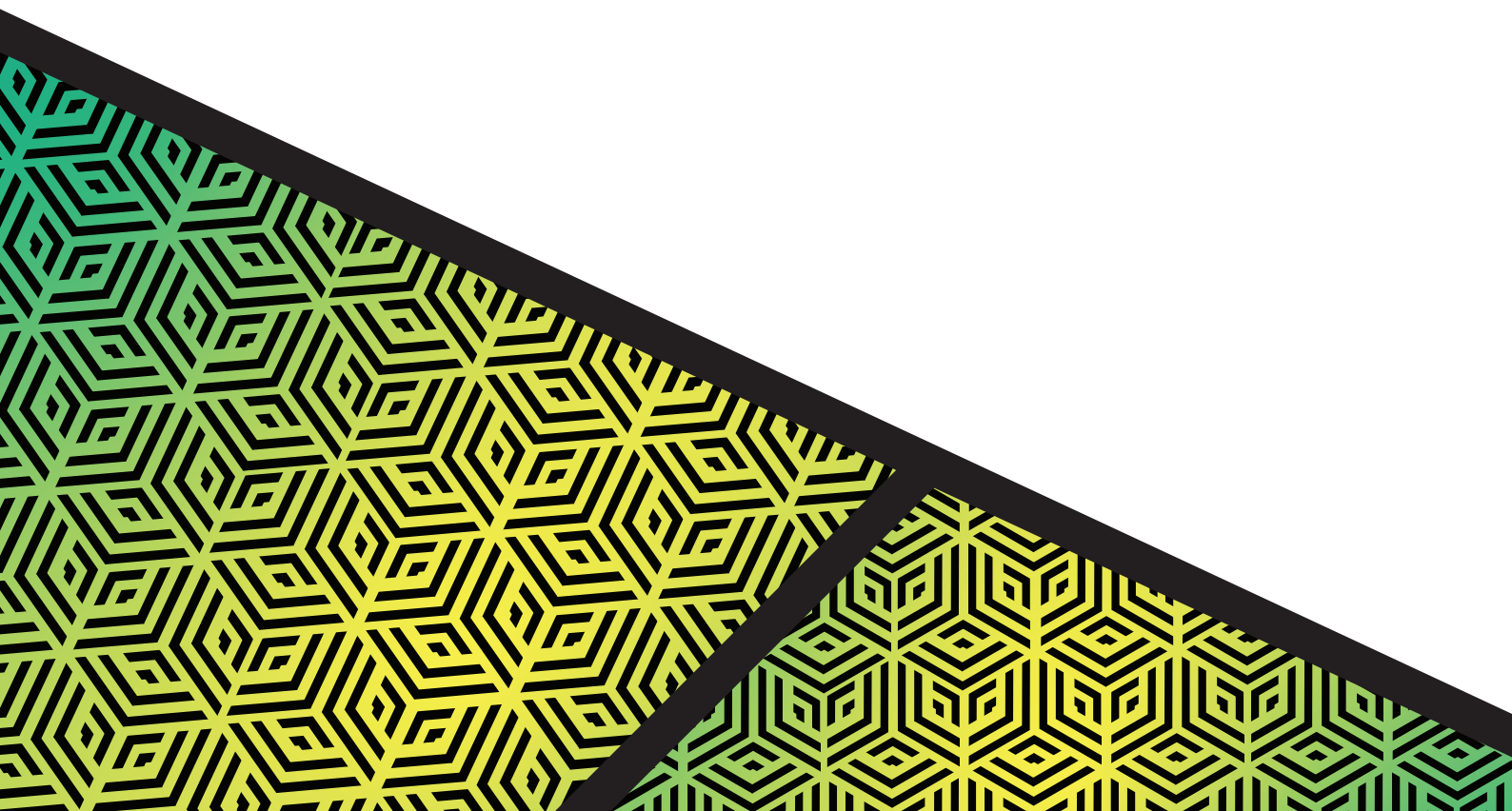
Australian Government
Australian Law Reform Commission

BACKGROUND PAPER FSL11

LEGISLATIVE FRAMEWORK FOR CORPORATIONS AND FINANCIAL SERVICES REGULATION

Superannuation and the Legislative Framework for Financial Services

May 2023



This discussion of superannuation and the legislative framework for financial services is the 11th in a series of background papers released by the Australian Law Reform Commission ('ALRC') as part of its Review of the Legislative Framework for Corporations and Financial Services Regulation ('the Inquiry').

