within the description of a trading or financial corporation. Accordingly, Commonwealth legislation could validly regulate the activities of such a corporation in relation to superannuation, at least so far as those activities were trading or financial activities.

7.10. ***Implications for superannuation regulation.*** While the Commonwealth could exercise policy control over the activities of corporate superannuation trustees, either through promoting amendments to the Corporations Law, or through legislating in its own right so far as the trustee body corporate is a trading or financial corporation, the Review has concluded that reliance on the corporations power will not be able to achieve fully the Commonwealth's policy objectives in this area.

7. Under the Constitution the Territories power, s 122, is not affected by the restrictions that apply in respect of s 51(xx).
8. The sole exception being for Lloyds.
9. Which the bodies corporate undoubtedly are.
10. Constitution s 51(xiii), (xiv).

The pensions power

7.11. ***The pensions and social security powers.*** The Constitution s 51(xxiii) and (xxiiiA) provide that the Parliament has power to make laws with respect to

> (xxiii) Invalid and old-age pensions;
> (xxiiiA) The provision of maternity allowances, widows' pensions, child endowment, unemployment, pharmaceutical, sickness and hospital benefits, medical and dental service (but not so as to authorise any form of civil conscription), benefits to students and family allowances;

A number of submissions suggested that s 51(xxiii) in particular could be an appropriate constitutional basis for Commonwealth legislative intervention.[11]

7.12. ***Social security power.*** Section 51(xxiiiA) has been held by the High Court to be limited to authorising legislation that relates to a provision of benefits including widows' pensions by the Commonwealth. It does not extend to authorising federal legislation with respect to the provision of pensions by private employers or bodies.[12]

7.13. ***Pension power.*** Section 51(xxiii) would probably support legislation regulating old-age and invalid pensions provided by bodies other than the Commonwealth, in particular by private employers to their employees, or by life insurance companies and fund managers who promote personal superannuation schemes. There are, however, a number of problems associated with the use of s 51(xxiii). First, the meaning of the expression 'old-age pensions' is not clear. A law that made provision with respect to the operation of schemes that provide pensions to people who reach an age beyond which the community would not generally expect persons to continue to have to work in the paid workforce would probably be supported by the power.[13] At the present time this would probably equate to 60 or 65 years. But the question is not free from doubt. A more serious problem is whether the power would authorise the regulation of schemes other than those which provide for the payment of a pension or annuity. Many schemes provide for lump sums or allow pensions or annuities to be commuted, in whole or in part. Unless the High Court were to take a broad approach that regarded the distinction between capital and income as no longer relevant, schemes that provided only for the payment of a lump sum, or which

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11. eg LIFA *Submission* March 1992; ASFA *Submission* March 1992; cf P Burke *Submission* February 1992.
12. *Federal Council of the British Medical Association in Australia v the Commonwealth* (1949) 79 CLR 201.
13. See eg Quick & Garran, *Annotated Constitution of the Commonwealth* 613.

allowed unrestricted commutation of a pension, might fall outside the power.[14] This may depend, in the long run, on whether the primary purpose of the scheme was the provision of an old-age pension[15] and whether the terms on which lump sums were paid or commutation was permitted were incidental to and consistent with that purpose. For example, there might be provision to pay a lump sum to dependants in case of death before or after retirement, or to discharge housing loans which otherwise might be paid from the retirement income. While the direct regulation of lump sums might fall outside the power, the schemes could still be regulated in so far as they provide for pensions.

7.14. *Conclusion.* Until the matter is settled it would be wise to regard s 51(xxiii) as authorising legislation only with respect to schemes the primary purpose of which is to provide old-age pensions and which provide for the payment of lump sums only where that is incidental to the main purpose. The Review has concluded that, given the extent to which superannuation schemes provide for benefits to be taken in the form of lump sums — though there are taxation incentives to convert these lump sums into pensions — the Constitution s 51(xxiii) would not support an adequate level of regulation of superannuation funds. Some other legislative basis must be found.

Other legislative powers

7.15. *The insurance and banking powers.* The Constitution s 51(xiii) and (xiv) provide that the Parliament has power to make laws with respect to

> (xiii) Banking, other than State banking; also State banking extending beyond the limits of the State concerned, the incorporation of banks, and the issue of paper money;
>
> (xiv) Insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned;

While these powers might seem to offer some potential for the achievement of Commonwealth policy, there are significant difficulties.

- *Exclusion of State activity.* The powers expressly exclude State banking and insurance not extending beyond the limits of the State concerned. This poses difficulties for the regulation, within the overall framework, of State superannuation schemes, that is, schemes established by State governments for their employees and officers.

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14. There is authority, in a different context, for the view that a lump sum representing the commutation of a pension is not a pension, for the purpose of a law which made the pension inalienable: *Crowe v Price* (1889) 22 QBD 429 (CA).
15. Or an invalid pension.

- ***Superannuation not necessarily banking.*** The banking power is a power with respect to banking, not banks. Superannuation provided by or through banks would not necessarily be caught by the power because there are certain aspects of the provision of superannuation which fall outside banking. It would not be possible to legislate comprehensively.[16]

- ***Superannuation not always insurance.*** The insurance power has some associations with the provision of superannuation benefits. As chapter 2 indicates, life insurance companies are major providers of superannuation and superannuation has certain features that are similar to insurance. The Review is satisfied, however, that, for constitutional purposes, superannuation cannot be completely equated with insurance.

It is therefore not possible to rely on either the banking or the insurance power to support comprehensive federal legislation regulating superannuation.

7.16. ***Bankruptcy and insolvency powers.*** The Constitution s 51(xvii) authorises the Parliament to make laws with respect to

> (xvii) Bankruptcy and insolvency;

Minimising the risk that superannuation schemes will be bankrupt or insolvent will be a key policy objective. However, it is not the only objective. Nor does the Review consider that the power extends to authorise all of the prudential controls that policy would demand. Many of these will be designed, not so much to prevent insolvency, as to secure the financial health of the scheme.

7.17. ***The Commonwealth's power in relation to its own employees and agencies and the Territories.*** The Commonwealth has complete legislative power in respect of its own public service. Under this and related powers the Commonwealth can and does establish superannuation schemes for its own employees and for employees and officers of federal agencies.[17] The power does not, however, extend beyond superannuation for employees or officers of the Commonwealth. The Commonwealth also has power to make laws with

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16. The Review understands that there is a proposal for banks to offer income retirement accounts which would have the effect of preserving money deposited in the fund in the same way as superannuation money is preserved.
17. Constitution s 52(ii) eg *Superannuation Act 1976* (Cth), *Judges' Pensions Act 1968* (Cth); *Parliamentary Contributory Superannuation Act 1948* (Cth).

respect to the Territories.[18] While this power would support federal legislation regulating the activities of superannuation schemes that have sufficient nexus with a Territory, the power would not support national legislation.

The recommended approach

No single comprehensive power

7.18. The objective is to identify an appropriate constitutional basis for the Commonwealth to legislate fully and effectively for the achievement of its policy goals in relation to superannuation. Furthermore, it should be able to do so in a way which is more flexible than the present reliance on taxation incentives alone.

Tax incentives necessary

7.19. No Commonwealth legislative power taken alone or in combination with other powers, will completely cover the areas for which provision needs to be made. Complete coverage would be achieved only if all superannuation providers were trading or financial corporations or if all superannuation was provided in the form of old-age pensions. Commonwealth power over superannuation provided in those ways is undoubted. There is no way to compel superannuation schemes to incorporate or to provide pensions. Tax incentives are the only practicable means to induce scheme operators to arrange their schemes so as to fall within Commonwealth legislative power. The only exception should be in respect of schemes that have a single member.

Recommendation

7.20. Accordingly, the Review recommends that tax incentives remain an essential element in the regulatory scheme and that Commonwealth income taxation concessions should only be granted to schemes that bring themselves clearly within Commonwealth legislative power. In order to attract such concessions, the trustee for such a scheme should have to have been, during the relevant year of income, a foreign corporation or a trading or financial corporation formed within the limits of the Commonwealth. Alternatively, the substantial or dominant purpose of the scheme should be to offer old-age pensions. Schemes which do not meet either of these conditions should only attract taxation concessions if, during the relevant year of income, they had no more than one contributing member and fulfilled all the other conditions currently, or about to be, imposed on superannuation schemes.

18. Constitution s 122.

Recommendation 7.1. Constitutional framework

The law should provide that the conditions under which a superannuation fund an ADF or a PST attract taxation concessions include a condition that, at all times during the relevant year of income, there was a responsible entity for the fund, ADF or PST and that:

- **the responsible entity was a foreign corporation within the meaning of the Constitution s 51(xx) or a trading or financial corporation within the meaning of that paragraph or**
- **in the case of a superannuation fund, the substantial or dominant purpose of the fund was to provide old-age pensions within the meaning of the Constitution s 51(xiii).**

Consequences

7.21. The recommended approach will require significant changes to the regulatory framework, in particular OSSA and the OSS Regulations. In some cases the appropriate sanction will be the removal of the taxation concession, as is presently the case. In other cases, a contravention should amount to an offence. Again, a contravention could make the trustees of the fund liable in damages to the members of the fund who suffered a loss thereby. Each recommendation in this report indicates what sanction should be imposed for contravention of the recommended rule.

8. Regulating the players: standards for operators

Introduction

8.1. The success of the Commonwealth's retirement incomes policy depends to a large degree on the quality and integrity of the participants in the industry. This chapter identifies the major participants in the superannuation industry and makes recommendations about the standards that ought to be required for their entry into, and continued presence in, the industry.

The responsible entity

The concept of a responsible entity

8.2. *Current confusion.* For all collective investments it is important for investors to know who is legally responsible for the management of their money and who will be held accountable if something goes wrong. Superannuation is no exception. In single employer sponsored and industry superannuation schemes it is clear that the trustee is the party responsible for the operation of the scheme. Identifying the responsible party in other cases, such as personal superannuation schemes and ADFs, is not, however, always so simple. These schemes are in many ways similar to other collective investments, such as unit trusts, in which the distinction between the duties owed by the trustee and those owed by the manager are not clearly understood by investors (nor, it seems in some instances, by trustees and managers). Invariably the manager promotes the scheme and plays a predominant role in investors' dealings with the scheme. The existence of the trustee and the identification of its role and responsibilities is more a background matter. Consequently, if a loss is suffered, it can sometimes be unclear which party is directly responsible to the investor or scheme member. This uncertainty about roles and responsibility can, and does, lead to mutual finger pointing by trustees and managers.

8.3. *Identifying the responsible party.* The party which bears primary responsibility to the investor, or member of a collective investment, should be able to be easily identified in all circumstances. This would be made easier if that party was referred to as the responsible entity. The responsible entity will be the party in control of the collective investment. In the case of superannuation, it will bear direct responsibility to members and take on the duties and obligations which this report proposes. In many cases, for example, single employer sponsored and industry superannuation schemes, the responsible entity will clearly be the trustee. In personal superannuation schemes, however, the responsible entity could be either the current manager or promoter, or the trustee: the identity of the responsible entity will have to be made clear. The manager/promoter could take on the role of responsible entity and the duties and obligations that accompany that role. If that happened there would be no need for an independent trustee. The responsible entity would effectively be the trustee and would undertake the ultimate responsibility. Alternatively, the current manager may decide that the duties of a responsible entity are too onerous and that it will become merely a hired investment manager. Another party, adequately remunerated, will have to be the responsible entity and take ultimate responsibility for the scheme. Focusing attention on the responsible entity will clarify the issue of accountability, thereby empowering investors and providing a more effective framework for all parties to fulfil their responsibilities. Whoever the responsible entity of the scheme is, it should have obligations of the same kind as a trustee owes to beneficiaries.[1] These obligations should be owed to non-contributing members, such as pensioners, as well as contributing members. In DP 50 the Review proposed that the party which bears direct and ultimate responsibility to investors in any collective investment, including members of a superannuation scheme, should be clearly identified and referred to as the responsible entity.[2] This proposal received a great deal of support in consultations and submissions.[3] Accordingly, the Review recommends that a deed or other document constituting a superannuation scheme should be required to identify the responsible entity for the scheme.

Recommendation 8.1: Appointment of responsible entity

The law should provide that the conditions under which a superannuation fund, an ADF or a PST attracts a tax concession include a condition that the deed or other instrument establishing the fund, ADF or PST must appoint a person as the responsible entity for the fund, ADF or PST.

Recommendation 8.2: Acceptance of appointment by responsible entity

The appointment (including an appointment by election) of a person as responsible entity, or as a member of the board of

1. See further ch 9.
2. DP 50 proposal 5.1. In some employer sponsored and industry schemes, a board or committee of management controls the policies of a scheme. There may, in addition to that controlling board or committee, be a trustee. In that case the trustee will be a mere custodian. The board or committee of management (the responsible entity) will be required to have equal employer and employee representation, not the custodian.
3. eg ASFA *Submission* March 1992; ISC *Submission* March 1992; Australian Federation of Consumer Organisations *Submission* February 1992; ASC *Submission* March 1992.

management of a responsible entity, for a superannuation fund, ADF or PST should not be effective unless the person concerned accepts it in writing.

Custody of assets

8.4. The Review has given considerable thought to the question who should hold the assets of a superannuation scheme and whether an independent custodian ought to be required. In the context of employer related schemes, an independent custodian means independent of the employer(s). For schemes that have member representatives on the responsible entity, and whose assets are held by the responsible entity, not the employer, an independent trustee is, effectively, already in existence. Smaller schemes may have one or more trustee appointed by agreement between the employer and employees.[4] To the extent that member involvement in such 'agreements' is exercised freely, the trustee can be said to be independent of the employer. For responsible entities of personal schemes that are not related to an employer or industry, the Review is of the opinion that there is less potential for a conflict of interests. The trustee-like duties and obligations to which the responsible entity is subject and the responsible entity's interest in the commercial success of the venture will be sufficient to protect the assets of the scheme. A custodian independent of the responsible entity is not required. The funds of the scheme must, however, be held separately from any other funds the responsible entity may have as a result of other business it conducts.

Standards for responsible entities of superannuation schemes

Introduction

8.5. Responsible entities are responsible for administering and investing the assets of superannuation schemes, either directly or through an external administrator or investment manager. If they fail to perform their function efficiently, honestly and fairly, members are likely to suffer loss or be otherwise disadvantaged. Responsible entities should, therefore, be subject to appropriate entry requirements.

Pre-vetting of responsible entities

8.6. *Current controls on superannuation schemes.* OSSA imposes no restrictions on who may be appointed trustee of complying single employer sponsored or industry superannuation schemes, although they do prescribe the compo-

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4. OSS Regulations reg 15.

sition of the trustee boards of those schemes.[5] It does, however, place restrictions on who may act as the trustee of a complying ADF. Trustees of ADFs must be one of the following[6]

- a life assurance company
- a bank
- a corporation to which the *Financial Corporations Act 1974* (Cth) s 8(1)(a) or (b) applies[7]
- a trade union
- a friendly society
- a corporation authorised by or under a law of a State or Territory to act as an executor, administrator and trustee
- the Bank of New South Wales Nominees Pty Ltd.

Superannuation schemes that fall within the definition of prescribed interest under the Corporations Law, that is, principally personal superannuation schemes and ADFs, are required to have trustees approved by the ASC.[8] The ASC requires trustees to be independent of the management company and to have the ability and resources to perform the duties required of it under the deed.[9]

8.7. *Proposal.* In DP 50 the Review proposed that the approval by the ASC of trustees of superannuation schemes that are prescribed interests should continue but that there be no additional requirements or pre-vetting imposed.[10] It also proposed that, for several reasons, including the considerable resources that would be required, the ability of members to participate in the operation of their scheme through member representation[11] and the possible industrial difficulties of pre-vetting member representatives, responsible entities of single employ-

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5. Principally by prescribing the minimum number of employee representatives on the board of trustees or, if a corporate trustee is appointed, on the board of that company: OSS Regulations reg 13.
6. OSS Regulations reg 19.
7. These are foreign corporations, trading corporations formed within the limits of Australia or financial corporations whose sole or principal activities, in Australia, are the borrowing of money and the provision of finance and whose value of debts due to it, resulting from the provision of finance, exceeds 50% of the value of all assets of the corporation in Australia.
8. A deed is not an approved deed unless the trustee appointed under its deed has been approved: Corporations Law s 1066(b).
9. The procedure for approval by the ASC as trustee of a prescribed interest scheme was established by the ASC's predecessor, the NCSC, and is set out in Release 126.
10. DP 50 para 5.8.
11. Those with over 200 members. The Review recommends this be reduced to schemes with more than 50 members: see recommendation 12.4.

er sponsored and industry schemes should not be required to be approved by a government agency before being established.[12] Trustees of those superannuation schemes would continue to be exempt from approval by the ASC.[13]

8.8. *Response.* Submissions tended to support this proposal.[14]

> We consider that any pre-vetting of trustees in addition to that already required under the Corporations Law in respect of prescribed interests or the *Life Insurance Act* would be unnecessary and have unacceptable resource implications.[15]

The Review remains of the view that the pre-vetting of responsible entities of superannuation schemes would be too great a resource burden on the regulator for the benefit that would be achieved. Accordingly, it recommends that the responsible entities of single employer sponsored and industry schemes not have to be pre-vetted before being established. The pre-vetting by the ASC of trustees of schemes that are prescribed interests (effectively the personal schemes and ADFs) should continue so as to maintain consistency between investments that are offered to investors independently of their specific employment. Also, members of those schemes do not usually have the opportunity to become intimately involved in the administration of their scheme (by way of member representation on the responsible entity) so a preliminary approval by the ASC is even more appropriate. Any additional screening or pre-vetting by the regulator is, however, in the Review's opinion, not warranted.

Are larger schemes different?

8.9. *Pre-vetting for competence.* It was suggested in consultations that responsible entities of some of the larger single employer sponsored and industry schemes should be pre-vetted by the regulator, not merely for likelihood of breaching the law, but more comprehensively, for example, for competence to carry out the role of responsible entity. The suggestion is that the regulator should take into account the financial resources of the responsible entity, the qualifications and experience of it and its staff and its management and administrative capabilities and determine whether the responsible entity can carry out its duties efficiently, honestly and fairly. Such pre-vetting would be required if those larger schemes were removed from the definitions of 'excluded offer' and 'excluded issue' and were thereby made subject to the requirements imposed on prescribed interests under the Corporations Law. The

12. DP 50 proposal 5.3.
13. Corporations Regulations reg 7.12.05, 7.12.06.
14. Trust Company of Australia Limited *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992; ACTU *Submission* February 1992.
15. ISC *Submission* March 1992.

Review acknowledges the importance of ensuring that responsible entities are suitable. However, given the requirement for member representation, it is not convinced that approval by the ASC under the Corporations Law of responsible entities of employer related schemes is either realistic or necessary.

8.10. *Recommendation.* The Review recommends, therefore, that there be no approval by the regulator required for responsible entities of employer related superannuation schemes before they commence operation. Responsible entities of schemes subject to the Corporations Law should, however, continue to be approved by the ASC, on the same grounds as at present. There should be no additional pre-vetting of those schemes by the regulator.[16]

> **Recommendation 8.3: Pre-vetting of responsible entities**
> **There should be no change to the law to require any further pre-vetting of responsible entities for superannuation funds, ADFs or PSTs or for the providers of DAs.**

Prohibition against acting as a responsible entity

8.11. *Need for a barrier.* The Review does not recommend pre-vetting by the regulator for responsible entities of superannuation schemes.[17] It is important, therefore, that there be conditions imposed making certain individuals and corporations ineligible to act as responsible entities. A breach of the conditions should result in immediate disqualification. DP 50 contained proposals for the prohibition of certain corporations and individuals from acting as responsible entities.[18] The proposals included factors such as being an undischarged bankrupt, having a receiver appointed and being convicted within the previous 10 years of an offence involving dishonesty.

8.12. *Submissions.* Submissions generally supported the Review's proposals.[19] The ASC suggested that a corporation should be prohibited from acting as a responsible entity if a receiver has been appointed to *any* of its assets. The Review agrees. The importance of trying to ensure the safety of superannuation funds justifies this strict restriction.

16. The Review recommends that the regulator should be able to suspend a member or director of a responsible entity of any superannuation scheme or replace a responsible entity with a temporary responsible entity: see recommendation 13.12.
17. Beyond whatever pre-vetting may be required under another law, such as the Corporations Law.
18. DP 50 proposals 5.5, 5.6.
19. Jacques Martin Industry *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992.

8.13. *Recommendation.* The Review recommends that a body corporate should be unsuitable to act as a responsible entity in a number of circumstances. The first is that it is externally administered, as defined in the Corporations Law. This covers a body corporate that is being wound up or is under official management and a body corporate that has property to which a receiver has been appointed.[20] The second is that it, or one of its responsible officers,[21] has been convicted of serious fraud.[22] Although some submissions suggested otherwise,[23] the Review takes the view that offences are not relevant to a person's suitability to care for the funds of a superannuation scheme unless they are offences of dishonesty. The third case is that the entity, or one of its responsible officers, has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty. The final case is that one of its responsible officers is an insolvent under administration.[24] An individual should be ineligible to act as a responsible entity for a superannuation scheme or as a member, or director, of the board of management of a responsible entity if he or she is an insolvent under administration, has been convicted of serious fraud or has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.

Recommendation 8.4: What are bodies, and who are persons, unsuitable to act as responsible entity

1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as the responsible entity for a superannuation fund, an ADF or a PST if

- **it is an externally administered body corporate as defined in the Corporations Law or**
- **it, or one of its responsible officers as defined in the Corporations Law**
    - **has been convicted of serious fraud as defined in the Corporations Law**
    - **has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or**
- **one of its officers is an insolvent under administration.**

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20. Corporations Law s 9.
21. Directors or persons who have control or substantial control of the body corporate.
22. As defined in the Corporations Law, serious fraud includes an offence involving dishonesty that is punishable by imprisonment for a period of at least three months: s 9. If a body corporate is convicted of serious fraud the *Crimes Act 1914* (Cth) s 4B(2),(3) provides a mechanism for the conversion of a prior sentence to a pecuniary penalty.
23. eg J Aitken *Submission* February 1992; Trustee Companies Association of Australia *Submission* February 1992.
24. As defined in the Corporations Law s 9.

2. The law should provide that an individual is not suitable to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST if he or she
- **is an insolvent under administration as defined in the Corporations Law or**
- **has been convicted of serious fraud as defined in the Corporations Law or**
- **has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.**

8.14. *Spent convictions.* The Review recommends, in relation to an individual or a body corporate being unsuitable to act as a responsible entity because of a conviction of serious fraud, that convictions that have become spent under the *Crimes Act 1914* (Cth) should, subject to one exception, not be counted. In most cases, a conviction is spent after 10 years have passed since the date of the conviction, provided the person was not sentenced to imprisonment or was sentenced to imprisonment for the offence for no more than two and a half years.[25] The regulator should, however, be able to apply to a court for a declaration that, despite a person's conviction being spent, he or she is unsuitable to act as a responsible entity or as a member or director of a responsible entity on the ground of the conviction. If the court forms the view that it is in the interest of the safety of the funds of a superannuation scheme that the person be declared unsuitable to act as a responsible entity or as a member or director of a responsible entity, it should declare that person unsuitable to so act. This view has been adopted because the Review sees the safety of the funds as paramount. In any event, being declared unsuitable to act as a responsible entity will not result in the loss of a person's livelihood.

Recommendation 8.5: Spent convictions

The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of recommendation 8.4. The court should not be able to make such an order unless it is satisfied that

25. If the person was dealt with as a minor the conviction is spent after five years: *Crimes Act 1914* (Cth) s 85ZM.

- **the person is or proposes to become the responsible entity, or a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST and**
- **it is necessary to make the order to protect the interests of the members of the scheme.**

Enforcement of suitability requirements

8.15. *Appointment to be void.* The appointment of an individual or a body corporate as a responsible entity, or as a member or director of a responsible entity whilst unsuitable, should be void. The regulator should be able to appoint a temporary responsible entity (if the whole responsible entity is unsuitable to act) to act until either a new responsible entity is appointed or the scheme is wound up. The aim of specifying conditions for unsuitability to act as a responsible entity or as a member or director is to try to prevent such individuals or corporations from becoming responsible entities. An action done by an unsuitable responsible entity is, nevertheless, not to be invalid or ineffective on that ground alone.[26]

8.16. *Becoming unsuitable.* If, however, a body corporate or an individual becomes unsuitable whilst acting as a responsible entity or as a member or director of a responsible entity, the appointment should terminate immediately and the matter reported to the responsible entity and to the regulator. As in the situation above, the regulator should be able to appoint a temporary responsible entity if necessary.

8.17. *Offence created.* Acting as a responsible entity or as a member or director of a responsible entity whilst unsuitable should be an offence for an individual and for a body corporate.

Recommendation 8.6: Persons etc. not to act as responsible entity while unsuitable

1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

26. See recommendation 8.18.

3. The law should provide that a purported appointment of an unsuitable body corporate or an unsuitable person as a responsible entity for a superannuation fund, an ADF or a PST, or of an unsuitable person as a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST, is of no effect.

4. The law should provide that, if a responsible entity, or a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or an unsuitable person
- **the matter must be reported to the regulator without delay — the body corporate or person commits an offence if the matter is not so reported and**
- **the body corporate's or person's appointment as responsible entity, or as member of the board of management of a responsible entity, thereupon ceases.**

8.18. ***Individuals to make written declaration.*** It is obviously better to try to prevent unsuitable individuals from acting than to have to remove them after they have commenced to act. Thus there needs to be a mechanism to make it more difficult for unsuitable individuals to be appointed to, or elected as responsible entities or as members or directors of responsible entities. Accordingly, the Review recommends that an individual who stands for election, or offers himself or herself for appointment, for such positions should be required to declare in writing that he or she is not unsuitable. Failure to make a declaration should disqualify a person from standing. Making a false declaration should be an offence. If an election is being held, declarations should be given to the returning officer; if appointments are being made, declarations must be given to the persons making the appointment. This requirement will considerably lessen the possibility of an unsuitable person becoming a responsible entity, or member or director of a responsible entity.

Recommendation 8.7: Declaration as to suitability

1. The law should provide that it is an offence for a person to offer himself or herself for appointment or election as the responsible entity, or as a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST without first making a written declaration stating that he or she is not an unsuitable person. The declaration is to be given to
- **in the case of an election — the returning officer for the election**
- **in the case of an appointment — the person making the appointment.**

2. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to offer itself for appointment or election as the responsible entity for a superannuation fund, an ADF or a PST unless it, and each of the members of its board of management, have made written declarations stating that it, he or she is not unsuitable. The declarations are to be given to

- **in the case of an election — the returning officer for the election**
- **in the case of an appointment — the person making the appointment.**

3. It should be an offence knowingly to make a false declaration.

Training in the duties of responsible entities

8.19. *The need for training.* It is essential that members and directors of responsible entities are aware of their responsibilities and duties. However, no specific qualifications are prescribed for the approval of trustees of superannuation schemes that are subject to the Corporations Law. Nor are qualifications prescribed for schemes that do not come within the Corporations Law. The Review is conscious of the difficulties which may arise in filling positions on the board of the responsible entity if educational qualifications were prescribed by law. However, given the importance and complexity of the role of responsible entity, it seems reasonable to suggest that all responsible entities (if individuals) and all members and directors of responsible entities, whether representing members or employers, complete some form of training. Training courses designed specifically for trustees are available and more are being developed.[27]

8.20. *Proposal to encourage training.* In DP 50 the Review proposed that all individuals who are responsible entities, or members or directors of responsible entities, should be encouraged to undertake training in their responsibilities and obligations.[28] It also noted the view that the importance of this role is such that training should be compulsory. All submissions that commented on this issue indicate support for training.[29] Several submissions favour mandatory training.[30] The majority of submissions, however, whilst agreeing that it is most important that responsible entities be aware of their duties and responsibilities,

27. Organisations which currently offer trustee training courses include ASFA and TCA.
28. DP 50 proposal 5.9.
29. eg ISC *Submission* March 1992; TCA *Submission* February 1992.
30. eg ASC *Submission* March 1992; LIFA *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992.

do not favour mandatory training.[31] In chapter 9, the Review recommends that the principal duties and responsibilities of responsible entities should be clarified. This will make the task of learning to be a responsible entity easier. In the light of that, and the submissions favouring mere encouragement of training, the Review recommends that members of responsible entities be strongly encouraged, by both industry organisations and the government, to undertake appropriate training.

Standards for investment managers of superannuation funds

Introduction

8.21. The integrity and security of the superannuation industry will continue to depend significantly on the quality and integrity of investment managers used by superannuation schemes. The Government has indicated that it is considering measures to control entry to the superannuation industry.[32] For the Review, the relevant question is what disqualifying factors should apply and whether there should be conditions of entry.

Prohibitions against acting: disqualifying factors[33]

8.22. ***The proposals.*** As is the case with responsible entities, there are certain corporations that should not be permitted to act or offer to act as the manager of funds belonging to a superannuation scheme. DP 50 proposed that they be those to which a receiver has been appointed, which are in liquidation and which have been convicted of dishonesty offences in the past 10 years.[34] The Review proposed that the regulator should be able to take direct action to stop a corporation with any of those characteristics from acting or continuing to act as an investment manager for a superannuation scheme. Unincorporated investment managers should be subject to similar barriers to acting or offering to act as the manager of funds belonging to a superannuation scheme. In DP 50 the

31. eg ASFA *Submission* March 1992; ACTU *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Limited *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; Shell Australia Limited *Submission* February 1992.
32. Treasurer's statement, paper 1 para 31.
33. For the grounds on which the regulator should be able to remove an investment manager (as distinct from becoming unsuitable to act) see recommendation 13.13.
34. DP 50 proposal 5.11.

Review proposed that individuals who are undischarged bankrupts or who have been convicted of a serious offence involving dishonesty in the past 10 years should be disqualified from offering to act or continuing to act as an investment manager for a superannuation scheme.[35]

8.23. ***Submissions and comment.*** Widespread support was received for these proposals.[36] Some modifications were suggested to bring this proposal into line with the Corporations Law.[37]

8.24. ***Recommendation.*** The Review does not recommend that investment managers be subject to any pre-vetting in addition to the vetting that they may be subject to in relation to their actually dealing with funds.[38] The Review recommends that a body corporate be unsuitable to act as an investment manager for a superannuation scheme on the same grounds as those on which a body corporate is unsuitable to act as a responsible entity, namely, that it is a body corporate

- externally administered
- it, or one of its responsible officers has been convicted of serious fraud or has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty and
- one of its officers is an insolvent under administration.

The Review recommends that the same factors that it recommends should make an *individual* unsuitable to be a responsible entity or a member or director of a responsible entity should also make an individual unsuitable to be an investment manager.[39]

Recommendation 8.8: Unsuitability to act as investment manager

1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST, if

- **it is an externally administered body corporate as defined in the Corporations Law or**

35. DP 50 proposal 5.12.
36. eg Australian Friendly Societies Association *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992; Mercer Campbell Cook & Knight *Submission* February 1992; ASC *Submission* March 1992; J McEachern *Submission* February 1992.
37. ASC *Submission* March 1992.
38. eg the 'pre-vetting' required to obtain a dealer's licence under the Corporations Law.
39. See recommendation 8.4.

• it, or one of its responsible officers as defined in the Corporations Law
  — has been convicted of serious fraud as defined in the Corporations Law
  — has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or

• one of its responsible officers is an insolvent under administration.

2. The law should provide that an individual is not suitable to act as an investment manager for the responsible entity for a superannuation fund, an ADF or a PST if he or she

• is an insolvent under administration as defined in the Corporations Law or

• has been convicted of serious fraud as defined in the Corporations Law or

• has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.

3. The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator, declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of this recommendation. The court should not be able to make such an order unless it is satisfied that

• the person is acting or proposes to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST and

• it is necessary to make the order to protect the interests of the members of the fund, ADF or PST.

8.25. ***Consequences of unsuitability to act.*** As with a responsible entity, the appointment of an unsuitable body corporate or individual as an investment manager should be void and the body corporate or individual should be guilty of an offence. If a body corporate or individual becomes unsuitable, it should have to report this to the responsible entity and to the regulator immediately. The engagement should thereupon be terminated. A consequence of that termination will be that the investment manager will have to return the assets it was managing to the responsible entity. It would be inappropriate for an investment manager to profit from such a situation. The Review recommends that the investment manager in such circumstances not be able to charge any fees in connection with the return of money or assets to the responsible entity.

Recommendation 8.9: Persons etc. not to act as investment managers while unsuitable

1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

3. The law should provide that a purported engagement by the responsible entity for a superannuation fund, an ADF or a PST of an unsuitable body corporate or an unsuitable person as investment manager is of no effect.

4. The law should provide that, if a foreign corporation or a trading or financial corporation or a person is acting as investment manager for the responsible entity for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or person:

- **the matter must be reported to the responsible entity without delay — the body corporate or person commits an offence if the matter is not so reported and**
- **the body corporate's or person's engagement as investment manager thereupon ceases.**

5. The law should provide that it is an offence for an investment manager for the responsible entity for a superannuation fund, an ADF or a PST who becomes unsuitable to charge the responsible entity a fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

6. 'Acting as investment manager' means dealing with the assets of the fund, ADF or PST by exercising a judgment as to their investment that is independent of the judgment of the responsible entity but is authorised by the responsible entity.

Standards for funds management

Introduction

8.26. The preceding paragraphs have dealt with the prohibitions on bodies corporate and individuals acting as responsible entities and investment managers. The following paragraphs deal with the required standards for those who invest the funds of a superannuation scheme.

Requirements for responsible entities

8.27. *Responsible entities dealing in securities.* There are many possible levels of involvement by a responsible entity in the investment of a superannuation scheme's funds, from direct investment of all the funds to engaging an investment manager to invest all the scheme's funds without any direction from the responsible entity. At present, trustees of employer related schemes do not have to hold a dealers licence to deal in securities for the scheme.[40] It is unlikely that trustees of superannuation schemes would carry on a business of dealing in securities because they would usually deal through a licensed agent.[41] Nevertheless, responsible entities should not automatically be exempted from the requirement to hold a dealers licence. Nor should they automatically have to hold a dealers licence simply because investment in securities is an option they may choose. The need for a licence should depend on whether they propose to deal in securities. Consequently, the Review proposed in DP 50 that, if a responsible entity deals in securities,[42] it should have to hold a dealers licence and should face the same barriers to entry as any other dealer.[43] This proposal received widespread support.[44]

8.28. *Recommendation.* The Review recommends that a responsible entity that deals in securities should have to hold a dealers licence. The ASC will be responsible for imposing conditions on that licence, including capital requirements,[45] appropriate to the activity to be carried out by the responsible entity in the same

40. Provided they only deal in securities as trustee of a superannuation scheme: Corporations Regulations reg 7.3.13(1).
41. Dealing in securities through an agent who is a licensed dealer does not constitute a business of dealing in securities: Corporations Law s 93(5).
42. As defined by the Corporations Law.
43. DP 50 proposal 5.7.
44. Permanent Trustee Company Limited *Submission* January 1992; ISC *Submission* March 1992; LIFA *Submission* March 1992; AMP Society *Submission* February 1992; ASC *Submission* March 1992.
45. The capital requirements for security dealers are under review at the international level: see para 8.36.

way that it imposes conditions on the issue of any other dealers licence.[46] This recommendation will require the repeal of Corporations Regulation 7.3.13(1).[47]

Recommendation 8.10: Dealing in securities
The Corporations Regulations reg 7.3.13 should be amended by omitting sub-regulation (1).

8.29. *Responsible entity not dealing in securities to obtain advice.* A responsible entity that invests superannuation funds itself but not at any time in securities will not need a dealers licence and will not be subject to the conditions which might apply. In DP 50 the Review proposed that a responsible entity not dealing in securities should have to seek professional advice, for example, by entering into a consultancy arrangement with an appropriately qualified person.[48] The Review sought suggestions as to how precise requirements of this nature might be formulated. Considerable concern was expressed in submissions about what 'advice from an appropriately qualified professional' means.[49] LIFA opposed this proposal on the grounds that trustees may already have sufficient expertise to make investment decisions and that the fiduciary responsibilities of trustees, such as the duty to act in the interest of members and with care and diligence, afford sufficient guidance to trustees to act prudently and to seek professional investment advice where needed.[50] The Review remains of the view that it is inappropriate to require a responsible entity that is not dealing in securities to obtain a dealers licence. It agrees that, as part of its fiduciary duties, a responsible entity should in such a case ensure that it has obtained proper advice. This requirement has been more fully elaborated and incorporated in the clarification of the duties of responsible entities in chapter 9.

Dealers licence for investment managers

8.30. *Dealing in securities.* Investment managers that deal directly in securities must be licensed under the Corporations Law.[51] In granting a dealers licence, the ASC must be satisfied that the responsible officers of the manager

46. Clearly, the more stringent the capital requirements imposed on the holders of dealers licences, the less likely it will be that responsible entities of smaller superannuation schemes intending to deal in securities on behalf of their scheme will be able to meet the requirement.
47. This will mean that life insurance companies will be the only exception to the requirement to hold a dealers licence when dealing in securities: Corporations Regulations reg 7.3.13(2). This may well be appropriate given the other standards required of life companies. This issue will be addressed in a later stage of the Collective Investments Review.
48. DP 50 proposal 5.8.
49. D Knox, *Submission* February 1992; AMP Society *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; National Mutual *Submission* February 1992.
50. LIFA *Submission* March 1992.
51. Corporations Law s 780.

have adequate educational qualifications and experience, and it must have no reason to believe that the manager will not perform its duties efficiently, honestly and fairly. It must consider whether an officer is an insolvent under administration, has had a serious fraud conviction in the previous 10 years or is not of good fame and character.[52] These requirements will be considered by the Review as part of its review of other collective investment schemes.[53] In any case, the Review does not recommend any change to the current requirement that investment managers who deal in securities must hold a dealers licence.

8.31. *Managers who do not deal in securities.* Although investment managers will almost always invest in securities as part of their management strategy, there may be some that will not, for example, investment managers who invest only in property. In DP 50 the Review noted that such managers ought to be subject to some form of approval process before they may act on behalf of a superannuation scheme and, in the absence of any alternative screening process, proposed that they also be required to hold a dealers licence.[54] This proposal was made on the basis that, although it would impose a burden on the ASC by way of an increased need for resources and expertise, the alternative of leaving the responsibility for assessing the competence of an investment manager entirely to the responsible entity seemed too onerous. Requiring all managers, even though they may not be planning to deal in securities, to hold a dealers licence would ensure a certain level of competence.

8.32. *Submissions.* A number of submissions did not support this proposal.[55] The ASC, for example, stated that investment managers that do not deal in Corporations Law securities (for example, property managers) should be subject to their ordinary regulation, not the Corporations Law licensing provisions.[56] Others took the view that requiring managers who do not deal in securities to hold a dealers licence is not an adequate solution to the problem of trying to ensure a certain level of competence in investment managers.

8.33. *Conclusions.* In practice, it seems that most investment managers will deal in securities and will, therefore, hold a dealers licence. There will be few

52. Corporations Law s 784.
53. The Review understands that the ASC intends to review the capital punishment requirements for securities dealers as a consequence of proposals currently being developed by the International Organisation of Securities Organisations (IOSCO): see, eg, Memorandum from IOSCO's Technical Committee to the Basle Committee on Banking Supervision, (1991) 1 *ASC Digest*, Reports and Speeches, 140.
54. DP 50 proposal 5.10.
55. eg Norwich Group *Submission* February 1992; Trust Company of Australia *Submission* February 1992; D Knox *Submission* February 1992; National Mutual *Submission* February 1992; ISC *Submission* 1992.
56. ASC *Submission* March 1992.

managers who do not require a dealers licence. Following its consultations on this issue, the Review has come to the view that the most effective way to regulate those managers is to highlight, and then rely upon, the obligation of responsible entities to take appropriate advice when dealing with an investment manager that does not hold a dealers licence. This obligation is dealt with in chapter 9. Accordingly, the Review does not propose that managers that do not deal in securities should be required to have a dealers licence.

> **Recommendation 8.11: Investment managers who do not carry on the business of dealing in securities**
>
> **Investment managers for responsible entities for superannuation funds, ADFs or PSTs should not have to hold a dealers licence under the Corporations Law if they do not carry on the business of dealing in securities within the meaning of the Corporations Law s 93.**

Additional requirements of investment managers

8.34. ***Proposal for minimum capital requirement.*** In DP 50 the view was put that the requirement to hold a securities dealers licence alone is not an adequate qualification for a corporation or individual to act as an investment manager of superannuation funds. The Review took the view that there needs to be some demonstration by a corporation that its shareholders have a substantial commitment to operations or by an individual that he or she is capable of undertaking the task.[57] The Treasurer has also indicated that consideration is being given to imposing a minimum capital requirement on investment managers of superannuation funds.[58] The Review proposed that an investment manager should be required either to have net assets of $5m or be a member of a professional indemnity fund with cover of at least $5m.[59]

8.35. ***Submissions.*** The response to this proposal was extremely varied. Some considered that the professional indemnity option was no substitute for a net asset requirement.[60] Others felt that $5m was too high a barrier to entry.[61] The Trustee Companies Association felt that both a net asset *and* professional indemnity should be required.[62] Others expressed the view that neither having $5m net assets nor professional indemnity insurance were any indication of competence or commitment.[63]

57. DP 50 para 5.21.
58. Treasurer's statement, paper 1 para 31.
59. DP 50 proposal 5.14.
60. IFA *Submission* February 1992.
61. ASC *Submission* March 1992; John A Nolan & Associates *Submission* February 1992.
62. TCA *Submission* February 1992; Permanent Trustee Company Ltd *Submission* January 1992.
63. See, eg, BT Asset Management *Submission* February 1992.

8.36. *Conclusion: no recommendation on this issue.* The Review agrees that neither requirement will necessarily guarantee the performance or integrity of an investment manager yet may operate to keep out of the industry small but talented investment managers. The Review is aware that IOSCO, in conjunction with the Basle Committee on Banking Supervision, is currently developing proposals for minimum capital requirements for securities dealers, which may be based on the riskiness of the dealer's transactions. If a risk weighted capital requirement for securities dealers is proposed by IOSCO and implemented in Australia, additional minimum capital and net asset requirements would almost certainly be unnecessary.[64] The Review recommends that any capital adequacy or net assets requirement be addressed through dealers licence requirements.[65] These will be looked at in detail at a later stage of the Collective Investments Review. The Review realises that this leaves a 'gap' in relation to investment managers that do not deal in securities and, therefore, do not require a dealers licence. However, given the refined duties of responsible entities to take appropriate advice[66] the Review is satisfied that this will not be a significant problem.

Managers who have custody of assets

8.37. In the majority of situations the custody of the assets of a superannuation scheme will be with the responsible entity. This will not always be the case. An investment manager could be hired on the basis that the custody of the assets that the manager is working with are held neither by the responsible entity nor by the investment manager but by an independent custodian. In such a case, the independent custodian would be instructed by the responsible entity as to when and how to release assets to the investment manager. This would be set out in a contract between the responsible entity and the independent custodian.[67] Alternatively, the manager may have custody of the assets it is

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64. The implementation of significantly higher capital requirements for security dealers under the IOSCO proposals obviously has implications for proposal 5.7 that responsible entities that deal in securities be required to hold a dealers licence.
65. See Balanced Equity Management *Submission* 11 March 1992.
66. See ch 9.
67. The Review has not proposed any net asset or other requirement for independent custodians. It considers that the most important matter to be addressed is the restrictions on custodians who have control over the investment of the assets of a superannuation scheme, as opposed to merely holding the assets as custodian. The ASC has suggested that a custodian appointed by a responsible entity must be an Approved Depository: *Submission* March 1992. The Review will examine the issue of standards for custodians and their licensing, if necessary, in the remainder of the Collective Investments Review.

managing. The Review is concerned to ensure that in that case the manager is able to demonstrate some substance by having net assets of $5m. To ensure that such a requirement is complied with, responsible entities should be required to ensure that investment managers meet that standard. The Review recommends

- that an investment manager that has custody of any assets of a superannuation scheme should be required to have net assets of $5m
- that it be an offence for a responsible entity to hire an investment manager under an agreement which allows the manager to have custody of assets of the scheme unless the manager has net assets of $5m
- that it be an offence for a responsible entity to hire an investment manager under a contract that permits the investment manager to deal in securities, unless the investment manager has a dealers licence.

Recommendation 8.12: Investment managers not to hold assets

The law should provide that, if

- **the responsible entity for a superannuation fund, an ADF or a PST enters into an agreement or arrangement with a person or with a body corporate under which the person or body corporate is to act an investment manager for the responsible entity and**
- **under the agreement or arrangement, the person or body is to hold or have custody of some or all of the assets of the fund, ADF or PST and**
- **at the time of entering into the agreement or arrangement and at all times while the agreement or arrangement is in effect, the person or body corporate had less than $5m in net tangible assets**

the responsible entity and the investment manager should each be guilty of an offence. The responsible entity should have a defence that it made reasonable inquiries, and exercised due diligence, in relation to the matter. There should be no similar defence for the investment manager.

