

SUPERANNUATION AND GROUP LIFE INSURANCE

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Legal Briefings - By **Michael Vrisakis, Sarah Yu, Scott Donald, Nita Alexander and Ally Crowther**

The Royal Commission was widely expected to bring the superannuation industry to its knees, and certainly there are findings that make sobering reading. How some of those play out over the coming months and years remains to be seen.

At the very least, we need to see the Commissioner's Report as an important reminder to keep customer and client needs, interests and objectives firmly in sight. For us, although the Commissioner's recommendations were - mostly - to be expected, it was the findings of Commissioner Hayne in respect of the obligations that already exist for trustees of superannuation funds that resonated most.

The message is loud and clear: the law already contains the obligations that underpin the unique "trustee" role, for example, those concerning the best interests duty, the avoidance of conflicts and the sole purpose test, but trustees are in many cases simply not discharging their obligations completely nor are regulators enforcing them with appropriate vigour.

Commissioner Hayne stopped short of prohibiting vertical integration, prohibiting trustees from making a profit, extending the best interests duty to shareholders or prescribing the composition of trustee boards. However, there were some important structural aspects of the superannuation system that Commissioner Hayne considered needed to be specifically addressed, that we discuss further below.

The bottom line is that superannuation trustees (and regulators) will have to review (and in some instances recalibrate) urgently how these rules and principles guide their decision-making, their processes and the very institutional structures in which the decisions are occurring. Norms of behaviour and business practices that once might have been accepted as common industry practice will have to be reviewed to ensure they respect what the Commissioner has demonstrated to be contemporary community expectations.

POLICY RECOMMENDATIONS

Set out below are the formal recommendations in relation to superannuation and group life insurance.

However, these do not provide a complete picture as Commissioner Hayne has made some key comments in relation to current practices in the superannuation industry.

Recommendation No.	Recommendation
Recommendation 3.1 - No other role or office	A superannuation trustee should be prohibited from assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund.
Recommendation 3.2 - No deducting advice fees from MySuper accounts	Deduction of any advice fee (other than for intra-fund advice) from a MySuper account should be prohibited.
Recommendation 3.3 - Limitations on deducting advice fees from choice accounts	Deduction of any advice fee (other than for intra-fund advice) from superannuation accounts other than MySuper accounts should be prohibited unless the requirements about annual renewal, prior written identification of service and provision of the client's express written authority set out in Recommendation 2.1 in connection with ongoing fee arrangements are met.
Recommendation 3.4 - No hawking	Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme. The law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact for the express purpose of inquiring about, discussing or entering into negotiations in relation to the offer of that kind of product.
Recommendation 3.5 - One default account	A person should have only one default account. To that end, machinery should be developed for 'stapling' a person to a single default account.
Recommendation 3.6 - No treating of employers	Section 68A of the <i>Superannuation Industry (Supervision) Act 1993</i> (Cth) (SIS Act) should be amended to prohibit a trustee of a regulated superannuation fund, and associates of a trustee, doing any of the acts specified in section 68A(1)(a), (b) or (c) where the act may reasonably be understood by the recipient to have a substantial purpose of having the recipient nominate the fund as a default fund or having one or more employees of the recipient apply or agree to become members of the fund. The provision should be a civil penalty provision enforceable by ASIC.
Recommendation 3.7 - Civil penalties for breach of covenants and like obligations	Breach of the trustee's covenants set out in section 52 or obligations set out in section 29VN, or the director's covenants set out in section 52A or obligations set out in section 29VO of the SIS Act should be enforceable by action for civil penalty.
Recommendation 3.8 - Adjustment of APRA and ASIC's roles	The roles of APRA and ASIC with respect to superannuation should be adjusted, as referred to in Recommendation 6.3.
Recommendation 3.9 - Accountability regime	Over time, provisions modelled on the BEAR should be extended to superannuation trustees, as referred to in Recommendation 6.8.
Recommendation 4.13 - Universal terms review	Treasury, in consultation with industry, should determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies.
Recommendation 4.14 - Additional scrutiny for related party engagements	APRA should amend Prudential Standard SPS 250 to require superannuation trustees that engage a related party to provide group life insurance, or who enter into a contract, arrangement or understanding with a life insurer by which the insurer is given a priority or privilege in connection with the provision of life insurance, to obtain and provide to APRA within a fixed time, independent certification that the arrangements and policies entered into are in the best interests of members and otherwise satisfy legal and regulatory requirements.
Recommendation 4.15 - Status attribution to be fair and reasonable	APRA should amend Prudential Standard SPS 250 to require superannuation trustees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.