These background papers are intended to provide a high-level overview of topics of relevance to the Inquiry. Further background papers may be released throughout the duration of the Inquiry, addressing key principles and areas of research that underpin the development of recommendations.

The ALRC is required to publish one further Interim Report during the Inquiry, and this Report will include specific questions and proposals for public comment. A call for further submissions will be made on the release of this Interim Report. In the meantime, feedback on the background papers is welcome at any time by email to financial.services@alrc.gov.au.

View the Financial Services Legislation Background Paper Series.

The Australian Law Reform Commission (ALRC) was established on 1 January 1975 and operates in accordance with the *Australian Law Reform Commission Act 1996* (Cth).

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Introduction

1. Superannuation is one of the pillars of Australia's retirement system. It sits alongside the Age Pension, voluntary savings, and the family home.[1]

2. Any reform to the legislative framework governing financial services and financial products warrants a consideration of how such reform might affect the superannuation sector, given its role in Australia's financial system. Australia's current superannuation savings have been estimated to be worth around $3.3 trillion as of September 2022.[2]. Given its scale and role in managing private savings, the superannuation system is integral to the wealth and wellbeing of Australians.[3]

3. This Background Paper is part of the Australian Law Reform Commission's ('ALRC') Review of the Legislative Framework for Corporations and Financial Services ('the Inquiry'). It does not undertake an exhaustive analysis of the legislative framework governing superannuation or offer solutions to the challenges that arise under that framework. Instead, it provides a general overview of key legal and regulatory issues concerning superannuation that are of relevance or interest to the Inquiry.

4. This Background Paper finds that there is significant complexity in the legislative framework governing superannuation. A more adaptive, efficient, and navigable framework in financial services legislation generally should benefit the superannuation industry.[4]

5. This Background Paper focuses on the role that Chapter 7 of the *Corporations Act 2001* (Cth) ('*Corporations Act*') plays in the regulation of superannuation. It also examines the legal and regulatory issues arising from other sources of law, including the *Australian Securities and Investments Commission Act 2001* (Cth) ('*ASIC Act*'), the *Superannuation Industry (Supervision) Act 1993* (Cth) ('*SIS Act*'), and the general law in areas such as trusts. The ALRC welcomes the views of stakeholders on further areas for simplification and reform regarding the legal and regulatory governance of superannuation.

6. This Background Paper is structured as follows:

- Part I provides background on superannuation funds and how superannuation works. It also describes the common classifications of superannuation funds and products.
- Part II sets out the complex legal and regulatory framework that governs the superannuation industry, including the roles of the Australian Securities and Investments Commission ('ASIC') and the Australian Prudential Regulation Authority ('APRA') as key regulators.
- Drawing on issues raised in previous Inquiry reports, submissions, and consultations, Part III unpacks the relationship between superannuation and the *Corporations Act.* Specifically, it examines:
    - how Chapter 7 of the *Corporations Act* regulates superannuation products and services;
    - the main obligations imposed on superannuation fund trustees and areas of overlap with the *SIS Act*, including the obligation to provide financial services 'efficiently, honestly and fairly', the best interests (and best financial interests) duty as well as obligations relating to conflicts of interests and duties;
    - the application of the retail client and wholesale client definitions in superannuation;

1 See, eg, Productivity Commission, *Superannuation: Assessing Efficiency and Competitiveness* (Report No 91, 2018) 3; Pamela Hanrahan, *Legal Framework Governing Aspects of the Australian Superannuation System* (Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Background Paper No 25, 2018) 1.

2 Association of Superannuation Funds of Australia, 'Super Statistics' <www.superannuation.asn.au/resources/superannuation-statistics>.

3 Productivity Commission (n 1) 3.

4 See Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 53–6.

- financial product advice in the superannuation context; and
- issues in relation to self-managed superannuation funds ('SMSFs').

Background

What are superannuation funds?

7. Following the introduction of the Superannuation Guarantee in 1992,[5] employers pay a specified percentage of an employee's ordinary time earnings into an employee's superannuation fund. The Superannuation Guarantee rate commenced at 3%, and is now 10.5% as of February 2023, legislated to reach 12% by 2025.[6]

8. In Australia, there are two types of superannuation funds: defined contribution (or accumulation) funds and defined benefit funds (or defined guarantee funds). Defined contribution funds represent the greater proportion of superannuation funds,[7] where the final retirement benefit payable to members is based upon contributions made, plus investment returns, less fees and taxes.[8] Defined contribution funds are distinguishable from defined benefit funds, where contributions are pooled (not allocated to particular members) and retirement benefits, calculated by a formula that includes factors such as salary and duration of employment, are guaranteed for life.[9] There is therefore an important distinction between the two forms of fund in terms of the risk placed on individual members in defined contribution funds.