Contracts between responsible entities and investment managers

8.38. ***Duties owed to the responsible entity.*** Under the Review's recommendations, the responsible entity will bear ultimate responsibility to members. The responsibilities owed by investment managers will primarily be owed to the responsible entity and will be contractual. There has been considerable attention paid to the question whether investment managers retained by responsible entities owe fiduciary duties directly to members or only to the responsible entity. For example, the NCSC took the view, in relation to property trusts, that unless the trust deed expressly provided for a direct relationship and for fiduciary duties between members and a hired investment manager, the members had no right to deal directly with the management company.[68] In DP 50 the Review asked whether a similar approach should be taken for superannuation schemes and suggested that managers do, and should continue to, owe fiduciary duties to members because they are managing superannuation funds, that is, funds that are already held on trust by the responsible entity. The Review suggested these duties would be similar to those owed to members by the responsible entity but will not be as extensive.[69] Several submissions disagreed with the Review on this point.[70] The main thrust of those submissions was that the relationship between the responsible entity and a hired investment manager is purely contractual and that this excludes any fiduciary duty being owed to the members. The Review is now of the view that the duties owed by an external hired investment manager are owed to the responsible entity principally under the contract between them. This does not, however, mean that the manager may not owe a fiduciary duty to the members. It may be argued that the benefit of the fiduciary duty owed by the hired investment manager to the responsible entity is held by the responsible entity on trust for the members of the scheme.[71]

8.39. *Unconscionable or other inappropriate contracts.* Although the likelihood of a manager putting pressure on a responsible entity to enter into an inappropriate contract should be far less under the Review's recommendations than under present arrangements, the possibility needs to be addressed. A particularly serious example concerns contracts in which the manager's liability for negligence is limited. This type of contract will, hopefully, become less common when responsible entities are, by the Review's recommendations, placed in the controlling or dominant position. Nevertheless, the Review considers that contracts of this kind should be unenforceable. This additional safeguard would be to make contracts of this kind subject to the provisions of the Trade Practices Act against unconscionable conduct.

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68. Release 121.
69. DP 50 para 5.27.
70. ASFA *Submission* March 1992; ASC *Submission* March 1992; LIFA *Submission* March 1992; Department of Finance (Cth) *Submission* February 1992; BT Asset Management *Submission* February 1992; County Natwest *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992; ISC *Submission* March 1992.
71. It has, in some circumstances, been held that contracts for the benefit of third parties import a trust; see eg *Re Schebsman* [1944] Ch 83; Meagher & Gummow, *Jacobs' Law of Trusts in Australia* 24–7. It would seem likely that in the circumstances of superannuation, where there already exists a trust, that there would be a trust imported into a contract between a responsible entity and a hired investment manager.

8.40. *Recommendation.* The Review recommends that agreements between investment managers and responsible entities that unreasonably exclude the investment manager's liability for negligence should be prohibited, and that the operation of the *Trade Practices Act 1974* (Cth) s 52A should apply to all contracts between responsible entities and investment managers, or other advisers, in respect of a superannuation scheme.[72]

> Recommendation 8.13: Contracts for investment managers
> **1. The Federal Court or the Supreme Court of a State or Territory should be able, on application by the responsible entity for a superannuation fund, an ADF or a PST, to vary, by order, a contract between the entity or provider and another person under which the other person is to act as investment manager for the entity so as to ensure that the contract does not unreasonably exclude or limit or unreasonably provide for indemnity in relation to, the manager's liability for negligence or breach of contract.**
>
> **2. The *Trade Practices Act 1974* (Cth) s 52A should extend to such contracts.**
>
> **3. The responsible entity for a superannuation fund, ADF or PST should have to be a foreign corporation or a trading or financial corporation formed within the limits of the Commonwealth, or the fund should have, as its substantial or dominant purpose, the provision of old-age pensions.**

Superannuation intermediaries

Introduction

8.41. The quality of advice given to people who are contemplating joining a personal superannuation scheme, investing in a single contribution superannuation scheme or rolling over superannuation benefits is an important factor in an individual's choice in relation to superannuation. The regulation of people who give such advice and sell these products will also be an important element in the success of the Government's retirement incomes policy. These people include financial planners, investment advisers, stockbrokers, accountants and insurance agents. A general review of quality control of financial advisers and agents has been recommended in a recent report by the House of Representatives Standing Committee on Finance and Public Administration.[73] The general issues of the

72. The ISC supports this recommendation: *Submission* March 1992.
73. Martin Report, recommendation 17.

standards, qualifications and licensing of these superannuation intermediaries will be given close consideration during the course of the Collective Investments Review. The time constraints on this report have not, however, allowed for a comprehensive review of this area to be included in this report.

Securities dealers licence

8.42. Dealers in securities, whether or not they are also life agents, must be licensed under the Corporations Law. The Review is satisfied at this preliminary stage that the Corporations Law standards are adequate for intermediaries selling superannuation. Consequently, the Review does not propose any additional entry restrictions on those intermediaries. However, the prerequisites for dealers licences will be dealt with more thoroughly in the general Collective Investments Review.

Standards for life agents

8.43. ***Trade Practices Commission inquiry.*** Life agents are another class of superannuation intermediary. They sell superannuation but do not require a dealers licence under the Corporations Law.[74] The Trade Practices Commission has been asked by the Minister for Justice and Consumer Affairs, Senator Michael Tate, to conduct empirical research into various aspects of the conduct and operations of life insurance agents. They include whether existing regulation is adequate to ensure fair and competitive conduct by life insurance agents, the availability to consumers of impartial financial advice in relation to life insurance and personal superannuation services and the extent to which current levels of disclosure may affect information and advice or contribute to unfair or anti-competitive conduct. The inquiry, which is to report by 30 November 1992, is to consult with the Review where relevant. The Review will maintain a close liaison with the Inquiry and take close note of the results of the Trade Practices Commission's empirical research. In the meantime, however, the Review makes several recommendations aimed at achieving, at least, a level playing field between financial advisers.

8.44. ***Proposals for uniform requirements.*** DP 50 made several proposals in relation to the standards that should be required of life agents when they sell superannuation.[75] The rationale for those proposals was to ensure a level

74. See discussion at para 8.45.
75. DP 50 proposals 5.18, 5.19, 5.20.

playing field for all sellers of superannuation, whether they are subject to the Corporations Law or the *Insurance (Agents and Brokers) Act 1984* (Cth). The Review remains of the view that standards should be the same across the board wherever possible.

8.45. ***Extending Corporations Law standards to life agents.*** Persons who deal in securities or carry on an investment advice business must be licensed under the Corporations Law. Superannuation is a prescribed interest and, therefore, a security.[76] In principle, therefore, it would seem that an intermediary selling superannuation that is not an excluded offer should have to have a dealers licence. However, intermediaries involved in dealing in or advising on life insurance based products (including personal superannuation schemes offered by life companies) are generally not treated as subject to these provisions.[77] Instead they are regulated, indirectly, under the *Insurance (Agents and Brokers) Act 1984* (Cth). This provides that a life company is responsible for the acts of its agents in relation to any matter relating to insurance, whether or not the agent acts within the scope of his or her authority.[78] There are no minimum professional standards set down. In DP 50 the Review proposed that intermediaries selling superannuation on behalf of life companies ought to be subject to the standards required of intermediaries under the Corporations Law.[79] Those standards require that the person be of good fame and character, not be an insolvent under administration and have educational qualifications and experience adequate for a licence of the kind applied for. Additionally, the ASC must have no reason to believe that the person will not perform his or her duties efficiently, honestly and fairly.[80] Regard is to be had to any conviction in the past 10 years for serious fraud.[81] This proposal was made subject to any changes that may be made to the Corporations Law standards at a later stage of the review.

8.46. ***Submissions.*** The Review's proposal received wide support in submissions.[82] Several submissions pointed out that standards for life agents are

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76. There are exemptions, eg, for trustees of superannuation funds and 'exempt dealers', which include dealers of 'excluded offers'.
77. Presumably because they argue that the superannuation policies they offer are in reality life insurance and do not, therefore, fall within the definition of securities.
78. This Act is currently being reviewed by the ISC.
79. DP 50 proposal 5.18.
80. Corporations Law s 783.
81. Corporations Law s 783(4). 'Serious fraud' means an offence involving fraud or dishonesty against an Australian or any other law, punishable by imprisonment of at least 3 months: Corporations Law s 9.
82. eg Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; DSS *Submission* February 1992; ASC *Submission* March 1992; Securities Institute of Australia *Submission* February 1992.

currently being reviewed by LIFA and the Australian Lifewriters Association in conjunction with the ISC, with a view to establishing a self regulatory code of conduct that will include matters relating to the selection of agents by life insurance companies.[83]

8.47. *Recommendation.* The Review is concerned primarily to ensure that standards for superannuation intermediaries, whether they be securities dealers, financial planners or life agents, are adequate and uniform. It recommends, therefore, that all superannuation intermediaries should be required to be solvent, of good fame and character, be in a position to perform his or her duties efficiently and honestly and have adequate educational qualifications and expertise. Life insurance companies should not be able to enter into agency contracts with persons to sell superannuation products for the company unless the company is satisfied, after proper inquiry, that the person is solvent, there is no reason to believe that the person is not of good fame and character and that the person will not perform his or her duties efficiently, honestly and fairly and the persons' educational qualifications and experience are adequate. This should be achieved by amending the *Insurance (Agents and Brokers) Act 1984* (Cth). Likewise, intermediaries selling or advising on, superannuation either as a securities dealer or a financial advisor will be required to meet those standards under the Corporations Law.

Recommendation 8.14: Standards for insurance intermediaries
1. Amend the *Insurance (Agents and Brokers) Act 1984* s 10 to provide that an insurer must not enter into an agreement for the purposes of s 10 under which the insurance intermediary is authorised to offer membership of a superannuation fund or DA for which the insurer is the responsible entity or provider as agent of the insurer unless the insurer is satisfied, after proper inquiry, that the intermediary

- **is of good fame and character[84] and**
- **will be able to act as agent honestly**
- **has adequate educational qualifications and expertise**
- **is not an undischarged bankrupt.**

Failure to comply should be an offence by the life insurance company.

The 'know your client' rule

8.48. *Proposal.* A person offering financial advice will be best able to offer good advice if he or she knows the needs and circumstances of the client. In

83. LIFA *Submission* March 1992; ISC *Submission* March 1992.
84. Although this is the formulation appearing the Corporations Law, it may be more precise to express it as 'unlikely to contravene, or cause a contravention of, the law'.

DP 50, the Review proposed that people selling or advising on superannuation should be under an obligation to make appropriate inquiries of a person before advising them about, or selling to them, superannuation and that all such people, including life agents selling superannuation policies on behalf of life insurance companies, should be subject to a requirement to know the needs and circumstances of their clients.[85] Such a requirement exists under the Corporations Law[86] although, as the Review pointed out in DP 50, the current wording imposes no positive obligation on a person to conduct an appropriate investigation to ensure that the advice fits the client's investment objectives, financial situation and needs.[87] The majority of submissions that commented on this issue strongly supported the proposal.[88] The Review remains convinced that such a requirement is an important means of improving the level of service of intermediaries and ensuring an appropriate matching of clients and financial services.

8.49. *Recommendation.* Accordingly, the Review recommends that all superannuation intermediaries should be subject to a 'know your client' requirement. The Corporations Law s 851 provides a good model but it, and any other relevant legislation,[89] should be amended to impose a positive obligation to ask clients about a client's investment objectives, financial situation and personal needs.

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85. DP 50 proposal 5.19.
86. Under the Corporations Law s 851(2) a dealer is liable to pay damages to a client who loses money after acting on that dealer's recommendation if the dealer did not have a reasonable basis for making the recommendation. A dealer does not have a reasonable basis for making a securities recommendation unless

    > in order to ascertain that the recommendation is appropriate having regard to the information the [dealer] has about the person's investment objectives, financial situation and particular needs, the [dealer] has given such consideration to, and conducted such investigation of, the subject matter of the recommendation as is reasonable in all the circumstances; and the recommendation is based on that consideration and investigation.

87. DP 50 para 5.32. Although the section does not expressly require the dealer to ask the client for information, the NCSC issued a release in 1990 saying that the equivalent to the Corporations Law s 851 under the old regime, the *Securities Industry Act 1980* (Cth) s 68E, imposed a positive duty on advisers to ask clients for such information if it was clear that the client needed to rely totally on advice sought from an adviser in relation to a particular matter: NCSC Release No 352, April 1990.
88. ASC *Submission* March 1992; Jacques Martin Industry *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992. The ISC noted that it has already accepted the need for this requirement. 'Circular 276 issued in April 1989 noted its intention that the new Life Insurance Act include a 'know your client' requirement': ISC *Submission* March 1992.
89. eg *Insurance (Agents and Brokers) Act 1984* (Cth).

Recommendation 8.15: Know your client rule

The law should apply the Corporations Law s 851 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of the insurer, membership of a scheme for which the insurer is the responsible entity or provider. The provision should require the person to make reasonable inquiries as to the client's circumstances.

Commissions

8.50. *Commission generally.* Most life agents earn commission on the sale of policies, including superannuation policies. In some cases, commissions are their sole source of income. There has been much discussion in recent years as to whether this system of remuneration leads to distortions in the market, poor quality advice and unnecessary rearrangement of policies.[90] This issue impacts on the area of superannuation and on collective investments generally. The Review will deal with this issue when considering collective investments generally. It expects that the research being done by the Trade Practices Commission inquiry will be of assistance in this area.

8.51. *Proposal.* In the meantime, the Review considered the issue of the disclosure of commissions. Under the Corporations Law a securities dealer or investment adviser must give clients particulars of any commission, fee or other benefit or advantage he or she will receive from making a recommendation or from a dealing in securities resulting from a recommendation.[91] A dealer or adviser must also advise a client of any other interest he or she has that may reasonably be expected to be capable of influencing a recommendation. This requirement is designed to ensure the integrity of the service provided by dealers and advisers licensed under the Corporations Law. The Review proposed in DP 50 that life agents selling superannuation policies should also be required to reveal such information to their clients.[92] At present, both single and regular premium superannuation policies sold by life companies must be accompanied by a disclosure statement. However, only the disclosure statement for single premium policies is required to disclose commissions.[93] Neither requirement, being embodied in ISC circulars only, is mandatory.

90. Commonly referred to as 'twisting'.
91. Corporations Law s 849.
92. DP 50 proposal 5.20.
93. ISC circulars 276, 290, 291.

8.52. *Submissions.* Most submissions supported the Review's proposal.[94] Several life insurance companies disagreed with it, principally on the grounds that the most meaningful disclosure is that of total fees and charges and the effect they have on a person's benefit, that the disclosure of commission may lead to restricting agents' remuneration without necessarily reducing costs and that a low commission does not necessarily equate with the best value policy.[95]

8.53. *Recommendation.* The Review is not convinced that the possible disadvantages of disclosure outweigh the advantages. It can only assist people to be aware when buying a policy of any sort what the benefit is to the seller. Accordingly, the Review recommends that life agents selling superannuation should be subject to requirements similar to the Corporations Law s 849, that is, to advise the client of any interest he or she has that may reasonably be expected to be capable of influencing a recommendation, and of any benefit that will flow to the agent from that recommendation.

Recommendation 8.16: Disclosure of interests etc.

The law should apply the Corporations Law s 849 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of an insurer, membership of a superannuation fund or DA for which the insurer is the responsible entity or provider.

Education and training of sellers of superannuation

Qualifications for dealers and life agents

8.54. At present, securities dealers must have education and experience to gain a dealers licence under the Corporations Law, but exact requirements are not specified.[96] Nor are they specified in the Review's recommendation that life companies only contract with agents who have adequate education and experience.[97] In DP 50 the Review proposed that, in the longer term, the required educational qualification and experience for licensed dealers and life agents

94. See, eg, Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; ASC *Submission* March 1992; Westpac Financial Services *Submission* February 1992.
95. AMP *Submission* February 1992.
96. In 1985, the NCSC proposed the establishment of prescribed educational standards for licence holders through the introduction of a Securities Industry Licence examination: *A Review of the Licensing Provisions of the Securities Industry Act and Codes.* No educational requirements have, however, been prescribed.
97. Recommendation 8.14.

should be prescribed. This proposal received general support.[98] The Securities Institute of Australia suggested that it be implemented as soon as possible rather than in the longer term and believes that it is appropriate to prescribe professional entry qualifications on fund managers, investment advisers and life agents.[99] It also noted that there are already appropriate educational courses available.[100] The Review remains of the opinion that the appropriate standards should be prescribed, at some stage, to provide consistency and to increase public confidence in the standards of intermediaries. It recommends that educational qualifications and experience should be prescribed for all superannuation intermediaries. To the extent that standards for life agents are prescribed separately under the *Insurance (Agents and Brokers) Act 1984* (Cth) instead of under the Corporations Law, it will be crucial to ensure consistency of the requirements prescribed under both pieces of legislation.

Continuing education

8.55. In DP 50 the Review proposed that a program of continuing education should be introduced for licensed dealers and life agents. The Review noted that the concept of training is not foreign to the Corporations Law. One of the conditions on which dealers licences are issued is that any representative of the holder is sufficiently trained in the duties he or she will be required to perform and keeps up to date by continuing training programs. The Corporations Law does not, however, specify which programs. The Securities Institute of Australia pointed out that it presents a continuing education program for its members, which may facilitate implementation of this proposal.[101] The Review understands that continuing education is already a requirement for the Australian Lifewriters Association accreditation scheme. The Review sees continuing education as a complement to initial education and a vital part of maintaining the standards of industry participants. Accordingly, it recommends that superannuation intermediaries should be required to undertake continuing education.

98. Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Ltd *Submission* January 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992.

99. Securities Institute of Australia *Submission* February 1992.

100. eg courses offered by the Financial Planning Association of Australia and the Securities Institute of Australia.

101. Securities Institute of Australia *Submission* February 1992.

Recommendation 8.17: Continuing professional education for dealers and life agents

1. The law should provide that it is a condition of holding a dealers licence that authorises the dealer to offer membership of a superannuation fund, an ADF or PST that the dealer satisfactorily complete courses or other training prescribed in the regulations.

2. The law should provide that each agreement for the purposes of the *Insurance (Agents and Brokers) Act 1984* s 10 under which an insurance intermediary is authorised to offer, as agent of an insurer, membership of a superannuation fund, ADF, PST or DA for which the insurer is the responsible entity or provider, that the intermediary will satisfactorily complete courses or other training prescribed in the regulations.

Validity of acts done

8.56. The recommendations in this chapter provide for certain individuals and body corporates to be unsuitable to act on various grounds. To avoid chaos it is necessary to guarantee the validity of acts done by a person who is unsuitable. The Review therefore recommends that, subject to some exceptions, for example, in the case of fraud, acts done by unsuitable responsible entities and unsuitable investment managers not be invalid or ineffective on that ground alone.

Recommendation 8.18: Preserving acts done

The law should provide that a third party who acts in good faith and without notice of the unsuitability of

- **the responsible entity for a superannuation fund, ADF or PST**
- **a member of the board of management of a responsible entity of a superannuation fund, ADF or PST**
- **an investment manager for a superannuation fund, ADF or PST**

is not affected by the unsuitability.

9. Duties of the responsible entity

Introduction

9.1. This chapter identifies the principal fiduciary duties owed by responsible entities to members of superannuation schemes. The Review recommends that they expressly be included in a statute as obligations from which a responsible entity cannot be excused by the governing document of the superannuation scheme.

Legal structure of superannuation schemes

Trust structure

9.2. All of the superannuation schemes established by employers in the private sector are established as trusts. Superannuation schemes covering public servants are established by Acts of Parliament, most of which are run as trusts. In DP 50 the Review noted that, in much of the literature concerning reform of superannuation, it was assumed that the trust is the most appropriate structure for superannuation schemes. The Review raised the issue whether some other structure would constitute a more appropriate legal form for superannuation.[1] Very few submissions addressed this issue and those that did considered that the trust was the most appropriate legal structure for superannuation schemes.[2]

The 'traditional' trust

9.3. *The history of the trust concept.* The trust as a legal concept has existed for approximately 1000 years. Before the Norman Conquest of England, individuals could transfer land to others and take a promise from the transferee that the latter would hold the land 'to the use of' those persons whom the transferor described. The concept of the 'use' which emerged from this practice became an important means of transferring land upon death without having to pay feudal taxes.[3] The Statute of Uses was enacted in 1535 to restrict this form of land holding (and tax avoidance). The effect of the Statute could be avoided by the

1. DP 50 para 2.18. For a discussion of the issue whether trusts law does or can provide a suitable framework for the regulation of pension schemes, see Moffat & Chesterman, *Trusts Law: Text and Materials* 533–55.
2. National Mutual *Submission* February 1992; Perpetual Trustees *Submission* March 1992; ASC *Submission* March 1992. G Walker, however, suggested that the general principle of trust law may well be redundant: *Submission* February 1992.
3. Ontario Law Reform Commission *Report on the Law of Trusts*, vol 1 p 5.

creation of two successive uses. The 'use upon a use' was finally recognised by the Court of Chancery in the early seventeenth century. To distinguish the second use from the first, it was called a trust, and the 'modern' law of trusts began to develop.

9.4. ***The key features of a traditional trust.*** A principal feature of a trust is the vesting of title to property in a person or persons on behalf of, or for the benefit of, another person or persons, or for the advancement of certain purposes. The holder of the legal title to the property is the trustee. The other party (or parties) is (are) the beneficiary (or beneficiaries). The person who provided the trust property is called the settlor. The settlor may be the trustee, the beneficiary or some third party. The key elements present in every such 'traditional' trust are

- ***The trustee.*** The trustee may be a person, several persons or a body corporate. The trustee owes a fiduciary duty to the beneficiary. It is a duty imposed upon the trustee not to place his or her personal interest in conflict with the interests of the beneficiary and not to use the position of trustee to acquire an advantage, whether or not at the expense of the beneficiary. A fiduciary must act honestly in what he or she considers to be the best interest of the beneficiaries.

- ***The trust property.*** The property may be real or personal. The trustee must have title to the property, not just possession, and this will be the legal title unless the property itself is solely equitable in nature.

- ***The beneficiary.*** The trustee may be a beneficiary but the trustee cannot be the sole beneficiary. The extent of the beneficiary's interest in the property is determined by the deed or other instrument constituting the trust, or by operation of law.

- ***A personal obligation to deal with the trust property.*** The trustee is under a personal obligation to deal with the trust property for the benefit of the beneficiary and this equitable obligation is annexed to the trust property.[4]

9.5. ***The trust concept in collective investments.*** Trusts were able to overcome the problem that unincorporated groups could not own property. The trustees hold property for the group, on the terms established by the trust deed.

4. Meagher & Gummow, *Jacobs' Law of Trusts in Australia* 8-9.

The trust was used as the basis for life insurance companies in which the members and the trustees entered into mutual covenants. It was also used as the basis for collective investment schemes and collective savings schemes.[5] Superannuation is a collective investment scheme which generally uses the trust form.[6]

9.6. *The trust concept in superannuation.* The trust is used in superannuation schemes to enable a wide range of interests in property to be created for beneficiaries. Nearly all superannuation schemes to which OSSA applies are trusts. Superannuation trusts are often established by complex deeds that set out the powers, duties and responsibilities of trustees and the interests of the beneficiaries. This gives considerable flexibility to cover a wide range of public and private schemes, though increasingly, the terms of the deed are influenced by tax considerations.[7] Superannuation schemes sometimes employ professional trustees, such as trust companies, that operate under State and Territory legislation. A higher standard of care is expected of professional trustees.[8]

Distinctive features of employer related superannuation trusts

9.7. While private employer related superannuation schemes are structured as trusts they have some distinct features, which differ from traditional trusts.[9] Some of these have been introduced by government policy, backed up by tax concessions.

- *Beneficiaries are not always volunteers.*[10] A number of employer related schemes involve employee contributions, or an election by the employee to convert some of his or her salary into an employer contribution, to a superannuation scheme.

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5. Moffat & Chesterman *Trusts Law: Text and Materials*, 525–6, quoting Cooke *Corporation, Trust and Company* 86–7.
6. There are exceptions such as superannuation schemes consisting entirely of policies of life insurance.
7. To get the tax concession available to superannuation schemes, OSSA requires deeds must contain certain clauses.
8. See para 5.2.
9. These features were recently examined in some detail in a speech by Lord Browne-Wilkinson, a Lord of Appeal in Ordinary, *Equity and its Relevance to Superannuation Today*, paper presented at the Superannuation 1992 Conference, Canberra, February 1992.
10. That is, recipients of a gift.

- *Associated contract of employment.* This special factor is closely allied to the first as being in paid employment is a legal condition of membership of a superannuation scheme.[11] Membership of an employer related scheme is also conditional upon employment with a particular employer.

- *Employer's obligation to fund.* The introduction of the SGL legislation will mean that all employers will be compelled to provide superannuation for their employees. Unlike a settlor, the employer cannot chooose the recipients of this particular kind of 'bounty'.

- *Employer's continuing financial interest.* In employer related schemes, employers obviously have an interest in any scheme they are required to finance. Under the SGL legislation all employers will be compelled to contribute a growing proportion of their wages bill to a complying superannuation scheme. In the case of defined benefit schemes, employers have an added interest in the fate of the scheme as they, not the employees, bear the investment risk. Employers also often have a residual interest in the surplus, if any, of the scheme upon its termination.

- *Beneficiaries are entitled to representation on trustee body.* Unlike traditional trusts where beneficiaries do not have any right to appoint trustees, the OSS Regulations will soon require all schemes with 200 or more members to have at least 50% of the trustees as representatives of the members.[12] Often the member representatives will also be beneficiaries.

- *Variable size of the trust fund.* In a traditional trust the size of the trust fund is normally defined at the outset and added to in readily identifiable portions. This is not the case with collective investments or superannuation schemes. The size of the trust fund is continually fluctuating due to payments in and out. In defined benefit schemes in particular, the size of the scheme will depend heavily on actuarial calculations.

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11. Although members who temporarily leave the workforce may remain a member of a scheme for up to two years: OSS Regulations reg 5AA.
12. OSS Regulations reg 13. Currently, the only funds that are required to have equal representation are those with 200 or more members, established after a prescribed date (16 December 1985 for private sector funds, 25 May 1988 for public sector funds). This requirement will apply to all funds with 200 or more members from 1 July 1995. The Review recommends that this requirement extend to all schemes with 50 or more members: see recommendation 12.4.

- *The employer's power to veto amendments to the terms of the trust.* Frequently the employer has a power of veto over any proposed change to the terms of a superannuation trust deed. The settlor on the other hand, does not normally reserve such a power.

Consequences of the special features of superannuation trusts

9.8. In traditional trusts the central concept is that the settlor acts out of bounty, and that the beneficiaries are fortunate recipients who have given no consideration. Clearly, this concept has limited relevance to superannuation schemes, especially where the employer is obliged by law to contribute and the employee can also contribute. Consequently, the doctrine of the resulting trust under which any surplus funds will revert to the employer as settlor must be questioned if the employer is not in fact the settlor.[13] Similarly, the right claimed by the employer in many schemes to determine the original content and to control the amendment of the rules must derive from some source other than the employer's role as settlor. Clearly it could not be said to arise from the traditional source of the settlor's right to reserve powers to him or herself. It has been suggested to the Review that such a power could possibly be construed as a contractual provision based on the employment relationship.[14]

Duties of a trustee

Principle duties

9.9. While superannuation schemes have features that distinguish them from traditional trusts, it does not necessarily follow that trust law applies differently to the superannuation trustee or that the duties and responsibilities of trustees are inappropriate for trustees of superannuation schemes. The duties of trustees have been developed, along with the concept of the trust, over many years and their fiduciary nature is highly appropriate to the needs of superannuation schemes.

> A trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of honour the most sensitive, is then the standard of behaviour. As to this there has developed a tradition that is unbend-

13. Lord Browne-Wilkinson described it as a doctrine of 'dubious application' to superannuation schemes: *Equity and its Relevance to Superannuation Today*, 6.
14. Lord Browne-Wilkinson *Equity and its Relevance to Superannuation Today* 6; see also Austin 'The Role and Responsibility of Trustees in Pension Plan Trusts: Some Problems of Trust Law' in Youdan (Ed) *Equity Fiduciaries and Trust* 113 where he notes that superannuation schemes, from a commercial point of view, 'frequently have the flavour of a bargain struck between the employer and representatives of employees'.

> ing and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rules of undivided loyalty by the disintegrating erosion of particular exceptions. Only thus has the level of conduct of fiduciaries been kept at a level higher than that trodden by the crowd.[15]

This fiduciary duty of a trustee has been said to comprise four fundamental duties

- the duty not to act for his or her own benefit or for the benefit of a third person
- the duty to treat beneficiaries of the same class equally
- the duty to treat beneficiaries of different classes fairly and
- the duty not to act capriciously or totally unreasonably.[16]

In DP 50 the Review suggested that, in addition to the duties outlined above, the trustee also owed a duty to act personally, honestly and to avoid conflict of interest and to exercise diligence and care in carrying out its functions under trust deed. Other important duties of trustees include:

- the duty to preserve the trust property
- the duty of loyalty (to the terms of the trust)
- the duty to keep and to render the beneficiaries full and candid accounts
- the duty to act personally.[17]

Trustees also have a duty to administer the trust fairly and effectively. This involves establishing procedures for

- processing membership applications
- recording personal membership details and benefits
- prompt receipt, banking, recording and accounting for all income including contributions, investments and insurance profits
- effective follow up of any contributions arrears
- receipt, approval, payment and recording of all expenditure including benefit payments, insurance premiums, administration expenses, investment and other professional fees, trustee expenses, statutory and legal costs
- regular auditing of accounts and control systems

15. *Meinhard v Salmon* (1928) 164 NE 545 Cardizo J, cited in Ford & Lee *Principles of the Law of Trusts* 2nd ed, 391.
16. Finn *Fiduciary Obligations* 45–6.
17. Ford & Lee *Principles of the Law of Trusts* 393.

- regular reporting to the trustee on the overall management of the fund with particular attention to investment performance, financial results and general trend analysis requiring policy review
- regular reporting to members on personal entitlements and the overall management and performance of the fund.[18]

The Review accepts that these duties are illustrative only, not exhaustive. They do, however, adequately demonstrate the kind of duties imposed on trustees sufficiently to enable a judgment to be made that they are duties appropriate to apply to the responsible entities of superannuation schemes.

Trust deed can not derogate from duties

9.10. Trustees cannot depart from or act inconsistently with these fiduciary duties unless especially permitted to do so by the trust deed. The Review considers it to be of great importance that the deed not permit derogation from the proper duties of trustees and that those duties ought to be clearly identified. This is especially important for those trustees who are unfamiliar with their duties. All employees will in future be required to be members of a superannuation scheme. As such, they require the full protection of the fiduciary duties imposed by equity upon superannuation scheme trustees. The presence in deeds of clauses that permit acts which would otherwise be prohibited by the general rules of equity are, however, commonplace.

Proposal to clarify minimum duties

Proposal

9.11. The Review is firmly of the view that it is inappropriate for the trust deed to contain clauses that allow a significant reduction of the duties imposed upon the responsible entity. It proposed in DP 50 that a minimum set of fiduciary responsibilities of the responsible entity be clearly identified and, where appropriate, included in legislation applying to superannuation schemes with a requirement that the deeds or other instruments constituting a superannuation scheme would not be able to derogate from these obligations.[19] This was supported by submissions.[20]

18. MTIA *Submission* February 1992.
19. DP 50 para 5.25, proposal 5.16.
20. See details at para 9.16.

Codification of superannuation scheme trustee duties — overseas experience

9.12. ***United States.*** The United States *Employee Retirement Income Security Act 1974* (ERISA) requires every employee benefit plan established under the Act to name one or more fiduciaries in the written instrument establishing the plan.[21] In the discharge of their duties in respect of the plan, fiduciaries are expected to exercise

> the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man, acting with the like capacity and familiar with such matters, would use in the conduct of an enterprise of a like character and with like aims.[22]

They are also required to diversify the investments of the plan so as to minimise the risk of loss unless under the circumstances it is clearly prudent not to do so.[23] A fiduciary is also prohibited from

- dealing with the assets of the plan 'in his own interest or for his own account'[24]
- acting in any capacity in a transaction involving the plan on behalf of a party whose interests are adverse to those of the plan or its beneficiaries[25]
- receiving any consideration from any party in connection with a transaction involving the plan.[26]

9.13. ***Canada.*** Codification of duties is also the approach taken in some provinces of Canada. For example, the *Pension Benefits Act 1987* (Ont) sets out the essential duties of administrators of pension plans. Under the Act the administrator is given overall responsibility for the general administration and investment of the pension plan and its funds.[27] The Act also includes several provisions entrenching key fiduciary duties of plan administrators. Section 23 of the Act specifically imposes a duty on the administrator to

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21. ERISA s 402(a)(1).
22. ERISA s 404(a)(1)(B).
23. ERISA s 404(a)(1)(C).
24. ERISA s 406(b)(1).
25. ERISA s 406(b)(2).
26. ERISA s 406(b)(3).
27. The full range of administrative and fiduciary obligations of pension plan administrators is discussed in Dickson QC 'The Administration of Pension Plans and the Administrator's Agents; Their Duties and Responsibilities' (1988) 9 *Estates and Trusts Journal* 39.

> exercise the care diligence and skill in the administration and investment of the pension fund that a person of ordinary prudence would exercise in dealing with the property of another person.[28]

That section also imposes on the plan administrator a standard of care which relates to the knowledge available to the administrator or which he or she ought to possess, rather than an absolute standard of care. The administrator of a pension plan is required to use, in the administration and investment of the pension fund, all relevant knowledge and skill that the administrator possesses, or, by reason of his or her profession, business or calling, ought to possess.[29]

Codification in Australia

9.14. *Model trustee code.* Codification of the duties of trustees generally has been considered in Australia for some time, most frequently in relation to authorised trustee investments. This matter is currently the subject of a review by a sub-committee of the Special Premiers' Conference Working Party on Non Bank Financial Institutions. A wide ranging review of the standards that may be expected of trustees was produced by a private group of experts in 1989.[30] The group suggested that legislation covering trustees should clearly establish that, unless permitted by law or expressly authorised by the trust instrument, the fiduciary duties of a trustee include that the trustee shall not

- make any profit or derive any benefit from his or her connection with the trust, whether for the trustee or for any other person
- allow his or her own personal interest to conflict with his or her duty as trustee
- undertake any duty which conflicts with his or her duty as a trustee.[31]

The group also proposed that

> [i]n the management and administration of the trust including the exercise of its powers, authorities and discretions, the trustee shall act with care, skill, prudence and diligence having regard to —

28. *Pension Benefits Act 1987* (Ont) s 23(1).
29. *Pension Benefits Act* 1987 (Ont) s 23(2).
30. The group consisted of Mr Justice Meagher, NSW Supreme Court; Mr Justice Gummow, Federal Court of Australia; Professor Emeritus HAJ Ford, University of Melbourne; Dr IJ Hardingham, Victorian Bar; Professor PD Finn, Research School of Social Sciences, Australian National University; Mr N Crago, Senior Lecturer in Law, University of Western Australia; Mr BT Ball, former General Manager Queensland Trustees Limited and Mr WA Lee (Convenor and Secretary).
31. Model Trustee Code for Australian States and Territories, section 1.10, cited in WA Lee 'Current Issues for Trustee Legislation' (1990) *University of Western Australia Law Review* 507-537, 514.

(a) the nature, composition and purposes of the trust; and
(b) the skills which the trustee possesses or ought, by reason of his business, or calling, to possess.[32]

In relation to the important question of the investment of funds, the group proposed, that

> [i]n the exercise of its powers of investment the trustee shall consider
> (a) the trust fund as a whole, the nature, composition and purposes of the trust and its anticipated duration
> (b) the needs and circumstances of the beneficiaries
> (c) the suitability of the investments held and of investments proposed
> (d) the need for diversification of investments
> (e) the administrative costs, including commission, fees, charges and duties payable, of making or varying any investment;
> (f) the taxation consequences of making or varying any investment, and
> (g) the possible impact of inflation or deflation.

9.15. *Codification of trustee duties and the Corporations Law.* The Corporations Law imposes upon trustees of prescribed interest schemes a number of duties which cannot be modified. These duties are imposed by means of statutory covenants. They include that the trustee will

- cause the accounts to be audited[33]
- take the reasonable steps necessary to become informed of the exercise by the management company of its powers and the performance of its functions, under the deed[34]
- retire from office in the prescribed circumstances[35]
- exercise all due diligence and vigilance in carrying out its functions and duties and in protecting the rights and interests of the holders of the prescribed interests[36]
- perform its functions and exercise its powers under the deed in the best interests of all the holders of the prescribed interests and not in the interests of the management company or the trustee if those interests are not the same as those of the holders of the prescribed interests generally[37]
- subject to the immediately preceding point, treat the holders of prescribed interests of the same class equally and will treat the holders of prescribed interests of different classes fairly.[38]

32. Model Trustee Code s 1.11.
33. Corporations Regulations reg 7.12.15(5).
34. Corporations Regulations reg 7.12.15(2)(g).
35. Corporations Regulations reg 7.12.15(2)(e).
36. Corporations Law s1069(1)(e)(i).
37. Corporations Regulations reg 7.12.15(1)(f)(i).
38. Corporations Regulations reg 7.12.15(l)(f)(ii).

Submissions and conclusions on the Review's proposals

9.16. *Submissions.* While most submissions supported the Review's proposal, some opposed it in the belief that it would involve codification of all the fiduciary duties of responsible entities and of the members of the boards of responsible entities.[39] The Review did not intend to codify or alter the underlying equitable principles. The proposal was limited to the inclusion in legislation of a minimum set of duties that could not be derogated from by the deed or other constituting document. That aspect of the proposal received widespread support from industry groups,[40] superannuation scheme providers,[41] the ACTU,[42] the Australian Securities Commission[43] and individuals.[44] The favourable reaction to this proposal and the Review's consultations[45] have confirmed its view that the inclusion of a minimum set of duties in legislation will bring the advantages mentioned in DP 50, namely

- it will lead to a better understanding and awareness of responsible entities' legal responsibilities and those of members of boards of responsible entities
- it will enable uniform modification of common law trust principles which are not appropriate for superannuation schemes
- it will enhance the ability of the regulator to enforce the fiduciary obligations of responsible entities when necessary
- it will eliminate the possibility that obligations considered essential for responsible entities of superannuation schemes could be eroded by the terms of the trust deed or other constituting document.[46]

9.17. *Recommendation.* Accordingly, the Review recommends that the law should include a set of fiduciary obligations for responsible entities of superannuation schemes, ADFs or PSTs. The duties should be paramount. To the extent that they conflict with other provisions of the governing document, the other provisions should be void.

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39. JSW Higgins, Partner, Mallesons Stephen Jacques *Submission* February 1992; Mercer Campbell, Cook and Knight *Submission* February 1992; Commonwealth Bank Group Financial Services *Submission* February 1992.
40. IFA *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; ASFA *Submission* March 1992; LIFA *Submission* March 1992.
41. AMP Society *Submission* February 1992; National Mutual *Submission* February 1992.
42. *Submission* February 1992.
43. *Submission* March 1992.
44. P Burke *Submission* February 1992, J Aitken *Submission* February 1992.
45. In particular those with Lord Browne-Wilkinson.
46. DP 50 para 5.25.

Recommendation 9.1: Fiduciary obligations of responsible entities to be set out in legislation

The law should set out the basic fiduciary obligations owed by responsible entities of superannuation funds, ADFs and PSTs to members. This provision should not affect any other duty that may be imposed on the responsible entity by the deed or other instrument constituting the fund, ADF or PST, or by some other law, if the other duty is not inconsistent with the basic obligations set out. Any provision of a deed or other agreement that purports to modify or exclude these basic obligations should be of no effect.

The essential duties of responsible entities

Duty to hold property for benefit of members

9.18. The responsible entity, by the very nature of being in a position of trust, does not hold the assets of the scheme in its own right. Rather it holds them on trust for, or for the benefit of, the members of the scheme. It should hold the property of the scheme not for the use or benefit of itself, but for the use and benefit of the members.

Duty to become familiar with the deed and interpret the deed or other rules fairly

9.19. The duty on trustees to act fairly when dealing with beneficiaries whose rights are dissimilar is well established. The Review acknowledges that it will be important to spell out to responsible entities that this duty is a duty to act honestly in the interest of all the beneficiaries of the scheme, and that such actions can, on occasion, result in apparent unfairness from the point of view of an individual beneficiary. This situation has been acknowledged by the courts:

> [it] is obvious that a decision which is considered to be fair for the ultimate benefit of the estate may be for the immediate advantage of one beneficiary, and to the disadvantage of the other.[47]

Duty to act honestly

9.20. It may be argued that a responsible entity cannot be acting in a position of trust if it does not act honestly. This obligation is, nevertheless, of such fundamental importance that it should be included in legislation,

47. *In re Charteris; Charteris v Biddulph* [1917] 2 Ch 379 379; see also *Perpetual Trustee Co v Noyes* (1925) 25 SR (NSW) 226, 248-9.

Duty to avoid conflict of interest and to fully disclose such conflicts

9.21. The importance of this duty in relation to trusts generally has already been referred to. The duty is of fundamental importance in the case of superannuation schemes, where the employer's representatives on the board of the responsible entity may be faced with a conflict of interest in considering proposals by the employer sponsor for investment by the superannuation scheme in the employer's enterprise. Accordingly, it should be specifically included as a requirement of responsible entities under the law. The fact that the Review proposes that such investments be permissible[48] does not relieve the responsible entity or members of the responsible entity board from this obligation. The employer representatives on the board of a responsible entity of a defined benefit scheme face an additional source of potential conflict when the actuary recommends a change in the assumptions governing the employer contribution which provides the employer with an opportunity to reduce its contributions.

Duty to act always in the best interests of the members of the scheme

9.22. Ford & Lee describe this duty as the duty which 'marshalls' the trustee's duty of loyalty to the service of the economic wellbeing of the trust fund and of the personal welfare of the beneficiaries.[49] This is a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill.

Duty to exercise care, diligence and skill

9.23. This duty should encompass the administration and investment of the superannuation scheme's funds. The level of skill to be exercised by a trustee has been held to be that which a person of ordinary prudence would exercise in dealing with the property of another person for whom he or she felt morally bound to provide.[50] This is not only a high standard, it is an objective standard. Acting honestly, while a fundamental requirement, is not sufficient. It is appropriate to repeat the standard of care, diligence and skill in the law to ensure it is brought to the attention of trustees. A responsible entity who is an individual should also be required to use all the skill and knowledge that he or she possess-

48. Up to 5% of the value of the fund at cost: see recommendation 11.4.
49. Ford & Lee *Principles of the Law of Trusts* 400.
50. *Re Whiteley; Whiteley v Learoyd* (1886) 33 ChD 347

es or, because of his or her profession, business or calling, ought to possess[51] to discharge the important functions of responsible entity. This is not to say that a responsible entity will be held strictly liable for all the misfortunes of the superannuation scheme.

> a trustee who is honest and reasonably competent is not to be held responsible for a mere error of judgement . . . provided he acts with reasonable care, prudence and circumspection.[52]

Duty to keep trust money separate from the employer's assets

9.24. It is now becoming clear that, without the ability of the Maxwell group to control the assets of the pension fund, the massive fraud which appears to have been perpetrated could not have happened. As a consequence of the investigation into the operation of pension funds, the House of Commons Social Security Committee has recommended that independent custodian trustees be appointed to hold all pension fund assets and that all assets of pension funds should have their ownership clearly designated upon them.[53] The Review accepts that, as a consequence of the requirement in the definition of a superannuation fund in OSSA that such a fund be established for the 'sole purpose' of providing superannuation benefits,[54] the assets of single employer sponsored superannuation schemes are likely to be kept in a separate account apart from the employer's assets. To the extent that, in practice, they are not, the law should require them to be separated.

Duty to exercise discretion only after proper consideration

9.25. The ability of the responsible entity to exercise discretion is a feature of virtually every superannuation scheme. The courts will not interfere in the manner in which trustees exercise their discretions provided the trustees can be seen to be acting in good faith. It is clear that this means that a trustee, in deciding whether or not to exercise its discretion, has a duty to consider the possibility of exercising a discretion. Trustees cannot ignore a power and

> refuse to consider whether it ought, in their judgment, to be exercised.[55]

51. See *Pension Benefits Act* 1987 (Ont) s 23(2) discussed at para 9.13.
52. *Re Chapman* [1986] 2 Ch 763, 778.
53. House of Commons Social Security Committee Second Report, *The Operation of Pension Funds*, 1992 (not yet printed) para 286(vi).
54. OSSA s 3(1).
55. *In re Gulbenkian's Settlement; Wishaw v Stephens* [1970] AC 508, 518 (Reid LJ).

It is argued that, not only has a trustee the duty to consider the exercise of its discretions, but it has a further duty to consider properly the exercise of such discretion. For example, in relation to a pension fund, Lord Wilberforce noted that a trustee's discretion

> cannot be controlled by the court unless he exercised it capriciously, or outside the field permitted by the trust.[56]

Similarly, in assessing the exercise by a liquidator in his exercise of a discretion conferred on him, Simonds J held that exercise of a discretion was justified where an opinion has been found *bona fide* and reasonable.[57] The duty to exercise a discretion only after proper consideration also seems to preclude a trustee from unfairly discriminating against one or more beneficiaries.

Duty to act on advice

9.26. It follows that, if a responsible entity is unable to meet the high objective standard of care required of it, from its own resources, including (in the case of a corporate responsible entity) the resources of the members of its board of directors, it must seek appropriate advice.[58] The fact that responsible entities of superannuation schemes will frequently comprise employees and employers who have little knowledge of financial markets is not relevant.[59] The task they are charged with is the proper investment of the superannuation schemes' funds. This must be undertaken with at least some degree of professional skill in an increasingly sophisticated market if the Commonwealth's retirement income policy aims are to be achieved. Accordingly, the requirement to seek proper advice should be imposed on responsible entities by legislation.