THE BIG PICTURE

It is important to recognise that the recommendations of the Royal Commission have been crafted in the midst of a range of other policy and regulatory initiatives related to the superannuation sector. 2018 was an extremely busy year in terms of proposals to reform different aspects of the superannuation industry. A number of Commissioner Hayne's recommendations and findings in the report complement and develop some of these proposals, and some depart. We set out below an indication of where the final Royal Commission findings sit against the backdrop of what is already a complex set of proposed reforms.

The culmination of all this is a set of proposals that reflect different perspectives within the industry (i.e. economics, law, academic) and it will be interesting to see how these are reconciled in the changes that are ultimately implemented given uncertainty in the political and regulatory processes.

Body	Report or proposal	Status	Is this impacted by the Royal Commission report?
ASIC	RG97 Review	Consultation is currently open	Limited impact.
	Report 562 - Financial advice: Vertically integrated institutions and conflicts of interest	Report issued in January 2018	Commissioner Hayne further explores the conflicts that exist in vertically integrated business but stops short of recommending that vertically integrated business should be prohibited.
	Insurance in Superannuation Voluntary Code	Commenced 1 July 2018	Commissioner Hayne recommends that the provisions of codes that govern the terms of the contract made (or to be made) between the insurer and the policyholder be designated as 'enforceable code provisions' by 30 June 2021.
	Fit for the future A capability review of the Australian Securities and Investments Commission	Report published December 2015	Commissioner Hayne has recommended that an ASIC capability review be undertaken at least once every four years.
	ASIC Enforcement Review Taskforce Report	Report provided to the Government in December 2017 and Government response published In April 2018	Commissioner Hayne has recommended that an ASIC capability review be undertaken at least once every four years and that certain recommendations in the Enforcement Review Taskforce Report be implemented.
APRA	Prudential Inquiry into the Commonwealth Bank of Australia	Published in May 2018	Commissioner Hayne provides further important guidance in relation to culture, remuneration and governance. The proposals will be critical and culture changes from the top-down will be required if trust is to be restored in the Australian financial system.
	Thematic Review - Governance	Published in May 2018	There are no recommendations in relation to specific board composition requirements, but Commissioner Hayne does comment on matters covered in the Thematic Review, for example, skills mix, competencies, tenure and board renewal.
	Thematic Review - Related Party Transactions	Published in May 2018	Commissioner Hayne has echoed some of APRA's findings in relation to related party arrangements (i.e. where trustees use related party service providers and insurers), for example, in relation to appropriate benchmarking of those providers.
	Strengthening superannuation member outcomes	SPS 515 Strategic Planning and Member Outcomes, effective 1 January 2020 Amendments to SPS 220 Risk Management, effective 1 January 2020	Commissioner Hayne has emphasised the importance of regulators focusing on member outcomes.
	BEAR	Passed and in force for large ADIs	Commissioner Hayne has recommended that the BEAR regime be extended to superannuation trustees (and APRA gave an indication that this might happen in its response to the Senate Economics Legislation Committee in 2017).
	Review of Prudential Standards	Consultation closed. APRA anticipates the outcomes will be released early 2019	In light of Commissioner Hayne's recommendations, further review and enhancement of Prudential Standards will be required, for example, in relation to culture and governance and scrutiny of related party engagements.
	APRA enforcement strategy review	Review to be presented on 31 March 2019	The Commonwealth Treasurer has appointed Mr Graeme Samuel to undertake the recommended review of APRA that is to occur at least once every four years.
Productivity Commission	Productivity Commission Inquiry Report: Superannuation: Assessing Efficiency and Competitiveness	Released on 10 January 2019	A key recommendation of the Productivity Commission was 'stapling' a default fund to a worker, and this has been repeated in Commissioner Hayne's recommendations. However, he did not state a preference as to how this will be given effect in practice. Commissioner Hayne does however implicitly counter the Productivity Commission's recommendation that trustee remuneration be limited to cost recovery. Other notable recommendations, including the 'Best in Show' process, were not addressed.
Parliament	Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Bill 2017	Before Senate	The Bill amends the MySuper outcomes assessment and Commissioner Hayne has emphasised the importance of regulators focusing on member outcomes. Commissioner Hayne has said that if the Bill is passed, and APRA gets a directions power, it could direct superannuation funds to merge.
	Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 2) Bill 2017	Before Senate	The final report does not touch upon the issues proposed under this Bill.
	Superannuation Laws Amendment (Strengthening Trustee Arrangements) Bill 2017	Before Senate	The idea of prescriptive rules about trustee board composition and selection was dismissed by Commissioner Hayne, on the basis that this would detract attention from ensuring the board is constituted by directors who, together and at all times, form a skilled and efficient board.
	Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018	Before Senate	The final report does not touch directly upon the issues proposed under this Bill however Commissioner Hayne does agree with Productivity Commission proposals to reduce the proliferation of unnecessary default accounts.
	Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018	Before the House of Representatives	Commissioner Hayne has questioned why this proposed legislation does not extend to all financial products and credit products within ASIC's regulatory responsibility.