9. Superannuation funds in Australia are established as trusts.[10] Fund trustees must fulfil the 'sole purpose' test contained in section 62(1) of the *SIS Act*. In other words, trustees must maintain superannuation funds under their administration solely for the provision of retirement income benefits to each member. In an early ruling on superannuation that pre-dated the modern system Windeyer J referred to a superannuation fund as

> a fund bona fide devoted as its sole purpose to providing for employees who are participants money benefits (or benefits having a monetary value) upon their reaching a prescribed age. In this connexion "fund", I take it, ordinarily means money (or investments) set aside and invested, the surplus income therefrom being capitalized.[11]

10. On 20 February 2023, the Department of Treasury (Cth) ('Treasury') issued a consultation paper titled 'Legislating the objective of superannuation'.[12] The consultation paper proposes that the purpose of superannuation should be codified in legislation and suggests that '[t]he objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way'.[13]

Classifying superannuation funds and products

11. As this section will demonstrate, the superannuation system consists of an intricate and diverse range of **funds**, **products**, and **administrative structures**. These distinctions are not neatly set out in legislation, although legislation often hinges on them. Professor Hanrahan suggests that superannuation funds are generally divided into three broad categories:

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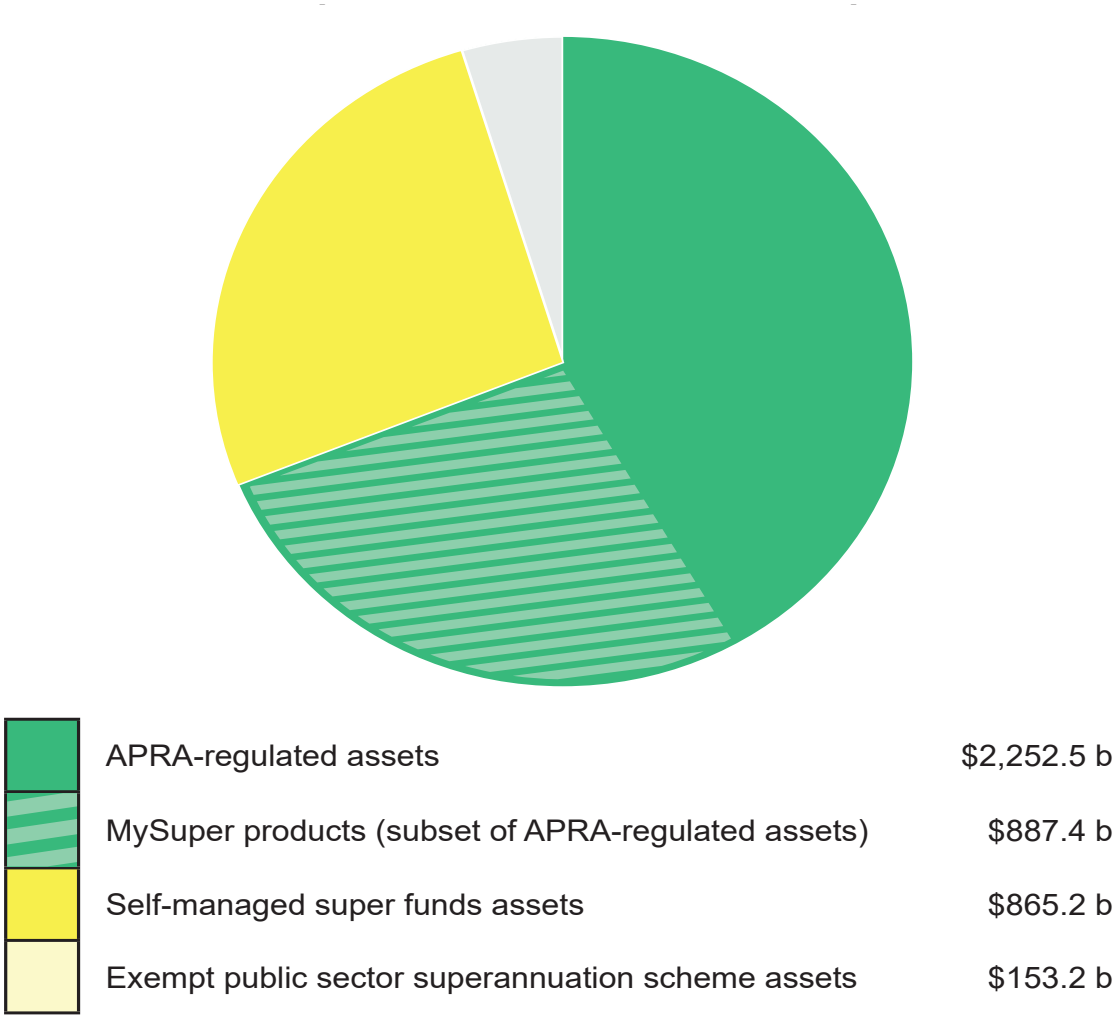
5 *Superannuation Guarantee Charge Act 1992* (Cth); *Superannuation Guarantee (Administration) Act 1992* (Cth).
6 Australian Taxation Office, 'The Super Guarantee Rate Increases from 1 July' (Media Release, 1 June 2022).
7 Hanrahan (n 1) 1.
8 Productivity Commission (n 1) xix.
9 Ibid. This guarantee is dependent on the continued solvency of the defined benefit fund, though such funds are prudentially regulated to minimise the risk of a fund collapsing.
10 The main exception being Retirement Savings Accounts that are established as ordinary banking accounts: LexisNexis, *Law of Superannuation in Australia* (online at 5 May 2023) [5,030].
11 *Scott v Federal Commissioner of Taxation (No 2)* (1966) 40 ALJR 265, 278.
12 Department of the Treasury (Cth), *Legislating the Objective of Superannuation* (Consultation Paper, 20 February 2023).
13 Ibid 9,12.