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56. *McPhail v Doulton* [1971] AC 424 at p 449; see Hardingham 'Controlling Discretionary Trustees' (1975) 12 *University of Western Australia Law Review* 91, 112 ff.
57. *Re Great Eastern Electric Company Limited* [1941] Ch 241; See also *Train v Clapperton* [1908] AC 342 regarding the 'sound and reasonable' exercise of a discretion by a trustee.
58. R Ellinson 'The Golden Fleece? Ethical Investment and Fiduciary Law' (1991) *Trust Law International* 160.
59. In *Fouche v Superannuation Fund Board* (1952) 88 CLR 609, the High Court, describing the standard of care to be observed by the trustee as that of reasonably prudent men of business, said 'It is nothing to the point that they were not men of business at all': 641 (Dixon, McTiernan & Fullagar JJ).

Duty to act personally and not to delegate

9.27. Although it has been commented that

> the trustees role has shifted from that of ever-watchful managers of capital to ever-watchful supervisors of managers[60]

it is fundamental to the concept of a superannuation trust that a responsible entity should not be able to shed itself of its responsibilities. This obligation should be included in the law to assist all responsible entities and the members of boards of responsible entities to understand that they will always retain the ultimate responsibility for acts done in their name. It should help make clear that their appointment of an agent, such as a fund manager, does not relieve them of their responsibility in relation to the investment of those funds by the manager.[61]

Duty not to profit from the trust

9.28. This duty is often closely associated with the duty to avoid conflicts of interest. It includes a duty not to take advantage of profits even though they could not have been available to the trust and a duty on the responsible entity that it has not by its action prejudiced or disadvantaged the trust in any way. This duty should not prevent an individual who is the responsible entity or a member of the board of management of a responsible entity from receiving reasonable remuneration for work done in that capacity.

Duty to monitor the cash flow of the scheme

9.29. In DP 50 the Review noted the essential obligation of the responsible entity to monitor the cash flow of a superannuation scheme to ensure that the expected liabilities of the scheme could be met as they fell due, and suggested it could fall into the category of duties which should be codified.[62] The proposal received widespread support.[63] As expected, several submissions suggested that it was something that trustees already do or ought to do.[64] Other submissions, while supporting the concept, were concerned that it not be a complicated

60. Moffatt & Chesterman, *Trust Law: Text & Materials* 550.
61. This is not to say, however, that the responsible entity may not rely on the purported expertise of a fund manager that has been engaged.
62. DP 50 para 7.19, fn 29.
63. IFA *Submission* February 1992; ACTU *Submission* February 1992; Securities Institute of Australia *Submission* February 1992.
64. Permanent Trustee Company Ltd *Submission* January 1992; National Mutual *Submission* February 1992; Mercer Campbell Cook and Knight, *Submission* February 1991.

or bureaucratic exercise.[65] The Review accepts the point that many responsible entities already perform this function, but considers that all responsible entities should do it.[66] Thus, the duty to do it should be expressly stated in the law. The ability of the superannuation scheme to meet its expected obligations without having to resort frequently to unplanned borrowing or forced sales of assets is crucial if the responsible entity is to maximise the rate of return within a prudentially sound investment strategy. The Review agrees that the reporting of the responsible entity's compliance with this requirement need not be extensive. Breaches would be breaches of the legislated standards and should be commented on by the auditor.

Duty to take a portfolio approach to investment

9.30. The principal function of a superannuation scheme is the investment of contributions to provide retirement income. Other trusts may or may not have such a long term objective. Because of the importance of the investment function, superannuation schemes are often granted wide powers of investment by their deed or other constituting document, to enable them to establish and manage a broad portfolio of investments. Several authors have observed that the court's approach when reviewing the investment decisions of superannuation schemes has been much more restrictive.[67] A more appropriate approach is that taken in *Nestle v National Westminster Bank Plc* where it was observed that the standard of care to be observed by trustees set out by *In Re Whitely*[68] is

> capable of adaption to current economic conditions and contemporary understanding of markets and investments . . . Modern trustees acting within their investment powers are entitled to be judged by the standards of current portfolio theory, which emphasises the risk level of the entire portfolio rather than the risk attaching to each investment taken in isolation.[69]

This is not to say that losses on investments made in breach of trust should now be able to be set off against gains in respect of the portfolio, only that an investment which in isolation appears to be risky and therefore may be in breach of

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65. AMP Society *Submission* February 1992, Department of Finance *Submission* February 1992.
66. This task, like that of fund management, should be capable of being delegated. The responsibility for ensuring it is done should, however, remain with the responsible entity.
67. Finn & Zeigler 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' (1987) 61 *Australian Law Journal* 329; Gordon 'The Puzzling Persistence of the Constrained Prudent Man Rule' (1987) 62 *New York University Law Review* 52.
68. The level of skill to be exercised by a trustee is that which a person of ordinary prudence would exercise in dealing with the property of another person for whom he be felt morally bound to provide: *In re Whitely* (1886) 33 ChD 247.
69. (1988) Unreported High Court Chancery Division No 1987 of 1988.

trust may be justified when considered in conjunction with other investments.[70] The Review endorses this approach and recommends that responsible entities be required by the new law to take such an approach in their management of a superannuation scheme's investments. The inclusion of such a duty in the new law would also clarify the approach to be taken when disputing in court a responsible entity's investment decisions. This issue is considered in more detail in chapter 11.

Duty to permit access to trust documents

9.31. The trustee's obligations also extend to allowing beneficiaries to inspect any trust document except for documents relating to the exercise of the trustee's discretion. Without this exemption, trustees would not be able to exercise their discretions impartially and without interference or inhibition.[71] The right of members of large superannuation schemes to access a wide variety of documents from their superannuation schemes could, if heavily used, impose significant costs on the schemes. The OSS Regulations already require superannuation schemes to make information available to members.[72] The Treasurer has set out extensive new disclosure requirements for superannuation schemes with five or more members.[73] These are reviewed in chapter 10. In DP 50, the Review proposed that members of superannuation schemes should have access to information about their interest in the scheme (at no charge) or about the scheme in general (subject to a reasonable access charge).[74] Submissions strongly supported this proposal.[75] The only opposition was on the basis that by allowing access to information, it may lead to abuse.[76] As the members already appear to have the right to request this information, the concern would seem to be unjustified.[77] The Review agrees that members should have rights of access to documents of their superannuation scheme, subject to considerations such as cost, commercial confidence and privacy rights of other members or confidential commercial information. The Review therefore recommends that superannua-

70. *Nestle v National Westminister Bank Plc* (188) Unreported High Court Chancery Division No 1987 of 1988.
71. *Re Londonderry's Settlement* [1964] 3 All ER 855; *Re Fairbairn* [1967] VR 633.
72. Superannuation schemes must provide the actuary's report, auditor's report and copies of certain notices issued by the ISC on request. This information is available only once a year, however, unless the trustees agree otherwise.
73. Treasurer's statement, paper 2. This includes details of annual report continuous disclosure and access to the scheme's governing rules.
74. DP 50 proposal 6.18.
75. Westpac Financial Services *Submission* February 1992, LIFA *Submission* March 1992, Australian Shareholders' Association *Submission* February 1992.
76. Jacques Martin Industry *Submission* February 1992, National Mutual *Submission* February 1992.
77. The Review accepts, however, that by drawing attention to the fact that members have the right to request information, some additional requests may be generated.

tion schemes should be able to levy a reasonable access charge and copying fee for information requested additional to the information to be supplied free to members under the Treasurer's proposals and the Review's recommendations elsewhere in this report.

Recommendation 9.2: Basic fiduciary obligations of the responsible entity

1. The law should specify the following obligations as basic fiduciary obligations of a responsible entity that cannot be excluded or modified:

- **to hold the property of the fund not for the use or benefit of itself or the members of the responsible entity, but for the use and benefit of the members of the fund, including non-contributing members**
- **to become familiar with and to observe the provisions of the deed or other instrument constituting the superannuation fund or ADF and to apply them fairly as between the members of the scheme**
- **to act honestly in all matters concerning the fund or ADF**
- **to avoid any conflict between the interests of the members and the interests of the responsible entity and, if such a conflict arises, to disclose it to the members**
- **to exercise its powers, and perform its duties, as responsible entity in the best interests of the members**
- **to act, in relation to all matters affecting the fund or ADF with the care, skill and diligence with which a person of ordinary prudence would act when dealing with property of another for whom he or she was morally bound to provide**
- **to keep the money and other assets of the fund or ADF separate from the money and other assets of itself, of the members of its board of management and, in the case of an employer sponsored or industry superannuation fund, of any employer involved in the fund**
- **to exercise a discretion or a power vested in the responsible entity, either by law or by the deed or other instrument constituting the scheme, only after proper consideration**
- **if it invests the money, or deals with the other assets, of the fund or ADF — to seek advice from an appropriately qualified person before doing so; however, nothing prevents that person from being a member of the board of management of the responsible entity**
- **not to delegate trustee responsibility in relation to a matter affecting the fund or ADF**

- not to profit from acting as responsible entity; this duty should not prevent an individual who is the responsible entity or a member of the board of management of a responsible entity from receiving reasonable remuneration for work done in that capacity
- to monitor regularly the relationship between the realisable assets of the fund or ADF and its liabilities and prospective liabilities to members to ensure that the scheme is able to pay benefits to which members become entitled as they fall due
- in determining whether to make a particular investment, to have regard to the whole of the circumstances of the fund or ADF including, but not limited to, the following:
  - — its other investments
  - — its obligations, both existing and prospective
  - — the nature of its membership
  - — the desirability of diversifying investments to minimise risk
- to allow a member access to any information or document in the possession or under the control of the responsible entity that relates to the fund or ADF, except a document the disclosure of which to the member who seeks it
  - — would unreasonably disclose another person's private affairs or
  - — would disclose trade secrets or other information that has a commercial value that would be destroyed or lessened by the disclosure, and in relation to which the responsible entity is under a duty of confidence to another person not to disclose.

2. Parallel obligations should be imposed on responsible entities of PSTs.

Duty of directors of incorporated responsible entities

9.32. The incorporation of responsible entities is recommended by the Review as one means of ensuring the Commonwealth's constitutional power to legislate for prudential supervision of superannuation schemes. One consequence of incorporation is to make the trustees of a scheme directors of a company that is a trustee. Directors traditionally owe their duty to the company as a separate legal entity. There is authority for the proposition that if a corporation acts as a trustee, the directors of that corporation no longer stand in a fiduciary relationship to the beneficiaries of the trust as the company occupies that role. The director's only liability in this case is said to be as a company director to the company.[78] However, in a strong dissent Fletcher Moulton LJ noted

> [W]here the directors actually perform their part in the management of the company they are both the brains and hands of the company; and they cannot shelter themselves under the plea that the knowledge of the trustee is not their knowledge, or that the nature and intention of the acts of the trustee were unknown to them.[79]

More recently, it has been stated by the Chief Justice of the Supreme Court of South Australia that

> [T]here is no authority which establishes that a director of a trustee company is under a fiduciary duty to the beneficiary of the trust in respect of property held by the trustee company in its capacity as trustee. It may well be that when the issue arises the Courts will hold that such a duty exists, but, for the time being at least, it remains to be established.[80]

There are circumstances where courts are prepared to look behind the corporate entity appointed as trustee to the persons who actually control it. These circumstances include where the company is being used as an instrument of fraud or where it is being used for persons to avoid their legal liabilities. However, courts are generally reluctant to lift the corporate veil. The Review has concluded that the duties and liabilities of the members of the board of a responsible entity should not be able to be diminished merely by its incorporation. Because the responsible entity's sole function is to manage the superannuation scheme on behalf of the members the directors of such a corporation should have a personal liability to the beneficiaries of the superannuation scheme in the same way that the directors of a trustee company are personally liable for their handling of estates and other property where they act as trustee.[81]

> Recommendation 9.3: Fiduciary obligations of members of boards of management of incorporated responsible entities
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> **The law should provide that each member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST owes to the members of the fund, ADF or PST the obligations set out in recommendation 9.2, changing what needs to be changed. In the case of a responsible entity that is a body corporate, this is in addition to any other obligation that he or she owes as director or officer of the body corporate.**

78. *Bath v Standard Land Company Limited* [1911] 1 Ch 618.
79. *Bath v Standard Land Company Limited* [1911] 1 Ch 618 at 636.
80. *Hurley & Anor v BGH Nominees Pty Ltd* (1982) 1 ACLC 387, 390-391.
81. eg *Trustee Companies Act 1964* (NSW) s 31(3).

10. Disclosure: a critical obligation

Introduction

Scope of chapter

10.1. This chapter explores the rationale for requiring comprehensive disclosure to members and to the regulator as a central feature of a system of prudential supervision. It includes proposals to clarify and extend the current disclosure requirements.

Importance of disclosure

10.2. Adequate disclosure is the fundamental requirement of any system of prudential supervision. As the Review noted in IP 10

> the goal of investor protection requires, as a minimum, adequate disclosure to enable the investor or potential investor to make an informed judgment about his or her investment.[1]

In the context of superannuation schemes, disclosure is important in three respects

- to prospective members, particularly of personal schemes
- to existing members of all schemes during membership of the scheme and on exit from the scheme
- to the regulator, to enable it to monitor schemes' compliance with the law.

In his statement of 20 August 1991 the Treasurer proposed additional disclosure requirements for superannuation schemes with more than five members.[2] The Review notes that the Treasurer's statement provides for a considerable expansion in the level of disclosure required in each case. The Review supports these proposals. In some cases the Review considers that, additional disclosure is required. The Review's additional requirements are set out below.

Inconsistencies in disclosure regimes

10.3. Consistency and increased competition. A principal objective of the Commonwealth's prudential framework for superannuation is to foster competition within the superannuation industry.[3] This objective will not be achieved if

1. IP 10 para 2.26.
2. See para 5.7 for a summary of the current disclosure requirements and Appendix 1 for additional disclosure requirements proposed by the then Treasurer, Mr John Kerin MP on 20 August 1991.
3. Treasurer's statement, paper 1 para 20.

members or potential members, as a result of different disclosure requirements, cannot compare superannuation schemes. Moreover, responsible entities may be encouraged to structure their schemes to take advantage of any inconsistencies in disclosure requirements, further disadvantaging potential scheme members. Removing these inconsistencies will enhance competitive neutrality, thereby making competition more likely.[4]

10.4. ***Proposal.*** In DP 50 the Review proposed that the quantity and quality of information provided by life companies in respect of superannuation policies should be increased to that required for prescribed interests under the Corporations Law.[5] This proposal received widespread support,[6] except from life insurance companies, who all considered that the disclosure required under the ISC circulars to be adequate. The Review acknowledges that compliance with ISC circulars 290 and 291 has greatly improved the level of disclosure required by life companies. To the extent that there are differences remaining, the Review considers they should be eliminated. The Review understands that these inconsistencies are also being addressed by the ISC as part of its review of the *Life Insurance Act 1945* (Cth). To the extent that they are eliminated as a result of that review, the concerns held by this Review will be addressed. The Review, therefore, limits its recommendation in respect of disclosure by life offices to the elimination of the remaining differences between the ISC circulars and the disclosure requirements under the Corporations Law and the application of the additional disclosure requirements recommended in this chapter. This is particularly important for investment linked products where the investment risk is borne by the investor.

10.5. ***Recommendation.*** Chapter 6 sets out differences and inconsistencies between the disclosure requirements imposed by the Corporations Law and by the other laws, such as OSSA, affecting superannuation schemes. The publication of the Treasurer's statement August 1991, and ISC circulars 290 and 291, would suggest that the Commonwealth recognises the need to bring up to the standard imposed by the Corporations Law disclosure requirements affecting schemes not regulated by the Corporations Law. The Review endorses the principle that disclosure requirements under the Corporations Law s 1022 are an appropriate standard to apply to disclosure for superannuation schemes. It construes the Treasurer's statement in August 1991 as an announcement of the

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4. The Treasurer indicated that it is now a priority of the Commonwealth to ensure that similar superannuation schemes are subject to the same regulatory requirements irrespective of the institution providing the scheme: Treasurer's press release No 73, 20 August 1991.
5. DP 50 proposal 6.6.
6. eg Permanent Trustee Company Ltd *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992.

Government's intention to apply this standard to schemes currently regulated by OSSA. The Review recommends that all superannuation schemes should conform to this standard of disclosure. At present, the standard is imposed by law only on those schemes regulated by the Corporations Law. In particular, it is not imposed by law on schemes that are subject only to circulars 290 and 291. These circulars are advisory and do not impose legal obligation.[7] It should be imposed by law on all schemes.

Recommendation 10.1 — Inconsistencies in disclosure requirements.
The law should impose on all superannuation funds, ADFs, PSTs and DAs disclosure requirements conforming to those imposed by the Corporations Law. Where requirements do not meet this criteria, they should be changed.

Application of disclosure requirements to small schemes

10.6. The additional disclosure requirements proposed by the Treasurer are only to apply to schemes with five or more members. The Review considers that the information that is referred to in paragraph 10 of the Treasurer's statement is information that is relevant to arms length members of superannuation schemes. It is information that is probably already available to members under the general principles of trust law.[8] To require responsible entities to distribute it to members automatically may be too costly. Accordingly, the Review recommends that information only be provided at the request of a member. All schemes with less than five members, at least one of whom is an arms length member, should be required to enclose, with members benefit statements, a notice to the effect that it is available on request. Single member schemes where the member is the responsible entity should not be subject to any disclosure requirements.

Recommendation 10.2: Disclosure to single member schemes
No disclosure requirements should apply to a superannuation scheme if the responsible entity is the only member.

7. The Review understands that there is widespread compliance with the standards embodied in these circulars.
8. In ch 9 the Review suggests that this principle be clarified and modified.

Reporting and disclosure — general principles

Disclosure to members

10.7. ***Comprehensible and consistent.*** The disclosure requirements imposed on superannuation schemes, ADFs and DAs are designed to inform members and the regulator about the activities of the schemes. They should enable members of superannuation schemes, ADFs and DAs (and, where appropriate, the regulator) to make meaningful comparisons between competing schemes, ADFs and DAs. To achieve these objectives, the requirements must satisfy the following general criteria:

- they must ensure that the information to be provided is comprehensible as well as comprehensive and
- they must, wherever possible, apply consistently across all competing schemes to allow comparisons.

10.8. ***Useful information.*** Simply providing members with more information about their superannuation scheme does not guarantee that they are able to understand it or make better decisions. Indeed, too much information may only serve to confuse members.

Disclosure to the regulator

10.9. Ensuring that the regulator receives all relevant information about superannuation schemes is an integral part of the regulatory framework for superannuation. Without that information, the regulator would be unable to use its investigative and enforcement powers effectively and fully. During consultations the view was expressed to the Review that if there are strict requirements to inform the regulator, members will become complacent and fail to protect their interests. For this reason it was put forward that no more information should be given to the regulator. On this view, members would be more alert and vigilant if they did not know that information about the scheme was being sent to the regulator as well as to them. The Review does not agree that information supplied to the regulator results in complacency. But member involvement in superannuation is undoubtedly an important element in the supervision and monitoring of superannuation. Members cannot always adequately supervise the superannuation industry themselves. The regulator must be involved. To be involved it must have information.

Plain language

10.10. There is little point in disclosure which uses technical jargon or sophisticated concepts not readily understood by the community. Even plain language documents may not measure up to the standard required if the true yardstick is the ability of members to comprehend the document. ISC circulars already provide that information must be provided by insurance companies in 'clear and not ambiguous language'.

> The use of ambiguous terms, or industry terms which are not explained in ordinary simple language and are not readily understood by the public at large, should be avoided.[9]

DP 50 proposed that all disclosure documents should be written in clear easily understandable language and presented in a reasonable way.[10] This proposal received widespread support.[11] Some concern was expressed during consultations about how successfully this proposal could be implemented, given the current complexity of superannuation. The Review does not see this as a problem. Common sense should prevail. There is a considerable body of literature on the principles of producing plain language documents[12] and there are several bodies with rapidly developing expertise in the area.[13] The Review recommends that the law should require that disclosure documents be written in clear and simple language. There should not be a criminal sanction, or tax sanction, for a contravention. That would be unrealistic. Instead, the regulator should be able to direct that certain terminology or expressions not be used by a responsible entity. Responsible entities may be helped by model disclosure guidelines. They would need to be modified for individual schemes but would provide some guidance. ASFA has already made commendable efforts in this area. It has published a reporting standard and has initiated annual communications awards.

> We believe there is a continuing role for bodies such as ASFA in promoting 'best practice' in the industry and encouraging innovation through acknowledgment of outstanding achievement.[14]

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9. ISC circular 291.
10. DP 50 proposal 6.3.
11. eg Permanent Trustee Company Ltd *Submission* January 1992; LIFA *Submission* February 1992; Australian Federation of Consumer Organisations *Submission* February 1992.
12. eg Eagleson *Writing in Plain English* AGPS Canberra, 1990.
13. eg the Law Foundation Centre for Plain Legal Language based at Sydney University.
14. ASFA *Submission* March 1992.

The Review recommends that the regulator, in conjunction with ASFA and other industry associations, establish guidelines as to best practices in providing information in clear and unambiguous language and encourage schemes to comply.[15]

Recommendation 10.3: Plain language

1. The law should provide that all documents issued by

- **the responsible entity of a superannuation fund or ADF or**
- **the provider of a DA**

and given to members or prospective members to inform them about the scheme are to be written in clear and simple language. Failure to comply should not be an offence, but the regulator may give a written direction to the responsible entity or provider not to issue, or to take reasonable steps to recall from circulation, a particular document on the grounds that it is not written in clear and simple language. Failure to comply with the direction should be an offence.

2. The regulator, in conjunction with ASFA, other industry bodies and other experts, should develop guidelines for plain language in superannuation and related documents.

Community languages

10.11. DP 50 included a proposal that members of superannuation schemes should be able to obtain, on request, basic information that is required to be disclosed, or a summary of it, in a relevant community language.[16] This proposal received some support.[17] It was criticised, however, mainly on the grounds of excessive cost and uncertainty as to how much information would be required to be provided in other languages.[18] The Review has refined the proposal in the light of those comments but remains of the view that because superannuation is increasingly becoming a matter of public policy, the government should take responsibility for ensuring that members of superannuation schemes get at least a minimum standard of information in a limited range of languages. It should prescribe a list of languages in which a member of a scheme may request information. The regulator should prepare a prescribed statement to be supplied to responsible entities free of charge, on request. Members should

15. The ISC has already expressed interest in working with the industry to establish guidelines: *Submission* March 1992.
16. DP 50 proposal 6.4.
17. eg Permanent Trustee Company Ltd *Submission* January 1992; DSS *Submission* February 1992; Office of Queensland Cabinet *Submission* February 1992.
18. AMP Society *Submission* February 1992; ASFA *Submission* March 1992; Mercer Campbell Cook & Knight *Submission* February 1992.

advise the responsible entity on joining a scheme if he or she would like information to be provided in one of the prescribed languages. The responsible entity should then include a prescribed statement, in the language the member chose, when sending to the member his or her benefit statement. The prescribed statement should point out that the benefit statement is an important document and that the member should seek help to have it translated if he or she cannot read it. Information about translation services should be made available at the Superannuation Advisory Service.[19]

Recommendation 10.4: Information to persons not fluent in English

1. The law should provide that the responsible entity for a superannuation fund or ADF, and the provider of a DA, must ensure that, as soon as practicable after a person becomes a contributing member of the scheme or starts to receive a pension from the scheme, the person is given an opportunity to indicate whether he or she is not fluent in English. If the person indicates that he or she is not fluent in English but is fluent in one of the prescribed languages, the responsible entity or provider must

- **forthwith give the person a copy of the statement prepared by the regulator for the scheme, or for schemes of the relevant kind, in that language and**
- **send, with each benefit statement or annual report sent or given to the person, a copy of the statement prepared by the regulator in that language.**

Failure to comply should be an offence.

2. Regulations under the law should prescribe such a statement, which should include words to the following effect:

> **This is an important document. It tells you about your superannuation scheme and the money you have in the scheme at the moment. You cannot get the money out of the scheme now, but you should take an interest in the scheme and how it is run.**
>
> **If you cannot understand the document, you should seek help to have it interpreted for you. If you do not know anyone who can help you, contact the Superannuation Advisory Service.**

19. See recommendation 12.7.

Information about benefits

10.12. ***Proposal that present day values be given.*** It is important that members of superannuation schemes understand the real purchasing power of the lump sum or pension they expect to receive some years hence on retirement. They are less likely to take an active interest in the effective management of their scheme or to make sensible investment decisions if they have been lured into false expectations of a 'pot of gold'. To try to enhance this understanding, DP 50 proposed that the information about prospective benefits reported to members should be expressed in real terms, that is, in present day dollar values, and that the assumptions on which all matters disclosed to members are based should be disclosed.[20] This would help people understand the actual purchasing power of their future benefit.

10.13. ***Response.*** Considerable support was expressed for both these proposals.[21]

> It is agreed that prospective benefits should be expressed in real terms. It is essential that the regulator provide guidance as to the appropriate discount or inflation rate to be used. The method and basis of calculation of prospective benefits should be disclosed prominently and in close proximity to the projections.[22]

The Department of Finance suggested that the proposal should not apply to defined benefit schemes.[23] The Review agrees that a special rule is necessary for defined benefit schemes. Several submissions referred to ISC circulars 290 and 291, which relate to the benefit illustrations of single and regular premium life insurance policies, and urged that they be 'given time to work' before further recommendations are made.[24] The Review does not consider that it is appropriate to set one standard for disclosure by one sector of the superannuation industry and a different standard for the rest of the industry unless the difference can be justified. There is no reason to set different standards in this instance. Nor is there any reason to have these standards imposed on one sector by law, but only set out in non-enforceable guidelines for another sector.

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20. DP 50 proposals 6.1, 6.2.
21. eg ASC *Submission* March 1992; Westpac Financial Services *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992.
22. Australian Shareholders Association *Submission* February 1992.
23. Department of Finance (Cth) *Submission* February 1992.
24. eg LIFA *Submission* March 1992; National Mutual *Submission* February 1992; Prudential Assurance Company Ltd *Submission* February 1992; AMP Society *Submission* February 1992.

10.14. ***Recommendation.*** To the extent, if any, that the disclosure standards suggested by ISC circulars for superannuation schemes operated by life insurance companies differ from the Review's recommendations, they should be modified. Furthermore, the standards involved should apply to both sectors of the industry by law. The Review recommends that, in a defined benefit scheme, if information is provided about the amount of benefit available under a scheme, and, under the scheme, the benefit is worked out only by reference to final average salary, the benefit should have to be expressed primarily as a multiple of final average salary. The benefit, expressed in this way, should have to be disclosed in a prominent way. If it is also expressed in some other way, that expression must be clearly distinguishable as secondary, for example, provided in smaller print. For all schemes, if benefits are expressed in dollar amounts, the Review recommends they should be expressed in both real and nominal terms. The information should also include a statement of the assumptions about inflation, the scheme's earning rate, and wages growth, used to work out the benefit, and a statement to the effect that the amounts stated as benefits available are not guaranteed.[25]

Recommendation 10.5: Information about benefits

1. The law should provide that it is an offence for the responsible entity for a superannuation fund to publish information to members or prospective members of the scheme about the benefits available under the scheme, being information that does not comply with the following requirements:

- **if the fund is a defined benefits superannuation fund under which the amount of the benefit for a member on ceasing employment is worked out by reference only to the amount of the member's remuneration during the year, or during 2 or more of the years, immediately before the member ceased the employment — the amount of the benefit must be expressed as a fraction or multiple of the amount of the member's remuneration during the year immediately before the member ceased the employment**

25. The Review envisages that this statement would be similar to the footnotes required to be included by ISC circular 290 in benefit illustrations for investment linked policies to the effect that the value of units may rise and fall; that the results shown are illustrations only; that the performance of the fund is not guaranteed and depends on economic conditions, investment management and future taxation and that care should be exercised in using past performance as a basis for assessing long term future performance.

- **in any case**
  - **— if the amount of the benefit is expressed in the information in dollars, the amount must be expressed in both present day dollars and in nominal dollar values**
  - **— the information must include a statement of the assumptions about the rate of inflation, the rate of earnings of the fund and the rate of wages growth used to work out the amount of the benefits**
  - **— the information must include a statement to the effect that the amounts of benefits stated are not to be taken to be the actual amounts to which the member or prospective member will be entitled, and that there is no guarantee that the amounts stated will be paid.**

10.15. ***Regulator to publish guidelines.*** Trying to standardise the reporting of benefits, or at least to make them such that comparisons may usefully be made between schemes, will be effective only if some limit is placed on the assumptions regarding inflation and wage rates that can be used in the calculation of benefits. The Review recommends that the regulator should issue a range of estimates to be used in such calculations. Approval of the regulator should be required to use rates outside that range.

Recommendation 10.6: Regulator to publish standard rates
1. The law should provide that the regulator may, by notice in the *Gazette*, specify estimates for factors to be used in working out amounts of benefits. The estimates may include estimates as to the rate of inflation and the rate of wages growth.

2. The law should provide that it is an offence for a responsible entity for a superannuation scheme or an ADF, or the provider of a DA, to publish, as mentioned in recommendation 10.5, estimates of benefits worked out using, for a factor for which an estimate has been specified by such a notice, an estimate other than that specified unless the regulator has given written approval to the publications.

10.16. ***Free look period.*** An investor in a superannuation scheme marketed by a life company will usually have a 14 day 'free look' period after signing the contract. During this period the investor may change his or her mind and cancel the policy. This allows people who have been the subject of high pressure sales tactics from insurance agents the opportunity to reconsider their commitment.[26] The Review proposed in DP 50 that instead of a free look period, offer documents for superannuation schemes marketed by life insurance companies should include a copy of the contract.[27] Submissions indicated overwhelming support for the retention of a free look period of 14 days.[28] The general view is that a free look is a better protection and safeguard for investors than providing a copy of the contract would be. The Review, therefore, recommends that life companies continue to give superannuation investors a 14 day free look period. This should be made compulsory by amending the *Insurance Contracts Act 1984* (Cth) s 64.

10.17. ***Extending the free look.*** There was such support for the free look period that the Review considered its extension to personal superannuation schemes not issued by life companies. Where a person has no choice whether to join or leave a scheme, that is, where membership of the scheme is a condition of holding the job, a free look period is not required. For personal schemes, however, where individuals have a choice about investing in a particular scheme, the Review recommends a 14 day free look period. Protection against abuse (by members withdrawing without penalty if there is a downturn in the scheme during the free look period) is needed for all situations where a free look period applies. The Review understands that the ISC has recommended that, for investment-linked business, the policy holder should bear the investment risk during the 14 day period.[29] This recommendation is consistent with the Review's thinking on this issue. The Review recommends that the withdrawal sum should be calculated at the date of the withdrawal request. No fees or charges should be imposed by the responsible entity on the investment if the withdrawal request is made within the 14 days.

Recommendation 10.7: Free look

1. The law should provide that a member of a personal superannuation fund, or of an ADF or DA, has a right, exercisable at any time before the end of 14 days after being first notified of his or her membership, to withdraw from the fund, ADF or DA. The right must be exercised by notice in writing given to the responsible entity of the fund or ADF or the provider of the DA.

26. Superannuation contracts are excluded from the requirement under the *Insurance Contracts Act 1984* (Cth) s 64 to provide a 14 day free look period but most life insurance companies seem to provide it for their superannuation policies voluntarily.
27. DP 50 proposal 6.7.
28. eg, D Knox *Submission* February 1992; Commonwealth Bank Group Financial Services *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; LIFA *Submission* March 1992.
29. *Australian Financial Review*, 18 March 1992, 27.

2. The law should provide that, on withdrawal of an investment within 14 days of the investment being made, the responsible entity or provider is liable to repay to the member the amount due to the member under the terms of the scheme, worked out as at the date of the withdrawal notice. No exit fees are to be charged to the member in this instance.

Advertising by superannuation schemes

Laws regulating advertising of superannuation schemes

10.18. ***Proposal to preclude misleading advertising.*** The Review is strongly of the view that it is most important to regulate advertising to ensure that a product or service provider does not mislead prospective purchasers and that information provided is truthful and realistic. In DP 50 it was proposed that, to the extent that they did not already apply, the *Trade Practices Act 1974* (Cth) s 52,[30] the Corporations Law s 995[31] and equivalent fair trading legislation[32] should apply to the marketing of superannuation schemes. This proposal would involve amending the *Insurance Contracts Act 1984* (Cth) s 15 so that those laws would apply to schemes marketed by life insurance companies.

10.19. ***Submissions support proposal.*** This proposal received almost unanimous support in submissions.[33] A few submissions disagreed with the proposal as it relates to life insurance companies, on the basis that matters of 'fair dealing' are adequately covered by ISC circular 291.[34] As this report has already noted, however, ISC circulars are not binding on life insurance companies and provide no redress for members who have suffered as a result of a breach of the standards set out in a circular.

10.20. ***Recommendation.*** The Review recommends that, to the extent that they do not apply, the *Trade Practices Act* s 52 and the Corporations Law s 995 should apply to the advertising of superannuation. In addition, the *Trades Practices Act* s 52A should apply.[35] The ALRC recommends in its report *Multiculturalism and the Law* that the *Insurance Contracts Act 1984* (Cth) be amended so as not to affect

30. This section prohibits misleading or deceptive conduct in trade and commerce.
31. This section prohibits misleading conduct.
32. *Fair Trading Act 1987* (NSW); *Fair Trading Act 1989* (Qld); *Fair Trading Act 1987* (SA); *Fair Trading Act 1990* (Tas); *Fair Trading Act 1985* (Vic); *Fair Trading Act 1987* (WA).
33. eg Women's Economic Think Tank *Submission* February 1992; County Natwest *Submission* February 1992; Westpac Financial Services *Submission* February 1992.
34. LIFA *Submission* March 1992; National Mutual *Submission* February 1992.
35. This section prohibits unconscionable conduct. The Review also recommends that s 52A should apply to contracts between responsible entities and investment managers: recommendation 8.13.

the operation of the *Trade Practices Act 1974* (Cth) Part V Division 1.[36] The Review supports that recommendation. The amendment should be extended, however, to apply the Corporations Law to contracts of insurance.

Recommendation 10.8: Misleading and deceptive conduct in advertising superannuation

The *Insurance Contracts Act 1984* (Cth) s 15 should be amended to ensure that it does not prevent the *Trade Practices Act 1974* (Cth) s 52 and 52A or the Corporations Law s 995 from applying in relation to insurance contracts issued in connection with a superannuation fund, an ADF, a PST or a DA. However, the effect of the *Insurance Contracts Act 1984* (Cth) s 33 and 55 should be preserved.

10.21. ***State fair trading legislation.*** The *Trade Practices Act* does not apply to the Crown in the right of any State, nor to any instrumentality of any government of any State.[37] Prima face, therefore, a State government superannuation scheme would not be subject to the Trade Practices Act.[38] The Review considers that the principles of fair trading should apply to State government superannuation schemes. This could be done by removing the exemption from the Trade Practices Act for State superannuation schemes or by leaving them subject to the various State fair trading Acts.[39] The disadvantage of the latter option is that the State fair trading Acts are not uniform. The Review does not consider it as appropriate that the application of these principles not be uniform throughout Australia. Accordingly, the Review recommends that the TPA be amended to remove the exemption for State government superannuation schemes.

Recommendation 10.9: State government superannuation schemes

The law should provide that the provisions of the *Trade Practices Act 1974* (Cth) relating to fair trading, that is, Pt V, extend to State government superannuation schemes.

10.22. ***Trade Practices Act s 74***. This section, which implies into a contract for the supply of services by a corporation to a consumer a warranty that the services will be rendered with due care and skill, is specifically excluded from

36. That includes s 52, s 52A. ALRC 57 para 12.30.
37. *Bradken Consolidated Ltd v BHP* (1979) 145 CLR 107.
38. Depending on the interpretation of the intention of the establishing legislation. It was held, for example, that the State Superannuation Board, a Victorian Statutory Corporation, had been established with such independence from government control that it was not entitled to immunity from the Trade Practices Act: *State Superannuation Board v Trade Practices Commission* (182) 60 FLR 165.
39. See fn 32.

applying to contracts of insurance.[40] It has been suggested that this should not be the case.[41] The Review agrees in principle. It sees no reason why such a warranty should not be implied into contracts of insurance that are superannuation business of life companies. Competitive neutrality between superannuation offered by life companies and superannuation not offered by life companies demands this. The Review is aware that the ISC is reviewing the *Insurance Contracts Act 1984* (Cth) and that it may be considering, in the context of that review, lifting the limitations on the applicability of the Trade Practices Act to insurance contracts. To the extent that the ISC review does not conclude so, the Review recommends that insurance contracts that represent superannuation business of life companies should be subject to the Trade Practices Act s 74.

Recommendation 10.10: Warranty of care and skill in superannuation
The *Trade Practices Act 1974* (Cth) s 74 should be amended to ensure that it applies to insurance contracts issued in connection with a superannuation fund, an ADF, a PST or a DA.

Advertising standards

10.23. ***Proposal for published criteria.*** For single employer sponsored and industry schemes, marketing of the scheme through advertising is not significant. For other schemes, however, advertising is common. The Review proposed in DP 50 that advertisements for personal schemes should meet criteria approved by the regulator.[42] This proposal did not involve the regulator ensuring compliance with the advertising criteria prior to release of each advertisement. Instead, it envisaged that the regulator should be able to act on complaint, that is, the regulator should be able to require the withdrawal of an offending advertisement and to impose a penalty on the responsible entity for issuing an advertisement that did not comply with advertising criteria approved and published by the regulator.[43] The majority of submissions that commented on this proposal agreed with it.[44]

10.24. ***Regulator may object to an advertisement.*** While the Review does not recommend that the regulator should have to approve advertisements for superannuation schemes, the regulator should be able to require an advertise-

40. *Trade Practices Act 1974* (Cth) s 74(3)(b).
41. Attorney-General's Department Submission to the Senate, October 1991.
42. DP 50 proposal 6.10.
43. cf *Life Insurance Act 1945* (Cth) s 77 which empowers the Life Insurance Commissioner to object to an advertisement for a life company only on the basis of the material in the advertisement, not on the basis of information alluded to by the advertisement.
44. eg DSS *Submission* February 1992; McNelis *Submission* February 1992; IFA *Submission* February 1992; ISC *Submission* March 1992.

ment to be submitted to it for inspection. It should have the power to object to an advertisement if it is of the opinion that the advertisement is likely to mislead.[45] It should be an offence to distribute an advertisement that has been objected to by the regulator.

Recommendation 10.11 : Power to require production of advertisements

The law should make provision analogous to the *Life Insurance Act 1945* (Cth) s 77, and that recommended by the ALRC in its report *Insurance Contracts* (ALRC 20) giving the regulator a power to require production of any advertising matter used or proposed to be used by or on behalf of the responsible entity of a superannuation fund, an ADF or a PST or by the provider of a DA, and to stop the use or further use of the matter as advertising on the ground that it is misleading or deceptive.

Application to join a scheme

10.25. Under the Corporations Law an investor may only apply to invest in a prescribed interest on a form attached to a prospectus.[46] This is a useful way of ensuring that investors receive the prospectus prior to investing in the scheme. Many employer related superannuation schemes follow a similar practice by attaching an application form to join the scheme to the back of the member booklet issued to prospective members. In view of the importance attached by the Review to the disclosure standards for prospective members set out in this report, it considers that it is appropriate to impose a similar requirement to that contained in the Corporations Law s 1020 on all superannuation schemes.

Recommendation 10.12: Applications for membership of schemes

The law should provide that it is an offence for the responsible entity for a superannuation fund, an ADF or a PST, or the provider of a DA, to accept an application by a person to become a contributing member of the scheme unless the application is made in writing on a form attached to a copy of the most recently issued prospectus or member booklet or, in the case of a DA, the most recently issued offer document, for the scheme.

45. This is similar to the power of the Commissioner under the *Life Insurance Act 1945* (Cth) s 77 in respect of forms of proposal or policy.
46. Corporations Law s 1020.

Recommendation 10.13: Information to accompany prospectuses etc.
The law should provide that it is an offence for
- **a responsible entity for a superannuation fund, an ADF or a PST, or the provider of a DA, to give a prospectus, member booklet or offer document to a person with a view to the person's becoming a contributing member of the scheme or**
- **a responsible entity for a superannuation fund to give a member booklet to a person who has become a member of the fund**

unless the responsible entity or provider also gives to the person
- **a copy of the most recent annual report for the scheme relating to the investments of the scheme and**
- **a copy of any statement of material adverse change notified to members since the most recent annual report was issued.**

Advertisements to identify responsible entities

10.26. ***Proposal.*** The responsible entity will be accountable to members for the administration and management of a superannuation scheme. The identity of the responsible entity should, therefore, be highlighted. The Review proposed in DP 50 that the responsible entity's name, and nobody else's, appear at the beginning of any advertisement for a superannuation scheme or on the front of any member booklet or prospectus produced in relation to the scheme.[47] It also proposed that near the name should appear a statement that the responsible entity is the organisation primarily responsible to members and whom they should approach with any complaints or queries.

10.27. ***Submissions.*** Some submissions disagreed with this proposal on the grounds that other names (for example, of the employer, an associated company or product provider) should also be allowed to be displayed.[48] The Review agrees that the name of the scheme should be allowed to appear, provided the name of the responsible entity is prominently displayed as well. The aim in highlighting the name of the responsible entity is to stress its fundamental role and primary responsibility. Most other information can be provided later in the document. The Review recommends that the name of the responsible entity be required by law to be displayed at the beginning of any advertisement or on the front of any document. The only other name to appear in that place should be the name of the scheme.

10.28. ***Further information to be disclosed.*** It is clear that the information which needs to be disclosed in member booklets, offer documents and prospectuses

47. DP 50 proposal 6.11.
48. Commonwealth Bank Group Financial Services *Submission* February 1992.

should do more than identify the name of the responsible entity. Several of the Treasurer's proposals require the annual notice to members to include further information about the responsible entity and other relevant parties, for example, the names of the trustees and advice as to who appointed them, the names of any investment managers or other financial advisers or consultants that have been appointed to control the investment of all or any part of the fund. Under the Treasurer's proposals that information will be available to members before they enter a scheme because prospective members will receive a copy of the annual notice last issued to members.[49]

10.29. ***Recommendation.*** The Review supports the disclosure of this information to prospective and existing members. It recommends that, in addition to the responsible entity's name, the names of the members or directors of the board of management of the responsible entity, and information whether there is institutional backing for the responsible entity or for the scheme and details of that backing, should be disclosed on the inside cover of any member booklet, offer document or prospectus.

Recommendation 10.14: Advertisements, brochures etc.

The law should provide that the cover of (or, if it does not have a cover, the front page of the document) a brochure, pamphlet or other document about a superannuation fund, ADF, PST or DA (including an annual report, member booklet, offer document or prospectus) published by the responsible entity for the scheme or the provider of the DA may only display the name of the responsible entity for the scheme or of the provider of the DA and the name of the scheme. A contravention should be an offence by the responsible entity or provider.

Recommendation 10.15: Further information: member booklets etc.

1. The law should provide that it is an offence if a prospectus, member booklet or offer document published by the responsible entity for a superannuation fund, ADF, PST or by the provider of a DA does not include, on the inside cover, the following information:

- **the name and address of the responsible entity**
- **if the responsible entity or provider is a body corporate or unincorporated — the names of the members of the board of management of the responsible entity**

49. Treasurer's statement, paper 2 para 10(g), 10(i), 13(a).

- **the name of each investment manager engaged by the responsible entity or by the provider during the 12 months immediately before the booklet, prospectus or offer document was issued**
- **whether there is institutional backing for the responsible entity, for the provider or for an investment manager and, if there is, the prescribed particulars of that backing.**

2. 'Institutional backing' means whether any return to the member of capital or interest is guaranteed by the responsible entity or a related corporation.

Disclosure to prospective and existing members

Contents page

10.30. An important part of being able to make the best use of available information is the ability to ascertain the key features quickly and easily. In DP 50 the Review proposed that detailed information booklets, offer documents or prospectuses provided to members or prospective members should include a summary of the information provided.[50] Whilst receiving much support,[51] this proposal was criticised in several submissions on the basis that providing a summary may result in the provision of too much information, to the detriment of the members' understanding.[52] It was suggested that a comprehensive contents page which lists the important issues for the member in plain language would help people to find the information they needed and would perhaps be more useful. The Review recommends that responsible entities that publish or distribute detailed member booklets, prospectuses or offer documents to members or prospective members should be encouraged to provide a comprehensive contents page.

Recommendation 10.16: Contents pages

Member booklets, prospectuses and offer documents for superannuation funds, ADFs, PSTs and DAs should include a comprehensive contents page or index, but failure to comply should not be an offence.

50. DP 50 proposal 6.5.
51. LIFA *Submission* March 1992; Permanent Trustee Company Ltd. *Submission* January 1992.
52. Department of Finance (Cth) *Submission* February 1992; ASFA *Submission* March 1992.

Enhanced disclosure

10.31. ***Enhanced disclosure for corporations.*** In 1991 the Advisory Committee released a report on enhanced disclosure by corporations.[53] The report proposed that 'disclosing entities' should be required to disclose all material matters to the ASC and, where appropriate, the Australian Stock Exchange (ASX).[54] A material change includes

- any change in, or reassessment of, the entity of which equity or debt holders would reasonably require disclosure for the purpose of their making an informed assessment of the disclosing entity
- any matter that is likely to affect 'materially' the price of the disclosing entity's debt or equity securities or the disclosure of which is necessary to avoid the establishment, or continuation, of a false market in those securities.

The rationale for the enhanced disclosure regime is that it will promote investor confidence in the integrity of Australian capital markets. The requirement is also seen as complementary to the requirement for disclosure to potential investors in securities in the Corporations Law s 1022. Under the report's proposals, superannuation schemes already subject to the prescribed interest provisions of the Corporations Law will, if they are large enough, have to meet the enhanced disclosure requirements.