INSIGHTS AND TRENDS

Some aspects of the superannuation system that Commissioner Hayne considered needed to be specifically addressed include:

- In relation to **conflicts of interest and duty**:
 - superannuation trustees being prohibited from assuming any other obligations (e.g. dual regulated entities);
 - avoidance (and not just management) of conflicts in certain circumstances; and
 - requirements in relation to engaging related party service providers.
- In relation to the **selling of superannuation**:
 - prohibiting hawking;
 - prohibiting 'treating' employers;
 - abolishing grandfathered commissions;
 - materially limiting advice fees being deducted from superannuation accounts; and
 - 'stapling' a worker to one default fund.
- In relation to **governance and accountability**:

- extension of the BEAR regime to superannuation as has already been foreshadowed by APRA in its response to the Senate Economics Legislation Committee in November 2017;
- remuneration reforms and APRA's proposed directions making power to require mergers; and
- civil penalties for breaches of covenants.
- In relation to **life insurance through superannuation:**

- standardisation of terms, definitions and exclusions for group life insurance for MySuper products;
- licensing of claims handling; and
- amendments to Prudential Standards in relation to additional requirements when a related party service provider is engaged and in relation to attributing a status under the policy to a default member.
- In relation to **regulators:**

- the adjustment of the roles and regulatory stance of APRA and ASIC in policing the superannuation industry; and
- due to the importance of superannuation to society, regulators' focus "must" be on member outcomes.

Importantly, the superannuation proposals need to be considered in the context of the overall proposals including that culture changes from the top-down are critical if trust is to be restored in the Australian superannuation system that is so important to the nation.

The six norms of conduct identified by Commissioner Hayne (obey the law, do not mislead or deceive, act fairly, provide services that are fit for purpose, deliver services with reasonable care and skill and when acting for another, act in their best interests) that he has suggested that legislation be connected to may be an appropriate cornerstone on which to build cultural change.

SO WHAT DOES THIS MEAN FOR THE INDUSTRY?

There are a number of important outcomes for the industry in relation to how superannuation funds are structured, the governance framework in which they operate, how products are managed and distributed, the legal duties and obligations of trustees and how life insurance is provided through super.

We look forward to sharing more detailed analysis with you on this in the coming weeks, but for now, we see the following points to be practical next steps:

CONFLICTS OF INTEREST AND DUTY

- Begin to consider how to transition into a new (separate) structure if your trustee business is arranged as a dual-regulated entity and keep a watching brief on whether the prohibition on other obligations will impact situations where, for example, a trustee has an advice business or life insurer as an investment of the fund.
- Consider the arrangements with related entities and ensure that these are given special consideration - was the process of appointment rigorous, with independent information? Is the trustee overly reliant on information provided to it by a related entity or unwilling to challenge that information? Is the office of the trustee sufficiently resourced to verify the information provided to it by its related party service providers?
- Revisit conflict management frameworks and ensure that these are not simply in existence to 'tick a box' - what *action* do these frameworks trigger and are they robust? Do they appropriately address where a trustee needs to *avoid* a conflict (instead of simply managing it)?