a. Registrable Superannuation Entities ('RSEs') that are regulated by APRA, in practice the superannuation trustee;
b. SMSFs that are mainly regulated by the Australian Taxation Office; and
c. exempt public sector superannuation schemes ('EPSSS').[14]

12. There are also retirement savings accounts ('RSAs') offered under the *Retirement Savings Account Act 1997* (Cth), though they are not widely used.[15]

13. **Figure 1** below illustrates the composition of superannuation assets in Australia as at 30 September 2022.[16]

Figure 1: Allocation of superannuation assets as at Sep 2022



Total superannuation assets: $3,270.9 billion (excluding balance of life office statutory fund assets)[17]

14 Hanrahan (n 1) 4. See *Superannuation Industry (Supervision) Regulations 1994* (Cth) sch 1AA for a list of EPSSS.
15 Hanrahan (n 1) 3–4.
16 Australian Prudential Regulation Authority, 'APRA Releases Superannuation Statistics for September 2022' (Media Release, 22 November 2022).
17 The definition of 'balance of life office statutory fund assets' is 'assets held for superannuation or retirement purposes in statutory funds of life insurance companies, excluding the assets held in life office statutory funds by superannuation entities. The balance of life office funds includes annuities and assets backing non-policyholder liabilities. These products are regulated under the *Life Insurance Act 1995*': Australian Prudential Regulation Authority, 'Quarterly Superannuation Performance - Glossary' <www.apra.gov.au/sites/default/files/qsp_glossary.pdf>.

14. As displayed in **Figure 1**, RSEs (that is, APRA-regulated assets) lead the superannuation system in terms of total asset value. However, SMSFs, which comprise approximately 26% of the superannuation system, have become more prevalent.[18] In the five years from June 2016 to June 2021, SMSF assets increased by $224.3 billion, or 38%.[19] This is a significant increase and underscores the benefits of managing complexity in the rules and compliance obligations under the *Corporations Act*, as noted by some stakeholders.[20]

MySuper products

15. An important development in the regulation of RSEs was the introduction of 'MySuper' products following the Stronger Super reforms introduced by the Australian Government in 2011 and 2012.[21] This followed the 2009–2010 Super System Review chaired by Jeremy Cooper.[22] The Super System Review advocated the use of 'choice architecture' and 'nudge theory' to offer superannuation members a simple, well-designed product.[23] It rejected prior assumptions (made by earlier reports) about rational decision-making by consumers, given the compulsory nature of the superannuation system generates disengagement which is further compounded by a system of industrial defaults.[24] The Review recognised that there were 'inadequate levels of financial literacy and appreciation of risk', as well as complex disclosures required for people to understand the available product options for superannuation.[25]