10.32. ***Enhanced disclosure for superannuation schemes proposed.*** In DP 50 the Review proposed that an enhanced reporting regime similar to that proposed to be introduced into the Corporations Law should be applied to personal superannuation schemes where appropriate. Disclosure would be made to the regulator. It also proposed that the regulator should be able to order the responsible entity to report any of these material changes to the members where the regulator considered that is appropriate.[55] The rationale for applying an enhanced disclosure regime to single employer sponsored and industry schemes of the requisite size was less obvious to the Review. Given that membership of these

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53. Companies and Securities Advisory Committee *Report on an Enhanced Statutory Disclosure System*, Sydney, 1991.
54. 'Disclosing entities' include
    - all listed companies or limited trusts
    - all public companies with 50 or more members or holders of debentures
    - all companies and prescribed interests with total (gross) assets in excess of $10 million
    - public sector corporations that carry on a business.
55. DP 50 proposal 6.8.

schemes is, in many cases, mandatory, it was argued that no immediate purpose is served in making information about material changes in the scheme's situation available to people who cannot act upon it. The Review accepted that the cost of enhanced disclosure may outweigh the benefits in this situation.

10.33. ***Submissions.*** The principle of continuous disclosure received considerable support in submissions.[56] The ASC favoured the principle being extended to all schemes.[57] Concern was expressed, however, about what would constitute 'material change'[58] and the minimum size of schemes that would be caught by the proposal. The Review notes that the Treasurer's statement proposes that, for schemes with five or more members

> details of any significant or material change subsequent to the date of the annual notice will be required to be provided by addendum to the annual notice to members.[59]

The Review understands that it is intended that material change will be advised to members on a timely basis.

10.34. ***Recommendation.*** The Review supports the Treasurer's view that it is important that adverse material changes are advised to members of all superannuation schemes. For members of schemes in which benefits are not transferable, disclosure of that information may assist members to evaluate the actions of the responsible entity and, maybe, take steps to have it dismissed. It recommends that responsible entities should be obliged to notify members of material changes to the scheme. The actual steps taken to advise members should, however, be left for the responsible entity to decide on the basis of what is reasonable in the circumstances. For some schemes, a notice on the workplace noticeboard may suffice, for others, a letter to all members. This will provide some flexibility for responsible entities and help to keep costs to a minimum. The Review recommends that the following constitute adverse material change for the purpose of this recommendation:

- in the case of defined benefit superannuation schemes — any adverse development which would reasonably be likely to be taken into account by a person in determining whether the fund will be able to meet its obligations as and when they fall due

56. eg Jacques Martin Industry *Submission* February 1992; ASFA *Submission* March 1992.
57. ASC *Submission* March 1992.
58. eg AMP Society *Submission* February 1992; D Knox *Submission* February 1992.
59. Treasurer's statement, paper 2 para 9.

- in the case of other superannuation schemes — any change in, or re-assessment of, the scheme which members and prospective members would reasonably require for the purpose of making an informed assessment of the assets and liabilities, financial position, profits and losses and prospects of the scheme.

In principle, a responsible entity and its members, or directors, should be subject to whatever civil liability is imposed under any continuous disclosure obligations introduced into the Corporations Law. Some modifications for superannuation schemes may be necessary.

10.35. ***Large schemes to notify ASC database.*** The Review also recommends that, if a scheme with more than 200 members suffers an adverse material change, the responsible entity should have to supply the information to the ASC database as well as take reasonable steps to notify the members. This will be very simple for the responsible entity to do and will provide the public with information about larger schemes. The database will provide an additional avenue for members to find information, at virtually no cost to the scheme.

Recommendation 10.17: Disclosure of adverse changes

1. The law should provide that the responsible entity for a superannuation fund, ADF or PST must take reasonable steps to notify the members of the scheme of any significant adverse change in the circumstances of the scheme. Non-compliance should be an offence.

2. If there are more than 200 members of the fund, the law should provide that the responsible entity must, within 14 days after becoming aware of the existence of such a change, notify the ASC. Failure to comply should be an offence.

3. The responsible entity for the scheme and the members of the board of management of the responsible entity should be subject to the same criminal and civil liability as will apply in respect of enhanced disclosure obligations under proposed amendments to the Corporations Law.

4. A 'significant adverse change in the circumstances of a scheme' should be defined as

- **in the case of a defined benefit superannuation fund — a change in the circumstances of the scheme that would reasonably be likely to be taken into account by a person in determining whether the scheme will be able to meet its obligations to members as and when they fall due**

- **in other cases — a change in, or re-assessment of, the circumstances of the scheme that members or prospective members would reasonably require to make an informed assessment of the assets and liabilities, financial position, profits, losses and prospects of the scheme**

being a change that tends to show that the scheme will not able so to meet its obligations to members as and when they fall due.

Performance history

10.36. ***Taking a longer term view.*** Superannuation is intended to be a long term undertaking. To assess a scheme's performance, information over a suitably long period needs to be provided. Otherwise the members may focus their attention on the recent annual performance of the scheme and compare it with volatile short term interest rates available from DTIs. Making inappropriate comparisons may lead members to draw conclusions about the performance of their scheme that are unwarranted given the objective of providing an adequate lump sum or pension for the member's retirement. On joining a scheme members must get details of the kinds of benefits provided by the scheme (such as a death benefit) and the conditions relating to them.[60] They are not entitled to a resume of the scheme's performance history. Under the proposals announced by the Treasurer, the annual notice for schemes with five or more members will include advice as to the actual rate (or amount) of earnings of the scheme in the relevant year of income and the previous two years of income. Prospective members of schemes with five or more members will receive a copy of the scheme's last annual notice and, where a benefit is determined on the basis of actual or credited earnings, information on the earnings rate and crediting rate of the scheme over the last three years.[61]

10.37. ***Proposal.*** The Review suggested in DP 50 that information covering five years of performance is more likely to be relevant to a long term investment. It proposed that information to prospective members should prominently display details of the long term performance of the scheme so as not to focus solely on short term performance and suggested that information should include details for each of the previous five years plus an average.[62] The addition of two years of data was not expected to add significantly to the cost involved in meeting the requirement compared to the benefit obtained.

60. OSS Regulations reg 17(g).
61. Employer sponsored schemes will be able to give this information as soon as is practical after a member has joined the fund: Treasurer's statement, paper 2, para 13.
62. DP 50 proposal 6.12.

10.38. ***Submissions.*** A number of submissions supported this proposal.[63] Others were concerned to ensure that the proposal did not prevent disclosure of performance over a longer period than five years.[64] The Department of Finance expressed doubt that even five years would provide members with the incentive to focus on long term performance and suggested disclosure of average earning rates over 10, 20, 30 and 40 years.[65] A number of submissions disagreed with the need to provide information for more than the previous three years, on the basis that a period of three years had been decided upon by the government and 'should be given an opportunity to work' and then be evaluated at some later stage.[66] Several submissions pointed out that the obligation to give information on returns for five years should not apply to schemes that have been in existence for less than five years.[67]

10.39. ***Recommendation.*** The Review remains of the view that it is important to try to get members to take a longer term attitude to superannuation. Whilst the Department of Finance argument has some merit, the Review is satisfied that making the minimum number of years performance to be disclosed five instead of three will go some way towards achieving this, without imposing significant costs on schemes. Schemes may choose to provide details of past performance for more than five years. If a scheme has not been in operation for five years, an average performance for the life of the scheme should be disclosed. The Treasurer's proposal applies to all schemes with five or more members. One submission suggested that the Review's proposal should not apply to small schemes or those with no arms length members.[68] In principle, the Review does not see why this information should not be available to members of schemes with two or more members. The Review is aware, however, of the costs that may be involved for smaller schemes and does not recommend that this requirement extend to schemes with fewer than five members.

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63. Permanent Trustee Company Ltd *Submission* January 1992; ASC *Submission* March 1992; Shell Australia Ltd *Submission* February 1992.
64. eg County Natwest *Submission* February 1992.
65. Department of Finance (Cth) *Submission* February 1992.
66. LIFA *Submission* March 1992; National Mutual *Submission* February 1992; ASFA *Submission* March 1992.
67. Jacques Martin Industry *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992.
68. Pelham Webb & Co *Submission* February 1992.

Recommendation 10.18: Information about financial performance
The law should provide that a prospectus, member booklet or offer document published by the responsible entity for a superannuation fund or ADF, being a fund or ADF that has 5 or more members, must include the prescribed particulars of the scheme's financial performance over

- **each of the 5 financial years immediately before the booklet or prospectus was issued or**
- **if the scheme has been in existence for less than 5 years, over all the years during which the scheme has been in existence.**

Failure to comply should be an offence. The prescribed particulars should include particulars about the arithmetic average performance of the scheme over the relevant period.

Performance of the scheme

10.40. ***Proposal.*** The Treasurer's statement includes a proposal to require each scheme with five or more members to report to members its investment objectives and the policy and strategies being used to meet them.[69] The Review agrees that this is a sound measure. However, it may not go far enough. The Review proposed in DP 50 that each scheme should be required to include in its statement of investment objectives performance criteria, including a benchmark rate of return for the scheme, and should be required to report the performance against these criteria, particularly the benchmark rate of return. It was felt that this would enable scheme members to assess the scheme's performance against a benchmark which had been determined by the responsible entity, specifically for its scheme.

10.41. ***Submissions.*** This proposal attracted considerable comment. It was criticised on various grounds, including the possibility of schemes setting high estimates to attract more investors, overemphasising the rate of return at the expense of risk, promoting short termism, cost of compliance and the fact the proposal applied to all schemes.[70] Many submissions did, however, support the proposal and, if not the exact wording, the principle of trying to increase the accountability of responsible entities.[71]

69. Treasurer's statement, paper 2 para 10(e).
70. Mercer Campbell Cook and Knight *Submission* February 1992; DSS *Submission* February 1992; BT Asset Management *Submission* February 1992; County Natwest *Submission* February 1992; Pelham Webb & Co. *Submission* February 1992.
71. Jacques Martin Industry *Submission* February 1992; GW Walker *Submission* February 1992; National Mutual *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992; ACTU *Submission* February 1992.

10.42. ***Recommendation.*** The Review is convinced that there is merit in requiring responsible entities, as part of formulating a scheme's investment objectives and implementation strategy, to establish investment performance criteria that includes
expected performance in relation to an appropriate index (such as the CPI) or expected performance relative to a benchmark portfolio. The Review does not agree that this is an impossible or unrealistic task to require of a responsible entity. Indeed, one would expect that it would be an integral part of setting a policy and strategy to implement the scheme's investment objectives. Accordingly, the Review recommends that responsible entities should establish financial performance goals that the scheme will seek to achieve over the medium term. These should be determined on a rolling five year basis. The goals should specify expected performance relative to either an appropriate index or a benchmark portfolio. The annual notice to members should include a report of the scheme's performance against these goals.

Recommendation 10.19: Establishing, and reporting performance against, investment targets

1. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must, before the start of each financial year, determine financial performance goals for the fund, ADF or PST. The goals must relate to the next 5 years (that is, a 5 year rolling investment plan). The goals are to be expressed in terms of the financial performance expected to be achieve by investments of the fund, ADF or PST when compared with

- **an appropriate index (such as the CPI) or**
- **a specified portfolio of investments.**

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must include in the annual report for the scheme the following information:

- **a statement of the goals determined in respect of the year to which the report relates (which will be the goals for the present 5 year investment plan)**
- **a statement of the financial performance of the scheme during that year measured against those goals, and how that performance relates to achievement of the relevant 5 year goals**
- **if the responsible entity has determined that the 5 year goals should be altered — a statement of those goals as altered and of the nature of the alterations.**

Failure to comply should be an offence.

Disclosure of reserving policy

10.43. ***Proposal.*** There has been, and continues to be, considerable debate about the ability of responsible entities of accumulation schemes to establish reserves out of the scheme's earnings without committing a breach of trust. The Review recommends in chapter 14 that the law should make it clear that reserving is permissible, that is, that it does not constitute a breach of trust by the responsible entity. The issue of disclosing reserves was raised in DP 50 and the Review proposed that information to existing and prospective members should include the fact that the scheme has a reserving policy, if it has one, and the basis on which amounts to go to reserves are worked out.[72] This proposal is similar to a proposal in the Treasurer's statement that the annual notice to members should include a statement of the basis on which a scheme's reserves are determined.[73] Submissions overwhelmingly support the Review's proposal.[74]

10.44. ***Recommendation.*** The Review has concluded that it is important that more than just the scheme's reserving policy is disclosed to members. The amount credited to reserves and its source and the amount transferred from reserves should also be disclosed. It seems that the Treasurer's proposal will not require this; rather the member will be left to guess what the reserves may amount to on the basis of information provided about the scheme's earnings and crediting rates. The Review recommends that the information in the annual notice to members (the latest copy of which will be given to prospective members) should include whether the scheme has a reserving policy and, if it does

- how amounts to go to reserves are worked out
- the amount of funds credited to reserves and the source of those funds.
- the amount transferred from reserves.

Recommendation 10.20: Reserving

The law should provide that the responsible entity for a superannuation fund must include in the annual report for the fund the following information:

- **whether amounts in the fund are credited to reserves and**

72. DP 50 proposal 6.14.
73. Treasurer's statement, paper 2 para 10(h).
74. eg ASFA *Submission* March 1992; Australia Retirement Fund *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992; John A Nolan & Associates *Submission* February 1992. Even those who would prefer that reserving be prohibited agree that, if it is permitted, it should be disclosed to members: Shell Australia Ltd *Submission* February 1992.

- **if amounts are credited to reserves**
  - **how the amount to be credited to reserves is worked out**
  - **the amount credited to reserves during the period to which the report relates**
  - **the source of the money credited in reserves during that time and**
- **what amounts, if any, have been transferred from reserves during the relevant year.**

Annual information to members

10.45. ***Additional to member benefit statements.*** Ensuring adequate information for superannuation scheme members is central to any framework of prudential supervision of superannuation schemes.[75] The Treasurer's statement of 20 August 1991 proposes that schemes with five or more members should distribute annual notices or reports to members. The proposal details a wide range of requirements for inclusion in the notice or report.[76] Prior to this announcement, the only information that had by law to be provided annually to members was that required under the OSS Regulations.[77] The new annual notice is to include information members would reasonably require, and reasonably expect to have provided, for the purpose of making an informed judgement as to the financial condition and administrative arrangements of the fund.[78] It is specifically to include information about the accounts of the scheme, details of the classes of assets of the scheme, details about investment managers appointed, advice as to the scheme's policy with regard to fees and charges and the earning rate of the scheme.[79] This annual notice is not intended, it seems, to be the same as the annual report of a company. It is not, for example, required to include the scheme's accounts. It is merely to state that the accounts and the auditor's report will be available to members. Where the audited accounts are not distributed to members with the notice, the notice is to include abridged financial information.[80]

10.46. ***Timing of the annual notice.*** The Treasurer proposes to allow schemes up to six months to prepare their annual notice, or nine months if more than one benefit statement is provided to members each year. Under the Corporations Law, a corporation's annual accounts must be provided to members within four

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75. Treasurer's statement, paper 1 para 18(a).
76. Treasurer's statement, paper 2 para 10.
77. reg 17(1)(e).
78. This is very similar to the information required to be contained in prospectuses under the Corporations Law s 1022.
79. Treasurer's statement, paper 2 para 10(c), 10(e)(i), 10(g), 10(m)(i), (ii).
80. What constitutes 'abridged financial information' will be determined by the ISC.

and a half months of the end of the corporation's financial year.[81] On the basis that the general consistency with relevant provisions of the Corporations Law which is evident in the rest of the Treasurer's statement should be maintained in relation to the preparation of the annual report, the Review proposed in DP 50 that the annual notice to members should be distributed to all members within four months after the end of the relevant financial year.[82]

10.47. ***Submissions.*** Considerable criticism was levied at this proposal. Many organisations pointed out that to require reporting within four months of the end of the financial year would be very difficult given that the Australian Tax Office (ATO) does not allow substituted accounting periods for superannuation schemes. The pressure on resources of actuaries and accountants is such that reporting within even six months is often difficult. A shortened reporting time would increase costs without assisting members significantly.[83] The Review agrees that the benefit of an extra two months may not outweigh the additional costs. Accordingly, it agrees with the Treasurer's proposal so far as it requires annual notices to members to be distributed within six months of the end of the financial year. It does not, however, agree that the time for distributing an annual notice should be extended to 9 months if members of the scheme are sent more than one benefit statement a year. The ACTU submission argued that more time should be allowed in such a case.[84] Benefit statements and annual notices serve distinct purposes, however, and the provision of more than one benefit statement a year does not reduce the need for timely provision of the annual notice to members. Accordingly, the Review recommends that the annual notice be distributed to all members not later than six months after the end of the relevant financial year, no matter how many benefit statements are provided to members during the year.[85]

Recommendation 10.21: Timing of annual reports

The law should provide that the responsible entity of a superannuation fund and the provider of a DA, must give an annual report to each member of the scheme not later than 6 months after the end of the period to which the report relates. Failure to comply should be an offence.

81. Under the Corporations Law s 292, 293 accounts must be circulated at least 14 days prior to a company's annual general meeting, which must, under s 245 be held no later than five months (six months for an exempt proprietary company) after the end of the financial year.
82. DP 50 proposal 6.15.
83. ASFA *Submission* March 1992; Clayton Utz *Submission* February 1992.
84. ACTU *Submission* February 1992.
85. The Review understands that the providers of ADFs and PSTs are subject to the tighter reporting timetable established by the Corporations Law and therefore do not need to be covered by this recommendation.

Disclosure of involvement of a related party

10.48. The Treasurer's statement includes a proposal that the details of any association between an investment manager, financial adviser or consultant who has been appointed to control the investment of any of a scheme's funds and the trustee, sponsor or administrator of the scheme should be reported in the annual notice to members.[86] The Review supports this proposal. In addition, however, the Review recommends that such matters should be reported to the regulator immediately after they occur.

Recommendation 10.22: Reporting associated third parties

1. The law should provide that the responsible entity for a superannuation fund must include in the annual report for the fund

- **a statement whether, during the period to which the report relates, the responsible entity or provider engaged or retained an associate, as defined in the Corporations Law, of the responsible entity or, if the fund is constituted by a deed or other agreement between parties, of 1 or more of the parties to the deed or other agreement, as investment manager, adviser, consultant or in any other capacity and**
- **if it did — the prescribed particulars of the engagement or retainer and of the association.**

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund must, within 14 days after so engaging such an associate, report the matter to the regulator. Failure to comply should be an offence.

Benefit statements

10.49. *Introduction.* The OSS Regulations require that, within six months of the end of the year of income of a scheme, trustees must give members a statement of their benefits.[87] This statement must include the amount of vested benefits at the beginning and at the end of the year, the method of determining the benefits at the end of the year, the amount of contributions for the year and the amount of the benefit that is required to be preserved. The Review recommends that several additional items of information be included in members' statements.

86. Treasurer's statement, paper 2 para 10(g).
87. OSS Regulations reg 17(1)(e).

10.50. ***Certification by employer.*** The Treasurer's statement proposes that, where employers contribute to schemes, the annual notice to members should include a statement that all contributions which, to the knowledge of the trustee, are payable by employers have been received, or if there are known to be substantial arrears, information as to any action being taken to recover those arrears.[88] The Review supports the principle of advising members whether the required contributions have been made but doubts whether the proposal, as worded, would achieve this. Unless responsible entities are given a means of ascertaining the relevant information, a statement limited to what is within the knowledge of the responsible entity may yield little worthwhile information. Accordingly, the Review recommends that benefit statements should include a statement that the employer has certified to the responsible entity that all payments required to be made to the scheme, including those that will satisfy the proposed Superannuation Guarantee Levy legislation requirements, have been made. Employers should be required to provide such certification within a specified period of request by the responsible entity. If an employer does not provide certification, this should be stated in the benefit statement. Responsible entities should have a responsibility to chase up contributions that have not been made by employers. In the case of payments made in satisfaction of the proposed SGL legislation, this would involve advising the ATO. Under the proposed SGL legislation requirements, employers will self-assess annually against the minimum standard. Advice from the responsible entity as to any underpayment will assist the ATO in its enforcement of the SGL. The Review agrees with the Treasurer that, where the responsible entity is taking any steps to recover arrears, this too should be noted in members' benefit statements.

Recommendation 10.23: SGL certification in benefit statements
1. The law should provide that, in the case of employer related superannuation funds, each employer must, within 2 weeks after receiving a written request from the responsible entity, certify to the responsible entity whether the employer has made all payments required to be made to the scheme (including those to be required under the SGL). Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund must include in each benefit statement sent to a member of the fund

- **a statement whether the employer has given a certificate in relation to the period since the last previous benefit statement was given to the member and**

88. Treasurer's statement, paper 2 para 10(d).

- **if any of the payments required to be made have not been made — what steps the responsible entity is taking to recover the amounts due but unpaid.**

Failure to comply should be an offence.

10.51. ***Advice as to amount of SGL contributions that actually vest.*** It will be important that employees are able to ensure that payments made in satisfaction of the SGL requirements are actually used to best advantage, and not dissipated in charges or administrative costs. Concern has been expressed about the lack of economic incentive on employers to search for a low cost product to place award payments into.[89] The Review sees this as an issue for contributions to defined benefit schemes as well as for award payments. This is important, particularly so if SGL contributions represent a wage trade off by employees. Employers will be permitted under the SGL legislation to count employer contributions to complying defined benefit schemes against the prescribed minimum level of employer support for SGL purposes.[90] Contributions will be measured, however, on a gross basis, that is, before deduction of administrative charges, tax and death and disability costs. Employers who take advantage of this offsetting should be required to state what percentage of the gross SGL contributions has been dissipated by administrative and other costs. For accumulation schemes, benefit statements should advise what proportion of the gross SGL payment has been credited to the member's account. Without such advice, a member may never know how much of the gross SGL contribution actually ends up in his or her account. This disclosure will allow for some comparison between schemes and may provide incentive for employers to try to keep administrative and other costs as low as possible.

Recommendation 10.24: Advice of SGL vesting etc.

The law should provide that the responsible entity for a superannuation fund must include in each benefit statement sent to a member of the fund

- **if the fund is an accumulation fund — the proportion of the gross SGL payment made to the responsible entity for the fund by an employer of the member that has been credited to the member's account in the fund**
- **in other cases — what percentage of the gross SGL payment during the period covered by the benefit statement has vested in the member.**

Failure to comply should be an offence.

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89. Ross *Union Perspective on Superannuation* paper given to Superannuation 1992 Conference, Canberra, 1992, 7.

90. *Superannuation Guarantee Levy*, an information paper released by Mr John Kerin, Treasurer, December 1992.

10.52. ***Offence to deduct contribution and not transfer.*** Another consequential matter needs attention. The Review recommends that it should be a criminal offence for an employer to deduct superannuation contributions from an employee's wages or salary and not transfer them to the scheme.

Recommendation 10.25: Employers not to divert superannuation payments

To ensure that the responsible entities concerned receive the amounts due to them, the law should provide that it is an offence for an employer to deduct an amount from an employee's remuneration on account of superannuation contributions to a superannuation scheme the responsible entity for which is a foreign corporation or a trading or financial corporation, or the substantial or dominant purpose of which is to provide old-age pensions, without immediately giving the amount to the responsible entity of the relevant eligible superannuation fund.

Fees and charges

10.53. ***Background and proposal.*** The Treasurer's statement on superannuation emphasises the importance of competition between superannuation schemes. This includes price competition. Accordingly, the new reporting requirements will require the annual report to include the amount (or basis of calculation) of any fees, charges or other expenses charged to the scheme. The report will also be required to include a summary of the scheme's policy on fees and charges applicable to accounts (active or dormant), including

- initial establishment charges
- continuing management, administrative or service charges (including fees levied against fund earnings) and
- termination charges.[91]

The Review fully supports such disclosure. However, disclosure should not be limited to the amount or basis of calculation of such charges. Where they are paid to outside bodies, those bodies should be identified. This will assist in generating competitive pressures which should, in turn, help to control such costs. Accordingly, the Review proposed in DP 50 that information provided to prospective and existing members of any superannuation scheme should include details of payments made by the scheme in respect of

91. Treasurers' statement, paper 2 para 10(m), 10(n).

- fees and charges of investment managers
- administration fees
- fees and charges of the responsible entity, and salaries of its directors
- commissions of intermediaries involved and not already included above.[92]

10.54. ***Submissions.*** This proposal received general support.[93] Concern was expressed by some that only directors' salaries paid out of the scheme should have to be disclosed.[94] It was never envisaged by the Review that salaries *other* than those paid directly from the scheme be disclosed. One organisation did not see the need for the fees and charges of individual managers to be disclosed at all.[95] Several submissions suggested that the amount of tax paid by the scheme, often greater than the total of other fees mentioned, should be disclosed.[96]

10.55. ***Recommendation.*** In the light of the response received, the Review confirms its view that it is important for prudential and competitive reasons that members be advised of the various costs charged to their scheme, and by whom. It therefore recommends that the annual notice to members should include, in addition to the information required under the Treasurer's proposal, details of payments made from the scheme in respect of fees and charges of each investment manager engaged by the scheme, administration fees, commission not included in the former categories, amounts paid to the responsible entity on account of its fees and charges and the total of amounts paid (and the value of benefits given) to members or director of the responsible entity direct from the scheme in respect of their membership of the responsible entity. The Review also recommends that, if at least 5% of the members so request in writing, the annual notice should also include details of amounts paid, and value of benefits given, direct from the scheme, to individual members of the board of management of the responsible entity.[97]

Recommendation 10.26: Disclosure of fees and charges
1. The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members of the fund a statement whether any of the following pay-

92. DP 50 proposal 6.16.
93. eg Westpac Financial Services *Submission* February 1992; ACTU *Submission* February 1992; ASC *Submission* March 1992.
94. eg IFA *Submission* February 1992; Australian Shareholders Association *Submission* February 1992; Securities Institute of Australia *Submission* February 1992.
95. Retirement Benefits Office *Submission* February 1992.
96. Institute of Actuaries of Australia *Submission* February 1992; National Mutual *Submission* February 1992.
97. This is consistent with the Corporations Law s 239.

ments were made by the responsible entity on account of the fund or ADF during the year to which the report relates and, if so, the amount of that payment:

- **payments of fees or charges to each investment manager**
- **payments of administration fees**
- **payments of commission not included in those amounts.**

Failure to comply should be an offence.

2. The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members of the fund a statement of

- **the amounts received from the fund by the responsible entity on account of its fees and charges**
- **the total of the amounts paid by the scheme directly to, and of the value of benefits given by the scheme directly to, the members of the board of management of the responsible entity because of their membership of the board of management of the responsible entity.**

Failure to comply should be an offence.

3. The law should provide that, if at least 5% of the members of a superannuation fund so require in writing given to the responsible entity, the annual reports for the scheme must also include a statement of amounts of the salaries and other emoluments paid by the responsible entity to, and the value of the benefits given by the responsible entity to, each member of the board of management of the responsible entity. Failure to comply should be an offence.

Large exposures

10.56. ***Proposal.*** The new reporting requirements following from the Treasurer's statement will include the disclosure by a scheme of all individual investments which exceed 10% of the total value of the assets of the scheme.[98] The Review proposed in DP 50 that this should be reduced to 5%.[99] There were several reasons for this. First, it would promote consistency with the recommended in-house investment limit.[100] Secondly, the 10% threshold appears to be in line with the Reserve Bank's prudential standard for the supervision of

98. Treasurer's statement paper 2 para 10(f).
99. DP 50 proposal 6.17. The Campbell Committee Report recommended not just that all investments greater than 5% be disclosed, but that they be prohibited: para 20.125.
100. See recommendation 11.4.

large credit exposures by banks.[101] The RBA requires banks to report exposures in excess of 10% of the bank's capital base, not of the bank's total assets. Ten per cent of a bank's capital would translate to approximately 1.5% of its total assets. Viewed in this light, the Review considers the 'large exposure' threshold proposed by the Treasurer to be inappropriately high. Thirdly, the Review takes the view that, as schemes grow in size (particularly if there is a degree of rationalisation within the industry), the 10% threshold will mean that many investments, which may be large in absolute terms and about which the members should be informed, will not be disclosed to members.

10.57. ***Submissions.*** Many submissions support this proposal.[102] Some favour a disclosure threshold lower than 5%.[103] Several organisations, however, recommend waiting until 1995, when the in-house investment limit is reduced to 10%, before any further changes are considered.[104] Another objected to the proposal on the basis that:

> The lower the reportable level, the more there is the opportunity to 'hide' such investments in a longer list.[105]

On the other hand, it was suggested that the details of a scheme's whole portfolio should be disclosed.[106] The Review notes that this has already been considered. The Treasurer's statement proposes that the statement of the schemes investment objectives, to be included in the annual notice to members should include details of the classes of assets in which the scheme is invested, subdivided to show the amount or proportion represented by each of those classes of assets.[107]

10.58. ***Recommendation.*** The Review is convinced that the benefits of this proposal outweigh its possible disadvantages. Nor does it see merit in delaying the implementation of something that may be of benefit to members in understanding and monitoring the operation of their schemes. Accordingly, the

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101. Reserve Bank of Australia *Supervision of Banks' Large Credit Exposures* Prudential Statement No E1 August 1989.
102. See, eg Norwich Group *Submission* February 1992; ISC *Submission* March 1992; Australian Friendly Societies Association *Submission* February 1992.
103. See, eg P Burke who favoured 1%: *Submission* February 1992; D Knox *Submission* February 1992.
104. See, eg ASFA *Submission* March 1992; LIFA *Submission* March 1992; National Mutual *Submission* February 1992.
105. Mercer Campbell Cook & Knight *Submission* February 1992.
106. TCA *Submission* February 1992.
107. Treasurer's statement, paper 2 para 10(e)(i).

Review recommends that the annual notice to members of schemes with five or more members should include details of all investments the market value of which is 5% or more of the value of the total assets of the scheme.[108]

Recommendation 10.27: Disclosure of significant holdings
The law should provide that the responsible entity for a superannuation fund or an ADF must include in each annual report issued to members the prescribed particulars of each asset the value of which, at the end of the period to which the report relates, was equal to 5% or more of the total value of all the assets of the fund. 'Value' means market value.

Disclosure to lost members

10.59. The Treasurer indicated in the statement of 20 August 1991 that consideration will be given to providing some relaxation of the annual reporting requirements in a situation where it is clearly established that a member can no longer be contacted.[109] The Review agrees that this is important to prevent administrative costs eroding either the benefits of members who have lost contact with the scheme or the benefits of other members (where the reporting costs are shared amongst all members of a scheme). It proposed in DP 50 that a scheme should not have to report to members who cannot be located.[110] This proposal received support in submissions.[111] The Review therefore recommends that superannuation schemes should not have to fulfill the reporting requirements in relation to members that are lost to the scheme. Members are to be considered 'lost' if the 'lost members' procedures have been followed by the responsible entity, the member has not been contacted and at least six months have passed.[112]

Recommendation 10.28: Disclosure to lost member
The law should provide that the responsible entity for a superannuation fund or ADF does not have to comply with any requirements to report to members in relation to a member who is 'lost' to the scheme. A member is lost if six months have passed since the prescribed procedures were followed and the responsible entity has not located the member.

108. The Review agrees with the Treasurer that any investment in a 'pooled' arrangement should be considered a single investment.
109. Treasurer's statement, paper 2 para 11.
110. DP 50 proposal 9.10.
111. eg ASFA *Submission* March 1992; ACTU *Submission* February 1992.
112. See recommendation 12.11 for prescribed procedures.

Information to non-contributing beneficiaries

10.60. The Review is concerned that there may be a lack of information provided to scheme members who are not contributing to the scheme, for example, scheme pensioners and reversionary beneficiaries. The Review notes that the Treasurer proposes that members who are fund pensioners (including reversionary beneficiaries), or who have deferred benefits, are to be advised once a year that the annual notice is available to them on request.[113] The Review cannot see any reason why *all* members should not receive the annual notice. Non-contributing beneficiaries have a strong interest in ensuring that the scheme stays healthy. Having the requisite information about a scheme's operations is an essential part of that.

Recommendation 10.29: Information to beneficiaries

The law should provide that disclosure and notification requirements imposed by law apply for the benefit of non-contributing members of the fund concerned.

Retirement information

10.61. The Review sought comment in DP 50 on the issue of whether schemes should be compelled to provide advisory information to members prior to their retirement.[114] Many schemes, particularly those providing only a lump sum, already provide seminars for members as they approach retirement to assist them to develop a sound investment strategy for their lump sum payment. These seminars can be crucial as poor, or no, advice could result in a superannuation scheme member losing a substantial proportion of his or her lump sum. Such a loss can no longer be made good by future earnings of the scheme. Consultations and submissions reveal that, whilst support for the provision of retirement information is high, especially among consumer groups, there was little support for responsible entities being compelled to provide retirement seminars or advice.[115] Consequently, the Review does not make a recommendation on this matter but notes that sound advice and increased information for members as they near retirement, particularly if they will be receiving a lump sum, is very important. The Review would support measures to improve the flow of information, whether by government or individual schemes or organisations.

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113. Treasurer's statement, paper 2 para 12.
114. DP 50 para 6.21.
115. eg National Mutual *Submission* February 1992.

Disclosure to the regulator by life insurance companies

10.62. As noted in chapter 5, it is difficult for the ISC to reconcile the returns provided by life insurance companies to the insurance Commissioner with those they provide to the superannuation Commissioner.[116] This seems to be because the questions asked in relation to the different types of business are different. It is important that the ISC knows exactly how much superannuation business a life company has, and what assets are held by that company for that business and likewise for its insurance business. The reporting requirements and returns for life companies should be altered so as to ensure that the ISC is easily able to reconcile the returns provided in respect of superannuation business and life business.

Recommendation 10.30: Reconcilable information
The law should provide that the reporting requirements and requirements to lodge returns imposed on life insurance companies are such that the ISC is easily able to reconcile the information provided in respect of superannuation business and in respect of life business.

Liability

10.63. A breach of the disclosure requirements of the Corporations Law attracts criminal and civil liability. The Review recommends that this should continue. Civil and criminal liability should attach to a breach of the disclosure requirements issued by the ISC. This would require the ISC circulars to be replaced by legislation in the *Life Insurance Act 1945* (Cth). The sanction for breach of the requirements for disclosure to prospective members of compulsory employer related schemes should, however, be criminal only.[117]

Recommendation 10.31: Consequences of breach of disclosure requirements
A contravention of the disclosure requirements recommended in this report should attract criminal liability except where otherwise indicated. Except in the case of disclosure by the responsible entity of an employer related superannuation fund, it should also attract civil liability to the same extent as provided for in the Corporations Law.

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116. Para 5.10.
117. No civil liability should attach to such a breach because no loss flows from a failure to disclose information to members of compulsory schemes.

11. Investment controls

Introduction

11.1. As a result of the Commonwealth's retirement incomes policy, there is expected to be a considerable growth in the money available to superannuation scheme managers.[1] A significant issue in prudential supervision is what (if any) investment controls should be placed on superannuation schemes, ADFs, PSTs and DAs. Currently there are very few controls over how superannuation schemes invest their funds. This chapter reviews the current investment controls on superannuation schemes and examines the rationale for imposing such controls. It makes a number of recommendations that take into account both the need to protect the interests of investors and market efficiency goals.

Current investment controls

Statutes

11.2. ***Life Insurance Act.*** As noted in chapter 6 the *Life Insurance Act 1945* (Cth) imposes investment controls on life companies. These controls are imposed for prudential purposes to ensure life insurance companies have the capital reserves to withstand the mortality risks their business faces.

11.3. ***OSSA.*** Chapter 5 also notes that the OSS Regulations set out a number of restrictions on the investment activity of superannuation schemes and ADFs. These controls are also imposed for prudential purposes.[2] They must be observed if the scheme is to obtain a concessional tax treatment.

Other controls

11.4. ***Trust deeds.*** In addition to the investment controls imposed by OSSA, a superannuation scheme may be restricted in its investment activities by the terms of its deed, or other establishing instrument, although generally a wide investment power is conferred on the trustees of superannuation schemes. If the deed or instrument is silent on the matter of investment powers, the superannuation scheme is restricted to investments authorised by State and Territory Trustee Acts.[3]

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1. See para 1.6, 2.3.
2. Treasurer's statement, paper 1 para 15.
3. These investments are either specifically prescribed or limited to securities which meet a prescribed investment rating.

11.5. *Common law.* As discussed in chapter 9, the common law fiduciary obligations of trustees also impose restrictions on the investment activities of trustees. Chief among these is the requirement that a trustee of a superannuation scheme, PST or ADF must act prudently when making investments.

> The duty of the trustee is not to take such care only as a prudent man would take if he had only himself to consider, the duty is rather to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.[4]

The rationale for investment controls

Introduction

11.6. From time to time investment controls have been proposed for superannuation schemes for the following reasons:

- to achieve national investment objectives
- to reduce institutional risk and
- to ensure prudential standards are maintained.

The justification for these objectives and the means by which they can be achieved are discussed below.

Achieving national investment objectives

11.7. *Investment in national interest projects.* It has been suggested that superannuation schemes should be directed to invest a proportion of their funds in projects which are in the national interest but are unable to attract funding on a commercial basis. Such projects include low cost housing, infrastructure projects like the Very Fast Train project and high risk projects (for example, so-called venture capital projects). Such investment controls are often justified as a trade-off for the substantial tax concessions received by complying superannuation schemes.[5]

11.8. *The Review's assessment.* The primary objection to requiring superannuation schemes to invest in certain national projects is that it will lower their returns. This would be contrary to the Commonwealth's retirement incomes policy objectives. If a national project provided rates of return appropriate for the risk involved, then the market would allocate funds to that project without it

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4. *Re Whiteley; Whiteley v Learoyd* (1886) 33 Ch D 347, 355 (Lindley LJ).
5. The investment income of complying funds is taxed at only 15%.

being prescribed. This does not happen because the project does not represent an efficient use of capital for the risk involved. If investment in such projects is only possible by prescription, then, by definition, the funds invested represent an inefficient use of resources from a superannuation scheme's point of view. It may be argued that prescription is necessary in some cases because the investment will provide social benefits which will not be reflected in the market rate of return offered to investors in the project. However, to force superannuation schemes to invest in such projects for a sub-commerical rate of return means that members of superannuation schemes would be forced to bear the social cost of such projects, not the community as a whole. If the community as a whole is to benefit from such projects, the community as a whole should pay for them. Therefore, the Review does not accept that this is a justifiable reason for imposing investment controls on superannuation schemes.

Reducing institutional risk

11.9. ***Using more than one manager.*** It has been suggested that the safety of larger superannuation schemes would be enhanced if they were required to use more than one investment manager.[6] This would reduce the risk that any one manager chosen could, through failure or incompetence, seriously diminish the value of a scheme's funds.

11.10. ***The Review's assessment.*** The use of a variety of external investment managers may reduce the institutional risk facing the scheme that the managers selected will fail. It will not, however, increase the diversification of the scheme's assets unless the investment managers have different investment strategies. It may, however, be prudent for the trustees not to rely on the advice of only one manager. The Review considers that the recommendation set out in chapter 9 in relation to the responsible entity's fiduciary obligations to the members of the scheme should be adequate to ensure that, if it is prudent to do so, more than one manager will be used. To require responsible entities to use a specified number of investment managers may expose the Commonwealth to claims for responsibility for the investment results. Accordingly, the Review does not accept this as a useful investment control for superannuation schemes.

6. eg Attorney-General's Department (Cth), *Submission to the Senate Select Committee on Superannuation*, para 55.

Use of external investment managers

Recommendation 11.1: No rule requiring the use of external investment managers

There should be no rule apart from the responsible entity's fiduciary obligations to members of the fund that requires the responsible entity for a superannuation fund, an ADF or a PST to engage an investment manager.

Maintaining prudential standards

11.11. Investment controls to limit the degree of market risk an institution may have, is a common form of prudential supervision designed to provide a level of protection to an institution without guaranteeing a return to investors. As noted in chapter 3, the government accepts the need for such prudential controls on superannuation schemes. The existing controls imposed on superannuation schemes and ADFs under OSSA are accepted by the government as having a prudential purpose.[7] In addition to the current prudential controls on investment the following have been proposed

- imposing maximum or minimum investments in specified asset classes
- establishing a liquidity requirement and
- a requirement to take a portfolio approach.

Maximum or minimum investment in specified asset classes

11.12. ***Diversification.*** Diversification of a scheme's investments can be ensured by prescribing either a minimum or maximum level of investment in particular asset classes. Under such an approach, the consequences of a decline in the value of any one of these classes of investment is restricted. A requirement that schemes can only hold up to a maximum amount in each asset class would have a similar effect. This latter option would provide responsible entities of superannuation schemes with more control over the investment decision but at the same time require a minimum acceptable level of diversification.

11.13. ***Problems.*** In DP 50 the Review expressed the view that such a restriction did not have value as a prudential control. Making a superannuation scheme comply with a particular maximum or minimum asset allocation may, instead of lessening the scheme's investment risk, force the scheme to be exposed to a risk it could otherwise have avoided and thereby actually increase the risk level of its

7. Although the Treasurer indicated that the Government does not intend to provide further special investment controls: Treasurer's statement, paper 1 para 30.

investment portfolio. For example, if superannuation schemes had been required to hold a minimum level of assets in property, they all would have suffered an involuntary or compulsory loss in 1990. Similarly, whilst appearing to reduce risk, a prescriptive approach may result in lower investment returns. In the case of maximum asset allocation requirements, a degree of distortion is introduced into investment patterns as schemes acquire assets to meet the asset allocation rules rather than for their investment value to the scheme. This may result in an inefficient allocation of resources. Indeed, previous experience in both Australia and overseas indicates that when investment controls are imposed by the Government, the result is lower returns.[8] The Commonwealth has stated that it does not believe that additional controls on superannuation schemes directing the specific placement of funds in particular assets or asset classes are warranted.[9] In DP 50 the Review agreed, proposing that there should not be any prescription of specific asset allocation for superannuation schemes. This proposal met with overwhelming support in submissions and consultations.[10] The Review recommends accordingly.

Recommendation 11.2: Asset allocation
There should be no prescription of specific asset allocation for superannuation funds, ADFs or PSTs.

Establishing a liquidity requirement

11.14. ***Minimum liquidity ratio.*** Superannuation schemes should maintain adequate liquidity levels to meet the scheme's current obligations to pay benefits to members.[11] It has been suggested that a minimum liquidity requirement[12] or ratio be imposed on superannuation schemes to ensure that they are able to meet such obligations. The measure most often proposed involves a requirement that superannuation schemes hold a fixed proportion of their assets in cash, or as government or other tradeable debt securities. One instance of such a requirement having been imposed is the so-called 30/20 rule, which was in force

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8. This was noted by BT Asset Management *Submission* February 1992.
9. Treasurer's statement, paper 1 para 30.
10. Australian Investment Managers' Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Superannuation Advisers Pty Ltd *Submission* February 1992; AMP Society *Submission* February 1992; ASFA *Submission* February 1992; ACTU *Submission* March 1992; IFA *Submission* February 1992; Shell Australia *Submission* February 1992; DSS *Submission* February 1992; NSW Superannuation Office *Submission* March 1992; National Australia Bank *Submission* March 1992.
11. Liquidity is used here in a wide sense, as relating to realisable assets.
12. Liquidity requirement is used here in the narrow sense of cash on tradeable securities.

between 1961 and September 1984.[13] Under this rule, life insurance companies and superannuation schemes received a tax concession if they held at least 30% of their assets in public securities with at least 20% of their total assets in securities issued by the Commonwealth.[14]

11.15. ***Problems.*** In DP 50 the Review indicated that its view was that a requirement of a specific ratio of liquid assets, such as government bonds, was inappropriate on at least two grounds. First, it may distort capital markets as schemes acquire securities to meet the ratio rather than their needs, thus increasing the exposure of some schemes to interest rate risk above that which is appropriate to their situation. Second, as argued by the Campbell Committee and the Martin Review Group,[15] forcing schemes to buy Government securities provides the Government with a guaranteed supply of loan funds. If the Government offers a below-market interest rate on its securities because it is guaranteed these loan funds, this will reduce the overall earnings rate of the schemes. As noted above, the imposition of a liquidity ratio on superannuation schemes may result in a scheme being required to hold an unnecessarily high level of liquid assets, with adverse consequences for scheme profits.

11.16. ***Proposal.*** DP 50 proposed, therefore, that only those schemes in which benefits are transferable should have to meet a prescribed liquidity standard.[16] Many submissions suggested that this proposal should be expressed in terms of realisable assets rather than liquidity. Some submissions expressed concern that the proposal was too inflexible to fit all schemes.[17] The Review agrees that the prescription of a liquidity test is undesirable as the need for liquidity can vary significantly between schemes and over time. It considers, however, that it is necessary to provide for appropriate liquidity levels within the context of individual schemes. It therefore recommends that a responsible entity of a superannuation scheme should be required to monitor the cash flow relationship between realisable assets and estimated liabilities to ensure that obligations can be met as they fall due. It is argued that this obligation already exists as one

13. The 30/20 rule provided a means by which the Commonwealth could reduce its cost of borrowing, and can be regarded as a trade-off for tax concessions. It was abolished by the Commonwealth as it was no longer considered to be a cost-effective way to subsidise public expenditure. Its abolition was recommended in the Campbell Committee Report para 10.23-10.24 and by the Martin Review Group Report ch 9 para 4.2.
14. ITAA s 23(ja), 23F.
15. Campbell Committe Report para 10.26-10.27; Martin Review Group Report ch 9 para 5.8.
16. DP 50 proposal 7.7.
17. eg Australian Friendly Societies Association *Submission* February 1992; Shell Australia Ltd *Submission* February 1992.

of the duties of a responsible entity. To remove any doubt, the Review has recommended that it be clarified as a specific duty of responsible entities.[18] The Review does not recommend that a specific liquidity requirement be maintained.

