SUBMISSION 1

Tax and Superannuation Laws Amendment (2013 Measures No. 2) Bill 2013

The Standing Committee on Economics

Submission by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia

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1. About the Law Council of Australia's Superannuation Committee

1.1 The Law Council of Australia is the peak national representative body of the Australian legal profession; it represents some 60,000 legal practitioners nationwide. Attachment A outlines further details in this regard.

1.2 This submission has been prepared by the Law Council of Australia's Superannuation Committee, which is a committee of the Legal Practice Section of the Law Council of Australia.

1.3 The Superannuation Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

2. Scope of submission

2.1 The Law Council of Australia's Superannuation Committee does not express any view on the policy underpinning proposed legislation. Our concern is simply to ensure that superannuation legislation is sound, equitable and demonstrably clear. As such, in this submission:

(a) we do not object at all to the policy underpinning Schedules 5 and 6 of the Bill, those being the provisions concerning:

(i) the merger of multiple accounts in a superannuation entity (Schedule 5); and

(ii) superannuation co-contributions (Schedule 6);

(b) we outline several legal issues arising from Schedule 5 of the Bill regarding the merger of multiple accounts in a superannuation entity; and

(c) we do not express any view on any other aspect of the Bill.

2.2 In broad terms, the legal issues concerning the merger of superannuation accounts can be summarised as follows:

(a) a more direct approach of prohibiting duplicated fees would have been simpler and would have achieved the policy intent;

(b) the Bill misconstrues the fiduciary duty to act in the best interests of members and suggests an impractical, artificial and manual approach in circumstances where trustees may administer hundreds of thousands of accounts and are being encouraged by the SuperStream reforms to automate those processes;

(c) trustees would be exposed to the risk of complaints and legal costs by aggrieved members, without there being any safe-harbour or protection provided by the legislation;

(d) the Bill does not include a requirement to actually process account mergers on an annual basis;

(e) the Bill requires trustees to focus on cost savings, but does not expressly permit regard to be had to other legitimate considerations;

(f) it is unclear how the Bill would apply to master trusts and platforms;

(g) there are several technical inconsistencies between the Bill and the Explanatory Memorandum.

These are outlined in further detail below.

3. A more direct approach may be simpler

3.1 It appears that the key concern underpinning Schedule 5 of the Bill is the duplication of administration fees which arises when members have multiple accounts. If this is the case, we query why this cannot simply be tackled in direct terms.

3.2 For example, the legislation might simply require trustees to take reasonable steps to ensure that lump sum fees which are only intended to be borne once by a member in any given period are in fact only borne once by any member in any given period. Trustees could then be afforded flexibility to address the issue by either waiving or rebating the fees (which seems to fall outside the ordinary meaning of a ‘merger’ of accounts) or, failing that, by being required to merge accounts if permitted by the governing rules (and subject to appropriate carve outs). This would side-step the other legal issues noted below.

4. The Bill misconstrues the duty to act in the best interests of members

4.1 The Bill and the Explanatory Memorandum both misconstrue the general law duty of a trustee to act in the best interests of members, by suggesting that a trustee must make a personalised determination as to whether merging accounts would be in the best interests of the particular member.

4.2 This is inconsistent with a trustee’s general law duty (which, in colloquial terms, is a duty to act in the best interests of members on the whole, but not a duty to act in the best interests of each member individually) and is unrealistic and impractical since large funds have hundreds of thousands of members.

4.3 In practical terms, the merger process will largely be automated, without any specific consideration of whether or not merging accounts would be beneficial for a particular member.

4.4 <u>The Bill should reflect this and fairly straight forward amendments could achieve this, for example, by requiring trustees to act in the best interests of members in preparing their policies for merging accounts (which is subtly but significantly different from the proposed approach of requiring a merger where it is in the best interests of the particular member to merge accounts).</u>

4.5 If a trustee were indeed required to consider the interests of individual members, this would give rise to a further question of what enquiries and additional information would have to be obtained before the trustee could form an informed view as to whether or not merging accounts would be in the best interests of the relevant member. If the change advocated above is not made, this further issue should in our view be addressed in the legislation and, unless major procedural changes are intended, it should be clarified that trustees are not required to make any further enquiries.

5. Trustees are exposed to unfair risk of complaints and legal costs

5.1 The Bill, if passed, would create a situation where trustees could be criticised by their members for merging accounts and criticised for not merging accounts, in cases where some members take a different view as to whether or not it was in their peculiar best interests for their accounts to be merged. Dealing with these kinds of complaints could give rise to significant costs and burdens for industry.

5.2 This risk exists because the Bill would require a determination to be made with regard to each individual member, in circumstances where the process will inevitably be automated and impersonal.