16. As a result, MySuper was introduced in 2012 as a 'simple, cost-effective default superannuation product'.[26] Employees who do not choose their own fund are defaulted (or 'nudged') into a MySuper product, instead of simply enrolling into their employer's default fund, which may incur unnecessary extra expenses.[27] Employers are required to select a default superannuation fund that offers a MySuper product if the employee has not chosen a fund or does not have a stapled super fund.[28] MySuper products consist of a single diversified investment strategy with restrictions on fees,[29] with these attributes fixed by section 29TC of the *SIS Act.* Consumer choice is still preserved — those who wished to choose a different product are free to leave the default option and select an alternative superannuation product. These other products are often 'choice' products offered by the large institutional funds. Individuals could also choose to use SMSFs.[30]

The legal and regulatory landscape

17. The superannuation industry is subject to a host of general law principles, Acts, standards, instruments, regulatory guidance materials as well as self-regulatory regimes.[31] **Table 1** below

18 Australian Prudential Regulation Authority, 'APRA Releases Superannuation Statistics for September 2022' (n 16).
19 Australian Taxation Office, 'SMSF Profile' <www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/SMSF/Self-managed-super-funds--A-statistical-overview-2019-20/>.
20 See, eg, SMSF Association, *Submission 28*.
21 Commonwealth of Australia, Stronger Super (Information Pack, 21 September 2011) <www.treasury.gov.au/sites/default/files/2021-01/stronger_super_info_pack.pdf>.
22 See Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department (Cth), *Super System Review* (Final Report, Part 1, June 2010).
23 Ibid, 1. Nicholas Simoes da Silva and William Isdale, 'Risk and Reform in Australian Financial Services Law' (2022) 96 *Australian Law Journal* 408, 418.
24 See Australian Law Reform Commission, 'Risk and Reform in Australian Financial Services Law' (Background Paper FSL5, March 2022) 15; Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department (Cth) (n 22) 9.
25 Review of the Governance, Efficiency, Structure and Operation of Australia's Superannuation System, Attorney-General's Department (Cth), *MySuper: Optimising Australian Superannuation* (Second Phase One — Preliminary Report, April 2010) 4.
26 Commonwealth of Australia (n 21) 1.
27 Hanrahan (n 1) 12.
28 See ASIC, 'Communicating with employees about choice of superannuation fund: What you can and cannot do' (INFO 89), available at <www.asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-relief-and-legislative-instruments/communicating-with-employees-about-choice-of-superannuation-fund-what-you-can-and-cannot-do/>.
29 *Superannuation Industry (Supervision) Act 1993* (Cth) s 29TC(1)(a).
30 Revised Explanatory Memorandum to the Superannuation Legislation Amendment (MySuper Core Provisions) Bill 2012 [1.7].
31 Hanrahan (n 1) 2.

summarises the various sources of soft (non-binding) law and hard (binding) law that affect superannuation.

Table 1: Sources of soft and hard law for the superannuation industry

Soft law	Hard law
Voluntary codes of conduct and other self-regulatory regimes	Primary legislation (Commonwealth, State, and Territory Acts)
Guidance materials from ASIC and APRA	Delegated legislation (for example, regulations, ASIC and APRA legislative instruments)
	General law (for example, tort, contract, trust law)

The general law

18. Superannuation funds are generally structured as trusts, where superannuation fund trustees (the RSE under APRA licensing) hold fund assets on trust for members (and any dependents).[32] Superannuation fund trustees are therefore subject to the ordinary principles of trust law except to the extent that those principles are inconsistent with statute.[33] This is reflected in the oft-quoted statement of Sir Robert Megarry V-C in *Cowan v Scargill* (which has been affirmed by Waddell CJ in Eq in *Lock v Westpac*[34]):

> I can see no reason for holding that different principles apply to pension fund trusts from those which apply to other trusts. Of course, there are many provisions in pension schemes which are not to be found in private trusts, and to these the general law of trusts will be subordinated. But subject to that, I think that the trusts of pension funds are subject to the same rules as other trusts.[35]

19. Other areas of the general law, including the law governing contract and tort, may also be relevant to questions such as how the terms of the superannuation fund should be interpreted and the potential liability of superannuation trustees for misrepresentations.[36]

Relevant primary legislation

20. On top of the general law, a range of Acts govern the superannuation industry, including the following:

- The ***Corporations Act***, which defines the terms 'financial product' and 'financial service' (including products and services that relate to superannuation) and sets out the Australian financial services licence ('AFS Licence') requirements relating to the provision of financial services and products by superannuation trustees, mandatory disclosure requirements, as well as design and distribution obligations ('DDO').[37] The *Corporations Act* also provides for when complaints relating to superannuation can be made under the Australian Financial

32 For RSEs, the trust structure is implied by section 29L of the *SIS Act*, which provides that an application to APRA for registration of a RSE must 'be accompanied by an up-to-date copy of the trust deed by which the registrable superannuation entity is constituted'.