A portfolio approach

11.17. ***Diversification and prudence.*** It has been suggested that, given the importance of superannuation, it is an appropriate objective of its prudential supervision to try to reduce the level of investment risk by specifying, in general terms, the degree of diversification of investment portfolios held by superannuation schemes.[19] In general, a superannuation scheme that holds a diversified portfolio will carry less overall risk than a scheme that restricts its investments to a few classes of assets.[20] While there are indications that trust law is now recognising the importance of the issue of risk management when assessing the actions of trustees, the courts have traditionally adopted a 'line-by-line' approach and examined the risk and return for each investment in the scheme, without reference to the risk and return of the other investments made by the trustee.[21] This line-by-line approach is inconsistent with modern portfolio theory.[22] As discussed in chapter 9, a fundamental tenet of trust law is that a trustee must act in a prudent fashion when making investments on behalf of superannuation scheme members. Generating an appropriate rate of return is, however, a vitally important objective of a superannuation trust. If a trustee is too conservative regarding investment decisions, the scheme will not earn a high enough rate of return to provide its members with a useful supplement to their publicly provided pension. To select assets broadly in the market, therefore, can be regarded as a prudent strategy, for it reduces the portfolio risk without significantly reducing the rate of return. Thus a strategy of diversification, being a prudent but not overly conservative policy, is appropriate in the superannua-

18. See recommendation 9.2.

19. In his statement on 20 August 1991, the Treasurer indicated that, while the Government does not intend to prescribe any further specific investment controls of the kind noted above, it will be encouraging superannuation schemes to diversify their investments: Treasurer's statement, paper 1 para 29.

20. A portfolio of shares which holds every kind of share available in the market, in the same proportion as those shares are to the total share markets, represents the ultimate in diversification and its return will mirror the markets return. In practice, however, it is not necessary to diversify to such an extent in order to significantly reduce the diversifiable risk: RA Brealey *An Introduction to Risk and Return from Common Stocks* 113.

21. FJ Finn & PA Ziegler 'Prudence and Fiduciary Obligations in the Investment of Trust Funds' (1987) 61 *ALJ* 329, 333.

22. Modern portfolio theory states that the level of portfolio risk depends not only on the risk of the individual assets but also on the degree of correlation between the assets.

tion context. To the extent that the 'line-by-line' approach taken by the courts ignores modern portfolio theory, the overall risk of the portfolio may be increased without a corresponding increase in return.

11.18. ***Overseas examples.*** This approach has been adopted in the United States and Canada.[23] In the United States, ERISA incorporates the prudent person requirement in connection with trust investments. ERISA requires the fiduciary to act 'with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims'.[24] The ERISA regulations state that the relative riskiness of a specific investment is not the sole determining factor as to whether the action was prudent, but that an investment is to be judged on the basis of the role it plays in the portfolio.[25] Similarly, the American Restatement (Third) of Trusts states

> The trustee is under a duty to the beneficiaries to invest and manage the funds of the trust as a prudent invester would, in light of the purposes, terms, distribution, requirements and other circumstances of the trust.
> (a) This standard requires the exercise of reasonable care, skill and caution, and is to be applied to investments not in isolation but in the context of the trust portfolio and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suitable to the trust.
> (b) In making and implementing investment decisions, the trustee has a duty to diversify the investments of the trust unless, under the circumstances, it is prudent not to do so.
> (c) In addition, the trustee must;
> (1) conform to fundamental fiduciary duties of loyalty (s 170) and impartiality (s 183);
> (2) act with prudence in deciding whether and how to delegate authority to others (s 171);
> (3) incur only costs that are reasonable in amount and appropriate to the investment responsibilities of the trusteeship (s 188).[26]

The Review notes that the American Restatement (Third) of Trusts proposes a 'prudent investor' standard rather than a 'prudent person' standard. As discussed in chapter 9, the Review does not consider that a prudent investor standard should be substituted for the prudent person standard traditionally applied to trusts, in particular, superannuation schemes. The Review is concerned that the prudent investor standard imports a degree of investment

23. See para 9.12, 9.13.
24. ERISA s 404(a)(1)(B).
25. B Coleman *Primer on Erisa* 88.
26. *American Restatement (Third) of Trusts*, s 227. The restatement was adopted by the American Law Institute in May 1990.

expertise which may not be present, particularly in the context of employer related schemes. The prudent investor standard may also be interpreted to encompass a degree of calculated risk which the prudent person standard would not. The Review does not consider that this degree of risk should be promoted in the superannuation context.

11.19. *Legislative change.* To the extent that some Australian courts may still follow the traditional 'line-by-line' approach, the Review considers that legislative amendment is warranted to ensure that trustees of superannuation schemes may, as part of a prudent investment strategy, use portfolio theory. In DP 50 the Review proposed that reliance by responsible entities on modern portfolio theory in the selection of investments should be taken into account in determining whether any single investment constitutes a breach of a responsible entity's fiduciary duties.[27] This means that while each investment decision is examinable, it ought to be examined in the context of the entire portfolio. This should remove potential trustee inhibitions regarding certain investments which would, on a line-by-line analysis, not be prudent. The vast majority of submissions that expressed a view on this issue supported the Review's proposal.[28] However, concerns were noted about what this proposal would mean in practice; in particular, what was meant by a requirement to use 'modern portfolio theory'. This issue has been clarified by the Review in recommendation 9.2.

Should PSTs be subject to investment controls?

11.20. In chapter 6 the Review notes that OSSA imposes investment controls on superannuation funds and ADFs but not on PSTs.[29] The Review considers the scope of investment controls to be an important issue. The consistency of controls across like investments is an essential element of an efficient financial system. The argument for imposing the same kinds of investment controls over PSTs as are placed on superannuation schemes and ADFs is based on the observation that PSTs can only accept funds from tax preferred investors (principally other superannuation schemes). Thus the consequences for the Commonwealth's retirement incomes policy of the collapse of a PST are similar to those of the collapse of a superannuation scheme. It may be argued that, because a PST may have all the funds of several small superannuation schemes

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27. DP 50 proposal 7.2.
28. eg ASFA *Submission* March 1992; LIFA *Submission* March 1992; Permanent Trustee Company Ltd *Submission* January 1992; Jacques Martin Industry *Submission* 1992.
29. Investment standards may be prescribed for PSTs: OSSA s 8A. To date no such standards have been prescribed.

invested in it, the consequences of the collapse of a PST are potentially far more significant than those of the collapse of a superannuation scheme or other collective investment.[30] In DP 50 the Review considered the following options

- no change to the current deregulated approach
- limit the investment that superannuation schemes can make in any one PST
- subject PSTs and like schemes to the same investment controls as superannuation schemes.

11.21. ***No controls.*** In DP 50 the Review expressed the opinion that, while the current lack of investment controls for PSTs may have been appropriate when superannuation was a voluntary collective investment, it is no longer appropriate. Similarly, the Review did not consider that it is acceptable to argue that a PST is merely a unit trust like any other in which a superannuation scheme may invest because PSTs have a crucial advantage in relation to superannuation schemes which no other unit trust has, namely their ability to pay tax on behalf of superannuation schemes. This sets PSTs and their regulation apart from that of other unit trusts. The Review remains of this opinion.

11.22. ***Limited investment in PSTs and like schemes.*** This proposition is based on the fact that a PST may only receive contributions from other superannuation schemes or tax preferred investors. It limits the risk each superannuation scheme can take by investing in a single PST by restricting the amount which may be invested in a single PST. In DP 50 the Review suggested that this argument is merely a variation of the maximum investment controls which the Review considered and found inappropriate.[31] The Review considered that it should be rejected for the same reasons. The Review has not changed its opinion.

11.23. ***Subject PSTs and like schemes to the same investment controls as superannuation schemes.*** The argument, considered by the Review in DP 50, in favour of this proposal is this:

- investment controls on superannuation schemes are appropriate because of the purpose for which funds are put into superannuation schemes

30. It is possible to imagine a scenario where an ordinary collective investment vehicle successfully marketed itself exclusively to superannuation schemes. The consequences of the collapse of such an investment vehicle would therefore be the same as the collapse of a PST. However, the fact that only investment in a PST can relieve superannuation schemes of the need to calculate their tax liabilities makes it less likely that other investment vehicles whose investors are all superannuation schemes, will emerge.
31. DP 50 para 7.25.

- PSTs and like schemes are simply larger superannuation schemes
- PSTs and like schemes should, therefore, be subject to the same investment controls as superannuation schemes.

In DP 50 the Review indicated its acceptance of this argument on the basis that if the current range of investment controls over superannuation schemes are considered appropriate to protect them, why should they not apply to PSTs and other like schemes which can only contain the same kind of tax preferred savings? The Review considered, but did not accept, the argument that PSTs are no different from other investment options open to a superannuation scheme, such as property trusts which are not subject to the same investment controls as superannuation schemes, although they may contain only funds from superannuation schemes. The Review accepted the proposal that, because of the administrative advantages associated with investing in PSTs (namely that all income tax is paid on behalf of the investors in the scheme) a superannuation scheme is likely to invest a larger proportion of its funds in a PST than any other investment offering a similar rate of return. Furthermore, PSTs will only have superannuation scheme funds invested in them, whereas other collective investments are likely to have non-superannuation funds invested in them as well as any superannuation funds it may have. The Review therefore proposed in DP 50 that the prudential regulations applying to superannuation schemes and ADFs should apply to PSTs, and any other vehicle that may only accept investments from superannuation schemes and other tax preferred investment schemes. This proposal received widespread support.[32] Several submissions did not agree that there was a need to regulate the investments of PSTs.[33]

> Trustees can control their liquidity position through the asset allocation process. Placing a further burden on pooled trusts would, in most circumstances, probably result in lower returns to members than would otherwise be obtained if the requirement did not exist.[34]

The Review remains of the view that, for the reasons given, PSTs ought to be subject to the same prudential regulation as superannuation schemes are.[35] PST's are currently subject to fundraising, disclosure and other controls under

32. AMP Society *Submission* February 1992; National Mutual *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Shell Australia Limited *Submission* February 1992.
33. ASC *Submission* March 1992; D Knox *Submission* February 1992.
34. Jacques Martin Industry *Submission* February 1992.
35. Australian Investment Managers' Group *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; LIFA *Submission* December 1991; Shell Australia Limited *Submission* February 1992.

the Corporations Law. These should continue to apply except where they are inconsistent with the prudential standards applying to the use of funds by superannuation schemes. In that case, the latter standards should apply.

Recommendation 11.3: Subject PSTs to the same investment controls
The law should provide that the prudential regulations applying to the use of superannuation scheme funds should apply to PSTs and to any other vehicle that may only accept investments from superannuation schemes and other tax preferred investment schemes.

In-house investment rule

11.24. ***Risks involved in in-house investments.*** An in-house investment is different from other investments of a superannuation scheme. Not only is the judgement of the person making the investment likely to be influenced by the relationship between the scheme and the sponsor. It involves an additional type of risk. If the employer goes out of business, not only will members lcse their jobs but their superannuation scheme will suffer a loss which it may not have suffered if it had not invested in-house. In view of this additional risk, DP 50 suggested that in-house investments should not be encouraged, and indeed, should be reduced below their current level. It proposed that the in-house investment rule that applies to superannuation schemes should be reduced from its current level of 10% to 5%.[36] In other jurisdictions there are restrictions or prohibitions on such in-house investment. For example, in the US there is a prohibition on certain transactions such as the aquisition of the sponsoring employer's securities[37] and in the UK self-investment is shortly to be restricted to 5% of the fund's assets.[38]

11.25. ***Submissions.*** There was general support among submissions for such a reduction. In the submissions generally there was a distinction drawn between arms length and non-arms length schemes (usually, smaller schemes). It was suggested that, in the latter case, a 5% limit might be too low. The Review has concluded that there are no compelling reasons for small schemes to be excused from such a requirement, especially in light of the Commonwealth's stated objective of securing retirement benefits.

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36. DP 50 proposal 7.3. The Review notes that the Campbell Committee Report proposed that a fund be prohibited from investing greater than 5% in any single investment, not just in-house investments: para 20.125.
37. ERISA s 407.
38. ACTU *Submission* March 1992; TCA *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; National Australia Bank *Submission* March 1992; Westpac Financial Services *Submission* February 1992. One exception was ASFA, which argued that it was premature to impose a tougher in-house test ASFA *Submission* March 1992.

11.26. ***Valuation.*** An in-house investment restriction could be expressed in terms of the cost or market value of scheme assets. Although conceptually correct, there are problems in using market value as the basis for this restriction. First, it requires that a market value be determined for all assets of a scheme. Such an exercise may be unduly costly. Secondly, market values could be subject to considerable fluctuations or changes (over time and between different market places) and arguably have greater potential for abuse. Accordingly, the Review accepts that the in-house asset restriction should be assessed on the basis of the historic cost of the assets of the scheme. The Review recommends that the 5% limit be applied to all schemes, whether or not there are arms-length members. To allow schemes an appropriate time to meet this requirement, it recommends that there be a lead time of three years beyond that currently applying to the 10% requirement.[39] The literature on in-house asset rules often assumes that there is only one employer sponsor. The Review considers that the same risks apply in the case of industry schemes. Accordingly, they should be subject to a similar restriction, namely that no more than 5% of the scheme be invested in the employers whose employees are members of the scheme.

Recommendation 11.4: In-house investments

1. The law should provide that the responsible entity for a superannuation fund must not knowingly lend to, or make an investment in, an employer sponsor of the fund or an associate of the employer within the meaning of the Income Tax Assessment Act of an employer sponsor of the fund if the amount of the loan and the value of the investment (worked out at cost in the prescribed way) is more than the prescribed percentage of the total of the value of the assets of the scheme.

2. The law should provide that the responsible entity of an industry fund must not knowingly lend to, or make an investment in, 2 or more of the employer sponsors of the fund or in an associate of such an employer within the meaning of the Income Tax Assessment Act if the total amount of the loans and value of the investments is more than the prescribed percentage of the total of the value of the assets of the scheme.

3. Contravention of this provision should be an offence on the part of the responsible entity.

39. Schemes established before 11 March 1985 have until 1 July 1995 before they have to comply fully with this requirement: OSS Regulations reg 16A(17)(b).

4. Values should be worked out as provided in OSS Regulations reg 16A.

5. The prescribed percentage should be such that, by 30 June 1998, it is 5%.

Borrowing by superannuation schemes

11.27. The OSS Regulations restriction on borrowing by superannuation schemes[40] goes hand in hand with the requirement that members' benefits be fully secured[41] and is designed to protect the scheme's assets. There was overwhelming support among the submissions for such a control.[42] The Review does not recommend any fundamental change to the current position in relation to superannuation schemes and ADFs.[43] The Review considers that the restriction on borrowing should apply to PSTs. They are comprised 100% of superannuation funds and, therefore, should be subject to the same controls as superannuation schemes.[44] If this were not the case, the restriction on borrowing by superannuation schemes could be overcome by investing in PSTs.

Recommendation 11.5: Borrowing by superannuation funds etc.
1. The law should provide that the responsible entity for a superannuation fund or an ADF must not borrow, or maintain a borrowing of, money, whether on security or not. Non-compliance should be an offence. There should be a defence that the borrowing was temporary and made only to enable the scheme or ADF to pay benefits due to its members.

2. The law should provide that the responsible entity for a PST must not borrow, or maintain a borrowing of, money. Failure to comply should be an offence. There should be a defence that the borrowing was temporary and made only to enable the PST to meet its buy-back obligations.

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40. OSS Regulations reg 16(1)(b).
41. OSS Regulations reg 5AB(2)(b).
42. eg Office of Queensland Cabinet *Submission* March 1992; National Australia Bank *Submission* March 1992; Securities Institute of Australia *Submission* February 1992; BT Asset Management *Submission* February 1992; Mercer Campbell Cook and Knight *Submission* February 1992; AMP Society *Submission* February 1992; National Mutual *Submission* February 1992.
43. The Review notes that the international trading in securities by superannuation schemes, ADFs and PSTs may result in a scheme being unintentionally temporarily geared because of the failure of the transaction to be settled before the transfer of the securities the subject of the transaction takes place. This issue should be addressed.
44. See recommendation 11.3.

Use of futures and derivatives

11.28. ***Proposal.*** At present, there are no specific restrictions on the use of futures contracts or derivative instruments by superannuation schemes.[45] While the Review recognises that derivatives and futures can represent a legitimate and efficient aspect of a scheme's investment management, it is concerned about the possible speculative use of such instruments. DP 50 proposed that the speculative use of futures and derivatives (as opposed to their use for hedging purposes) be prohibited.[46] This received strong support in submissions.[47] However, concerns were noted regarding the definition of the term 'speculative'.[48]

11.29. ***Recommendation.*** After consultation on this matter, the Review has refined the wording of the proposal and recommends that the use of futures, options and derivative instruments should be prohibited unless used for hedging purposes, for risk management, for duration management of fixed interest portfolios or as a substitute for the outright purchase of other assets. The Review is also of the opinion that futures should not be used in such a way as to cause the scheme to be geared. In particular, 'uncovered' writing of futures and call options should not be permitted. The complexity and difficulty of adequately defining gearing in this context are, however, immense. The Review recommends, therefore, that the Government, in consultation with relevant industry bodies, should investigate an appropriate terminology and standard so as to be able, in the longer term, to prohibit the use of futures, options and derivative instruments for gearing purposes.

Recommendation 11.6: Use of futures etc.
1. The law should provide that the responsible entity for a superannuation fund, an ADF or a PST must not invest in a futures contract or a derivative instrument except

- **for hedging purposes or**
- **for risk management or**

45. The Treasurer proposed that 'an outline of any futures options or other derivative mechanism strategies relevant to fund or sub-plan assets' be included in the annual report to members. Treasurer's statement, paper 2 para 10(e)(ii).
46. DP 50 proposal 7.5.
47. Jacques Martin Industry *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Women's Economic Think Tank *Submission* February 1992; ASFA *Submission* March 1992; D Knox *Submission* February 1992; Department of Finance *Submission* February 1992; National Australia Bank *Submission* March 1992.
48. eg Australian Securities Commission *Submission* March 1992; Securities Institute of Australia *Submission* February 1992.

- **for duration management of fixed interest portfolios or**
- **as a substitute for the outright purchase of other assets.**

Failure to comply should be an offence.

2. The law should provide that, if, because of an investment in a futures contract or a derivative instrument, the fund, ADF or PST becomes geared, the responsible entity is guilty of an offence.

Liquidity requirements for superannuation schemes

11.30. ***Annual certification as to solvency.*** In view of the strict controls on borrowing by superannuation schemes, responsible entities need to ensure that their expected liabilities can be met from the realisable assets of the scheme without unnecessary recourse to borrowing. Indeed, the Review considers this to be so important an obligation on responsible entities that it recommends that the obligation be included in legislation. The Review sees merit in requiring the responsible entity to report annually to the regulator on whether the expected liabilities for the next year can be met as they fall due without recourse to borrowing. Where necessary the regulator can take appropriate action, which may include enforcing a higher level of liquidity. This annual notice to the regulator should also include information about what happened in the previous year as regards the scheme meeting its liabilities and any recourse to borrowing.

Recommendation 11.7: Certifying solvency

The law should provide that the responsible entity for a superannuation scheme, an ADF or a PST must, within 2 months after the beginning of a financial year, certify in writing to the regulator whether the expected liabilities of the fund, ADF or PST for that year can be met as they fall due without recourse to borrowing. Non-compliance should be an offence.

11.31. *Matching requirement for personal schemes and ADFs.* Because amounts held in personal schemes are transferable at the election of scheme members, it is further recommended by the Review that the responsible entities of personal schemes should be required to ensure that the portfolio of assets held by the scheme is appropriate (in terms of realisability) to the scheme's redemption period.[49] For example, schemes that have longer redemption periods could

49. The suggestion that schemes be required to match their redemption period and the underlying liquidity of their assets was made in DP 50 para 7.23. There was a paucity of written responses on this paragraph.

hold a higher proportion of illiquid assets. An ADF's redemption period is set in its deed. For taxation purposes, however, the deed must comply with the ITAA, in particular, the provision that the fund must repay depositors 'upon request'.[50] There is a similar provision in OSSA.[51] The Review understands that the ISC has generally viewed 'upon request' to mean within 30 days.[52] The Review is aware that, during the property boom, some ADFs invested up to 80% of their funds in property trusts. When the property market collapsed and property trusts froze redemptions, those ADFs were unable to meet their own redemption obligations. The Review considered prescribing a longer redemption period for ADFs that invest more than a prescribed proportion of their funds in property or in property trusts, but has decided against such a recommendation. Instead, the Review recommends that all ADFs be formally required to match their assets to meet their redemption periods.[53]

Recommendation 11.8: Redemption periods for personal schemes

The law should provide that personal schemes must have assets appropriate to their redemption periods. No specific sanction is required as the question is dealt with under recommendation 9.2.

Emergency liquidity support

11.32. DP 50 called for comments on the desirability of a mutual emergency liquidity support mechanism, as an alternative to a prescribed liquidity ratio.[54] Under such a regime each scheme would be required to keep a prescribed level of liquid assets which the regulator could direct it to liquidate and lend to another scheme facing temporary liquidity problems. This matter drew little response. Those that did comment suggested that such an arrangement should not be introduced.[55] Accordingly, the Review has not proceeded further with this idea.

50. ITAA s 27(A)(1)(c).
51. OSSA s 3(1), definition of 'approved deposit fund' and 'approved purposes'.
52. Although the OSS Regulations reg 20 provides that depositors must receive their entitlements on their 65th birthday or, in the event of death, 90 days from the grant of probate.
53. It is to be hoped that by formally requiring this matching, the irresponsible investment strategies pursued by some ADFs recently will not be repeated, as a failure to properly match investments will be actionable by scheme members as a breach of the ADF's statutory fiduciary duties.
54. DP 50 para 7.22.
55. For example, the ASC stated that such a scheme would involve financially successful funds providing loans to funds in financial difficulty on a non-commercial basis. It argued that this would be contrary to the best interests of the members of the financially-successful fund: ASC *Submission* March 1992.

Liquidity requirement for PSTs

11.33. PSTs, like most other collective investments, may also be subject to mass unexpected withdrawals. The PST's buy back period will, to a large extent, determine whether any difficulties are experienced. The increasing sophistication of trustees may mean they will begin to more often move funds. DP 50 raised the issue whether it is appropriate that in these circumstances a minimum liquidity requirement should be imposed. Although submissions did not seem to comment directly on this issue, in the light of comments received on the proposal to impose prescribed liquidity standards on superannuation schemes and the Review's recommendation that PSTs be subject to the same kind of investment and gearing controls as superannuation schemes,[56] it is of the view that there is no need to prescribe a minimum liquidity standard for PSTs.

56. Recommendation 11.3.

12. Members' rights

Introduction

12.1. This chapter discusses a number of issues surrounding the relationship between superannuation schemes and their members. First, it deals with the extent to which members can exercise control over the activities of their schemes. This includes the ability of members to transfer their investment to another scheme and member representation on the board of the responsible entity. Secondly, it considers the rights that members have to enforce the fiduciary and other obligations that the responsible entity owes them. Thirdly, it examines a number of alternative means of resolving disputes between members and responsible entities. Fourthly, it considers the desirability of earlier vesting of contributions, the reduction of qualifying periods of service and of restricting relief in hardship cases. Finally, the chapter deals with the rights of scheme members to their superannuation entitlements on the bankruptcy of the scheme member or employer sponsor and on the divorce or separation of spouses or de facto spouses.

Consumer control of superannuation

Different types of schemes offer different means of control to members

12.2. Control over a superannuation scheme can be exercised by members in two ways. First, members may simply leave the scheme. This option is available to members of personal superannuation schemes. While it may not provide members with direct control concerning the activities of scheme management, it acts as a disciplinary mechanism on the responsible entity. Secondly, members may have input into the decision making process of the scheme. This happens in single employer sponsored and industry schemes because of the Commonwealth's policy of requiring member representation on the controlling bodies of superannuation schemes.

Consumer sovereignty and personal superannuation schemes

12.3. *Ability to transfer.* Economic theory postulates that the freedom of consumers to choose how they dispose of their income is vital to the efficient allocation of resources in a market economy. Consumers of personal superannuation schemes and ADFs generally have the right to switch their contributions from one scheme to another. The ability of members to 'vote with their feet' can be a significant control over scheme management, as it acts as a form of partial liquidation.[1] However, the transfer of contributions from one scheme to another can involve quite high transaction costs. This reduces the likelihood that this option will be exercised. As competition between offerors of such schemes increases, particularly if new offering institutions such as banks emerge, the transaction costs are likely to fall, making it easier for members of these schemes to express dissatisfaction with their scheme in this way.

12.4. ***Schemes subject to the prescribed interests provisions of the Corporations Law.*** Subject to the terms of the deed or other instrument constituting the scheme, members of schemes that are prescribed interests[2] have the rights and powers to control their schemes as set out in the Corporations Law.[3] These rights include the ability to enlist the aid of the Australian Securities Commission (ASC) in taking action against the promoters of a scheme.[4] However, as has been demonstrated by the recent turmoil in the property trust sector, these rights appear to be ineffective in enabling investors to exercise any significant influence over the direction of the policies of a scheme. The most practical means available to members to express dissatisfaction with such a superannuation scheme's performance is to transfer their funds to another scheme.

12.5. ***Schemes subject to the Life Insurance Act.*** Members of these schemes have neither the right to become directly involved in the management of their scheme nor the right to enlist the aid of the insurance industry regulator (the ISC) in the way members of prescribed interest schemes can enlist the aid of the ASC. They must rely on the vigilance of the ISC[5] or 'vote with their feet' and transfer their contributions to another scheme. Once again, exercising the second option may involve high transaction costs.

12.6. ***Recommendation.*** The Review considers that freedom of choice is an essential feature of personal superannuation schemes. DP 50 proposed that, in accordance with existing policy, benefits in personal superannuation schemes should continue to be fully transferable. This proposal received wide support.[6] It therefore recommends no changes to the current transferability arrangements

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1. Fama and McJensen, 'Agency Problems and Residual Claims', (1983) 26 *Journal of Law and Economics*, 327-50.
2. As defined in the Corporations Law s 9.
3. Corporations Law s 1069; Corporations Regulations reg 7.12.05; see also s 1084.
4. eg, under the *Australian Securities Commission Act* (Cth) s 50. This power is predicated on the ASC initiating an investigation and forming the opinion that the action is in the public interest.
5. They may provide the ISC with information which causes it to launch an inquiry into the insurance company using its powers under the *Life Insurance Act 1945* (Cth).
6. S McNelis *Submission* February 1992; Women's Economic Think Tank, *Submission* February 1992; ASFA *Submission* March 1992; WJ Burke *Submission* February 1992.

for personal superannuation schemes. In accordance with existing policy, where superannuation schemes permit members to transfer their benefits to another scheme other than on termination of employment, benefits should continue to be fully transferable, subject to a redemption period appropriate to the assets of the scheme.

Recommendation 12.1: Personal superannuation funds: transferability restrictions

There should be no change to the law in relation to the ability of members of personal superannuation funds to transfer or withdraw their benefits.

Consumer sovereignty in employer related schemes

12.7. *Limited transferability.* When membership of a superannuation scheme is offered by an employer, it is generally a condition of the offer that the employee may only join the scheme nominated by the employer. In a few cases employers will offer employees the opportunity to nominate a personal scheme to which the employer agrees to make contributions on behalf of the employee. This option is not available to members of industry schemes, where the superannuation scheme is either identified in the relevant industrial award or agreed by each employer and union. While the introduction of the SGL will ensure that many more employees benefit from superannuation, it will not change these limited choices.

12.8. *Transferability in employer sponsored schemes — problems and difficulties.* The virtual absence of direct competition for members of employer related superannuation schemes has recently been the subject of public debate. It has been suggested by some that members of compulsory single employer sponsored schemes and industry schemes should be able to choose which scheme their employer's contribution is paid into, including contributions required to be paid under the SGL legislation.[7] The *Industrial Relations Act 1991* (NSW) provides that employers may agree to pay contributions into a scheme other than that nominated in the award.[8] There are, however, problems with this proposal. First, there is some risk that it may encourage members to focus on short term performance rather than on long term performance. Secondly, to the extent that members do exercise their right and transfer their benefits, these schemes will have to increase their liquid and realisable assets to meet the demand for repayments, which could lower the overall return on the scheme's investments,

7. eg, Hewson and Fischer *Fightback!* Supplementary paper No 2 'Superannuation', 21 November 1991, para 2.4.6.
8. s 180.

thus diminishing the ability of the scheme to provide significant additional retirement income to scheme members. Thirdly, these schemes would also be subject to the possibility of a 'run' by contributors in the wake of performance significantly below average. This is a risk these schemes do not presently face.[9] This is perhaps the most important consequence for single employer sponsored schemes. As single employer sponsored schemes are, in general, smaller than personal schemes, they could suffer significant damage from such a 'run'. Fourthly, as a result of the short term focus of members and increased liquidity of funds, these schemes may be much less likely to invest in long term projects, such as infrastructure development. This may increase political pressure to force all schemes to invest in such projects, possibly at sub-commercial rates. Fifthly, on a practical level, employers, particularly large employers, would face significant administrative costs if superannuation payments on behalf of their employees were directed to a wide variety of superannuation schemes rather than to a single scheme.[10] Employers offering defined benefit schemes would face particular administrative difficulties if some of their employees chose to switch from their employer's scheme to a personal accumulation scheme and then attempted to switch back to the employer's scheme.

12.9. ***Proposal.*** In DP 50 the Review proposed that the existing transferability arrangements for single employer sponsored and industry superannuation schemes remain unchanged, namely that the law should not prescribe any level of transferability for single employer sponsored and industry superannuation schemes. This aspect of these schemes should continue to be regulated by the deed or other instrument constituting the scheme. Submissions supported this proposal.[11] Some, however, preferred that members of all schemes be allowed to transfer to another scheme without penalty.[12] For the reasons discussed, the Review remains of the view that it is not appropriate to prescribe any level of transferability for single employer sponsored or industry schemes. Accordingly, it recommends that the law should not prescribe any level of transferability for industry and single employer sponsored superannuation schemes. Transferability in these schemes should continue to be regulated by the deed or other instrument constituting the scheme. If those schemes offer transferability, the Review recommends that the value of the benefit is to be calculated at the date

9. See Ross, *Retirement Incomes: Communicating a Vision for the 21st Century*, speech to Conference of Major Superannuation Funds, Wollongong, March 1992, 3.
10. The Review notes that some employers now limit the bank accounts employees can have their salary deposited into on the basis that the administrative problems associated with allowing their employees complete freedom of choice are too great.
11. ASFA *Submission* March 1992; ACTU *Submission* March 1992; Jacques Martin Industry *Submission* February 1992; Shell Australia Limited *Submission* February 1992; IFA *Submission* February 1992; LIFA *Submission* March 1992.
12. eg ASC *Submission* March 1992.

when the employee has done all that is required by him or her for the sum to be calculated. Interest at a prescribed rate should be payable from that date until payment. An employee who does all he or she has to do to withdraw should not suffer the consequences of further changes in the value of the fund.

Recommendation 12.2: Single employer sponsored and industry schemes: transferability restrictions
1. There should be no change to the law in relation to the ability of members of employer related superannuation funds to transfer or withdraw their benefits: these should continue to be governed by the provisions of the deed or other instrument constituting the fund.

2. The law should provide that, despite any provision in the deed or other instrument constituting the fund, the date as at which the amount of a payment to which a member of an employer related superannuation fund is entitled on withdrawing from the fund otherwise than on ceasing the employment to which his or her membership relates is to be worked out is the date on which the member completes all that is required of him or her to withdraw from the fund. If payment is made after that date, interest, at a rate to be prescribed, should be payable on the amount outstanding.

Member representation — an alternative means of member control

Introduction

12.10. Recent federal Government announcements about superannuation have stressed the importance of the accountability of responsible entities to scheme members.[13] For members of schemes out of which members cannot transfer their benefits other than by leaving their current job or industry (that is, employer related schemes), member representation on their scheme's responsible entity is an important part of improving that accountability. It is also an important element of the supervisory framework for superannuation.

Employer related schemes

12.11. *Member involvement.* Members of complying single employer sponsored and industry schemes are able to influence their scheme through the member representatives on the board of management of the responsible entity.[14] An

13. Treasurer's statement, paper 1 para 6.
14. The members also have all the power that the beneficiaries of a trust have.

equal number of employer and member representatives are required for the boards of large (that is, those with 200 or more members) industry and single employer sponsored schemes.[15] Employee representation is optional for smaller funds.[16] Having members on the boards of responsible entities of these schemes provides an active role for members in the management and protection of their money, particularly where the member representative is in constant contact with the other members of the scheme.[17] They can provide direct member feedback to the responsible entity.

12.12. ***The Review's proposal.*** The Review is of the opinion that it is desirable gradually to make equal representation for smaller schemes (that is, less than 200 members) compulsory, instead of optional as at present. The Review recognises that, where the members of a scheme are also the principals of the employing enterprise, there is no need for such requirement, as the employees and their employer have no conflicting interests. In principle, it would seem desirable to extend the requirement for equal representation to all schemes with members who are not also principals, that is, arms length members. The Review recognises, however, that such a recommendation may not be practical. In DP 50 the Review proposed that equal representation of members and employers on responsible entities of single employer sponsored and industry schemes should be extended by 1998 to all schemes with five or more members.

12.13. ***Submissions.*** Submissions showed considerable support for extending equal representation beyond schemes with 200 or more members. Exactly where the cut off point should be was not clear.

> Equal representation is a cornerstone of ASFA's preferred model of prudential control based on active member interest and involvement. Conceptually, therefore, we would support an extension of the equal trusteeship requirement wherever there are arms length members. We are, however, concerned about the costs of equal trusteeship which can be considerable (on a per member basis) for smaller funds.[18]

15. OSS Regulations reg 13.
16. OSS Regulations reg 15.
17. Member representatives are obliged to act in the interests of all members of the scheme, not just in the interests of the members who elected them or on whose behalf they were appointed.
18. ASFA *Submission* March 1992.

Some submissions suggested a threshold of 10,[19] others 50.[20] Concern was also expressed that, apart from cost, the number of members in smaller schemes who would be prepared to be trustees may not be sufficient.[21] One submission expressed the view that equal representation does not go far enough.

> Whilst it is acknowledged that employers have initiated many of the superannuation schemes, that should be no reason for the employer to have equal status on the responsible entity. In light of the very fact that the employers have often initiated the establishment of a superannuation scheme, there should be a positive and absolute requirement that the employee members of the scheme should have the majority representation on the responsible entity. This would ensure that there cannot be a circumstance in which the will of the employee members of the scheme can be thwarted by the employer representatives on the scheme.[22]

12.14. ***Independence of the responsible entity.*** The Review has considered whether, even with member representation, responsible entities are sufficiently independent of the underlying contract of employment between the employer and the employee members of the responsible entity to be able always to act in the best interests of members. The governing rules of schemes with 200 or more members may, with the written approval of the ISC, appoint an independent body corporate as the sole trustee of the scheme. The members and the employer of a scheme with fewer than 200 members may agree to appoint an independent body corporate as trustee.[23] The Review considered requiring an independent chairperson for the responsible entity, either with a power of veto or with no voting power. Neither of those options seemed appropriate or feasible as a mandatory requirement.[24] The Review remains concerned that employees should not be put in the position where, as trustees, they can be subject to undue influence from their employer. The most appropriate way to ensure that employers do not exert pressure on member representatives of responsible entities to act as the employer wants, even if that is not in the interest of the members of the scheme, is to make it an offence for an employer to dismiss, threaten to dismiss, intimidate or attempt to influence an employee for any reason connected to the actions of the employee as a member of responsible entity. There

19. Prudential Assurance Company Limited *Submission* February 1992; Pelham Webb and Co. *Submission* February 1992; D Knox *Submission* February 1992.
20. National Mutual *Submission* February 1992.
21. ASFA *Submission* March 1992.
22. J Ryan *Submission* February 1992.
23. OSS Regulations reg 13(1)(e)(ii), 15(1)(a)(ii). The Review is of the opinion that the members of large schemes should also be able to have input into whether their scheme has an independent trustee.
24. There may not be enough independent chairpersons to go round.

are precedents for this type of offence.[25] Education of the members representatives as to their duties and obligations will increase their awareness of their obligations including their obligation to act solely in the best interests of the members of the scheme, as will the inclusion of such an obligation in the legislation setting out the fundamental duties of members of responsible entity boards.[26]

12.15. ***Employer representation.*** In DP 50 the Review raised for comment the issue whether the representation of employers on the boards of accumulation schemes should be phased out in the future.[27] Submissions that commented on this issue were generally of the view that employer representation on accumulation schemes should continue.[28] The Review does not propose to make any recommendation on this issue.

12.16. ***Recommendation.*** The Review has concluded that it is important to extend member representation to schemes below the current limit. It sees no point, however, in imposing on schemes a requirement that they may find impossible to comply with. Accordingly, it recommends that equal representation be extended to all schemes with 50 or more members. This requirement should come into operation in 1998 to allow time for members of schemes with between 50 and 200 members to arrange for appropriate training, if necessary.

Recommendation 12.3: Outlawing victimisation

The law should make provision similar to the *Industrial Relations Act 1988* (Cth) s 301 protecting persons who are members of the board of management of a responsible entity for a superannuation fund by making it an offence to threaten, coerce or intimidate, or prejudice in connection with their employment or otherwise, such a person on account of the exercise by the person in good faith of a power or duty as member of the board of management.

25. eg the *Human Rights and Equal Opportunity Commission Act 1986* (Cth) s 26 makes it an offence to dismiss, or threaten to dismiss, a person because he or she has made a complaint to the Commission.
26. See ch 9.
27. DP 50 para 9.8. The Review acknowledges that employer representation on the board of a defined benefit scheme is clearly appropriate as it is the employer who bears the risk of the scheme.
28. eg Western Mining Corporation Holdings Ltd *Submission* February 1992; LIFA *Submission* March 1992.

Recommendation 12.4: Employee representation

The law should provide that the conditions under which an employer related superannuation fund that has 50 or more members attracts a tax concession include a condition that the deed or other instrument constituting the fund makes appropriate provision to ensure that

- **the responsible entity for the fund not be an individual and**
- **the board of management of the responsible entity for the fund have at least one half of its members appointed (whether by election or otherwise) by the members of the fund.**

This provision should take effect from 1998.

Members' rights and powers

Members' rights against the responsible entity

12.17. *What rights members have and how they can enforce them.* The Review has recommended that the fiduciary obligations owed by the responsible entity to the members of the scheme be clarified.[29] Subject to what is said below about alternative dispute resolution mechanisms,[30] the main way of enforcing these obligations will be through legal action. Remedies available include injunctions to prevent or halt a breach, and, in some cases, recovery of compensation for loss or damage caused by a breach.[31] The enhanced representative procedure now available in the Federal Court may further assist civil action by members.[32] In appropriate cases, the responsible entity's dealers licence, if it has one, can be revoked by the ASC in the exercise of its existing powers.

12.18. *Removing the responsible entity.* In DP 50 the Review suggested that member representation, and the prospect of legal action by members of a single employer sponsored or industry scheme is not enough to ensure adequate member control of the scheme. The ultimate expression of member control is the ability to remove the responsible entity or, to be more precise, some or all the members of the board of the responsible entity.[33] The Review concluded, however, that this right should be restricted in the case of members of defined

29. See ch 9.
30. See para 12.30-12.42.
31. The Review recommends that the regulator should have injunctive powers and the power to take civil proceedings on behalf of a member to recover damages for loss suffered: see recommendations 13.7 and 13.11.
32. *Federal Court of Australia Act 1976* Part IVA.
33. If the members of a scheme agree to the appointment of a professional responsible entity the power discussed in this paragraph should be taken to mean the power to dismiss the professional responsible entity.

benefit schemes.[34] The Review proposed that a responsible entity (or one or more members of its board) should be subject to dismissal by a 75% majority vote of members who represent at least 25% of the total membership. Voting by postal ballot should be required except in the case of schemes where all members have the opportunity to attend in person. It was considered that high standards are appropriate for such an important decision. The proposal provided for a ballot to be requisitioned by 10%, or 50 of the members, whichever is less. The scheme should bear the cost of the ballot.[35] The proposal was intended to apply only to member representatives or members who had been appointed to the responsible entity by agreement between the members and the employer. Accordingly, it did not apply to personal schemes.

12.19. ***Response.*** The proposal was criticised in several submissions as being inconsistent with the general premise of trust law whereby the trustees act for all members of the scheme and should not, therefore, be subject to removal by '20% of the total fund membership'.[36] Some regard the opportunity at each election for members to remove the trustees who represent them as sufficient involvement for the members. ASFA opposed the proposal as it relates to the dismissal of the entire responsible entity. It considers that such an approach is likely to draw industrial issues and disputes into the trusteeship arena. It regards the dismissal of individual member representatives as workable but suggested that a particular representative should be subject to dismissal by a vote of his or her constituency. With regard to dismissal of the whole responsible entity, ASFA would prefer members to approach the regulator for the appointment of a judicial manager if they are dissatisfied with the performance of the responsible entity.[37] Strong support for the proposal was received from a number of individuals who made submissions.

> I agree wholeheartedly with the sentiments of the Discussion Paper which suggests that increased control should be able to be exercised by employees in relation to control over the responsible entity.[38]

The ASC supported the ability of members to remove the responsible entity subject to the modification that the vote required is 75% by value (not number) of members voting at a meeting of at least 25% (by value) of members.[39]

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34. This is because the investment risk does not lie with the members in those schemes but with the employer. The members alone should not, therefore, be able to dismiss the entire board of a responsible entity of such a scheme.
35. For defined benefit schemes, the employer will, in effect, bear the cost of such ballot.
36. eg Mercer Campbell Cook and Knight *Submission* February 1992.
37. As was suggested in DP 50 proposal 8.8. ASFA *Submission* March 1992.
38. J Ryan *Submission* February 1992.
39. ASC *Submission* March 1992.

12.20. ***Recommendation.*** If members are unhappy with the performance of an individual member who is a trustee or director of the responsible entity, they should wait until the next election, or appointment period, to remove that member. Alternatively, they could seek to have the regulator remove them from office. This would require the regulator to hold the opinion either that the person ought to be removed having regard to the risk he or she poses of non-compliance with the law or that the person is unable to fulfil his or her duties.[40] If members are dissatisfied with the performance of the responsible entity as a whole, they have the option of approaching the court for dismissal of the responsible entity and the appointment of a temporary responsible entity on terms and conditions as the court sees fit. The ground for such dismissal is that the responsible entity is unable to fulfil, or has failed to fulfil its obligations. Approaching the court would be an expensive exercise, possibly beyond the means of most members. They could seek the assistance of the regulator in taking the matter before the court.[41] The Review is not satisfied, however, that those options give the members adequate avenues of redress. Accordingly, it recommends that 10% of members of an employer related superannuation scheme should be able to call for a ballot for the dismissal of the responsible entity and to appoint an independent responsible entity to act for the balance of the responsible entity's term. This remedy should be available to members of defined benefits schemes as well as to those of accumulation schemes. Because at least two thirds of the members of a board of a responsible entity must agree to decisions of the responsible entity, it is reasonable that the entire entity be accountable to members. A 75% majority vote of members who represent at least 25% of the total membership of the scheme should be required to pass the resolution. The Review does not agree with the ASC that voting by value rather than by numbers is appropriate for superannuation schemes. Superannuation is a long term investment, and each member has a continuing interest in the success of the scheme. For the purposes of voting, 'members' should include all contributing members and adult beneficiaries. Voting should be by postal ballot unless the scheme is such that all members have the opportunity to attend in person. The vote should be by secret ballot in any case. The Review also recommends that the responsible entity be obliged to ensure that any notice it sends out convening a meeting of members contains adequate notice of any matters of which it is aware that are to be considered at the meeting, any resolutions of which it is aware that are to be put at the meeting and a summary of

40. See recommendation 13.12.
41. See recommendation 13.8.

information relating to these matters and resolutions that is relevant to the decision of a member on how to vote at the meeting.[42] The notice would have to include the proposed replacement for the position of responsible entity.[43]

Recommendation 12.5: Members' power to replace responsible entity
The law should provide that the responsible entity for a superannuation scheme may be replaced as follows:

- **10% or more of the members of the fund, may, by notice in writing given to the responsible entity, require a ballot to be held for the removal of the responsible entity and the appointment of another person as responsible entity; the other person must consent to appointment as the responsible entity and give the declaration required by recommendation 8.7**
- **the responsible entity must then arrange for a postal ballot to be held on the question; if all members of the fund will have a reasonable opportunity to attend a meeting at which the question can be put, the responsible entity may arrange for such a meeting instead**
- **the responsible entity must, if it arranges such a meeting, also include in the notice of meeting a statement of the procedure to be put to the meeting as the procedure to be adopted by the meeting for conducting the meeting and for taking votes**
- **the question is not to be taken as having been agreed to unless at least 25% of the members cast a vote and the votes in favour of it amount to at least 75% of the members voting.**

The law should provide that this provision does not prevent other business being transacted at the meeting.

