

16 March 2017

Financial Services Unit
Financial System Division
Markets Group
The Treasury
Langton Crescent
PARKES ACT 2600

Email: ProductRegulation@treasury.gov.au

Dear Sir/Madam

Design and Distribution Obligations and Product Intervention Power

1. I am pleased to enclose a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia (**the Committee**). The Committee is grateful for the opportunity to provide comments on the Proposals Paper entitled *Design and Distribution Obligations and Product Intervention Power* (December 2016) (**the Proposals Paper**).
2. The Committee's submission is guided by its objectives which are to ensure that the law relating to superannuation in Australia is sound, equitable and clear. The Committee therefore confines its submission to:
 - Question 1: 'Are there any financial products where the existing level of consumer protections means they should be excluded from the [design and distribution] measures (for example, default (MySuper) or mass-customised (comprehensive income products for retirement) superannuation products)?'
 - Question 9: 'If [the design and distribution measures] apply to unlicensed issuers and distributors, are there any unlicensed entities that should be excluded from the obligations (for example, entities covered by the regulatory sandbox exemption)?'
 - Question 23: 'Do you agree that ASIC should be able to make interventions in relation to the product (or product feature), the types of consumers that can access a product or the circumstances in which a consumer can access the product?'
3. The Committee responds to each of these questions, in turn.

Question 1 – financial products that should be excluded from the design and distribution measures

4. The Proposals Paper states that the design and distribution obligations will apply to 'financial products made available to retail clients' and that this would include 'investment products'.¹ On this basis, an interest in a regulated superannuation fund will invariably be a financial product falling within the proposed new regime, unless a specific exclusion applies.

5. The Proposals Paper also states:

While the measures proposed in this paper are intended to reduce the risk of consumers acquiring or being mis-sold products that do not meet their needs, they will not eliminate all product failures or mis-selling. In particular, it is not proposed that the Government 'pre-vet' financial products before they are made available to consumers. Providers will be responsible for ensuring products are targeted based on consumer needs, while consumers will still be responsible for the ultimate outcomes of their financial decisions.²

6. This statement provides a useful reference point for addressing Question 1 and commenting on whether any kinds of superannuation product should be excluded from the proposed new regime.

MySuper products

7. The Committee considers that MySuper products should be excluded from the proposed new regime. It may be unlikely that a consumer will acquire a MySuper product that does not (to use the language in the Proposals Paper) 'meet their needs' or that they will be mis-sold such a product. APRA 'pre-vets' MySuper products, in the sense that it is an offence to offer a superannuation product as a MySuper product without a MySuper authorisation from APRA.³ APRA may only authorise a product as a MySuper product if various conditions are satisfied, including the product complying with the prescribed core characteristics found in section 29TC of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**). In addition, the MySuper fee rules must be satisfied,⁴ the trustee must comply with the enhanced MySuper obligations,⁵ and relevant kinds of insurance must be provided on an opt-out basis.⁶

8. A trustee is only required (in practice) to provide a MySuper product to someone for whom default superannuation contributions are made by an employer.⁷ That is the target market for a MySuper product, as set by Parliament. There is little or no incentive (or reason) for a trustee to provide a MySuper product to anyone else, particularly given the heightened focus on fees and costs in the case of MySuper

¹ The Treasury, 'Design and Distribution Obligations and Product Intervention Power' (Proposals Paper, December 2016) <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power>> 4.

² Ibid.

³ *Superannuation Industry (Supervision) Act 1993* (Cth) s 29W.

⁴ Ibid pt 2C div 5.

⁵ Ibid pt 2C div 6.

⁶ Ibid s 68AA.

⁷ Ibid s 29WA.

products (relative to choice products). Similarly, a trustee is prohibited from funding conflicted remuneration payments from a MySuper product,⁸ and a financial adviser may struggle to justify charging a fee for recommending a MySuper product.