SELLING

- Begin to plan for the unwinding of all arrangements under which advice fees (other than

intra-fund advice fees) are deducted from MySuper accounts.

- Review advice fee arrangements from choice accounts and to the extent that fees are deducted for advice that goes beyond just superannuation, consider how these arrangements will be unwound.
- To the extent that any grandfathered commissions are still being paid, prepare to unwind these.
- Consider the proposal on superannuation sales practices to retail clients (given the no hawking recommendation) and consider redesigning remuneration structures for front line staff so that these no longer encourage unsolicited recommendations of superannuation products.
- Consider business strategy – what differentiates your fund and how do you ensure that members and employers choose it given the proposals to staple a default fund to each worker and that hawking and treating employers will no longer be permitted? What is the impact on fund cash flows, resourcing and sustainability?
- If the Productivity Commission’s ‘best in show’ proposal is legislated would it be a commercial advantage to address Commissioner Hayne’s recommendations earlier than required?

GOVERNANCE AND ACCOUNTABILITY

- Give due attention to the processes in place that address the turnover of trustee directors and board skills. Are nomination processes for new trustee directors properly designed? Do these processes ensure that the board is, as far as possible, constituted at all times by directors who, together, will form a skilled and efficient board?
- Consider whether the superannuation trustee’s remuneration arrangements are consistent with the Financial Stability Board’s publications concerning sound compensation and Commissioner Hayne’s recommendations.
- Review the changes made under the BEAR regime and prepare for directors and senior executives to be subject to similar statutory obligations.
- Review any remediation or other client-complaint related activities currently underway to ensure they are proceeding expeditiously and in a transparent and independent manner, and under the close watch of the most senior executives and Board of the organisation.
- Begin to consider how you will assess and manage the trustee’s culture and governance.

LIFE INSURANCE THROUGH SUPERANNUATION

- Consider the fund's membership and whether standard terms, definitions and exclusions for default insurance in MySuper is feasible and respond to the consultation accordingly – for example, are standard definitions appropriate if your membership is made up of a large number of heavy industry workers?
- Identify where you have deviated from the Life Insurance Code of Practice and consider what steps you would need to take to comply with it, if this becomes law.

OTHER CONSEQUENCES

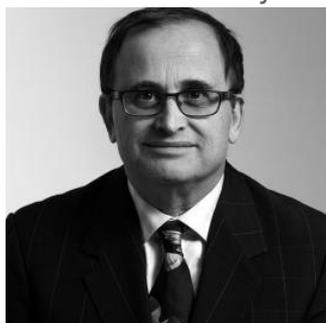
- Consider your disclosure obligations to members in light of any findings by Commissioner Hayne.
- Consider the adequacy of your decision-making processes and what enhancements can be made in light of Commissioner Hayne's findings in relation to the application and enforcement of existing legal duties and obligations of trustees, especially in relation to conflicts of interest, standard of care, fairness and the best interests of members.
- Consider the adequacy of your breach reporting framework and the extent to which it is adhered to.
- Keep a watching brief on the Government's announcement that the remit of the Australian Financial Complaints Authority (**AFCA**) will be expanded for a period of 12 months to accept 'applications for disputes' dating back to 1 January 2008 to ensure that consumers who have suffered from misconduct, but have not yet been heard, will be able to have these considered – will claims that were dismissed for being 'out of time' be brought back into the fore? It will be prudent to reconsider your records management policies and practices in light of this.
- Review and consider the contractual arrangement with the trustee's administrator – who is responsible under that agreement for implementing any of the changes, how should it be done and what is the cost?
- If you have not already done so, review any Directors and Officers insurance policies in place in light of the report to ensure there are no limits or restrictions that may be relevant.

There will be a lot to do, so ensure the office of the trustee (or equivalent) is sufficiently resourced and that you have sufficient compliance, risk, legal and audit capabilities to hand.

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KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



MICHAEL VRISAKIS
PARTNER, SYDNEY

+61 2 9322 4411
Michael.Vrisakis@hsf.com



SCOTT DONALD
EXTERNAL
CONSULTANT,
SYDNEY

+61 2 9225 5640
scott.donald@hsf.com

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