Mergers of superannuation schemes

12.21. ***Proposal.*** The development of the superannuation industry may well result in rationalisation through mergers. The merger mechanism for the joining together of two schemes is usually a matter for each deed. In many cases, however, schemes have incompatible merger provisions. In DP 50 the Review

42. These matters are required by one of the prescribed covenants to bind certain parties in a prescribed interest scheme. Corporations Regulations reg 7.12.15(1)(g).
43. The Review considered whether the regulations should prescribe who may be appointed as independent responsible entity in this case. It anticipates that professional trustee companies would be selected in most cases and does not propose prescribing this.

proposed that the regulator should have the power to propose a merger of two or more schemes to the members of those schemes. It also proposed that the regulator should develop guidelines for merger provisions in superannuation schemes.[44]

12.22. ***Submissions.*** The proposals received reasonable support.[45] A number of submissions expressed reservations, however. Some were concerned to ensure that the regulator could not force a merger, particularly of single employer sponsored schemes to take place.[46] Others saw no role for the regulator in this area.[47] The Review did not intend that the regulator should have power to force a merger against the wishes of the responsible entity or the members; rather that it should play a somewhat more pro-active role than it does at present in suggesting mergers where appropriate and where the responsible entities of the particular schemes may not have considered that as an option.

12.23. ***Recommendation.*** The Review has concluded that the option of merging is important and should be available to all schemes. Accordingly, it recommends that provisions in trust deeds that prohibit or limit a merger should be invalid. The decision whether to merge should rest primarily with the relevant responsible entities. The regulator should, however, be advised of a proposed merger.[48] The members of both schemes should also be advised of the proposal. If 10% of the members of either scheme request, in writing, a ballot on the proposed merger, a vote must be taken. The cost of that ballot is to be borne by the schemes. For the purposes of voting, members should include all contributing members and adult beneficiaries. If 75% of the members voting, representing at least 25% of the members of either scheme, vote against the merger proposal it is not to proceed. This right ensures that members retain power over their scheme.

> Recommendation 12.6: Mergers
>
> **1. The law should provide that the conditions under which a superannuation fund attracts a tax concession include a condition that the deed or other instrument constituting the fund not prevent or restrict a merger of the fund with another fund, restrictions implied by the responsible entity's fiduciary obligations to the members of the fund apart.**

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44. DP 50 proposals 8.6, 8.7.
45. eg Jacques Martin Industry *Submission* 1992; ASC *Submission* March 1992; IFA *Submission* February 1992.
46. eg LIFA *Submission* March 1992; Department of Finance (Cth) *Submission* February 1992.
47. eg Prudential Assurance Company Limited *Submission* February 1992.
48. See recommendation 13.18.

2. The law should provide that the responsible entity of a superannuation fund must not put into effect a merger of the fund with another superannuation fund unless the entity has given written notice of the proposed merger

- **to the regulator and**
- **to the members of the fund.**

The period of notice is to be not less than 3 months. Failure to comply should be an offence.

3. The law should provide that, if 10% or more of the members of either fund, by notice in writing given to the responsible entity before the end of the 3 months, require a ballot to be held on the motion that the merger not proceed

- **the responsible entities must then arrange for a postal ballot to be held on the question; if all members of a fund will have a reasonable opportunity to attend a meeting at which the question can be put, the responsible entity may arrange for such a meeting instead**
- **the responsible entity must, if it arranges such a meeting, also include in the notice of meeting a statement of the procedure to be put to the meeting as the procedure to be adopted by the meeting for conducting the meeting and for taking votes**
- **the question is to be taken as having been agreed to by the members, unless at least 25% of the members of a fund cast a vote and the votes against the merger amount to at least 75% of the members voting in a scheme in which 25% of the members cast a vote.**

The law should provide that this provision does not prevent other business being transacted at the meeting.

4. If the motion is passed, the merger is not to proceed.

Members' rights over the policy of the scheme

Proposal to give directions

12.24. DP 50 suggested that the ways in which the members can control the operations of employer related schemes should not be limited to removing the responsible entity. It proposed that if enough members of a scheme agree on a particular course of action, they should be able to give binding directions to the responsible entity. A general meeting of members, or a postal referendum, should be able to be requisitioned by 10%, or 50, of the members, whichever is less. Such a meeting or referendum should be able to give directions to the responsible entity in relation to any matter affecting the scheme generally by resolution carried by a 75% majority vote of members representing at least 25% of the total membership. Postal and proxy voting should be permitted.[49]

Submissions

12.25. This proposal received considerable support although there was significant disagreement as to what should be the threshold for calling such a meeting[50] and the voting requirements. The proposal was rejected by some on the basis that the concept of members giving directions to a trustee to act in a certain way is inconsistent with trust law.[51] Concern was expressed about who would bear responsibility for action taken by a responsible entity pursuant to a direction by the members. The Review now considers that the right to give directions to the responsible entity may be open to abuse and could become a forum for playing out union disputes. Issues put to a meeting may involve a decision to put the interests of one group of members ahead of the interests of another group. The recommended external disputes mechanism[52] will improve the situation for members who have problems in relation to their own interest in the scheme. Those sorts of issues should never become an issue involving the entire scheme membership. As far as general policies of the scheme are concerned, the Review has concluded that election or appointment of member representatives should be the means by which they can be influenced. Where the members are strongly dissatisfied with the policies and performance of the responsible entity, mechanisms for the dismissal of the responsible entity are recommended.[53] Accordingly, the Review does not recommend that members should be able to give directions to the responsible entity. Without the power to direct responsible entities, the Review does not consider that an ability to call a meeting of members is of benefit to members and does not make any recommendation in that regard.[54]

Members' rights against external investment managers

12.26. As discussed in chapter 8, it appears that hired investment managers may owe fiduciary duties to members.[55] In DP 50 the Review suggested that

49. DP 50 proposal 9.5.
50. eg ACTU *Submission* March 1992; Office of Queensland Cabinet *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992.
51. Department of Finance (Cth) *Submission* February 1992.
52. See recommendation 12.9.
53. See recommendations 12.5 and 13.12.
54. cf ASFA. It supported the requirement that members be able to requisition a general meeting but opposed the suggestion that such a meeting could give directions to the responsible entity.
55. See para 8.38.

managers should be subject to dismissal by the members.[56] The Review no longer takes that view. The duties owed by an external hired investment manager are primarily of a contractual nature and will be owed to the responsible entity. The members should have no right to remove an investment manager themselves. Usually, if a hired investment manager breaches its contractual duty to the responsible entity, the responsible entity will take action. Its own fiduciary obligations would require it to. If, for whatever reason, the responsible entity does not act, the regulator will be able to take legal action directly against the manager.[57] If the responsible entity fails to act against an investment manager that has breached its fiduciary obligations, and loss is suffered, the responsible entity will be liable to members for that loss. It can be argued though that the benefit of the fiduciary duties owed by a manager to the responsible entity are held on trust for the members.[58] Accordingly, the members could be said to have a right to join as a co-defendant an investment manager hired by the responsible entity of their superannuation scheme in any action against the responsible entity for failing to take action on a breach of fiduciary duty by the investment manager.

Advice and internal dispute resolution

Introduction

12.27. As superannuation coverage spreads throughout the workforce, more and more people will be dealing with superannuation schemes for the first time. The complexity of these schemes makes it more than likely that disputes will arise between responsible entities and their members. These disputes could range from not being able to gain access to the trust deed to a disagreement with the responsible entity's assessment of an application for benefits by a member on the basis that the member has been totally and permanently disabled. The following paragraphs look at the members' need for advice when a dispute arises, the current mechanisms for dealing with disputes, whether it is appropriate that disputes be dealt with other than by the responsible entity and possible alternatives.

An advisory service

12.28. ***Advice service covering all schemes.*** Education and information will play important roles in the success of individual superannuation schemes and, ultimately, the success of any retirement incomes policy. DP 50 therefore pro-

56. DP 50 para 9.14.
57. See recommendation 13.13.
58. See para 8.38.

posed that there be an easily accessible information and advisory service that covers all superannuation schemes, ADFs and DAs. The service would provide information and advice on issues such as members' rights, portability of superannuation benefits, unclaimed benefits, the interaction between superannuation and social security entitlements, dispute resolution, basic tax information and rollover options. DP 50 noted that one benefit of providing such information is that it would prevent many members' problems developing into fully-fledged disputes. It also noted that ASFA was considering establishing such a service for its own member schemes, and suggested that ASFA might be an appropriate body to administer the proposed service.[59]

12.29. ***Discussion and recommendation.*** The majority of submissions generally supported the proposal, but a number were concerned about practical issues such as funding.[60] ASFA has now indicated that it has abandoned plans to establish an advisory service, chiefly on grounds of coverage and cost.[61] In any event, most submissions supporting the proposal considered that the regulator should handle the advisory service.[62] In the light of ASFA's decision and of the consultations and submissions, the Review considers that it would be more appropriate for the regulator to establish and administer the proposed service. Furthermore, the service should not provide investment advice to retirees or anyone else. Later paragraphs discuss the desirability of schemes establishing internal dispute resolution mechanisms. The Superannuation Advisory Service should assist schemes to establish and use these mechanisms by setting up a panel of conciliators able to assist schemes on request. These conciliators would be particularly useful for smaller schemes. Questions of cost recovery also arise. There are strong arguments for such a service to be free to members, given the importance of superannuation to the Commonwealth's retirement incomes policy. Nevertheless, the Review considers that whether members are charged directly for the provision of advice, or schemes are charged directly for the use of the services of conciliators, or whether the members have to pay indirectly through levies on their superannuation schemes, is a question better left to government.

59. DP 50 proposal 9.6.
60. eg Permanent Trustee Company Limited *Submission* February 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992; D Knox *Submission* February 1992.
61. ASFA *Submission* March 1992; D Shirlow, 'The ASFA Proposal in relation to an alternative dispute resolution mechanism for the occupational superannuation movement' *Paper* (unpublished) 25 March 1992.
62. eg LIFA *Submission* March 1992; ACTU *Submission* March 1992; AMP Society *Submission* February 1992.

Recommendation 12.7: Superannuation Advisory Service
1. A Superannuation Advisory Service should be established with the function of providing education and information to members of superannuation schemes about the operation of schemes and their entitlements as members.

2. The Superannuation Advisory Service should establish a panel of conciliators, able to provide conciliation services to assist in resolving disputes between members of superannuation funds, ADFs and DAs and the responsible entities for, or providers of, the schemes.

Internal dispute resolution mechanisms

12.30. ***DP 50 proposal.*** An advisory service would help to avoid problems and also ensure that problems did not develop unnecessarily into disputes. Even if an advisory service is established, however, the possibility of problems and disputes cannot be completely prevented. It is important, that members be able to approach their scheme with confidence that any problem they may have will be dealt with efficiently and thoroughly. DP 50 therefore proposed that each scheme should establish an internal procedure for dealing with member disputes, which would be free to members.[63] The existence and method of operation of the procedure should be made known to members.

12.31. ***Submissions.*** Most submissions supported this proposal. ASFA regards internal review and dispute resolution as particularly important. A number of industry based groups supported it in preference to later proposals for external review of superannuation scheme decisions.[64] Other submissions pointed to the importance of maintaining, as well as internal dispute resolution mechanisms, access to external mechanisms[65] and drew attention to the importance of independent reviews.[66]

12.32. ***Recommendation.*** There is widespread agreement that each scheme have an internal dispute resolution mechanism. Given the recommendation that the Advisory Service have a conciliation function, and the recommendations that the Review Panel be able to review decisions, but only if there is an internal dispute resolution mechanism, if that mechanism has been used, there is no need to require, as a matter of law, each scheme to have such a mechanism. The functions should emphasise informal methods of dealing with complaints and

63. DP 50 proposal 9.7.
64. eg ASFA *Submission* March 1992; LIFA *Submission* March 1992.
65. eg Australian Shareholders' Association Ltd *Submission* February 1992.
66. eg H Baker *Submission* February 1992; B Abrahams *Submission* March 1992; J A Ziedars *Submission* February 1992; R Cogger *Submission* February 1992; A Group of Members *Submission* February 1992.

problems, many of which may relate to administrative matters. Conciliation should be available when there is a dispute over the exercise of powers in relation to the members. The mechanism should be free to members — to encourage its use and to resolve disputes as early as possible. It will also be necessary to ensure that members are aware, when they enter the scheme, of the existence of the mechanism and how it operates. The Review recommends that this information be included in the member booklet or prospectus for the scheme given to members and prospective members.

Recommendation 12.8: Internal dispute resolution

1. Responsible entities for superannuation funds and ADFs and providers of DAs should be strongly encouraged to maintain a fair, easily accessible internal dispute resolution mechanism that is free to members.

2. The law should provide that the responsible entity for a superannuation fund, or an ADF and the provider of a DA, must include in each prospectus, member booklet or offer document issued to members or prospective members the prescribed particulars of the internal dispute resolution mechanism, if any.

External dispute resolution mechanisms

The present position

12.33. There are three established dispute resolution mechanisms, apart from the courts, available to members of some superannuation schemes.

- *LIFA scheme.* For those superannuation schemes provided by a life insurance company, the dispute resolution mechanism established by LIFA is available.[67] This involves an approach, in the first instance, by

67. This scheme has been criticised on a number of grounds, including, for example, that it is not seen to be independent of the insurance industry, and that there are too many steps before review by the Complaints Review Committee: see, eg, R Drake, *Superannuation Inquiries, Complaints and Disputes*, paper to ASFA Conference, November 1991.

the member to LIFA. If this proves unsuccessful, the matter is sent to a Complaints Review Committee. The decision of this Committee is not binding on the member, although it is binding on the insurance company.[68]

- *Banking Ombudsman.* If the superannuation is provided through a subsidiary of a bank that is a party to the Banking Ombudsman scheme and that subsidiary has been specifically designated, the Banking Ombudsman has jurisdiction.[69] Again, this is a private scheme that is based on a contract between participating banks. It is very informal, requiring only a contact by the member with the Banking Ombudsman's office. The emphasis is on conciliating complaints, but the Ombudsman can make a determination which is binding on the bank but not the customer.

- *Industrial Relations Commission.* Members of public sector superannuation schemes may appeal to the Industrial Relations Commission (IRC) if their internal appeals are unsuccessful. Additionally, members of award based superannuation schemes may complain to the IRC if the dispute concerns an alleged breach of the award.

Other schemes do not have an external dispute resolution mechanism. The Commonwealth has acknowledged that this is a deficiency in the coverage of the available alternative dispute resolution mechanisms. Further, the Commonwealth has indicated it believes there should be a suitable low cost dispute resolution mechanism to raise consumers' confidence in the superannuation industry and increase their willingness to invest in superannuation.[70]

DP 50 proposal

12.34. DP 50 examined a number of alternative options for external dispute resolution mechanisms. One suggestion was that a single dispute resolution mechanism be established for all superannuation schemes, a 'superannuation Ombudsman'. A detailed statement of the proposed Ombudsman's jurisdiction was suggested, including the following

68. ie, the insurance company's contract under which it participates in the scheme includes a provision that it will not contest an adverse decision by the Committee. If a company decided to breach this undertaking and ignore a decision of the Committee it is doubtful if the company's customer could enforce adherence to the contract (and hence the decision) as customers are not parties to the contract.
69. To date, there has been no such designation: Banking Industry Ombudsman *Submission* April 1992.
70. Treasurer's statement, paper 1 para 7.

- Issues affecting the scheme as a whole, such as the scheme's investment policy and strategy, reserving policy (if any) and selection of investment managers should clearly be outside the scope of the Ombudsman's jurisdiction.

- The Ombudsman should not have jurisdiction in disputes that are essentially industrial disputes, that is, disputes between members and their employers.

Submissions

12.35. Submissions from, and consultations with, industry groups showed considerable concern on this issue.

> AMP believes that an external dispute resolution mechanism is essential and that it would be better to establish it either under the direction of the regulator or an industry body such as ASFA. AMP does not believe that an Ombudsman would be satisfactory given the specialised nature of superannuation and the wide variety of superannuation arrangements in existence.
>
> Care will need to be taken regarding the nature of disputes which are able to be decided by this mechanism. [the proposal refers to] the jurisdiction of an Ombudsman over matters of fact such as qualification for total and permanent disablement benefits. Given that these benefits are generally provided under an insurance arrangement and the establishment and interpretation of the facts may be contentious, we would strongly dispute that this example should fall within the jurisdiction of a superannuation dispute mechanism.[71]

The Review's attention was also drawn to the need, in considering questions such as the degree of disablement, for responsible entities to consider and interpret medical evidence, often conflicting, and the overriding obligations of responsible entities to act in the best interests of the members. Other submissions expressed concern at the possibility of excessive use of such a scheme by frivolous complainants.[72]

The issues

12.36. ***Should there be external review?*** Under the present arrangements, a member of any superannuation scheme dissatisfied with a decision concerning him or her by the responsible entity can seek judicial review of the decision by the Supreme Court of the relevant State or Territory. For most people, this is

71. AMP Society *Submission* February 1992.
72. QUF Industries Ltd *Submission* February 1992.

simply an unrealistic option because of the cost involved.[73] It amounts to no right of review at all. The availability of review outside the court system depends on who is the responsible entity and whether the scheme is an industry scheme or one promoted by a life insurance company. Like treatment of like cases is a key indicator of justice. The federal Government has indicated its view that the differences in review rights, and the fact that members of some schemes have no access to review at all, is unjust and unfair. The Review has concluded that there should be a single mechanism available to members of all schemes with jurisdiction to review responsible entities' decisions affecting individual members.[74] The nature and scope of that mechanism are discussed in the following paragraphs.

12.37. ***Who should be the review body?*** A number of commentators on DP 50 criticised the proposal that there be an 'Ombudsman', preferring instead a 'panel'. The concern seemed to be that a single person — an Ombudsman — would not be as effective or efficient as a panel of persons. The Review agrees that it would be better if a panel of persons were to make up the review body. It should be independent of government, of schemes and the regulator. Because its function is to ensure fairness in schemes that help implement Commonwealth policy, its funding and resources should be provided from the Commonwealth. The need for the review to be independent was emphasised in several submissions.[75] To meet these requirements, the Review recommends that the panel should be appointed by the Minister from nominations by relevant interest groups. These would include consumer and union representatives, and representatives of suppliers of insurance products. It is important that at least some members of the review panel have experience and expertise in superannuation matters.

12.38. ***Kinds of decisions — the role of discretion.*** A not untypical clause in a deed establishing a scheme is

> Total but Temporary Disablement in relation to that Member shall mean the disablement of that Member resulting from an illness accident or injury (but excluding self-injury) which commences or occurs prior to the sixtieth (60th) birthday of the Member and as a result of which the Member has been continuously absent from employment for a period of at least three (3) consecutive

73. See ALRC 46 para 15-20.
74. Not all members of the Advisory Committee agree with this conclusion.
75. eg B Abrahams *Submission* February 1992; J Ziedars *Submission* February 1992; R Cogger *Submission* February 1992.

> months ending not later than the sixtieth (60th) birthday and in the opinion of the Trustee after consideration of such medical or other evidence as the Trustee may require the Member is unable to resume work in the Member's former occupation.

The Commonwealth Superannuation Scheme provides that

> "**[T]otally and permanently incapacitated**" means that, because of a physical or mental condition the person is unlikely ever to work again in a job for which he or she is reasonably qualified by education, training or experience or could be so qualified after retraining.[76]

In consultations it became clear that provisions of this kind are generally understood to give the responsible entity a discretion. The fact that a judgment has to be made whether a person is totally and permanently disabled, often on the basis of medical evidence, reinforces this view. As one commentator put it in discussions with the Review:

> [T]he majority of ill-health and total and permanent disability retirement claims involve the responsible entity in exercising its discretion to decide upon the eligibility of the claim. In these cases, there is little or no measurable physiological disability. Rather, they involve described but not physically detectable or measurable pain, constraint on movement, or, most difficult, psychological symptoms. These cases cannot be determined as matters of fact in the way that, for example, cancer, heart disease, or permanent organ or limb damage can... [A] judgement about them must be made by somebody on the basis of appropriate available evidence and that judgement takes on the character of fact.

12.39. ***Legal analysis.*** The responsible entity's obligation is to apply the terms of the deed or other instrument constituting the fund in accordance with fiduciary and other legal obligations. In the examples mentioned above, this involves forming a judgment whether the person 'is unable to resume work' or 'is unlikely ever to work again'. In many cases it will be difficult to make this judgment. But it must be made only on the medical or other evidence about the individual available to the responsible entity. It would be wrong, and a breach of its fiduciary obligation to the member, for the responsible entity to take into account, in forming that judgment, the effect on the scheme or on other scheme members if the judgment is made that the member is unable to work. There are, however, circumstances where the responsible entity will have to exercise a different kind of discretion. Provisions in deeds and other constituting documents governing the proportions in which members' dependants will be paid, and whether they will be paid at all, usually allow the responsible entity to

76. *Superannuation Act 1990* (Cth) Sch 1.

decide this matter 'in its absolute discretion'. In these cases, the effect of the decision on the interests of the other members is a relevant consideration that the responsible entity must take into account. The distinction between the two kinds of decisions is clear. The drafting of particular deeds may, however, not make it immediately clear which kind of decision is involved in a particular case.

12.40. ***Review.*** The Review recommends that both kinds of decision should be reviewable by the Panel just recommended. They are both presently reviewable by the courts. It is essential that a cheaper form of review should be available. The Panel should not decide the issue on the merits, except in limited circumstances. Its powers should broadly equate with those of the court. The Panel should first consider whether the responsible entity properly applied the law or the terms of the deed or other instrument constituting the scheme. The question should be, was the power of the responsible entity exercised legally and properly, that is, did the responsible entity, in making the decision

- fail to take a relevant consideration or matter into account
- take an irrelevant consideration or matter into account
- act in bad faith or with malice.

If the decision was not improper in that sense, it should not be interfered with. If it was improper, however, the Panel should be able to

- refer the matter back to the responsible entity to reconsider the matter and make a fresh decision in accordance with directions given by the Panel
- vary the decision
- substitute for the decision its own decision.

It should be emphasised that what the Review envisages is not a merits review. The Panel would not reconsider the issue afresh. It would only make a different order where it was satisfied that the original discretion had not been properly exercised. The Review Panel should be under a statutory requirement that it is bound, in deciding whether to make an order of the latter two kinds, by the same fiduciary obligations towards all the scheme members as the responsible entity. While it is, in the Review's opinion, important to have decisions that may have a significant impact on a person's post retirement income open to review, focussing the review, in the first instance, on the lawfulness of the exercise of the power by the responsible entity, and allowing a wider range of relief if the power was wrongly exercised, strikes the appropriate balance.

12.41. ***Who should be bound?*** For a review by the Review Panel to be effective, the responsible entity whose decision is the subject of the review will have to be bound by it. For constitutional reasons, the Review Panel will not be able to make orders that are, of themselves, effective to determine rights and obligations.[77] The LIFA scheme and the Banking Ombudsman scheme both operate on a contractual basis. The various parties to the scheme[78] have entered into a contract under which they undertake to be bound by the decisions given under the scheme. The clients (policy holders, members or bank customers) are not parties to these contracts. It is doubtful whether, because of the doctrine of privity of contract, they could enforce the contract. To ensure that superannuation responsible entities are bound, therefore, their access to tax concessions should depend on their complying with any order lawfully made by the Review Panel. The Review considers that a member who wants to use the Review Panel process should also be bound by the result, to the extent of waiving his or her right to take proceedings in a Supreme Court on the question. The decisions and actions of the Panel, however, should be open to judicial review under the *Administrative Decisions (Judicial Review) Act 1975* (Cth).[79] This will have the effect of ensuring that disputes can be quickly and cheaply disposed of, while preserving the right to approach a court.

12.42. ***Practical aspects.*** There are several practical matters that will need to be provided for. As the focus of the Review Panel recommendation is on speedy, cheap alternative dispute resolution, there should be an emphasis on informality in the Panel's operation. In particular, the Panel should not be bound by the rules of evidence. The Panel should have to give reasons for its decisions. To act as a filter against frivolous or vexatious applications for review, it should be a requirement that the member have first approached the scheme through the internal dispute resolution mechanism recommended above. However, where there is no internal mechanism for resolving disputes, the internal mechanism is not likely to be of assistance (because, for example, the trustees have exercised their discretion finally) or where there are other special circumstances, the Panel should be able to hear an application for review.

77. Under the Constitution, such orders may only be made by courts exercising the judicial power of the Commonwealth. They cannot be made by administrative agencies or tribunals.
78. In the case of LIFA, life companies and LIFA; in the case of the Banking Ombudsman, banks and the Banking Ombudsman Pty Ltd.
79. This Act only provides for review as to questions of law. The court cannot review the matter on the merits, or substitute its own decision. It is not possible to exclude, for either party, access to the prerogative writs: Constitution s 75(v); *Judiciary Act 1903* (Cth) s 33.

Recommendation 12.9: Superannuation Review Panel
1. The law should establish a Superannuation Review Panel, with the function of adjudicating disputes between members of superannuation funds or ADFs and the responsible entities of the funds.

2. The Panel should have no more than 3 members, appointed by the Minister on the nomination of interested groups. At least one member should have to have experience and knowledge of superannuation matters.

3. The Panel should be able to review any decision in relation to the member made by the responsible entity for the fund in the exercise or purported exercise of a power it has as responsible entity.

4. The Panel should only be able to make orders as follows:

- **if the Panel finds that the power has been not been exercised improperly — an order affirming the decision**
- **if the Panel finds that the power has been exercised improperly**
  - **an order referring the matter back to the responsible entity to reconsider the matter and make a fresh decision in accordance with directions given by the Panel**
  - **an order varying the decision**
  - **an order substituting for the decision its own decision.**

Without limiting the circumstances in which the Panel may find that the exercise of a power by a responsible entity was improper, the Panel should so find if it finds that the responsible entity, in making the decision

- **failed to take a relevant consideration or matter into account or**
- **took an irrelevant consideration or matter into account or**
- **acted in bad faith or with malice.**

5. A member of a scheme should not be able to apply to the Panel unless

- **he or she agrees not to take proceedings in equity in relation to the subject matter of the application, but the Constitution (that is, the prerogative writs (Constitution s 75(v)) and the ability to seek judicial review under the *Administrative Decisions (Judicial Review) Act 1975* (Cth), of the Panel's decision on the application, should not be affected**

- **either**
  - **there is no internal review mechanism established for the scheme**
  - **the decision concerned has been reconsidered in accordance with the internal review mechanism established for the scheme or**
  - **the Panel determines that the internal review mechanism is unlikely to assist or there are special circumstances that justify the application being made.**

6. The law should provide that the conditions under which a superannuation scheme or an ADF attracts a tax concession include that the responsible entity must agree to be bound by any decision of the Superannuation Review Panel, but without prejudice to its rights to take proceedings under the Constitution (that is, the prerogative writs (Constitution s 75(v)) or *Administrative Decisions (Judicial Review) Act 1975* (Cth) in relation to the Panel's decision on the application.

Access to superannuation schemes

Qualifying periods

12.43. Many single employer sponsored superannuation schemes are not available to employees immediately upon commencing employment. A qualifying period of employment has first to be served.[80] The qualifying period is justified by employers on the basis of the administration costs involved in high turnover industries and because superannuation is designed as a reward for loyalty by employees to the enterprise and a qualifying period helps to reinforce this. In the past, superannuation qualifying periods were often different for women and men. The Review understands that in more recent times, industry practice has changed, and that this is no longer common practice. Furthermore, recent amendments to the *Sex Discrimination Act 1984* (Cth) will ensure that, as of June 1993, qualifying periods which discriminate either directly or indirectly on the basis of sex will be unlawful.[81]

80. There are minimal qualifying periods for the superannuation entitlements under awards and for superannuation provided in relation to the SGL legislation. Under the SGL legislation, it is proposed that employers be liable to provide superannuation for employers if they earn more than $300 in a seven consecutive day period or they earn more than $3000 in the financial year concerned: SGL Information paper, 6.
81. The Act was amended by the *Sex Discrimination Amendment Act 1991* (Cth) s 9.

Delayed vesting

12.44. Not all employer contributions to superannuation schemes vest, that is become the property of the employee, immediately. Member-financed benefits are required to vest immediately and in full. Contributions by employers pursuant to an industrial award vest immediately, as will the contributions made under the proposed SGL legislation. Other contributions made by employers vest only in accordance with the trust deed or other instrument constituting the scheme. In the case of accumulation schemes, an employee who leaves before the employer's contributions vest is only entitled to receive his or her own contribution and the fund's credited earnings rate (or some lower designated rate). In the case of defined benefit schemes a similar 'deemed' earnings rate is generally applied to the contributions of a member who leaves the scheme before any benefit from the employer has vested in the employee. The Commonwealth has proposed that, from 1 July 1995, the maximum period for vesting of employer contributions will be 10 years from the date of contribution.[82]

Problems and difficulties

12.45. Qualifying periods and deferred vesting pose significant problems for several groups of superannuation scheme members, particularly women and those in part time or casual employment. Quite apart from the gender differences built into wage and salary rates,[83] the structure of women's participation in the workforce, combined with typical qualifying periods and vesting provisions, mean that it generally takes longer for women than for men to achieve a comparable vesting level. In addition, breaks in employment, for maternity or other reasons, usually mean that the qualifying period, both to join the scheme and for vesting purposes, is interrupted and must often be recommenced at the next time of employment.[84] The restriction of superannuation to persons in paid employment[85] also limits the ability of women to save for their retirement.

82. In 1989 the Minister for Social Security announced additional minimum vesting and preservation standards to come into question from 1 July 1995. These standards will require that all employer financed benefits accruing from 1 July 1995 vest in the employee at a rate of not less than 10% so that by the end of the tenth year with an employer there will be 100% vesting of those benefits: B Howe, *Better Incomes; Retirement Income Policy into the Next Century* 39.

83. Statistics for August 1991 show that average weekly earnings for females are 84.47% of those for males: Australian Bureau of Statistics, *Average weekly earnings, State and Australia*, August 1991.

84. See generally H Martin, *The Impact of the 1991 Budget Superannuation Reforms on Women*, speech to the Superannuation Agenda Conference, December 1991.

85. Contributions to superannuation schemes can only be made for up to two years following cessation of employment (full time or part time): OSS Regulations reg 5AA(3).

The ALRC is bound to have regard in its work to the Commonwealth's Access and Equity policy. The problems arising from delayed vesting and qualifying periods clearly involve issues that need to be considered in the light of that policy.

The Superannuation Guarantee Levy (SGL) legislation

12.46. In the 1991-92 Budget the Commonwealth announced its intention to impose a levy from 1 July 1992 on all employers who do not make a contribution to a superannuation scheme on behalf of all their employees. The amount of the levy will be equivalent to 3% or 5% of salary, depending on the size of the employer's payroll. This proportion will rise to 9% by the year 2000.[86] These contributions are to be fully vested in the employee and subject to a minimum qualifying period of employment.[87]

The Review's position

12.47. The ability of superannuation schemes to be a privately funded complement to the age pension will clearly be enhanced if the qualifying periods and vesting restrictions were reduced or eliminated, because a greater number of persons will receive superannuation benefits. The Review notes that the 10 year vesting schedule proposed by the Government in 1989 for contributions to superannuation schemes other than those made under the SGL legislation is to be reviewed in the light of the Government's policy announced in the 1991–92 Budget. Vesting of employer contributions should occur as early as possible. The Review proposed in DP 50 that there should be no qualifying periods for superannuation schemes other than a period sufficient to ensure that the administrative costs of establishing an account for a member do not outweigh the member's accrued benefits. SGL contributions will be payable after 7 consecutive days of employment during which earnings are $300 or more. The Review suggested in DP 50 that a similar regime exist for non SGL superannuation benefits.[88] It also proposed that all superannuation scheme deeds should, within a period of four or five years, provide for immediate vesting.[89] The Review understands from the ISC that the removal of all existing vesting restrictions and qualifying periods would add approximately 1% to wages costs

86. J Kerin, *1991–92 Budget Speech*, 11.
87. See fn 80.
88. DP 50 proposal 9.8.
89. DP 50 proposal 9.9.

for employers. The Review considered that the additional cost is justified on the public policy grounds stated above. The Review sought comment on whether this would have any adverse consequences, for example, whether employers may tend to underfund employer sponsored defined benefit schemes.

Submissions

12.48. ***No qualifying period.*** This proposal received significant comment. A number of submissions considered that, where employers voluntarily provide benefits in excess of the SGL legislation requirements, there is no justification for specifying a qualifying period for those additional benefits.[90] It was argued that if the qualifying period for voluntary contributions is aligned with that for SGL legislation contributions, employers will stop offering voluntary superannuation to any of their employees.[91] One submission suggested that the purpose of a qualifying period is to avoid the administrative expense of high turnover in early service where the administrative costs would dissipate a significant part of the benefit accruing and thus defeat the purpose of providing a benefit.[92] The proposal received support from a number of organisations.[93] The Securities Institute of Australia suggests that a qualifying period of three months would be more appropriate than the SGL legislation 7 days.[94]

12.49. ***Immediate vesting.*** A number of submissions disagreed with the proposal to introduce immediate vesting.[95] Most opposition focused around the argument that an employer voluntarily offering benefits should be able to impose whatever conditions he or she sees fit. Additionally, it was suggested that greater withdrawal benefits are likely to influence a fund's investment strategies.[96] Some submissions support the principle of immediate vesting but suggest that it should be phased in over a number of years.[97] Several submissions disagreed that immediate vesting is appropriate but indicated that a shorter period than 10 years would be appropriate.[98]

90. eg Mercer Campbell Cook and Knight *Submission* February 1992.
91. D Knox *Submission* February 1992.
92. AMP Society *Submission* February 1992.
93. eg Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Ltd *Submission* January 1992.
94. Securities Institute of Australia *Submission* February 1992.
95. eg ASFA *Submission* March 1992; LIFA *Submission* March 1992.
96. See, eg, Mercer Campbell Cook and Knight *Submission* February 1992.
97. See eg, D Knox *Submission* February 1992.
98. See eg, Australian Friendly Societies Association suggested vesting should be phased in at 20% each year aiming at full vesting after five years: *Submission* February 1992; National Mutual believes that vesting over five to 10 years is appropriate: *Submission* February 1992.

12.50. ***Recommendation — qualifying period.*** The Review remains of the view that ideally, the qualifying period for the SGL legislation contributions and voluntary contributions should be the same. It does not accept that employers will stop offering voluntary benefits. The Review acknowledges there may be legitimate concerns with regard to the administrative costs of opening and closing membership 'accounts' for staff with very high turnover rates. The Review recommends, therefore, that the maximum qualifying period for voluntary superannuation schemes should be three months.

12.51. ***Recommendation — vesting.*** The Review remains of the view that immediate vesting should be required at some future time. The Review does not accept that the government has no right to impose vesting scales on voluntary contributions in excess of the SGL legislation requirements. The Commonwealth's policy is to encourage such superannuation with the concessions for the same ultimate purpose — namely to provide better retirement support income. It is of little benefit if the vesting scales determined by employers are so long that very few employees benefit from the scheme. Even if employers reduce the amount of superannuation offered to some employees, so as to keep their overall cost of superannuation the same, the distribution of benefits amongst the workforce will be more equitable. For the moment, the Review accepts that there is significant opposition to this principle and that a reasonable lead up period must be provided before any change is made. Accordingly, the Review recommends that schemes should provide by 1995 that employer contributions should vest at 20% a year (that is, total vesting, within five years of being made).

Recommendation 12.10: Qualifying and vesting periods

1. The law should provide that the conditions under which a superannuation fund attracts a tax concession include that the qualifying period for access to benefits under the scheme be no more than 3 months. This should be phased in over 3 years.

2. The law should provide that the conditions under which a single employer sponsored or industry superannuation fund attracts a tax concession include that employer contributions to the fund in excess of those to be required under the Superannuation Guarantee Levy Bill 1992 vest in the employee at the rate of 20% each year. This requirement should be introduced in 3 years.

Unclaimed benefits

Introduction

12.52. As compulsory contribution rates increase and vesting periods decrease, more members, especially those with broken work patterns, will accrue benefits. This, combined with an increasingly mobile workforce, will mean that the possibility for schemes to 'lose' members who are entitled to benefits will increase. DP 50 noted that this made it important that mechanisms be established to deal with unclaimed benefits in a way that will maximise the prospect of members receiving contributions made on their behalf. While increasing community awareness about superannuation means that more people will be aware of their obligation to preserve the superannuation benefits they receive on termination and of the consequent need to keep the scheme informed of their address, it is likely that schemes will lose contact with a growing number of members.

Procedures for locating members

12.53. ***DP 50 proposal.*** Each superannuation scheme should establish a set procedure to minimise the chance of losing members. One possibility suggested was that schemes ask joining members to nominate a rollover fund into which they would like their benefit paid should they leave the job without notifying the scheme. The members should have appropriate information about this mechanism. DP 50 also raised the possibility of establishing standard procedures for schemes trying to locate lost members, including obtaining access to the members' tax file number (TFN). DP 50 proposed that the scheme be exempt from requirements to report to a lost member whose address has been proven to be not current in accordance with a standard procedure.[99]

12.54. ***Submissions and recommendations.*** Most submissions supported this proposal in principle.[100] Submissions that addressed the issue of access to TFNs drew attention to the need to ensure that the Information Privacy Principles in the *Privacy Act 1988* (Cth) are adhered to.[101] One submission pointed to the particular importance of this proposal for casual workers:

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99. DP 50 proposal 9.10; see recommendation 10.28.

100. eg Norwich Group *Submission* February 1992; AMP Society *Submission* February 1992; ASFA *Submission* March 1992; Women's Economic Think Tank *Submission* February 1992.

101. Australian Taxation Office *Submission* February 1992; DSS *Submission* February 1992.

> Our worry is that casual and part time workers, who are often female will be lost if there is not some system for central collection of such funds and relation to tax file number, with a responsibility on the agency to find the member. There must be a continuing obligation on funds to chase members with some entitlements over a set amount if there is no government alternative.[102]

Given the support the proposal received, the Review recommends that it be adopted. For greater certainty, the procedure should accord with guidelines issued by the regulator. The mechanism for requiring compliance will have to be access to tax concessions. However, because of the importance of retaining restricted access to the tax file numbers, the Review is not proceeding with the suggestion that responsible entities be given access to tax file numbers.

Recommendation 12.11: Unclaimed benefits procedure

1. The law should provide that the responsible entity for a superannuation fund or ADF, and the provider of a DA, must establish a procedure, conforming to guidelines published by the regulator by notice in the *Gazette*, for finding members of the scheme who do not claim benefits that are due to them, or whom the responsible entity or provider cannot locate.

2. The law should provide that the responsible entity for a superannuation scheme must ensure that each member booklet, prospectus or offer document for the scheme include particulars of this procedure.

Unclaimed benefits arrangements

12.55. *A single register.* Any scheme to deal with unclaimed benefits should be designed to maximise the possibility of those benefits being claimed. DP 50 noted the Review's view that this will best be achieved if, as well as the scheme mechanisms just recommended, there is established a single, central register of unclaimed benefits. People would then know exactly where to go to check whether any money is being held on their behalf. DP 50 proposed that the regulator establish such a scheme.[103] It would be called an Unclaimed Benefits Fund (UBF). Suggestions were made concerning its administration, including that the management of the UBF be contracted out. The regulator would nevertheless maintain a central register of 'lost' members. DP 50 also noted that the ISC has for some time been working on devising a scheme to deal with unclaimed benefits, involving the establishment of specialist schemes (Automatic Rollover Funds — ARFs) into which lost benefits would automatically be

102. Women's Economic Think Tank *Submission* February 1992.
103. DP 50 proposal 9.11.

transferred. That proposal does not, however, appear to provide for a central register to be kept nor does there appear to be any limit on the number of ARFs. DP 50 explained that the Review considers such a proposal as less likely to result in lost funds being returned to their owners than the Review's proposal.

12.56. ***Submissions.*** Very few submissions opposed the UBF proposal. ASFA was concerned at the regulator's involvement.

> A relevant consideration, particularly in a review of the prudential framework, is the question of who would control the proposed single fund (ie who is the responsible entity) and to whom is that entity answerable. ASFA is concerned at the review suggestion that the regulator should be responsible for the UBF. A regulatory agency is ill-equipped to take the commercial decisions involved in contracting the administration and investment activities and in balancing the (often conflicting) interests of members.[104]

It also expressed support for a vehicle along the line suggested by the ISC's proposal:

> ASFA believes that a small number of ARFs (or similar), together with a centralised register, might achieve most of the economies available from a single UBF (or similar) and would aid in creating a competitive environment to maximise returns and minimise costs. Furthermore, if it is accepted that some form of automatic rollover is an efficient way of dealing with preserved benefits (particularly relatively small ones), then it should be noted that many members would be happy to accept such arrangements where the trustees of the scheme chose the rollover vehicle, but would not be happy for the amount to automatically go to a central, regulator-run fund.[105]

Most other submissions supported the proposal.[106] It was said that the databases of many funds would need to be improved for the system to function effectively.[107] A number of submissions were concerned to ensure that there would be no, or only a limited, compulsion to transfer money to the UBF.[108]

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104. ASFA *Submission* March 1992.
105. ASFA *Submission* March 1992.
106. eg Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Ltd *Submission* February 1992; Westpac Financial Services *Submission* February 1992; The Securities Institute of Australia *Submission* February 1992; Shell Australia Ltd *Submission* February 1992.
107. Australian Taxation Office *Submission* February 1992.
108. eg Mercer Campbell Cook & Knight *Submission* February 1992; Office of the Cabinet (Qld) *Submission* February 1992.

12.57. ***Recommendation.*** A system along the lines proposed in DP 50 will be needed. There are a number of issues that need to be clarified.

- ***Administration and management.*** The Review did not intend that the UBF become a large government run ADF. It was intended that the government's role would be restricted to a clearing house of information and contributions. All the administration and management should be awarded by tender to private sector suppliers. To reinforce this point the proposal is referred to below as the Unclaimed Benefits System (UBS). So long as the administration and the management of the funds in the UBS are tendered out to independent professional administrators and investment managers, the concerns expressed by ASFA in relation to the regulator's involvement should be met.

- ***Transferring money to the UBS.*** The UBS should be able to accept money from responsible entities for superannuation schemes or ADFs, and they should be legally able to transfer the money to the UBS, at any time after six months after the member has become 'lost'.[109] The law should require the responsible entity of a scheme to transfer the money to the UBS after a member has been lost for two years.

- ***Fees and charges.*** The administration costs of the UBS should be paid out of the gross earnings of the funds in the UBS.

- ***'Lost' members.*** A member should be regarded as 'lost' if, using the mechanism recommended above,[110] the responsible entity has been unable to locate him or her and at least six months have passed.[111]

- ***Returning members.*** When a 'lost' member is located, the amount standing to the member's credit should be notified to the member and have the same status as an ETP.

Recommendation 12.12. Unclaimed benefits

An arrangement for an unclaimed benefits scheme (UBS) should be established as an ADF. However, disclosure requirements, reporting to member requirements and member representation requirements should not apply to the UBS. The law should provide for a UBS as follows:

109. If the scheme is not an 'eligible' scheme, ie, does not attract tax concessions, there should be no bar on its transferring money for lost members — defined by the scheme — to the UBS.
110. Recommendation 12.11.
111. See recommendation 10.28.

- **the regulator should keep a register of 'lost' members notified to it by responsible entities**
- **the regulator should not manage or administer the money covered by the UBS and should regularly put these functions out to competitive tender.**
- **the UBS, or its agents, should be able to accept money from any scheme**
- **the administration costs of the UBS should be paid out of the gross earnings of the funds in the UBS**
- **the responsible entity for an eligible superannuation scheme or eligible ADF**
  - **may transfer unclaimed benefits to the UBS after the member has been lost (to their scheme) for six months and**
  - **must transfer unclaimed benefits to the UBS as soon as practicable after the member has been lost (to their scheme) for a total of two years.**

Small amounts to reserves?

12.58. It has been suggested that small amounts, for example, of up to $100, are not worth keeping for a member who is lost and should be counted as part of a scheme's reserves. Some trust deeds presently provide for this. DP 50 suggested that all amounts, no matter how small, ought to be transferred to the UBS.[112] It may happen that several small amounts will be transferred for the one person and combine to make a worthwhile sum. To provide otherwise would eliminate any chance that the accrued benefit may one day be obtained by the member. If, after cross checking with the DSS and the ATO, the UBS does not succeed in locating a particular member by the time that person would have reached a specified age,[113] that money should be used to fund the administration of the UBS. However, it can be expected that with the establishment of the UBS there will be fewer and fewer lost benefits. Most submissions agreed with this approach.[114] It is important to preserve for members as much as possible of their retirement benefits. The Review confirms its proposal in DP 50.

112. DP 50 proposal 9.12.
113. DP 50 suggested 66 years: para 9.40.
114. AMP Society *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; Women's Economic Think Tank *Submission* February 1992; ASFA *Submission* March 1992.

Recommendation 12.13: Unclaimed benefits not to be put to reserves

The law should provide that it is an offence for the responsible entity for a superannuation fund to transfer the amount of benefits not claimed by the members entitled to them to the reserve established for the fund.

Hardship cases

12.59. ***Proposal.*** Superannuation benefits over $500 are preserved until the member reaches the age of 55.[115] Access to benefits before retirement is generally not permitted. However, most deeds provide for early release of preserved benefits at the trustee's discretion, because of hardship. It could be argued that the early release of money specifically designed to provide for retirement income directly contradicts the purpose of superannuation. ASFA considers that access to benefits in the event of hardship should not be allowed.[116] DP 50 proposed that so long as the terms of the trust deed provide very strict criteria for the proof of hardship, early release of benefits ought be permitted in extreme circumstances.[117]

12.60. ***Submissions.*** A number of submissions agreed with this proposal,[118] which is a restatement of the present situation, but many expressed concern about the need for rigidly defined criteria for the assessment of early releases on the grounds of hardship.[119] Some suggested that no hardship releases should be allowed in any circumstances

> [T]he current high level of early payments is in our view negating member respect for the preservation requirements. It reflects the impossibility of trustees, of large funds in particular, and a regulator satisfactorily sorting out the cases which are genuine.... These problems can only be resolved by removing the right to seek release in the case of hardship. Retirement benefits are for use in retirement and the community will not appreciate [that] this is the case if preservation requirements are treated lightly.[120]

115. OSS Regulations regs 9, 10, 11, 12.
116. ASFA *Policy Issues Paper* 1991, 57.
117. DP 50 proposal 9.13.
118. AMP Society *Submission* February 1992;
119. eg Jacques Martin Industry *Submission* February 1992; KPMG Peat Marwick *Submission* February 1992.
120. Mercer Campbell Cook & Knight *Submission* February 1992.