33 See *Superannuation Industry (Supervision) Act 1993* (Cth) s 350, which provides that '[i]t is the intention of the Parliament that this Act is not to apply to the exclusion of a law of a State or Territory to the extent that that law is capable of operating concurrently with this Act'. The *Trustee Acts* or *Trust Acts* in each state and territory concerning the conduct of trusts also apply, particularly in relation to the appointment of superannuation fund trustees: (n 10) [5,030].

34 *Lock v Westpac* (1991) 25 NSWLR 593, 610.

35 *Cowan v Scargill* (1984) 2 ER 750, 763. See also *Re QSuper Board* [2021] QSC 276 which similarly confirms that superannuation fund trustees are subject to the trust obligations in general law.

36 For a discussion, see M Scott Donald, 'Parallel Streams? The Role of Contract, Trust, Tort and Statute in Superannuation Funds and Managed Investment Schemes' (2020) 14(2) *Journal of Equity* 151.

37 See *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019* (Cth); *Corporations Act 2001* (Cth) pt 7.8A.

Complaints Authority ('AFCA') dispute resolution scheme.[38] ASIC is the regulator of superannuation under the *Corporations Act*.

- The ***SIS Act***, which establishes the broader framework for the regulation of superannuation funds. Its main object is 'to make provision for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts'.[39] The *SIS Act* uses 'both the mechanisms of trust law … and its language'.[40] Certain provisions of the *SIS Act* are deemed to be covenants in the governing rules — ordinarily the trust deed — of RSEs and SMSFs.[41] As a result of the implementation of the Your Future Your Super reform package in 2021, the *SIS Act* now requires APRA to conduct an annual performance test on all MySuper products and introduced new personal penalties for directors on trustee boards.[42] APRA, ASIC, and the Commissioner of Taxation share regulatory oversight for different aspects of the *SIS Act*.
- The ***Superannuation Guarantee (Administration) Act 1992*** (Cth), under which employers must make superannuation contributions into a complying fund.
- The ***Retirement Savings Account Act 1997*** (Cth), which governs RSAs; namely, accounts offered by financial institutions that are used to save money for retirement.
- The ***Income Tax Assessment Act 1997*** (Cth) and the ***Income Tax Assessment Act 1936*** (Cth), which both contain provisions in respect of the taxation of superannuation contributions, investments, and benefits.
- The ***ASIC Act*** which contains consumer protection provisions in respect of financial services.

21. The superannuation sector is also subject to the regulations associated with the above Acts, such as the *Superannuation (Industry) Supervision Regulations 1994* (Cth) ('*SIS Regulations*') and the *Corporations Regulations 2001* (Cth) ('*Corporations Regulations*').

22. Additionally, the *Financial Accountability Regime Bill 2022* (Cth) was reintroduced to Parliament on 8 September 2022 and will apply to the superannuation industry if enacted.

38 See *Corporations Act 2001* (Cth) s 1053.
39 *Superannuation Industry (Supervision) Act 1993* (Cth) s 3.
40 M Scott Donald, 'Beneficiary, Investor, Citizen: Characterising Australia's Super Fund Participants' in *The Evolving Role of Trust in Superannuation* (Federation Press, 2017) 33, 35.
41 For RSEs, see sections 52, 52A and 54B of the *SIS Act*. For SMSFs, see sections 52B and 52C. See also section 54A which provides that the regulations may prescribe other covenants.
42 See *Superannuation Industry (Supervision) Act 1993* (Cth) pt 6A.

Delegated legislation, guidance materials, and self-regulatory regimes

23. Delegated legislation, guidance materials, and self-regulatory regimes play an important role in superannuation regulation. Delegated legislation includes regulations,[43] APRA's prudential and reporting standards,[44] as well as ASIC's legislative instruments.[45] All forms of delegated legislation are legally binding.

24. Generally speaking, guidance materials issued by ASIC and APRA are not legally binding.[46] Superannuation fund trustees must still consider ASIC and APRA guidance.