9. If MySuper products were included in the proposed new regime, this would raise questions as to what the trustee should do:
 - in terms of designing the product, when the design of the product has already been specified by legislation; and
 - in terms of distributing the product, when the target market for the product, and the circumstances in which the product is required, have already been specified by legislation.
10. Overlaying the proposed new regime on top of the existing MySuper rules is likely to produce confusion.
11. The Committee considers it would be a mistake to think that including MySuper within the new regime would not cause problems because a trustee would easily comply with the new 'principles-based' requirements almost as a matter of course if they comply with the highly prescriptive requirements for a MySuper product. The law concerning superannuation should be clear and it would not be clear if there were two sets of rules dealing with essentially the same matters in different ways (particularly as the general rules would post-date the specific rules).

Comprehensive income products for retirement

12. In contrast to MySuper products, the rules for comprehensive income products for retirement (**CIPRs**) have yet to be made. However, it is clear from Treasury's discussion paper concerning CIPRs – *Development of the framework for Comprehensive Income Products for Retirement (CIPR Discussion Paper)* – that those rules, as with the MySuper rules, are likely to deal in considerable detail with product design and distribution matters.⁹
13. The CIPR discussion paper indicates that third-party vetting of a CIPR – whether by APRA or an actuary – is a possibility. Irrespective of whether third-party vetting ultimately forms part of the final CIPR regime, many of the points made above in relation to MySuper products are also likely to apply in relation to CIPRs. The Committee considers that CIPRs should be excluded from the proposed new regime, unless clear, specific reasons for including them can be identified. The Committee has not identified any such reasons but the Committee would welcome the opportunity to consider and assess any that arise in this consultation.

Other superannuation products

14. The Committee acknowledges that the grounds for excluding non-MySuper accumulation superannuation products from the regime may not be as strong as

⁸ Ibid s 29SAC.

⁹ The Treasury, *Development of the framework for Comprehensive Income Products for Retirement* (Consultation Paper, December 2016) <<https://consult.treasury.gov.au/retirement-income-policy-division/comprehensive-income-products-for-retirement/>>.

they are for MySuper. This is not to say that such products are free from existing design rules that are intended to protect the interests of consumers. On the contrary, see for example, the general fee rules in Part 11A of the SIS Act. Holders of superannuation products are also the beneficiaries of the protections afforded by the various covenants imposed on superannuation trustees under section 52 of SIS Act and by superannuation funds invariably being structured as trusts. For example, a trustee is bound to exercise its powers in the best interests of members in formulating and giving effect to investment objectives and investment strategies which are suitable given the circumstances of the relevant superannuation fund. If a particular product were to be offered, the decision to offer that product would be a compliant decision (in which case no additional restrictions would be warranted) or the decision would breach existing requirements (in which case, action would already be available to be taken by members or the relevant regulator).

15. The Committee also acknowledges that the grounds for excluding non-CIPR retirement products from the regime may not be as strong as they are for CIPRs. However, the Committee anticipates that there may well be non-CIPR retirement products that are effectively indistinguishable from CIPRs and, in those cases, the question will arise whether they, too, should be excluded.
16. In the end, the Committee suggests that all interests in APRA-regulated superannuation funds should be excluded from the regime.

Question 9 - unlicensed entities that should be excluded from the design and distribution measures

17. According to the Proposals Paper, 'distributors' will be entities that either arrange for the issue of the product to a consumer or engage in conduct likely to influence a consumer to acquire a product (for example, through advertising or making disclosure documents available), in exchange for a benefit from the issuer.¹⁰
18. It is possible that, in certain circumstances, an employer could satisfy the definition of 'distributor' in relation to an accumulation superannuation product, such as a MySuper product. That outcome could apply in circumstances that are far removed from those of an inappropriate 'kickback' of the kind with which s 68A of the SIS Act is concerned. For example, a trustee might offer reporting services to the employer (arguably a 'benefit'), to which the employer would not be entitled, were it not a sponsoring employer.
19. In the event that Treasury does not accept the Committee's recommendation that MySuper products should be excluded from the regime, the Committee submits that employers should be excluded from being distributors in respect of MySuper products. The reasons in support of this submission include those in support of excluding MySuper products outright. In addition, the Committee submits that it is not reasonable to expect a superannuation trustee to enter into a distribution arrangement with all sponsoring employers and to engage in all of the distribution monitoring and review activities suggested. The cost and inconvenience for trustees of having potentially some or all employers qualify as distributors would be

¹⁰ The Treasury, 'Design and Distribution Obligations and Product Intervention Power' (Proposals Paper, December 2016) <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power>> 4.

considerable, while the benefit of not positively excluding employers from being distributors is not readily apparent.