The Review understands that the ISC is also concerned about the increased number of requests for early release on the grounds of hardship.[121] This increase is no doubt a direct reflection of the current poor economic climate. Nevertheless, permitting such payments represents a significant encroachment on the retirement incomes policy. It is clear that the assessment of early releases is a time consuming and often very difficult task; one that neither trustees nor the ISC seem keen to do. The Review understands that the ISC proposes to involve trustees to a much greater degree in the assessment process.

12.61. ***Recommendation.*** The Review is concerned that the objectives of the Commonwealth's retirement incomes policy may be threatened by the early release of benefits. Even with a tightening of the criteria and the procedure for applying[122] there can be no guarantee that this does not happen. The burden on trustees and the regulator is also significant, although the Review acknowledges that the demand for early releases is somewhat cyclical. Accordingly, it recommends that trust deeds should not be able to permit early releases on the grounds of hardship. A transitional period should be allowed for trust deeds that currently provide for such releases.

Recommendation 12.14: Hardship cases

The law should provide that a provision in the deed or other instrument constituting a superannuation fund that permits a member to withdraw money from the fund, on the ground of hardship is of no effect.

Bankruptcy

Bankruptcy of member

12.62. Currently, many superannuation deeds provide that, if a member becomes bankrupt, the member's benefits under the scheme are forfeited to the fund. The trustees often have an absolute discretion whether to use the money for the benefit of the bankrupt or their dependants, to reduce the employer's contributions in respect of other members or otherwise for the benefit of other members. The Review regards this situation as inequitable. It is inconsistent with the aims of retirement incomes policy. The question is how to balance the needs of the bankrupt for retirement income support with the policy of divisibility of the bankrupt's property for the satisfaction of creditors. The Review

121. The ISC received 4,700 applications for early release of benefits in 1989/90, about 12,000 in 1990/91. It expects to receive between 25,000 and 30,000 requests in 1991/92. The Review understands that about 75% of applications for release of preserved benefits are approved.

122. eg requiring applicants to sign a statutory declaration as to their financial affairs.

recommends that the law should prevent a bankrupt member's vested benefits, so far as they represent contributions made in satisfaction of the SGL, being forfeited to the scheme. Instead, they should be applied by the responsible entity to buy an annuity for the member, either immediate or deferred (depending on the member's age). The income from the annuity should be treated as protected income under the *Bankruptcy Act 1966* (Cth).[123] A deferred annuity should not be counted as an asset of the member. This recommendation will mean that members will, consistent with the Commonwealth's retirement incomes policy, benefit from their superannuation. Similar considerations might apply to the amount in the member's account that represents the excess over SGL contributions. It is important that the protection of the kind just recommended is not used by individuals to escape their proper liability to their creditors by making large contributions to their superannuation scheme just before they are declared bankrupt. Superannuation benefits which relate to contributions in excess of those made pursuant to the SGL legislation should not, therefore, be automatically protected. The trustee in bankruptcy of the bankrupt's estate should be able to apply to the court for an order requiring the responsible entity to release to the receiver the contributions in excess of the SGL contributions that have been made on behalf of the bankrupt within the previous two years.[124] The same regime should apply to deposits in ADFs and DAs.

Recommendation 12.15: Bankruptcy of scheme member

1. The law should provide that, except as recommended below, on bankruptcy of a member of a superannuation fund or an ADF, none of the amount standing to a person's account in the fund or ADF is capable of being taken by the trustee in bankruptcy as part of the person's estate.

2. The law should provide that, on becoming aware that a member of the superannuation fund is bankrupt, the responsible entity for the fund must apply so much of the amount standing to a person's account in the fund as represents the contributions required to be made under SGL, and the earnings thereon, to buy an annuity for the member, either immediate or deferred (depending on the member's age).

3. The law should provide that the income from the annuity is protected income under the *Bankruptcy Act 1966* (Cth) and that the deferred annuity is not property of the member divisible among the creditors.

123. See *Bankruptcy Act 1966* (Cth) s 116(e), (f), (fa).

124. This equates with the period recommended by the ALRC in its report *General Insolvency Inquiry* (ALRC 45, 1988) as the period for relation back in respect of transfers to associates.

4. A court having jurisdiction in bankruptcy should be able, on application by the trustee in bankruptcy or the Official Receiver of a bankrupt's estate, to declare, by order, that some or all of the amounts standing to a bankrupt's account in a superannuation fund or ADF that is

- **more than the amount referred to in 2 and**
- **represents contributions made within the previous two years, and the earnings thereon,**

is property divisible among creditors.

Bankruptcy of employer

12.63. Another issue relating to bankruptcy about which the Review is concerned is the bankruptcy, or liquidation, of an employer sponsor. The employer's receiver will be placed in the employer's shoes in relation to the superannuation scheme. The receiver will be placed in a difficult position involving a potentially significant conflict of interest between its duty to the creditors and its duty as a member of the responsible entity board to the members of the scheme. Concern has been expressed to the Review that the employees are more likely than not to be the losers when such conflicts arise. The only way to ensure such conflicts do not arise is to require the appointment of a temporary independent person as the responsible entity of a single employer sponsored scheme as soon as the employer is placed in liquidation. Accordingly, the Review recommends that, when an employer entitled to appoint at least 50% of the members of a responsible entity board is placed in liquidation, the board of the responsible entity should be replaced by a temporary independent responsible entity.

Recommendation 12.16: Bankruptcy of employer

The law should provide that the regulator, on becoming aware that the employer in a single employer sponsored superannuation fund has become bankrupt or, in the case of a company, become an externally administered body corporate, must, by written instrument, remove the responsible entity from office and appoint another responsible entity in its stead.

Superannuation on divorce or separation

Significance of family law issues

12.64. The main focus of this reference is on the proper regulation of superannuation schemes and the prudential requirements which should apply. While it is not absolutely essential in the context of this reference to deal with questions concerning the property rights of married people or de factos, there are good reasons to do so. It has been recognised in the Commonwealth's retirement incomes policy that superannuation entitlements are generally intended to provide for the needs of both parties, and the spouse of a member does make a (non-monetary) contribution to superannuation.[125] It is desirable that the fairness which is intended to flow from the retirement incomes policy extend to the partner of the contributing member. The Review has considered significant aspects of the relationship between the members of superannuation schemes and the responsible entities. The changes necessary to achieve justice between partners to a marriage will affect that relationship. Finally, the recommendations made earlier to require incorporation of most schemes will put it beyond doubt that there is constitutional power to deal with the issue, a problem which has up to now precluded a satisfactory resolution of the problem.[126]

The issues

12.65. There are two main issues. The first is what principles should apply to the allocation of interests in superannuation funds between parties to a marriage, or to a de facto relationship. The second issue is how to implement this principle in the most effective way.

General principles that should apply

12.66. ***Present law.*** Under the present law, the Family Court has an almost unfettered discretion to alter the property interests of spouses who separate or divorce. The Court may

> make such order as it thinks fit altering the interests of the parties in the property [of the marriage].[127]

No property is excluded. However, it has been held that until a superannuation entitlement matures in the hands of the beneficiary it is not property and cannot be dealt with directly.[128] Nevertheless, under the *Family Law Act 1975* (Cth)[129]

125. Howe *Better Incomes: Retirement Incomes Policy into the Next Century.*
126. See ALRC 39 para 467-8; the Attorney-General's Department's Discussion Paper *The Treatment of Superannuation in Family Law* (1992) argues that, although the marriage power is sufficient in the case of spouses, that power does not extend to the case of de factos spouses: para 37-8.
127. *Family Law Act 1979* (Cth) s 79(1).
128. *In the Marriage of Crapp* (1978) 32 FamLR 286; *Evans v Public Trustee (WA)* (1991) FamLR 646.
129. s 75(2).

it is a relevant financial resource to be considered when determining property rights between the spouses. This limits the court in the kind of orders it can make, though it does not necessarily affect the principles of sharing which are addressed here.

12.67. ***Equal sharing principle.*** The superannuation entitlements of the spouse who is a member of a superannuation scheme have been built up over a working life. However, superannuation is usually a valuable joint matrimonial asset to which both parties have contributed directly or indirectly. One of the parties will frequently have acted to his or her disadvantage by relying for security on the prospective superannuation entitlement of the spouse. The Family Court generally takes the view that, because the parties have, in effect, given up current income for future security they should both be regarded as contributors to the superannuation fund.[130] This view was reflected in the *Better Incomes* statement of the Minister for Social Security:

> [W]omen who work at home — as well as those paid in employment — contribute to their spouse's superannuation. However, they do so by providing household services and by giving up current income.[131]

The Review accepts the principle, set out in the ALRC's report *Matrimonial Property*, that, unless the circumstances are exceptional, the contributions that spouses make to the economic life of a marriage should be regarded by the law as equal.[132] This is particularly so for superannuation entitlements which are wholly related to the spouses' employment. This means that the portion of the superannuation entitlements that is attributable to the period of the spouses' cohabitation should be seen as the joint product of the spouses' equal efforts. The Review takes the approach that the principle upon which this entitlement ought to be divided on separation or divorce is that of equal sharing.

Implementation

12.68. ***Present problem.*** The main problem under the present law is to find a satisfactory way to implement the principle of equal sharing. The reason is that superannuation cannot usually be dealt with as property; even if the interest has fully vested, the amount may not be ascertainable. The unsatisfactory situation

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130. eg *In the Marriage of Bailey* (1979) 33 FamLR 10; *In the Marriage of Crapp* (1978) 32 FamLR 286; *In the Marriage of Lalor* (1989) 14 FamLR 282.
131. Howe, *Better Incomes: Retirement Incomes Policy into the Next Century* 25.
132. ALRC 39 para 350.

regarding superannuation was recognised by the Family Law Council[133] and by the first Joint Select Committee on the Family Law Act in 1980.[134] In 1987, the ALRC recommended a straightforward formula to deal with superannuation, under which the notional value of a spouse's benefit in a superannuation scheme would be included in the property to be divided between the parties.[135] The formula included a method of working out the value of the superannuation. The basic value is the amount which would be paid to the spouse if he or she resigned from the superannuation scheme on the date selected by the court.[136] If the spouses had lived together for the whole period of contribution to the scheme, the basic value worked out in the way described would be the value to be divided. If the period of contribution had commenced before the relationship, or extended beyond it, the amount to be divided would be a proportion of the basic value. For example, if the couple lived together for 7 years, and the spouse had contributed to the scheme for 10 years, 7/10ths of the basic value would be included in the property for division. These recommendations establish a clear method of valuation and enable other property to be divided more equitably. They do not, however, create any direct interest in a superannuation scheme for a spouse or partner of the member. To this extent they are not adequate to implement the Commonwealth's retirement incomes policy.

12.69. *Splitting the fund.* A better objective for which the law ought to strive in this area is to divide the contributing spouse's entitlement in the fund (or that part of it which is attributable to the relationship) into two. Each spouse could then have the benefit of one of these shares as a continuing interest in the superannuation fund. Such an approach to the reallocation of superannuation benefits will achieve the following goals of policy in this area.

- *Equity.* It will be equitable as between the spouses and will recognise the equal contributions of each spouse.

- *Supporting retirement income.* It will give the non-contributing spouse the opportunity to have a superannuation entitlement which he or she can add to or roll over into another scheme and thus be in keeping with retirement incomes policy.

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133. Family Law Council, Working Paper No 8 *Superannuation and Family Law* (1980). The Family Law Council in 1980 recommended joint Commonwealth and State legislation to provide that divorced wives and all children be included as beneficiaries in all super schemes; to make orders of Family Court enforceable.
134. Joint Select Committee on the Family Law Act, report *Family Law in Australia*, 95–7.
135. ALRC 39.
136. ALRC 39 para 469. If the superannuation is taken as a pension, it is given a lump sum value for this purpose.

In 1987 the ALRC considered the prospect of splitting the funds in a similar way. It concluded at that time that such a proposal was not warranted.[137] Since then, however, the position has changed markedly. The Commonwealth's retirement incomes policy has been established and superannuation is an integral and important part of that policy. The Review considers that the reservations expressed in 1987 by the ALRC should be re-examined.

12.70. ***Legislative power.*** One reason why the ALRC did not recommend that a spouse be given a direct interest in the superannuation entitlements of the partner, or that the court be given power to order an assignment of an interest in a scheme which would bind the trustees, was the lack of constitutional power. The recommendations made earlier in this report[138] will overcome this problem by requiring superannuation schemes which seek tax concessions to have an incorporated responsible entity or to bring themselves within the ambit of the Commonwealth's power in respect of old-age and invalid pensions. This will remove the objection.

12.71. ***Delay in finalising the financial relationship.*** Another issue raised by the ALRC in its earlier report was the undesirability of delaying the financial settlement until the spouse who was a scheme member retired or died. This objection recedes in importance when the implications of the retirement incomes policy are bought into account. Superannuation is intended to provide a supplement to retirement incomes and is a long term interest. Ways need to be explored of preserving the interests of both parties without keeping them tied together financially as a result.

Submissions

12.72. Most submissions which dealt with this issue supported the Commission's approach.[139] Those who did not thought the matter fell outside the ambit of the Review's terms of reference or that the formula would be difficult to apply. Those who supported the proposal made a number of suggestions, for example, to consider tax consequences, to clarify the formula and to consider contributions before and after marriage.

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137. ALRC 39 para 467–8.
138. Recommendation 7.1.
139. eg Australian Shareholders' Association *Submission* February 1992; IFA *Submission* February 1992; Permanent Trustee Company Limited *Submission* February 1992; DSS *Submission* February 1992.

Application to different kinds of schemes

12.73. ***Treatment of entitlements in accumulated schemes.*** The application of the principle of equal sharing in the case of entitlements in an accumulation scheme presents few problems. The responsible entity could to be required to determine the amount to be credited to an account for the non-contributing spouse. That account should have credited to it an amount equal to half the amount in the scheme standing to the credit of the contributing spouse. If the scheme represents in part contributions made before or after cohabitation, an appropriate apportionment would be made. The contributing spouse's share in the scheme should be decreased accordingly. The non-contributing spouse's entitlement should be 'rolled over' into an ADF or similar superannuation scheme. Nothing in the deed or other instrument establishing the scheme should be able to inhibit this. In particular, provisions restricting membership of the scheme to particular occupations, or employment with a particular employer, and provisions that give the responsible entity a discretion to exclude or vary an entitlement, should be ineffective in this context.

12.74. ***Treatment of entitlements in defined benefit schemes.*** Entitlements in defined benefit schemes present more difficulties. As with accumulation schemes, the responsible entity ought to be required to determine the amount to be credited to an account for the non-contributing spouse. That amount should in principle represent one half of the contributing member's entitlement accrued during the period of cohabitation. But as the amount may be difficult to ascertain, a formula will need to be devised, to take into account the particular circumstances of the scheme and the way the defined benefit is calculated.[140] If possible, that formula ought to be prescribed in legislation in accordance with the principle which has been outlined. In any event, deeds and other instruments creating defined benefit schemes ought in future to include provision for such a formula. The effect of the formula ought to be to credit the non-contributing spouse with the amount, worked out under the formula, and to reduce the contributing spouse's entitlement accordingly. As with accumulation schemes, the non-contributing spouse's entitlement should be 'rolled over' into an ADF or similar superannuation scheme. Appropriate provision could be made to enable this amount to be ascertained. The deed or other instrument establishing the scheme should not be able to inhibit the creation of the new account.

12.75. ***Variation of shares.*** Under the present law the court has a complete and unfettered discretion to adjust the parties' shares in their property. In its report

140. This formula could be based on the formula that will have to be devised under the SGL legislation to calculate the prescribed maximum level of employer superannuation support: see SGL Information paper, Appendix B.

on *Matrimonial Property*[141] the Commission recommended that this broad discretion be replaced with a structured discretion, under which the court would apply a basic rule of equal division of property. The ALRC recommended that, while the basic rule was equal division, the parties should be able to make their own arrangements for the division of their property on separation or divorce. Subject to strict safeguards as to fairness, these arrangements would be enforceable.[142] Should the court or the parties be able to vary the shares proposed above? The Review is of the view that they should. There may be cases where appropriate superannuation arrangements for the non-contributing spouse can be made without the need to disturb the contributing spouse's entitlement, as, for example, where there are enough funds otherwise available to buy the non-contributing spouse an appropriate superannuation entitlement in another scheme. The restrictions as to fairness of the agreement proposed by the ALRC should remain, but should be strengthened by the inclusion of a further, specific consideration: whether the net result of the arrangement proposed would be to leave the non-contributing spouse without appropriate superannuation coverage. To ensure that this provision is respected, agreements should be subject to court approval. The court should also have a limited power of adjustment, taking into account the factor just mentioned.

Attorney-Generals' Department Discussion Paper

12.76. ***Deemed reallocation.*** In a Discussion Paper published in March 1992, the Attorney-General's Department proposed a statutory scheme under which

> As from the date of permanent separation, the contributing spouse's superannuation entitlement would be deemed by statute to have been reallocated between the parties. Parties who did not want the deemed reallocation to apply would have to seek court approval to depart from the statutory scheme.[143]

The grounds of departure would be limited. This scheme would avoid the need for a court application unless the parties could not agree, or wanted a different, or no, superannuation arrangement. On the other hand, the facts which the trustees would need to know (such as relevant dates) would not be readily ascertainable unless either the parties or the court made a formal assignment. The trustees would be required to provide information to the non-contributing spouse. While the proposed formula provides for equal division, it would do so without regard to the way in which the other property of the parties was dealt with. It would apply only to vested funds.

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141. ALRC 39.
142. ALRC 39 ch 10; see also ALRC DP 46, para 3.70.
143. Para 27.

12.77. ***Comparison with DP 50 proposal.*** The principles behind the Attorney-General's Department proposal are similar to those the Review has put forward. The main difference is that they would operate without a court order, though a court might need to make an assignment if the parties could not agree. The Review proposes that the matter always be dealt with by court order or by court approval of an agreement. The grounds for allowing a court to depart from equality are limited in each case and require consideration of each party's superannuation positions. The Attorney-General's Department's proposal would apply only to vested funds, whereas the Review proposal could be adapted to apply to any superannuation interest, even before vesting and before the amount of the interest was known. The non-contributing spouse could not acquire an interest or prospective interest that was more than the appropriate proportion of the interest achieved by the contributing spouse.

Recommendation

12.78. The Review has considered this question in the light of submissions received and of the more recent proposals in the Attorney-General's Department Discussion Paper. It has concluded that the principles upon which the superannuation entitlements of spouses ought to be re-arranged on separation or divorce is the principle of equal sharing recommended by the ALRC in its 1987 report. There are some attractions in trying to devise a mechanism for prescribing, in legislation, the way in which superannuation should be divided. The Review agrees with the thrust of the proposals in the Attorney-General's Department's discussion paper, that parties should, in relation to their superannuation as in relation to other kinds of property, be encouraged to resolve matters without the need for court adjudication. But its view is that court oversight is still desirable. The re-allocation of superannuation arrangements on divorce or separation should continue to be subject to court control. The principal reasons for this are

- the desirability, from the responsible entity's point of view, of having a clear, simple and authoritative statement of the entitlements that need to be dealt with or created
- the need for court control where some variation of the general rule proposed is wanted by the parties and to ensure that the final re-allocation of superannuation entitlements is fair having regard to all the circumstances.[144]

144. Additionally, reallocation under a court order is required in order to ensure that the re-allocation does not create capital gains tax liabilities: ITAA s 160ZZM, 160ZZMA.

In other respects the Review confirms the proposal in DP 50 and recommends accordingly.

Recommendation 12.17: Superannuation on divorce or separation

1. The *Family Law Act 1975* (Cth) should be amended to empower a court exercising jurisdiction in proceedings with respect to the property of parties to a marriage to direct the responsible entity of an accumulation scheme of which one of the parties is a member to split the account of the contributing spouse and roll the amount (if any) awarded to the non-contributory spouse into an ADF. The proportion of the fund allocated to the non-contributory spouse should, unless the court orders otherwise, be half the value of that part of the fund accumulated during cohabitation. The ADF must be fully preserved. The order should have to be obeyed despite anything in the deed or other instrument establishing the scheme.

2. The *Family Law Act 1975* (Cth) should be amended to empower a court exercising jurisdiction in proceedings with respect to the property of parties to a marriage to direct the responsible entity of a defined benefit scheme of which one of the parties is a member to pay the entitlement of the non-contributing spouse, determined by the court, into an ADF. The entitlement of the member should be divided between the parties according to a prescribed formula.

3. The court should be able to depart from the prescribed shares (that is, 50/50 for accumulation schemes, as prescribed for defined benefit schemes) in limited circumstances. The parties should be able to vary the shares by agreement, subject to the protection recommended in the ALRC's report *Matrimonial Property* (ALRC 39) and subject to court approval. In deciding whether to depart from the prescribed shares, or to approve an agreement to that effect, the superannuation position of the non-contributing spouse should be considered.

4. The transfer should not be subject to any tax or duty.

De factos

Background

12.79. The reasons which make it important to deal fairly with the superannuation entitlements of married persons when they divorce or separate apply with equal force when persons in a de facto relationship separate. Several jurisdictions now have legislation allowing a court to distribute the property of parties to some de facto relationships when the relationship breaks down. These laws, however, do not apply throughout Australia, and are not uniform. In DP 50 the Review proposed that courts exercising jurisdiction under those laws should have the same powers as were recommended for courts exercising jurisdiction under the Family Law Act.[145] Very little comment was made on this proposal in submissions. Such comment as was made raised the same matters as were raised in relation to married persons.[146]

Recommendation

12.80. It would be undesirable for the law on this matter to apply differently in different parts of Australia. Responsible entities for schemes that operated on a national basis would face additional costs. There would be inequities between members of the same scheme who were in different jurisdictions. The earlier recommendations that are designed to ensure either that responsible entities incorporate as trading or financial corporations, or that schemes offer old-age pensions, will ensure that the Commonwealth will have constitutional power to legislate with respect to entitlements in these schemes, whether they are held by married persons or persons in de facto relationships. Given that retirement incomes policy has as much interest in adequate levels of post-retirement income for persons in de facto relationships as it does for married persons, the Review has concluded that the same principles ought to apply to the reallocation of superannuation entitlements on the breakdown of a de facto relationship as have been recommended for divorce or separation of married persons. The basis of that re-allocation is fair, and the Review sees the need to ensure enhanced levels of post-retirement income as the primary public policy goal in this area. Accordingly, the Review recommends that the law should provide that the parties to a de facto relationship are entitled and required to share the superannuation entitlements related to the period of their cohabitation on the same basis as that recommended for married persons. Again, a court order, or court approval of an agreement, should be required. The Review suggests that the Family Court be given jurisdiction in these matters, but that State and Territory Supreme Courts, which already have jurisdiction, either in their general equitable jurisdiction or under specific legislation in those jurisdictions where it has been enacted, should continue to have jurisdiction. The question which court should have jurisdiction was not raised by the Review in DP 50 and the Review expects that the Commonwealth will consult with the States and Territories before legislating to implement this recommendation.

145. DP 50 proposal 9.14.
146. eg Women's Economic Think Tank *Submission* February 1992.

Recommendation 12.18: Superannuation and breakdown of de facto relationships

The law should provide that, on the breakdown of a de facto relationship, the superannuation entitlements of the parties to the relationship should be re-allocated on the same basis as provided for in recommendation 12.17. Jurisdiction in respect of proceedings under this recommendation should be conferred on the Family Court, the Family Court of Western Australia and on the Supreme Courts of the States and Territories.

13. Powers of the regulator

Introduction

13.1. This chapter considers what powers the regulator will need to ensure the integrity of the system of prudential supervision and to provide an appropriate level of protection for members of superannuation schemes. It covers the powers that the current agencies have, such as the power to conduct audits, and those which the Review considers a regulator of superannuation should have, such as powers to enforce the deed or other instrument constituting a scheme and to issue stop orders. It also addresses the scope of the investigative powers that the regulator ought to have and what the regulator's role should be when superannuation schemes merge. Consideration is given to matters affecting the way criminal offences should be constructed and the possible use of civil penalties rather than criminal prosecutions. Finally, this chapter looks at the issue of funding of the regulator.

The regulators' existing powers

Introduction

13.2. The present law, and the Review's proposals, impose a number of obligations on responsible entities and other relevant persons. The deed or other instrument constituting the scheme, together with the general law of trusts, will impose some of these obligations.[1] Others will be imposed by statute, such as OSSA, the Corporations Law and the *Life Insurance Act 1945* (Cth). These Acts also confer various powers on the regulators. The following paragraphs outline the statutory powers currently available to the regulators to enforce adherence to the regulations and what additional powers the Review considers the superannuation regulator requires to adequately supervise the industry.

OSSA

13.3. OSSA applies to all employer related schemes, ADFs, PSTs and, to a degree, other schemes that allow the transfer of benefits independently of current employment. It provides the ISC with the power, in respect of any scheme claiming concessional taxation treatment to

1. For a discussion of the Review's view on the application of trust law see ch 9.

- require superannuation schemes, ADFs and PSTs to supply information to the ISC
- require the production of documents to, and the taking of copies or extracts by, the ISC
- exercise a discretion to treat a non-complying superannuation scheme, ADF or PST as a complying scheme, ADF or PST
- revoke the certificate of compliance necessary for a superannuation scheme, ADF or PST to obtain a tax concession.

Life Insurance Act

13.4. The *Life Insurance Act 1945* (Cth) provides the ISC with its only powers in relation to DAs, as well as additional powers in respect of other superannuation schemes provided by life insurance companies. It does this by giving the ISC the power, in relation to any life insurance company,

- to cancel the company's licence to act as a life insurance company[2]
- to require the provision of information[3]
- to require the production of its books and other documents[4]
- to gain access to its premises to search for documents, and to inspect and copy them[5]
- to undertake an investigation of the company[6]
- to obtain information pursuant to an investigation of the company[7]
- to apply to the court for an order to place the company or a part of the business of the company under judicial management[8]
- to apply to the court for an order that the company be wound up[9]
- to transfer any or all of the business of the company to another life insurance company.[10]

2. s 23A.
3. s 54.
4. s 54A.
5. s 54B.
6. s 55.
7. s 56.
8. s 59(1)(a).
9. s 59(1)(b).
10. s 65, 73–6.

Corporations Law

13.5. Superannuation schemes, ADFs and PSTs, except where specifically exempt, are subject to the Corporations Law because they fall within the definition of 'prescribed interest'. The ASC has the following powers in relation to these schemes

- to revoke approval of a trust deed or a trustee[11]
- to refuse to register a prospectus[12]
- to issue a stop order on the issue of securities[13]
- to require a securities dealer to provide specific information and if directed have that information audited[14]
- to revoke a manager's dealers licence[15]
- to suspend a dealers licence[16]
- to issue a banning order.[17]

In addition, the ASC has broad investigative powers in relation to any of the powers it has under the Corporations Law.[18] These include the powers to inspect books,[19] to require persons to give assistance to the ASC and to appear for examination,[20] to require the production of books[21] and to require the disclosure of information relating to the acquisition or disposal of securities.[22]

Inadequacies in current powers

13.6. As this outline demonstrates, the regulators' abilities to enforce the regulations vary considerably. The ASC's powers are confined to those activities of superannuation schemes falling within the Corporations Law. The most glaring deficiencies are in OSSA. In particular

11. s 1067(5).
12. s 1020A(2).
13. s 1033.
14. s 788.
15. s 825, 826.
16. s 827.
17. s 828.
18. These are conferred by the *Australian Securities Commission Act 1989* (Cth).
19. *ASC Act* s 29.
20. *ASC Act* s 19.
21. *ASC Act* s 30.
22. *ASC Act* s 41.

- there is no power to prudentially supervise non-complying superannuation schemes
- the powers of the regulator are not targeted towards the responsible entity
- no penalties, other than removal of the tax concession available to complying funds, can be imposed on responsible entities that breach (intentionally or unintentionally) any of the standards.

This situation is inconsistent with the Commonwealth's clearly stated objective of having consistency in regulation of superannuation schemes whatever the institution providing the scheme. The following paragraphs discuss some additional powers that the Review considers the regulator will need for all superannuation schemes, ADFs, PSTs and DAs.

Additional powers for the regulator

Surveillance and investigation

13.7. ***Background.*** A successful regulatory system which is designed to provide prudential supervision requires that the regulator have adequate information gathering powers. It is essential that the regulator have appropriate powers to monitor compliance with the laws governing superannuation, including conducting surveillance programs, requiring the production of documents and the disclosure of the whereabouts of information not supplied, examining persons capable of giving relevant information and, ultimately, gaining access to premises where sought-after documents may be located. However, care needs to be taken in drafting such investigative powers to ensure that they are adequate to enable the regulator to enforce the regulations without being excessive or overly costly. The recommendations in this chapter do not cover all the detailed matters that will need to be addressed in the design of such powers, for example, whether they can be exercised without suspicion of a contravention.

13.8. ***The proposal.*** In DP 50 the Review proposed that the regulator should have the same powers of investigation in relation to responsible entities of superannuation schemes, ADFs and PSTs and investment managers as the ASC has under the Corporations Law and the *Australian Securities Commission Act 1989* (Cth).[23] This proposal was supported in many submissions.[24] In

23. DP 50 proposal 8.1.
24. eg Norwich Group *Submission* February 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992; LIFA *Submission* March 1992; National Australia Bank *Submission* March 1992.

response to submissions and consultations on this proposal, the Review recommends additional information gathering and investigative powers similar to those currently available to the ASC and ISC.

Investigation powers

13.9. ***Sources of information.*** The regulator will receive from various sources information that may lead to investigative or enforcement action, including

- information lodged with the regulator under existing and proposed statutory reporting obligations
- complaints from scheme contributors or beneficiaries
- reports lodged by a scheme auditor
- random audits conducted by the regulator.

Comprehensive investigative powers are required to support this information gathering capacity and to ensure that the regulator can adequately and effectively respond to instances of uncertainty or suspected breach.

13.10. ***Providing written information.*** The ASC may, at any time and without any suspicion of a contravention, require a securities dealer to provide written information in relation to his or her securities business. The ASC can require specific information and require it to be audited.[25] The superannuation regulator should have similar compliance powers over responsible entities and investment managers, whether or not they hold dealers licences.

13.11. ***Random audits.*** There are over 100 000 superannuation schemes. It will be impractical for any regulator, no matter how well resourced, to pay close attention to each scheme. Moreover, the benefits gained from close supervision of all these schemes are almost certain to be outweighed by the additional costs. The disclosure measures already proposed by the Government and by the Review recognise this fact. The system must, therefore, rely on a high level of self regulation, reinforced by a strong program of random audits by the regulator and active involvement and interest by scheme members. A system of self assessment backed up by random audits is used by the Australian Taxation Office (ATO) to deal with its workload. It is proposed that the Australian Financial Institutions Commission (AFIC) will also use random audits as part of its prudential regulation of building societies and credit unions.[26] The Review

25. Corporations Law s 788.
26. See Special Premiers' Conference Working Group on Non-Bank Financial Institutions, *Proposals for the Reform of the Supervisory Structure for Non-Bank Financial Institutions*, Information Paper, April 1991.

considers that the system of prudential supervision of superannuation schemes proposed in this report would be significantly enhanced by a vigorous program of random audits by the regulator.[27] Enough resources should be given to the regulator to enable it to carry out such a program of audits.[28]

13.12. ***Production and explanation of documents.*** OSSA[29] and the ASC Act[30] contain extensive provisions dealing with the power of the regulator to inspect and retain documents and, in the case of the ASC, to require an explanation of their contents. These powers may be exercised whether or not the ISC or ASC, respectively, has any suspicion of a breach of the law. Powers of this nature are essential to any form of prudential supervision of the superannuation industry. The ASC Act provisions are more comprehensive, particularly in respect of persons other than the responsible entity who may hold relevant information. The regulator's powers in the event of non-compliance could, with appropriate modifications, be modelled on the ASC Act Pt 3 Div 7 and 8. It will be especially important for the regulator to be able to require production of documents and the provision of information from superannuation scheme auditors, given the important role that they will have in the regulatory framework.

13.13. ***Access to premises.*** The powers to obtain documents could be defeated if the regulator is unable to ensure their security. The ISC has power of access to premises to search for and take possession of documents, but only in respect of life insurance companies.[31] The ATO and the TPC also have powers to enter premises to inspect, and take extracts from or copies of, appropriate documents.[32] A full access power should be available to the superannuation regulator. This will limit the possibility of persons destroying or altering documents in anticipation or in the face of a notice for their production.[33]

27. The ISC currently conducts random audits of superannuation schemes that fall within its jurisdiction.
28. The Commonwealth has indicated that increased resources will be given to the ISC to allow it to increase its audit program for schemes for which it has regulatory responsibility: Treasurer's statement, paper 1 para 32.
29. s 11.
30. Pt 3 Div 3.
31. *Life Insurance Act 1945* (Cth) s 54B.
32. ITAA s 263; *Trade Practices Act 1974* (Cth) s 155(2). The ATO may exercise the access power for any of the purposes of the ITAA, whereas the TPC may so act only where it has reason to believe that a contravention may have taken place.
33. Such a power is available in other jurisdictions which prudentially supervise superannuation schemes eg see *Pension Benefits Act 1987* (Ont) s 107(3).

13.14. ***Search warrants.*** To complement the access powers, the superannuation regulator should be empowered to seek the issue and execution of search warrants. The ASC has these powers both under the ASC Act[34] and under the *Crimes Act 1914* (Cth).[35] The Review notes the extensive case law regulating the exercise of the search warrant powers.

13.15. ***Examination of persons.*** To ensure effective investigation, the regulator should be given appropriate powers to require persons to answer questions under compulsion. This power is given by the ASC Act[36] to the ASC where it reasonably suspects a contravention of the law. Comparable powers should be given to the superannuation regulator whenever it has 'reason to suspect' that a contravention of any relevant law may have been committed.

13.16. ***Protection of examinees.*** The proposed investigative and other information gathering powers will require persons to provide oral or written information under direction. The legislature has recognised the need for statutory coercive powers of this nature to accommodate the important 'right to silence' principles long recognised at common law. For instance, the ASC Act maintains the right of legal practitioners to claim legal professional privilege (or 'client legal privilege'), and the right of examinees to invoke an evidential immunity by claiming self-incrimination before answering questions under compulsion. The Review notes that these privileges are not absolute and that any evidential immunity arising in consequence of giving the information may be restricted. The Review supports the approach adopted in the ASC Act, subject to abolition of the 'derivative use' immunity, and the exclusion of corporations from claims of self-incrimination, as proposed in the *Corporations Legislation (Evidence) Amendment Bill 1992* (Cth).

Recommendation 13.1: Random audits

The regulator should conduct a program of random audits of responsible entities and investment managers for superannuation funds, ADFs and PSTs and the providers of DAs. Enough resources should be provided to the regulator to ensure that such a program can be established and maintained.

Recommendation 13.2: Investigation powers

In addition to any powers of investigation the regulator may have at present, the law should provide that the regulator has the power to

34. s 36.
35. s 10.
36. Pt 3 Div 2.

- **require from a responsible entity's external auditors information obtained by them in the course of the audit**
- **require from any person the production and explanation of documents relating to the affairs of a superannuation scheme and take copies or extracts of them**
- **enter upon and obtain full and free access within premises for the purpose of obtaining relevant information**
- **obtain and execute search warrants**
- **conduct examinations of relevant persons.**

Recommendation 13.3: Privileges

The privileges from disclosure, the immunities from use in evidence and the liabilities for non-compliance should be similar to those applicable under the Corporations Law and the *Australian Securities Commission Act 1989* (Cth), as proposed to be amended by the *Corporations Legislation (Evidence) Amendment Bill 1992* (Cth).

Auditors

Auditors to report

13.17. ***External auditor.*** The external auditor of a superannuation scheme, ADF or PST plays a key role in their prudential supervision. Random audits by the regulator cannot alone effectively monitor compliance with prudential standards by all superannuation schemes. The external auditor is often best placed to ensure observation of the prudential controls over schemes, ADFs and PSTs and detect possible breaches.

13.18. ***Proposal.*** In DP 50 the Review noted that the Reserve Bank requires auditors as part of their audit of a bank to examine whether the bank's internal management systems for limiting risks to prudential levels set by the Reserve Bank are adequate. Similarly they are required to report on the efficacy of systems of credit control and data collection.[37] The Review considers a similar system of regulatory supervision for prudential purposes involving the auditors of superannuation schemes is essential if an adequate degree of safety for these schemes is to be provided cost effectively. Accordingly the Review proposed that auditors should be obliged to report to the regulator any breach, or suspected breach, of the prudential standards, or of any statutory or regulatory requirements, that comes to their notice in the course of their dealing with, or auditing of, a superannuation scheme. The Review also proposed that an auditor should be obliged to report to the regulator if, in its opinion, the responsible entity's

37. See Reserve Bank of Australia, Prudential Statement H1, 1986.

management systems limiting risks to prudential levels are inadequate. The proposal added that auditors should receive appropriate protection for the contents of these reports.[38] Such a system could, for example, include a requirement for the auditor to check and report upon the efficacy of systems which were designed to ensure that

- the prohibition on borrowing is not breached
- the in-house investment limitation is not breached
- all assets worth more than 5% of the value of the scheme are identified
- the cash flow of the scheme is adequate to meet expected liabilities.

The regulator could, in addition, issue guidelines requiring superannuation auditors to determine, for instance, whether

- contributions have been properly paid into appropriate accounts
- fees have been charged and expenses allocated in accordance with the deeds or other instruments constituting the schemes
- superannuation payouts have been calculated in accordance with the deeds or other instruments constituting the schemes
- correct valuation procedures have been followed.

13.19. ***Submissions.*** There was considerable support for this proposal.[39] However, a number of submissions suggested that the auditor should have to discuss these items with the responsible entity before involving the regulator. They suggested that unless responsible entities are given an opportunity to rectify any problems first, reporting directly to the regulator could create an unnecessary workload for the regulator.[40] Some submissions opposed the proposal for notification on the ground that it was not the auditor's responsibility to report to the regulator.[41]

38. DP 50 proposal 6.23.
39. eg Permanent Trustee Company Limited *Submission* February 1992; AMP Society *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; ASC *Submission* March 1992; National Australia Bank *Submission* March 1992.
40. Norwich Group *Submission* February 1992; LIFA *Submission* March 1992; National Mutual *Submission* February 1992; Westpac Financial Services *Submission* February 1992.
41. Shell Australia Ltd *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992. ASFA queried whether the auditing profession was well placed to furnish an appropriate report on the risk management activities of the responsible entity: ASFA *Submission* March 1992.

13.20. ***Recommendation.*** The Corporations Law obliges company auditors to draw possible irregularities to the attention of the ASC. They are given protection from civil liability.[42] The Review considers that this is an appropriate model to follow. Whether the auditor first approaches the responsible entity should be left to the discretion of the auditor. It should not be compulsory. To require the auditor to discuss the matter with the responsible entity first may impede the regulator's ability to respond quickly.

Recommendation 13.4: Auditors to report suspected breaches etc.
1. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation fund, an ADF or a PST, suspects on reasonable grounds that the responsible entity, or an investment manager engaged by the responsible entity, has contravened the laws governing superannuation, a prescribed law or the deed or other instrument constituting the scheme must report the matter without delay to the regulator. Failure to comply should be an offence.

2. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation scheme, ADF or PST, forms the opinion that the steps taken by the responsible entity to limit the risk of loss to prudent levels are not achieving their apparent objectives must report the matter without delay to the regulator. Failure to comply should be an offence.

3. The law should provide that an auditor who makes either such report has protection similar to that provided under the Corporations Law s 332(9)–(10) and s 1289.

Qualifications for superannuation auditors

13.21. Given the importance of auditors in the regulatory process and the specific requirements of superannuation accounting, the standard of superannuation auditors should be subject to regulatory supervision. Auditors for life insurance companies are presently required to be specially approved by the ISC.[43] The ISC is investigating similar licensing options for superannuation scheme auditors.[44] The Review does not, however, recommend a licensing scheme for auditors. The objectives of a licensing scheme can be achieved,

42. s 332(9)–(10); s 1289. The Review also notes the House of Representatives Standing Committee on Legal and Constitutional Affairs report *Corporate Practices and the Rights of Shareholders* (November 1991) recommendation 18, concerning the pre-requisite requirement of suspicion by the auditor.
43. *Life Insurance Act 1945* (Cth) s 47.
44. ISC *Submission* March 1992.

without the administrative cost of licensing, if the law makes it an offence for an unqualified person to act as auditor for superannuation schemes without the permission of the regulator. The qualifications should be specified by the regulator by *Gazette* notice. There will also need to be provision for the regulator to step in and restrain an otherwise qualified auditor from auditing one or more specified schemes. The regulator should have power to give such a direction to an auditor. However, the direction ought to be based on the regulator's perception of the risk of a contravention of a relevant law if the auditor is not prevented from auditing the scheme in question, and the direction should be reviewable by the AAT.

Recommendation 13.5: Qualified auditors

1. The law should provide that a person who does not have the proper qualifications must not

- **act or purport to act as auditor of a superannuation fund, an ADF or PST or**
- **hold himself or herself out as willing or able so to act.**

Non compliance should be an offence. A person should be taken to have the proper qualifications only if the person

- **has satisfactorily completed a course of instruction approved by the regulator by notice in the *Gazette* or**
- **has experience of a kind, gained over a period, specified by the regulator by notice in the *Gazette***

or if the regulator is satisfied that the person has enough knowledge and experience to conduct such audits competently and so certifies in writing; the regulator may give a person such a certificate, with or without an application.

2. An application for a certificate should have to be in accordance with a form approved by the regulator. If an application does not contain enough information to allow the regulator to consider the application properly, the regulator should be able, by notice in writing given to the applicant, request the applicant

- **to give further information or**
- **to produce to the regulator a specified document.**

Non-compliance with a request should not be an offence, but the regulator should be able to decline to deal further with the application.

3. On an application, the regulator should grant or refuse to grant the certificate. The decision should be reviewable by the AAT.

4. The regulator should notify the applicant in writing without delay after making the decision on the application. If the decision is unfavourable to the applicant, the notice should state the reasons for the decision. If the regulator has not notified the applicant in writing of the decision on an application

- **within 28 days after the application was received or**
- **if the regulator has given the applicant a notice under paragraph 2 — within 28 days after the notice is complied with**

the application should be taken to have been refused.

5. The regulator should be able to direct a qualified auditor not to act or to offer or hold himself or herself out as able to act as auditor of a particular superannuation scheme, ADF or PST. The direction should be in writing and should only be given if the regulator is satisfied that, because of the risk of a contravention of the law imposing prudential control over the scheme, ADF or PST, or the Corporations Law, the *Life Insurance Act 1945* (Cth) or a prescribed law, the direction ought to be given. A decision to give the direction should be reviewable by the AAT.

Power to order actuarial certificates

Proposal

13.22. Currently, an actuarial investigation of a defined benefit scheme must be carried out every three years.[45] The trustee is responsible for organising that investigation. The Review proposed in DP 50 that the regulator and a scheme's auditor should be able to require an actuarial certificate within a three year period.[46] It also proposed that the actuarial assumptions used in the preparation of actuarial certificates should be disclosed.[47]

Comments

13.23. Both proposals received considerable support.[48] Several submissions suggested, however, that this is beyond the role of both the auditor and the regulator.

45. OSS Regulations reg 17(1)(a).
46. DP 50 proposal 6.19, para 6.23.
47. DP 50 proposal 6.20.
48. eg Permanent Trustee Ltd *Submission* January 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992.

> It is difficult to see how an auditor or even the regulator would know whether an actuarial certificate should be called for within the regular three year period. If there has been some sudden, dramatic event that would seem to indicate a need for an actuarial certificate, it is unlikely that an actuary would be able to make realistic assumptions until there has been some experience under the new conditions. If the event is simply a stockmarket crash or something similar, then its effect on the scheme could probably be estimated without an actuarial review.[49]

One submission suggested allowing an auditor to recommend to the trustees that an investigation be made, and requiring the auditor to report that recommendation to the regulator if the recommendation is not accepted. The regulator could then require the trustees to advise members that they had rejected the auditor's recommendation.[50] The Review understands from submissions that the Institute of Actuaries standards already require actuarial assumptions used in calculations to be disclosed.

Recommendation

13.24. The Review now agrees that it is not appropriate for an auditor to be able to require a trustee to obtain an actuarial certificate. An auditor could recommend to a trustee that a new actuarial certificate would be desirable. The Review considers it is important, however, that the regulator be able to require the responsible entity of such a scheme to arrange for an actuarial investigation to be done within three years.

> **Recommendation 13.6: Actuarial certificates**
> **1. The law should provide that the responsible entity for a superannuation fund that is a defined benefit fund must have a current actuarial certificate no more than 3 years old. Failure to comply should be an offence.**
>
> **2. The law should provide that the regulator may, by notice in writing given to a responsible entity for a defined benefit superannuation fund, require the responsible entity to obtain another actuarial certificate within such time as is specified in the notice, or such longer time as the regulator allows. Failure to comply with the requirement should be an offence.**

49. Department of Finance (Cth) *Submission* February 1992.
50. Mercer Campbell Cook & Knight *Submission* February 1992.