25. Self-regulatory regimes also regulate the superannuation sector. Superannuation fund trustees may choose to adopt industry or individual fund-level codes of practice (such as the *Australian Institute of Superannuation Trustees Governance Code* 2017, and the Financial Services Council *Standard 20 – Superannuation Governance Policy*) or other voluntary frameworks.

Complexity in superannuation law

26. There is a complicated and nuanced relationship that exists between the different sources of law in the superannuation context.[47] As Associate Professor Donald notes, the streams of law governing superannuation are not neatly parallel — instead, there is a 'roiling intermingling of trust, contract, tort and statute'.[48] As a result, certain conduct can attract liability under multiple sources of law. Further, because these various sources of law have different requirements, elements and objectives, the precise circumstances are important and slight differences could lead to different legal findings.[49]

27. There is also a complex interrelationship between the various pieces of legislation and delegated legislation, which creates navigability challenges.[50] **Figure 2** below aims to capture the challenges in locating and identifying the relevant law, spread across various pieces of legislation.[51]

43 See, eg, *Corporations Regulations 2001* (Cth), *Superannuation Industry (Supervision) Regulations 1994* (Cth); *Australian Securities and Investments Commission Regulations 2001* (Cth).

44 See *Superannuation Industry (Supervision) Act 1993* (Cth) ss 10 ('definition of RSE licensee law'), 34C. For a list of relevant APRA prudential standards, reporting standards and guidance materials relevant to the superannuation industry, see Australian Prudential Regulation Authority, 'Prudential and Reporting Standards for Superannuation' <www.apra.gov.au/industries/33/standards>.

45 However, these are subject to parliamentary disallowance: Parliament of Australia, Disallowance (Guides to Senate Procedure No 19) <www.aph.gov.au/About_Parliament/Senate/Powers_practice_n_procedures/Brief_Guides_to_Senate_Procedure/No_19>.

46 There are, however, certain exceptions to this. For example, RG 65 (ASIC's guidelines on section 1013DA disclosure) 'must be complied with': *Corporations Act 2001* (Cth) 1013DA.

47 See Donald, 'Parallel Streams? The Role of Contract, Trust, Tort and Statute in Superannuation Funds and Managed Investment Schemes' (n 36).

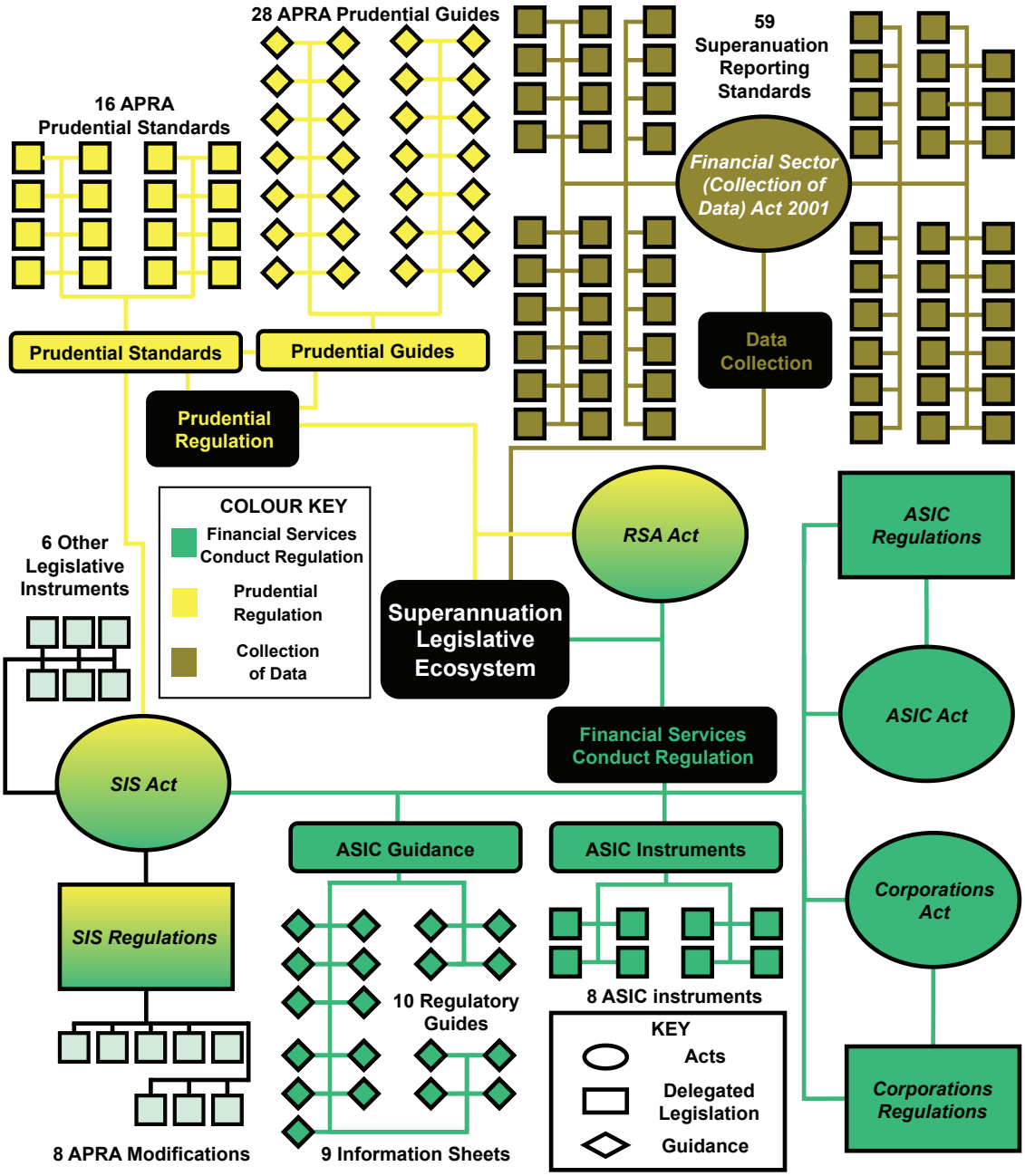
48 Ibid 152.