20. Finally, the Committee submits that Treasury should consider whether, in addition to excluding employers, anyone else who may be involved in the negotiation and making of awards or other workplace instruments or agreements should also be excluded from being a distributor, to the extent that they are responsible for, or involved in, particular default funds being named.

Question 23 – limitations on interventions by ASIC

21. The Committee submits that the proposed new product intervention power for ASIC should not extend to MySuper products, CIPRs or any other superannuation products that are excluded from the proposed new design and distribution obligation regime.
22. In the circumstances, it might be thought very unlikely or perhaps inconceivable that ASIC might exercise its power in the case of a MySuper product and very unlikely that it might do so in the case of a CIPR. In each case, the design and distribution of the product in question would already be heavily regulated. Any change to the requirements concerning the design and distribution of CIPRs should be a matter for Government, APRA and any third party involved in authorising a CIPR. It is very difficult to see a role for ASIC in these areas.
23. However, as unlikely as it might seem that ASIC might intervene in, or interfere with, the operation of the governing requirements for those products, it is not impossible. The Committee considers the better approach would be to exclude the relevant kinds of products from the proposed product intervention power. Again, this is to reduce the prospect of confusion and to increase clarity in the law.
24. An alternative would be to retain them within the product intervention power but to require ASIC to consult with, and obtain the prior approval of, APRA, to the proposed intervention. If this alternative were pursued, the Committee submits it should apply in respect of all superannuation and retirement products, not just MySuper products and CIPRs. Where the issuer of a product is prudentially regulated (as in the case of an Registrable Superannuation Entity (**RSE**) licensee), there is plenty of precedent for either excluding the issuer or product from an aspect of financial services regulation or for including them but requiring ASIC to consult with APRA – see, for example, s 915I of the *Corporations Act 2001* (Cth) concerning ASIC's power to cancel or suspend an Australian Financial Services licence held by an APRA-regulated institution. Given the potentially far-reaching repercussions of ASIC exercising the proposed new product intervention power, the Committee submits that not just consultation with, but obtaining the prior approval of, APRA, would be appropriate.
25. In addition to the above, it seems to the Committee that if there were ever to be an intervention in relation to superannuation, it would be likely to arise in the context of a particular investment option which, for whatever reason, is not considered appropriate for its target market. Superannuation funds typically offer access to a large number of investment options. These new powers would be a blunt instrument if they only permitted intervention on a whole of superannuation fund basis, since such an intervention could affect other investment options which may

be completely appropriate and unobjectionable. Without limiting our earlier submissions, consideration should be given to clarifying that any intervention may be targeted (or should be limited) to the particular investment option(s) concerned.

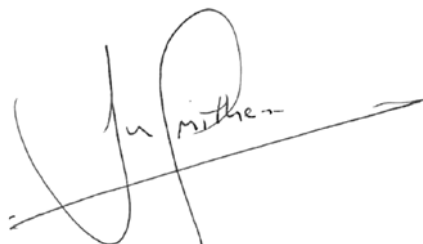
26. Further, in the case of 'superannuation platforms', a power to intervene vis a vis the underlying product issuer and product should be sufficient in and of itself. It would seem to involve regulatory duplication for there to be intervention powers as against the underlying product issuer and also as against the superannuation platform provider.

Contact

The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact:

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Yours sincerely

A handwritten signature in black ink, appearing to read 'Jonathan Smithers', with a long horizontal line extending to the right from the end of the signature.

Jonathan Smithers
Chief Executive Officer