3. The law should provide that a certificate is not effective for the purposes of this recommendation unless it includes or has attached to it a statement of the assumptions on which the actuarial calculations to which it relates are based.

Enforcement

Types of enforcement powers

13.25. Adequate enforcement powers are essential to create a deterrent against contravention of the law, to protect the interests of superannuation scheme members and to ensure, as far as practicable, compliance with the superannuation laws. Simply relying on the threatened withdrawal of tax concessions is not enough. The superannuation regulator should have an array of enforcement powers to ensure an effective enforcement strategy. These powers should comprise

- civil preservation actions
- civil recovery and representative proceedings
- administrative remedies
- criminal prosecutions.

Civil preservation actions

13.26. These actions are designed to prevent or contain loss caused by wrongdoing, contraventions of the law or by a breach of a deed. In the case of superannuation they would permit the regulator to take civil proceedings to seek to preserve assets at risk or forestall actions by responsible entities, investment managers or others that appear to breach the laws governing superannuation schemes. The Review considers that the preservation powers available to the ASC are a suitable model for the powers that should be available to the superannuation regulator. Under its various powers the ASC may, by court order, obtain

- a Mareva injunction
- a statutory injunction and related orders
- an order for asset freezing, receivership and related remedies
- a dealers' restraining order
- provisional liquidations[51]
- an oppression order.

51. cf judicial managers: *Life Insurance Act 1945* (Cth) s 59(1)(a).

Recommendation 13.7. Preservation remedies
The law should provide that the regulator have preservation powers, including the power to seek injunctions, similar to those now available to the ASC.

Appointment of a judicial manager

13.27. In DP 50 the Review suggested that there should be, for superannuation schemes, a power similar to a power that the ISC has, in the context of life insurance companies, to appoint a judicial manager.[52] An application for appointment could be made by the regulator, the responsible entity or a member of a superannuation scheme. This proposal received support in submissions.[53] The Review is satisfied that this is an important power for the regulator to have. The appointment should be of a temporary responsible entity. To exercise this power it should have to be of the opinion that the responsible entity is unable to fulfil its obligations. Because of the seriousness of the step, it should be under court control. Accordingly, the Review recommends that a court should have the power, on application by the regulator, the responsible entity or a member of a superannuation scheme, to appoint a temporary responsible entity for the scheme. The appointment should be on such terms and conditions as the court may specify, and should only be made if the court is satisfied that the responsible entity is unable to fulfil, or has failed to fulfil, its obligations.

Recommendation 13.8: Temporary responsible entity
1. The law should provide that the Federal Court, or the Supreme Court of a State or Territory, may, by order, on application by the regulator, the responsible entity for or a member of a superannuation fund, an ADF or a PST, appoint a temporary responsible entity for the scheme. The order should specify the powers of the responsible entity and be subject to such terms and conditions, including as to period of appointment, as are specified in the order.

2. Such an order should not be made unless the court finds that the responsible entity is not able to fulfil, or has not fulfilled, its obligations as responsible entity.

52. DP 50 proposal 8.8.
53. eg Australian Shareholders' Association *Submission* February 1922; ASC *Submission* March 1992; ASFA *Submission* March 1992.

Civil recovery and representative proceedings

13.28. ***Introduction.*** To further the goals of effective enforcement and to protect the interests of superannuation scheme members, the regulator should have suitable powers to take civil proceedings on behalf of, or for the benefit of, members. These civil powers should be exercisable independently of any possible criminal prosecutions. The regulator should be empowered to

- enforce the deed
- proceed against investment managers
- undertake representative actions against the responsible entity.

13.29. ***Power to enforce the deed.*** Currently, the deed of a superannuation scheme is enforceable against the responsible entity only by the scheme members. However, enforcing the deed through private litigation can be a time consuming and very expensive process.[54] Consequently, the power is unlikely to be used by members. The members' inability to take action is likely tc be due to a lack of resources and cost effective remedies. The regulator simply lacks the requisite power. As the Review noted in IP 10, in a similar situation the law provided the NCSC with fewer powers in relation to unit trusts than were provided for members.[55] The Review proposed in DP 50 that the regulator should have the same power to enforce the deed against the responsible entity as the members have.[56] It proposed that the regulator should be able to stand in the shoes of the members to avail itself of the same rights, to enforce the deed and the obligations it and the general law impose, as the members do. This proposal was supported in many submissions.[57] Accordingly, the Review recommends that the regulator should have the same powers to enforce the deed against the responsible entity as the members have.

Recommendation 13.9: Regulator may enforce members' rights

The law should provide that the regulator may, without the consent of the members of a superannuation fund, an ADF or a PST, take the same proceedings for relief against the responsible entity that a member of the scheme may take. "Relief" does not include damages or compensation.

54. See Treasurer's statement, paper 1 para 15.
55. IP 10 para 3.70. In 1990 the NCSC bought a small number of units in the Estate Mortgage trusts so that it could have available to it remedies that were available to the unitholders but not to the regulator.
56. DP 50 proposal 8.3.
57. eg Jacques Martin Industry *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992.

13.30. ***Proceedings against an investment manager.*** The responsible entity has the right to proceed against an investment manager in both contract and tort. Responsible entities of some schemes may find their resources insufficient to launch such an action, or may otherwise decline to act. Therefore, it may be necessary in such cases for the regulator to take action. The Review proposed in DP 50 that the regulator should be empowered to ensure that the investment manager complies with its contractual and other obligations to the responsible entity.[58] However, this power should not relieve responsible entities of any fiduciary obligations to act in the interests of members. Submissions generally supported this proposal.[59] Some submissions expressed their support with the reservation that the regulator act with the consent of members of the responsible entity.[60] The Review considers that to allow the regulator to act only with the consent of the responsible entity may limit the effectiveness of this remedy. However, in practice, it would be unlikely that the regulator would act in the face of serious opposition by members of the scheme or by the responsible entity. The Review does not, therefore, does not propose such a restriction on this power.

Recommendation 13.10: Regulator may enforce contracts against investment managers

1. The law should provide that the regulator may, without the consent of the responsible entity for, or members of, a superannuation fund, take, in the name and on behalf of the responsible entity, the same proceedings for relief against an investment manager engaged by the responsible entity as the responsible entity may take. "Relief" includes damages and compensation.

2. The law should provide that the regulator is to be bound, in taking such proceedings, by the same obligations to the members as bind the responsible entity.

3. The law should provide that the regulator's taking those proceedings is not to affect any liability of the responsible entity for a breach of fiduciary obligation in failing to act.

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58. DP 50 proposal 8.4.
59. eg Permanent Trustee Company Ltd *Submission* February 1992; Commonwealth Bank Group Financial Services *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992.
60. eg, National Mutual *Submission* February 1992; LIFA *Submission* March 1992; Pelham Webb & Co *Submission* February 1992; D Knox *Submission* February 1992. ASFA *Submission* March 1992 and DSS *Submission* February 1992 argued that the regulator should act only on the request of a responsible entity.

13.31. ***Power of the regulator to undertake representative actions against the responsible entity.*** In DP 50, the Review proposed that the regulator should be able to take proceedings against the responsible entity as the representative party under the enhanced representative procedure provided for in the *Federal Court of Australia Act 1975* (Cth)[61] as if it were a member of the scheme.[62] This would enable the regulator to recover damages on behalf of the members. The importance of this power lies not just in its ability to reduce the legal costs associated with members enforcing their rights. It is also an important tool in the enforcement strategy regulators may adopt. Under that procedure, the regulator would not have to obtain the consent of the members being represented. However, if fewer than seven members are involved, the court may order that the proceedings no longer continue as an enhanced representative proceeding. In these cases the regulator should still be able to sue on behalf of the members, but only with the consent of the members.[63] There was support for this proposal in submissions.[64] The Review suggests that the regulator may act with the consent of one or more members. However, any requirement for majority member support would unduly limit representative actions. This civil representative power should not be used to bypass, or as a substitute for, external dispute resolution procedures between members and the responsible entity.[65]

Recommendation 13.11: Regulator may sue for compensation for members

1. The law should provide that the regulator has the power to take proceedings on behalf of a member of a superannuation fund, an ADF or a PST for compensation for loss or damage suffered by the member by conduct of the responsible entity that constitutes a contravention of the law regulating superannuation funds, ADFs and PSTs or the deed or other instrument constituting the scheme.

2. The law should provide that such an action may not be taken on behalf of a member except with the written consent of the member.

61. See *Federal Court of Australia Act 1976* Pt IVA. The amendment was made following the ALRC's report *Grouped Proceedings in the Federal Court* (ALRC 46).
62. DP 50 proposal 8.5.
63. This is similar to the power of the Trade Practices Commission under *Trade Practices Act 1974* (Cth) s 87(1B).
64. eg Jacques Martin Industry *Submission* February 1992; Women's Economic Think Tank *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; National Australia Bank *Submission* March 1992.
65. See para 12.33–12.42.

3. The law should provide that such a proceeding may be commenced in respect of an alleged contravention even though another proceeding has been commenced against the responsible entity in respect of the alleged contravention.

4. The law should provide that the court may find on the balance of probabilities, for the purposes of the proceeding, that a contravention has occurred.

Administrative remedies

13.32. ***Banning orders and freezing transactions.*** There is an obvious public interest in ensuring that dishonest or incompetent persons are precluded from controlling or managing superannuation schemes. Action by the regulator through banning or removal orders to curtail the activities of these persons may obviate or lessen reliance on later civil preservative or recovery remedies. Likewise, the capacity of the regulator to freeze transactions through stop orders may prevent or minimise detriment caused through incompetent or dishonest behaviour by such persons. In part this policing function is currently exercised by the ASC through the licensing requirements of the Corporations Law,[66] which apply to all persons dealing in securities, the suspension, revocation and banning order provisions[67] and the stop order capacity concerning prospectuses.[68] The Review supports and assumes the continued application of these provisions to the superannuation industry. However, these regulatory controls need further supplementation given, for instance, that the licensing provisions do not apply to responsible entities or investment managers that do not deal in securities, and the stop order power applies only in the context of prospectuses.

13.33. ***Removal and banning orders — responsible entities.*** Notwithstanding that the regulator will not have a pre-vetting or approval role in relation to the formation of a responsible entity,[69] the Review proposes that the regulator be able to remove or suspend a responsible entity, or a member or director of a responsible entity, of any superannuation scheme. In DP 50 the Review argued that, because these persons control other people's money, it is important that the regulator be able to act quickly to remove them if the regulator forms the opinion that this is necessary.[70] The regulator should be entitled to act if, in its opinion, a person ought to be removed or suspended having regard to the risk posed of their non-compliance with the relevant law, or where the person is

66. Pt 7.3 Div 1.
67. Pt 7.3 Div 5.
68. s 1033.
69. Recommendation 8.3.
70. DP 50 para 5.10.

unable to fulfil his or her functions and duties. This may happen, for example, if a director of a responsible entity acts dishonestly or fails to exercise a reasonable degree of care and diligence in performing his or her duties.[71] This power should be able to be exercised in relation to all directors or members of a responsible entity including those elected or appointed as member representatives and employer representatives. The Review proposed that the regulator not be required to obtain a court order before removing a member or director from his or her position with the responsible entity.[72] Rather, the regulator should have an immediate stop order capacity,[73] subject only to the right of the affected person to seek a review under the *Administrative Appeals Tribunal Act 1975* (Cth).

13.34. ***Recommendation.*** This proposal received support in various submissions.[74] There were a number of submissions, however, that disagreed with the proposal.[75]

> ASFA considers that measures which are aimed at giving the regulator some or all of the powers of a member run the risk of producing complacent members with the result that we end up with the 'worst of all worlds'; no one is watching the responsible entity. We recognise that the Review intends many of these powers to be 'reserve powers' to be used only when the system of member supervision breaks down. We are concerned, however, that this is not the way it will be perceived by members. For example, if the regulator has the power to remove or suspend a person it is not unreasonable to assume that, if there had been a need, the regulator would have done so. The implication of non exercise is that the regulator does not see a need — a member who has concerns could be excused for believing that, if there had been a significant problem, the regulator would have exercised the powers given to it.[76]

The Review concedes that some members may take that approach. However, it does not accept the proposition that the mere existence of such a power will lead to a significant decline in the level of members' interest in the administration of superannuation schemes. It has concluded that, on balance, the advantages of

71. Those grounds can provide the basis for a court order prohibiting a person from managing a corporation: Corporations Law s 230(1)(d).
72. DP 50 proposal 5.4.
73. cf the ASC's interim stop order power in relation to the issue of securities under the Corporations Law s 1033(4).
74. eg Jacques Martin Industry *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992; ASC *Submission* March 1992.
75. Trust Company of Australia *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992.
76. ASFA *Submission* March 1992.

the regulator having this power outweigh the disadvantages. The removal powers are a crucial element of any effective regulatory scheme, and are essential for the protection of the interests of contributors and beneficiaries of superannuation schemes.

> **Recommendation 13.12: Removal and banning orders**
> **The law should give the regulator powers to ban or remove a responsible entity, a member of an unincorporated responsible entity or a director of an incorporated responsible entity. The law should provide that the regulator is able to suspend, indefinitely or for such period as it may specify, a person who is a director or member of a responsible entity of a superannuation scheme from the board of the responsible entity. This power should be exercisable if, in the regulator's opinion**
> - **the person ought to be removed having regard to the risk posed of non-compliance with the relevant law, either by the director or the member of the responsible entity or**
> - **the person is unable to fulfil, or has failed to fulfil, his or her duties or functions under the law or under the deed or other instrument constituting the scheme.**

13.35. ***Removal and banning orders — investment managers.*** For similar protection reasons, the regulator should have the power to ban a corporation or an individual from acting as an investment manager for a superannuation scheme. In DP 50 the Review proposed that the regulator should have the power to remove an investment manager if, in the regulator's opinion, it ought to be suspended having regard to the risk posed of non-compliance with the relevant law or the apparent inability of the investment manager to fulfil its duties and functions. As with the removal of responsible entities, the regulator should not have to obtain a court order first; rather, the action of the regulator should be reviewable under the *Administrative Appeals Tribunal Act 1975* (Cth).[77]

13.36. ***Recommendation.*** The Review received submissions in support of this proposal.[78] Some submissions expressed concern about disruption to investment and management that could arise from the exercise of this removal power.[79] The Review recognises this concern, but considers that the regulator

77. DP 50 proposal 5.13, para 5.20.
78. eg John A Nolan & Associates *Submission* February 1992; Permanent Trustee Company Ltd *Submission* February 1992; LIFA *Submission* March 1992.
79. AMP Society *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992; ASFA *Submission* March 1992.

nevertheless needs this power to be effective. The Review anticipates that the regulator would act only in cases of necessity, and where protection of the scheme clearly outweighs these possible disruptions.

Recommendation 13.13: Regulator may direct investment managers not to act

1. The law should provide that the regulator may, by notice in writing served on a person, direct the person not to act or to continue to act as investment manager for the responsible entity for a superannuation fund. Non-compliance with the direction should be an offence. The direction should be reviewable by the AAT.

2. The law should provide that the regulator is not to serve such a notice unless it is of the opinion that

- **having regard to the risk of non-compliance with the law, the regulations or the deed or other instrument constituting the fund, the person ought not to act as investment manager for the fund or**
- **the investment manager has not fulfilled or cannot fulfil its duties and functions as investment manager.**

3. The law should provide that, if such a notice is served, the person on whom it is served is not to charge the responsible entity any fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

Stop orders

13.37. *Prevent further sales.* To complete the range of appropriate administrative remedies, special provision needs to be made for personal superannuation schemes. The Review has concluded that the regulator should have 'stop order' powers, that is, power to issue an interim and, subject to a hearing, a final order preventing a responsible entity for a personal superannuation scheme from issuing further units or interests in the scheme to members of the public. The grounds on which an interim order could be issued should accord with those for which the ASC, under the Corporations Law,[80] can prevent the issue of further securities: that is, that, in its opinion, any information issued by the responsible entity concerning the scheme is false, misleading or deceptive.

80. s 1033.

Recommendation 13.14: Stop orders

The law should provide that the regulator may issue a stop order preventing the responsible entity for a personal superannuation scheme or an ADF or the provider of a DA from issuing further units or interests in the scheme. Subject to a hearing requirement, the regulator should be able to issue a final stop order. The provision should be modelled on the Corporations Law s 1033.

13.38. *Cancel dealers licence.* In DP 50 the Review proposed that the regulator should be able to cancel or suspend a dealers licence or issue a stop order against a life insurance agent, so far as it relates to his or her superannuation activities.[81] Many submissions supported this proposal.[82] One submission went further to suggest that all life insurance agents should be required to come under the same licensing requirements as those prescribed by the Corporations Law and that the regulator should have the same powers to discipline agents as it does licensed dealers, representatives and advisers.[83] Another submission supported the proposal, but believed that the regulator should deal through the life insurer for any action against an agent.[84] The Review will consider the general question of licensing of life insurance agents in its later report. In practice, any stop order would have to be issued against both the insurance company and the particular agent.

Recommendation 13.15: Stop orders: life agents

The law should provide that the regulator may issue a stop order to a life insurance company preventing the company from continuing to use a particular life insurance agent in so far as the agent is involved in selling superannuation. If the regulator does not seek to confirm the order within a specified period the order should lapse.

Criminal prosecutions

13.39. *Taking proceedings.* Enforcement of the superannuation law through criminal proceedings is a central function of the regulator. The ASC undertakes this task under the Corporations Law, in conjunction with the Director of Public Prosecutions (Cth).[85] A similar power should reside with the superannuation regulator.

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81. DP 50 proposal 8.9.
82. eg Australian Investment Managers' Group *Submission* February 1992; ASC *Submission* March 1992; Jacques Martin Industry *Submission* February 1992.
83. Securities Institute of Australia *Submission* February 1992.
84. AMP Society *Submission* February 1992.
85. Corporations Law s 1315; *Australian Securities Commission Act 1989* (Cth) s 49.

Recommendation 13.16: Instituting prosecutions
An information, charge, complaint or application in relation to any proceedings for an offence against a superannuation law may be laid or made by the regulator or a delegate of the regulator.

13.40. *Grounds of liability.* The Review has not identified in detail all the necessary elements of offences under its recommended superannuation laws, or the level or nature of appropriate penalty. However, in relation to breaches of fiduciary obligations, the Review considers that such offences should be based on the principle that criminal liability should not apply in the absence of criminality.[86] The *Corporate Law Reform Bill 1992* proposes that, in the context of directors' duties, only contraventions committed knowingly, intentionally or recklessly constitute an offence, and then only if committed dishonestly, intending to gain an advantage for themselves or some other person or with intent to deceive or defraud someone.[87] The same principles should apply to members of responsible entities who contravene the superannuation law.

Recommendation 13.17: Issues of criminal liability
The criteria for criminal liability of individuals, or directors of bodies corporate or members of the board of the responsible entity for breach of duty should, in principle, be the same as is proposed in the *Corporate Law Reform Bill 1992*. An act or omission of an individual, a director or member of a responsible entity that would, if done or omitted by a director of a company, attract the civil penalty orders provisions proposed to be inserted in the Corporations Law by the *Corporate Law Reform Bill 1992* (proposed Pt 9.4AA, Div 2) should attract similar liability under the proposed new law.

Merger of superannuation schemes

13.41. The Review considers that the process of merger should be left to the relevant responsible entities and scheme members, and that it would be inappropriate to authorise the regulator to compel mergers. Rather, the regulator should have a monitoring role. The Review recommends that the regulator should have a supervisory power to monitor merger proposals and, if necessary, impose an interim stop order, subject to court confirmation. This mechanism of

86. Breaches of merely regulatory laws, such as laws requiring reporting to the regulator, are in a different category.
87. *Corporate Law Reform Bill 1992* (Cth) proposed s 1317AT(1).

residual regulator and judicial involvement is preferred over the more complex procedures governing mergers and reconstruction of companies under the Corporations Law.[88]

Recommendation 13.18: Merger of superannuation schemes

1. The law should not require the prior approval of a court or the regulator for mergers of superannuation schemes.

2. The law should provide that a proposed merger should have to be notified to the regulator, who should be able to issue, within 21 days, an interim stop order to prevent the merger proceeding. The regulator should be required to initiate court proceedings within 14 days of issue to have the order confirmed.

Funding the regulator

13.42. Effective prudential supervision of superannuation schemes is too important to be jeopardised by insufficient funding of the regulator. The ASC is funded from parliamentary appropriation and registration fees levied on corporations. Currently the ISC is funded indirectly through a system of industry levies. The Review considers that, given the importance of superannuation for a number of Commonwealth policies, the regulator should be publicly funded rather than industry funded, wholly or partly, directly or indirectly. Unless it is publicly funded, conflicts of interest may arise or may be seen to arise between the regulator's public duty and the interests of the industry which, directly or indirectly, funds it.

Recommendation 13.19: Funding the regulator

The regulator should be funded solely from Consolidated Revenue. The funding should be fully independent of any levy that government may choose to impose on the superannuation industry.

88. Pt 5.1.

14. Surpluses and reserves

Introduction

14.1. There has been considerable attention paid to the issues of surpluses and reserves in recent years. The existence, creation and ownership of surpluses and reserves raise issues of equity and legality. The Review considers that it is important, especially in the light of the increasingly important role of superannuation, that these issues be resolved. This chapter makes recommendations to clarify, where possible, current uncertainties relating to surpluses and reserves.

Surpluses

Defined benefit schemes

14.2. *Two types of surplus.* There are two types of surpluses in defined benefit schemes: an actual surplus of assets over liabilities on termination of a scheme or an actuarial surplus, estimated for an on-going scheme. An actuarial surplus is the actuarially assessed excess of the assets of a scheme over its estimated liabilities. That is, it is simply an estimate of the degree to which existing investments will be more than enough to provide for accrued benefits.[1] There is no simple rule for determining the existence of a surplus, because its calculation is largely dependent on the underlying actuarial assumptions.

14.3. *How a surplus occurs.* A surplus may arise in a defined benefit scheme for several reasons. For example, the scheme might have a more favourable investment performance than was allowed for when the employer's contribution was calculated, or there may have been a lower than expected rate of inflation. Alternatively, the employer may have contributed more than necessary, either inadvertently or as the result of a deliberate policy to minimise tax by directing money into the superannuation scheme.[2] Alternatively, there may have been a

1. Where a fund is on-going the alleged surplus is a purely notional one: *Re Imperial Foods Ltd's Pension Scheme* [1986] 2 All ER 802; see also Lord Browne-Wilkinson *Equity and its relevance to Superannuation Today* 1.20.
2. Contributions in excess of those required to fund the scheme are taxed at the same concessional rate as those required to fund the scheme. If they are subsequently repatriated to the employer as part of a surplus, the employer is not required to pay the difference between the 15% contributions tax and the 39% corporate tax. From 1995, however, employers will not be able to minimise tax in this way. When concessionally taxed contributions are returned to the employer, the employer will be required to pay the additional 24% tax.

higher than expected attrition rate of members before their interests vested fully. This may occur because of redundancies, retirements or as a result of corporate strategy involving retrenchment of employees before their interests vest.[3]

14.4. *Ownership of the surplus.* There are no clear guidelines, under existing law, as to how surpluses in defined benefit schemes are be to distributed between sponsor and members. There are a number of possibilities:

- contribution holidays, that is, use the surplus to reduce or suspend employer or member contributions
- improve benefits to members
- transfer some or all of the surplus to another scheme with a group of outgoing members
- return all or part of it to the employer while the scheme is continuing
- leave it indefinitely, in anticipation of a future economic downturn or relaxation of benefit limits.[4]

Deeds or other instruments constituting schemes rarely make provision in this regard. The most relevant usual provision is that, upon partial or complete winding up of the scheme the assets should be, on the advice of an actuary, equitably apportioned among the members as at the date of winding up and held in trust for them. The deed is often silent as to the ownership of any actuarial surplus that may arise from time to time. Given the failure of many trust deeds to address the issue of disposal of an actuarial surplus adequately, legislative direction may be necessary to clarify these issues and to avoid further litigation and the need to amend trust deeds.

14.5. *Ownership of the surplus overseas.* In the USA, specific legislation allows the actuarial surplus in a defined benefit scheme to revert to the sponsoring employer primarily when the employer has over-contributed because of a mistake of law or fact or an actuarial error[5] and provided the plan specifically allows such a surplus to be returned to the employer. In addition, any amendment providing for this return is not effective until five years after it is adopted. In the UK, ownership of an actuarial surplus is not determined by legislation. The case law in the US tends to the view that, in a defined benefit scheme, the employer has a moral claim to the actuarial surplus; however, the matter ultimately depends upon the drafting of the deed.

3. Schemes in which this occurred were known as 'cherry picker' schemes. The practice was eliminated some time ago.
4. Bakel 'Superannuation Fund Surpluses: To Whom do they Belong' (1991) *Australian Business Law Review* 404, 423; see also E Slater *Superannuation Fund Surpluses* 12,411-2.
5. This does not include the situation where the employer used the fund as a tax shelter.

14.6. ***Proposal.*** In DP 50 the Review proposed that deeds for defined benefit schemes should be required to include provisions to deal with the distribution of surpluses while the scheme is operating and on its winding up. It proposed that provisions should be subject to guidelines established by the regulator about how a surplus is to be established and how it should be distributed. For accumulation schemes, the Review proposed that deeds should provide for the distribution between remaining members of surpluses created by members leaving non-vested employer contributions behind when they leave a scheme.[6]

14.7. ***Submissions.*** It appears from submissions that there is considerable uncertainty regarding the treatment of surpluses in superannuation schemes. ASFA agrees that many deeds fail to address adequately the issue of the disposal of a surplus, even on a winding up. There seems a general concern that any attempt to clarify the situation may be too restrictive and work to the disadvantage of the employer. Some submissions suggested that, if legislation prevented the return of 'excess' funds to the employer, there would be a strong disincentive to provide any level of funding higher than the minimum necessary to provide the defined benefit.[7] Others went even further.

> Such action would almost ensure that employers underfund rather than overfund their defined benefit plans. As a result, while some members might gain some access to existing surpluses in the short term, the medium to long term effect would be to significantly reduce the security of members' benefits in such funds.[8]

14.8. ***Recommendation.*** An actuarial surplus is only an estimate arrived at by an actuary. It is for this reason that great care should be exercised in dealing with such a surplus. As was acknowledged in many submissions, actuarial surpluses can quickly vanish, for example, if there is a sharp drop in the value of the scheme's investments.[9] The Review is strongly of the view that there should be restrictions on how an actuarial surplus can be used. It should not automatically be returned to the employer at its discretion. It is true that employers bear the investment risk in defined benefits schemes. But there is always the possibility that an employer will be unable to pay the promised benefit when the time comes. For this reason, the Review's attitude is that employers should not be able to repatriate an entire surplus. The Review therefore recommends that an

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6. These contributions are known as forfeited benefits. OSS Regulations reg 17A a reallocation of amounts previously held for particular members. The application of such forfeited benefits for any purpose approved by the ISC is also allowed. Such purposes have included repatriation to the employer.
7. See, eg Institute of Actuaries of Australia *Submission* February 1992.
8. ASFA *Submission* March 1992.
9. See eg ASFA *Submission* March 1992.

employer should only be able to repatriate up to 50% of a surplus in any accounting period, and only with the agreement of the responsible entity. Further, before any repatriation, members must be advised about the cause of the surplus and about how it is proposed to deal with it. An employer should, however, be able to repatriate more than 50% of a surplus with the approval of the regulator. The approval of the regulator is a more appropriate check than the agreement of members because it will take the issue out of the industrial arena. The regulator may be in a better position to assess the liquidity of the scheme and its ability to withstand the repatriation of more than 50% of the surplus. Finally, the Review recommends that any inconsistent provisions in the governing rules of a defined benefit scheme should be void.

Recommendation 14.1: Surpluses not to be repatriated

The law should provide that it is an offence for the responsible entity for a superannuation fund to pay a person who is liable to make contributions to the fund, except a member, any amount representing the whole or some of a surplus in the fund except as follows:

- **an actuary has certified that there is a surplus in the fund**
- **the amount, or the sum of the amounts paid since the certificate was given, must not be more than 50% of the amount certified by the actuary as the amount of the surplus unless the regulator, subject to review by the AAT, has given written approval to making the payment**
- **the responsible entity must have given to the members of the fund written notice of its intention to make the payment not less than 2 months before the payment is made.**

Recommendation 14.2: Deeds etc. to make provision for surpluses

The law should provide that a provision in the deed or other instrument constituting a superannuation fund that makes provision inconsistent with Recommendation 14.1 is void to the extent of the inconsistency.

14.9. ***Deficits in defined benefit schemes.*** Every three years an actuary must make an assessment of the contributions that are needed to enable the scheme to pay the benefits promised under the deed. Actuaries usually recommend a range of amounts within which the employer can choose to contribute. If employers do not have to make these contributions they may, whilst reaping the benefits in good times by repatriating the surplus, be able to avoid contributing appropriately to the scheme. The Review notes that the Accounting Standards Board has proposed that deficits in employer sponsored defined benefit schemes should be recorded in the organisation's balance sheet as a liability.[10] By requiring shareholders and creditors to be advised of this 'obligation' the Board is reflecting the general community expectation that the employer's commitment to fund its defined benefit superannuation scheme is genuine. Failure to meet the commitment to the scheme will be reflected in the valuation of the firm. The members of the scheme, as well as the shareholders and the market generally, should be informed directly if the employer does not propose to make any of the actuarially determined contributions. The responsible entity should be required to ask the employer about its intentions and report the results to members in the next annual report. There is a further precaution that ought to be required. Any deficit in a defined benefit scheme should be reported to the regulator with a statement by the responsible entity as to how it proposes to fund the deficit. Opposition to these proposals stressed that superannuation provided voluntarily by employers in excess of the SGL legislation requirements should not be subject to this kind of regulation. To the extent that this concern reflects the view that employers should have the right not to fund benefits in defined benefit schemes,[11] when they are able to do so, it is rejected by the Review. The Review does not accept that such promises, made in the context of the contract of employment, should be able to be made worthless at the employer's election without just cause. In principle, these recommendations should apply equally to both the private and public sectors. It is acknowledged, however, that several government provided defined benefit schemes have significant deficits and that the governments sponsoring them would be unable to pay immediately the contribution required to fund the actuarial deficit. A lengthy transition period may therefore be required for those schemes.

Recommendation 14.3: Employers to disclose intention about deficits in defined benefits schemes

The law should provide that, if an actuary certifies, in relation to a single employer defined benefit superannuation scheme, that the employer must make a particular contribution, or a contribution of not less than a particular amount, to the fund to ensure that benefits reasonably likely to become payable by the scheme will be able to be paid

- **the responsible entity for the scheme must, without delay, request in writing from the employer advice as to whether the employer proposes to make such payments**
- **the employer must give a written reply containing that advice within 3 months after the request is given**

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10. Australian Accounting Standards Board, ED 53 *Accounting for Employee Entitlements*.
11. Also known as benefit promise schemes.

- **the next annual report to members must include a statement of the effect of the actuary's certificate, and a copy of the employer's response.**

Failure to comply should be an offence.

Recommendation 14.4: Deficits in defined benefits fund to be reported

The law should provide that, if an actuary certifies to the responsible entity for a defined benefit fund that there will be a deficit in the fund, the matter must be reported without delay to the regulator, and the responsible entity must inform the regulator how it proposes to deal with the matter. Failure to comply should be an offence.

Reserves

Background

14.10. *Creating reserves.* Reserves are created when some of a scheme's investment returns are not allocated to members' accounts but instead credited to a separate reserve account. Reserves are designed to protect against years when investment returns are low or negative and to enable a scheme to provide, during such a time, benefits comparable to those paid to members who retired when yields were higher. Because reserving involves holding back investment income from members' accounts, a question arises whether, as a matter of policy, schemes should be permitted to create reserves.

14.11. *Reserves and trust law.* The creation of reserves may, arguably, be a breach of trust, as the benefits paid to members who resign or retire during periods of high return are diminished to subsidise others. Opponents of the right to create reserves also argue that their existence may make the responsible entity less vigilant because it is able to use reserves to declare a return on investments that it would not otherwise have achieved.

14.12. *Reserves and investment strategy.* A responsible entity may have an obligation under the deed not to declare a negative earnings rate. There is in any event a natural disinclination to declare such an earnings rate. It may therefore invest conservatively to ensure a positive rate of return every year. The scheme will, therefore, earn a lower overall rate. This is significant because, even a small reduction in the earnings of the scheme will result in a very significant reduction in the payout to members on resignation or retirement.[12] A conservative policy

12. eg the difference between a 12% and 13% earning rate on $1000 per year for 30 years has been calculated to make a difference of 23% to the final sum: Bankers Trust Australia Limited *Submission* December 1991.

will, in effect, disadvantage all scheme members, including those who leave the scheme during times of high investment returns. If, on the other hand, a policy of allowing reserves to build up is permitted, the fund is able to pursue more aggressive but not more risky investment strategies which will in turn result in a more volatile rate of return. Such a strategy will also tend to yield a higher average rate of return over time, which is clearly in the interests of all members. The Treasurer's proposals for improved disclosure includes the reporting of a scheme's reserving policy to its members.[13] This seems to indicate that Commonwealth policy accepts reserving as an acceptable management strategy for superannuation schemes.

DP 50 proposal

14.13. It seems appropriate that to remove any doubt about the legality of reserving, legislation should provide that reserving by the responsible entity should not constitute a breach of trust. In DP 50 the Review proposed that the law be amended to clarify whether the establishment of reserves is a breach of a responsible entity's fiduciary obligations.[14]

Response to discussion paper

14.14. A small number of submissions recommended the prohibition of reserves. For example, the Reserve Bank saw no reason for reserves in accumulation schemes.

> [R]eserves in such funds may lead to inequitable treatment between fund members over time, and reserves might be used to obscure the actual performance of the fund.[15]

The overwhelming majority of submission, however, support reserving.[16]

> [T]he fluctuations in results which would occur if there were no reserves are likely to be less acceptable to superannuation scheme members than any deferral of receipt of investment returns implicit in the establishment of reserves. More importantly unless there is reserving many responsible entities will find it

13. Treasurer's statement, paper 2 para 10(h).
14. DP 50 proposal 10.4.
15. Reserve Bank *Submission* March 1992; see also Australian Friendly Societies Association *Submission* February 1992.
16. See eg KPMG Peat Marwick *Submission* February 1992; ASFA *Submission* March 1992; AMP Society *Submission* February 1992; Mercer Campbell Cook and Knight *Submission* February 1992; Australian Retirement Fund *Submission* February 1992; ACTU *Submission* March 1992.

necessary to adopt short-term investment strategies, quite probably to the long-term disadvantage of the members of superannuation funds, and the Australian community in general.[17]

Recommendation

14.15. The Review agrees that reserving should be permitted subject to the general fiduciary principles underlying the obligations of the responsible entity. Any disadvantage to members is outweighed by the overall benefit of the higher returns that are possible when trustees adopt less conservative investment strategies in the knowledge that there are reserves to smooth any negative returns. Accordingly, the Review recommends that the law should make it clear that the establishment of a reserve will not of itself constitute a breach of trust. However, the Review does not recommend that reserving be required.[18]

Recommendation 14.5: Reserving not to be a breach of trust

The law should provide that a responsible entity for an eligible scheme does not contravene their fiduciary obligation to the members imposed by law, merely because the responsible entity credits amounts to reserves in the scheme in accordance with a policy that itself is prudent.

17. Institute of Actuaries of Australia *Submission* February 1992.
18. The Review also recommends that a scheme's reserving policy, the amount credited to reserves and the source of the amount be disclosed to members annually: recommendation 10.20.

Appendix 1 — Additional information to be provided to scheme members

(Excerpt from Treasurer's statement, paper 2)

Additional information to be provided on request

7. On request by a member, trustees are to provide prompt and convenient access to, or to ensure prompt access is provided to:
   (a) audited accounts of the fund; and
   (b) fund governing rules, or provisions of the rules that are relevant to the particular interests and circumstances of the member.

Additional annual information to members

8. Trustees are to provide each member with a notice or annual report, or be satisfied that each member is provided with appropriate notification, as soon as practicable but in any event within a period of not more than 6 months of the end of each year of income (9 months in the case of funds providing benefit statements to members more than once a year).

9. This notice will be required to contain all such information as members of superannuation funds would reasonably require, and reasonably expect to have provided, for the purpose of making an informed judgment as to the financial condition and administrative arrangements of the fund. Details of any significant or material change subsequent to the date of the notice will be required to be provided by addendum.

10. The notice will provide the following specified information:
   (a) a name of the superannuation fund;
   (b) a statement whether it is the trustees' intention to operate the fund as a complying superannuation fund and, if so, a statement that they have no reason to believe the fund will not be accepted as a complying superannuation fund or, if that is not the case, a statement of the reasons why it may not be or has not been accepted as a complying superannuation fund;
   (c) the following advice relating to fund or sub-plan accounts —
      (i) where the accounts have been audited at the time of issue of the notice, advice that fund audited accounts and auditor's report are being distributed to members or are available on request by members. Where such audited accounts are not distributed to members with the notice, the notice is to include abridged financial information and a statement as to whether there were any qualifications in the auditor's report and details of any such qualifications;

(ii) where the accounts have not been audited at the time of issue of the notice, advice as to when the audited accounts are likely to be distributed or are likely to be available on request. Consideration will be given to requiring the relevant abridged financial information drawn from the draft accounts to be included. Details of any material variations to this financial information or any qualifications in the auditor's report received subsequent to the issue of the notice will be required to be provided to members;

(iii) the abridged financial information (to be developed by the ISC in consultation with relevant industry and other bodies and issued as guidelines) will show information such as the net assets available to pay benefits, the amount of investment revenue and contributions received and benefits paid, together with other key information of relevance to the fund type;

(d) where employers of members contribute to a fund or sub-plan, a statement that all contributions which, to the knowledge of the trustees, are payable by employers have been received, or if there are known to be substantial or material arrears, information as to any action being taken regarding those arrears;

(e) a statement of fund or sub-plan investment objectives and the policy and strategy being used to meet those objectives. This statement will include:

(i) details of the classes of assets (along the lines of those shown on the ISC Annual Return form) in which the fund or sub-plan was invested and details of the total assets of the fund or sub-plan at the last balance date and the immediately preceding balance date, subdivided to show the amount or proportion represented by each of those classes of assets;

(ii) an outline of any futures, options or other derivative mechanism strategies relevant to fund or sub-plan assets;

(f) where at balance date the value included in the balance sheet of any single investment, or the combined value of all investments in the same or associated entities, exceeds 10 per cent of the total value of the fund or sub-plan assets as shown in the balance sheet, a description of all such investment and their values. (This disclosure requirement will extend to investments made by a fund manager on behalf of a superannuation fund. An investment in a 'pooled' arrangement will be considered a single investment.);

(g) where an investment manager or other financial advisers or consultants have been appointed to control the investment of all or any part of the fund, the name(s) of the manager(s) appointed and, if the manager is associated with the fund trustees, sponsor or administrator, details of that association;

(h) a statement of the basis on which the fund's crediting rate and reserves are determined;
(i) the names of the trustees holding office during the period to which the notice relates, as well as at the reporting date to which the notice relates and, for each such trustee, advice as to whether that trustee was appointed by members, the employers or some other person or group;
(j) the names of the members of any separate sub-plan management committee at the reporting date;
(k) advice of fund or sub-plan members' right of access to the documents specified in OSS regulation 17(l)(i) and to the additional information specified to be provided on request at paragraph 7 above;
(l) advice as to where (and to whom) members may make enquires regarding the fund (including requests for access to audited accounts, actuarial reports and governing rules or other information that is required under the Regulations to be available on request);
(m) in addition to the existing requirements for the disclosure of the amount or rate of net earnings allotted to the member, advice as to —
  (i) the amount (or basis of calculation) of any fees, charges or other expenses charged to the member's account or to the fund or sub-plan;
  (ii) the actual rate (or amount) of earnings of the fund or sub-plan in the year of income to which the accounts relate and in the previous two years of income (or such lesser period as may apply); and
(n) a summary of governing rule provisions, or the fund's policy, with respect to fees and charges applicable to accounts (whether active or dormant) including —
  (i) initial or establishment charges;
  (ii) continuing management, administrative or service charges (including fees levied against fund earnings);
  (iii) termination charges.

Missing members

11. In recognition of administrative difficulties being experienced by funds, consideration will be given to providing some relaxation of the annual reporting requirements in a situation where it is clearly established that a member is no longer able to be traced.

Pension and deferred benefits

12. The arrangements will require members who are fund pensioners (including reversionary beneficiaries), or who have deferred benefits, to be advised once a year that the annual information outlined above is available to them on request.

Additional information to be provided prior to entry

13. Before joining a fund (in the case of an employer sponsored fund, before joining or as soon as is practical thereafter), trustees are to provide to a member or to be satisfied that a member is provided with:

(a) a copy of the abovementioned additional annual information last issued to members, where necessary updated (by addendum if appropriate) to allow for material changes;

(b) where a benefit relevant to a member is determined on the basis of actual or credited earnings, advice of the actual and credited rates which applied for each of the last three completed accounting periods. (In the case of unitised arrangements, unit price movements for each of the three accounting periods could be substituted.)

14. The existing Regulations will also be amended to make it clear that the member or prospective member need only be provided with details of the kinds of benefits provided by the fund or sub-plan for, or in respect of, that member.

Information to be provided at exit

15. Consideration will also be given to amendment of the existing disclosure requirement in respect of death benefit to ensure that advice of the amount of any death benefit that remains current after the date of exit from the fund, and the period of effect of such continuing cover, is provided.

Additional personal superannuation information before entry

16. In the case of personal superannuation (where not subject to prospectus requirements under the Corporations Law or ISC guidelines to life offices), in additional to the reporting requirements applicable to funds generally, trustees are to provide, or to be satisfied that the following additional information is provided, prior to entry to the fund:

(a) the name and address of the controlling company or sponsoring organisation of the fund;

(b) name and address of ultimate owner of corporate trustee (if different from the controlling company or sponsoring organisation above);

(c) names and addresses of any administration managers or other appointments made by the trustee(s) in conjunction with the operation of the fund;

(d) a summary of the key features of the operation of the fund;

(e) the manner in which the value of the account will be determined on termination (to the extent that this not provided in accordance with regulation 17(1)(g)).

Additional information relating to master trust and similar arrangements

17. The annual and entry disclosure requirements outlined above will apply to master trust or master fund arrangements in the same manner as they will apply to other superannuation funds, subject to provision of the following additional information:

(a) the name and address of the company controlling or sponsoring the master trust fund; and
(b) the identity of any relevant sub-plan.

Return of surplus to employer

18. Appropriate arrangements for the provision of information to members in advance of a repatriation of surplus moneys from a superannuation fund to a sponsoring employer will be developed.

Appendix 2
List of submissions

Abrahams B
ACT Treasury
A Group of Members
Aitken J
Allen, Allen & Hemsley
AMP Society
AMPAC Life Limited
ANZ Funds Management Limited
Association of Superannuation Funds of Australia Limited
Australian Accounting Research Foundation
Australian Council of Trade Unions
Australian Federation of Aids Oganisations Inc
Australian Federation of Consumer Oganisations Inc
Australian Friendly Societies Association
Australian Government Actuary
Australian Investment Managers' Group
Australian Labour Party, Burwood Branch
Australian Retirement Fund
Australian Securites Commission
Australian Shareholders' Association Ltd
Australian Taxation Office
Baker & McKenzie
Baker H
Balanced Equity Management Pty Limited
Bennett Carroll & Gibbons
BT Asset Management Limited
Burke P
Burke WJ
Burns Philip and Co Ltd
Business and Retirement Clinic Pty Ltd
Clayton Utz
Cogger R
Commonwealth Bank Group Financial Services
Commonwealth Funds Management Limited
Consumer Appeals Centre
Cook GP
County Natwest Investment Management
Defence, Department of
Environment Youth Alliance & National Union of Students
Finance, Department of (Cth)
Foley J

Health Employees Superannuation Trust Australia Limited
Higgins JWA, Partner, Mallesons Stephen Jacques
Industrial Affairs, Department of (Cth)
Institute of Actuaries of Australia, the
Insurance and Superannuation Commission
Investment Funds Association of Australia Ltd
Jacques Martin Industry
John A Nolan & Associates Pty Ltd
Knox D, Associate Professor
KPMG Peat Marwick
Leviston D
Life Insurance Federation of Australia Inc
McEachern J
McNelis S
Mercer Campbell Cook & Knight
Metal Trades Industry Association of Australia
MLC Investments
MLC Life Limited
Mills AC
More S
National Australia Bank
National Consumer Affairs Advisory Council
National Mutual Life Association of Australasia Limited
New South Wales Superannuation Office
Nipper MRG & Weeks PL
Norwich Group, the
Office of the Cabinet, Queensland
Page Harrison & Co
Pelham Webb & Co
Permanent Trustee Co Limited
Perpetual Trustees
Piaud CL
Pinnock MR
Price Waterhouse
Prudential Superannuation Services
QUF Industries itd
Reserve Bank of Australia
Retail Employees Superannuation Trust
Retirement Benefits Office
Ridd I
Ryan J
Savings & Loans Society Limited
Scheiwe D

Sclare H
Securities Institute of Australia, the
Shell Australia Limited
Sinha T, Associate Professor
Social Security, Department of, Social Policy Division
South Australian Government
Superannuation Advisors Pty Limited
Tidswell Administration Limited
Tindal B
Treasury, SA
Trust Company of Australia Limited
Trustee Companies Association of Australia Limited
Uni Superannuation Ltd
Victorian Retirement Advisory Association
Walker GW
Western Mining Corporation Holdings Ltd
Wessex Fund Management Limited
Westpac Financial Services
Women's Economic Think Tank
White RJ
Ziedars JA

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Table of legislation

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