5.3 <u>A mandatory obligation to merge accounts (with appropriate carve outs) would have avoided this issue, as would the alternative suggestion outlined in paragraph 3.2 above. However, in the circumstances, a statutory 'safe-harbour' to protect trustees from complaints about good faith policies would also alleviate this issue and, in our submission, consideration should be given to including a protective provision along these lines.</u>

6. The Explanatory Memorandum suggests an unusual concept of 'merger'

6.1 Whereas the Bill contemplates accounts being 'merged', the Explanatory Memorandum contemplates an alternative course of action being taken which would not necessarily be understood to constitute a 'merger' of accounts.

6.2 For example, the Explanatory Memorandum suggests that it would be sufficient for trustees merely to waive duplicate fees, but otherwise maintain multiple accounts for a particular member. While such an approach would no doubt be consistent with the policy intent, it would be inconsistent with the proposed legislation.

6.3 <u>If the Explanatory Memorandum accurately reflects the policy intent, then the Bill requires modification so as to be consistent with the Explanatory Memorandum insofar as the latter suggests that waiving fees may be a legitimate alternative to merging accounts.</u>

7. Trustees will be exposed to unfair risk of claims for investment losses

7.1 The Bill seems to contemplate that in cases where accounts are 'merged' in a practical sense, that it is open to the trustee either to consolidate the entire account balance within a single investment option or to maintain the account balance in multiple investment options consistently with the member's investment position immediately before the merger.

7.2 There are legitimate reasons why some trustees may adopt the first of these courses (i.e. consolidating the entire account balance within a single investment option).

7.3 For example, a trustee's systems may not permit a single account to be invested in multiple investment options, or perhaps access to multiple investment options would trigger additional fees. Alternatively, where the member's accounts were held within different sub-plans, some investment options may not be available to members in other sub-plans. In these cases, there is a risk of members complaining and claiming damages from the trustee for investment losses (or forgone investment earnings) as a result of their investment exposures being changed unilaterally by the trustee.

7.4 For these reasons, consideration should be given to including a 'safe harbour' or other protective provision for trustees in circumstances where the merger of accounts results in a change to the member's investment exposure.

8. The Bill omits to require mergers to be processed on an annual basis

8.1 It is significant to note that, whereas the Bill requires trustees to identify members with multiple accounts at least once each financial year, the Bill fails to impose any requirement to actually merge accounts within any particular timeframe or frequency.

9. It is unclear how the Bill would apply to master trusts and platforms

9.1 A serious question arises as to how the Bill would apply to master trusts and platforms. For example, a superannuation fund may be established as a master trust comprising various sub-plans, each of which might be established for employees of different corporate groups and/or marketed as distinct financial products.

9.2 There is a real prospect of some members having multiple accounts, technically within the one master trust, but in distinct sub-plans which, in practical terms, are different financial products.

9.3 Consideration should be given to how the Bill would apply to master trusts and similar platforms. Alternatively, if it is intended that trustees of master trusts could rely on the exception for cases where it is 'not practicable' to merge accounts, this should be clarified.

10. Trustees should be permitted to have regard to other factors

10.1 The Bill is not limited to cases where the relevant accounts have low account balances. We query whether there would be any interaction with the speculated changes to the taxation of superannuation accounts with high account balances.

10.2 More generally, given that the Bill (only) requires a trustee to consider the potential fee savings in forming a view whether it would be in a member's best interests to merge accounts, it is unclear to what extent a trustee may legitimately have regard to other factors, for example, taxation implications or perhaps the loss of the benefit of the Government-guarantee for investments in bank accounts with balances of less than $100,000. Further, any other restrictions on dealing with the member's account should also be recognised, for example, any payment flags under the superannuation legislation which might prevent the trustee from consolidating accounts.

11. Error in the Explanatory Memorandum

11.1 Finally, it should be noted that Example 5.1 in the Explanatory Memorandum (which follows paragraph 5.27) seems to include a significant typographical error. The example seems to require a trustee to consider the circumstances of "Jack" when deciding whether to merge multiple accounts in the name of "Brendon". Presumably this is a typographical error and the example is only meant to utilise one of those names, but if Example 5.1 of the Explanatory Memorandum is suggesting that trustees must consider the circumstances of non-member beneficiaries, such as spouses, relationship partners and children, then that would be a contentious suggestion.

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 the Chair of the Law Council of Australia's Superannuation Committee, Pamela McAlister on (03) 9670 9632 or at pam.mcalister@hallandwilcox.com.au.

Attachment A: Profile of the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its constituent bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Large Law Firm Group, which are known collectively as the Council's constituent bodies. The Law Council's constituent bodies are:

- Australian Capital Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Independent Bar
- The Large Law Firm Group (LLFG)
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of approximately 60,000 lawyers across Australia.

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2013 Executive are:

- Mr Joe Catanzariti, President
- Mr Michael Colbran QC, President-elect
- Mr Duncan McConnel, Treasurer
- Ms Fiona McLeod SC, Member
- Mr Justin Dowd, Member
- Ms Leanne Topfer, Member

The Secretariat serves the Law Council nationally and is based in Canberra.