49 Ibid 178–9.

50 See Australian Law Reform Commission, 'Improving the Navigability of Legislation' (Background Paper FSL3, October 2021).

51 The content in Figure 3 is derived from Australian Law Reform Commission, 'DataHub' <www.alrc.gov.au/datahub/>; Australian Securities and Investments Commission, 'Superannuation Guidance, Relief and Legislative Instruments' <www.asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-relief-and-legislative-instruments/>; Australian Prudential Regulation Authority, *Prudential and Reporting Standards for Superannuation* (n 44).

Figure 2: Superannuation legislative ecosystem[52]



28. As shown in **Figure 2**, the superannuation legislative ecosystem is highly interconnected. This is particularly evident in respect of defined terms, with crossover occurring between legislation and regulations.[53] For example, section 764A(1)(g) of the *Corporations Act* treats 'a superannuation interest within the meaning of the *SIS Act* as a financial product'. As the SMSF Association noted, care must therefore be taken to 'ensure that the broader impacts of any amendments, removal or relocations are clearly mapped, assessed and addressed'.[54]

52 The *Financial Sector (Collection of Data) Act 2001* (Cth) is not discussed in this paper. The Act ensures that APRA collects the data it requires for the purposes of its prudential functions, and it is therefore a key component of the APRA prudential framework.

53 SMSF Association, *Submission 28*.

54 Ibid.

29. Moreover, as highlighted in Interim Report B, the current legislative hierarchy underpinning financial services law lacks coherence and is difficult to navigate. Managing and sifting through the various levels of the legislative hierarchy can be challenging for users, including regulators, and may result in errors or inconsistencies among Acts, instruments and guidance materials.[55] The Association of Superannuation Funds of Australia submitted that 'numerous iterative changes over the years in combination with a lack of awareness/understanding of existing provisions' have created a 'labyrinthine' regime.[56] Further, the rules on issuing a new superannuation interest are particularly complex, and require an examination of Acts, regulations, and other legislative instruments.[57]

30. The need to classify and distinguish between superannuation products and funds, and to treat superannuation in its own separate category for certain purposes, has generated a high level of prescription in legislative drafting. For instance, many detailed disclosure requirements apply specifically to MySuper products.[58] There are also definitions, exclusions, and exemptions under the *Corporations Act* that are particular to superannuation; for example, the superannuation-specific exemptions in relation to licensing,[59] and the definition of retail client under section 761G(6) of the *Corporations Act*. These issues will be explored in detail below.[60] Even though prescription in legislative drafting has been necessary to respond to diverse circumstances and needs, 'prescription, particularly where it reflects the density and technicality of rules, can lead to legislative complexity'.[61]

31. It is also difficult to fit certain classes of superannuation funds and investments within the existing legislative framework, resulting in 'misfits'. This is apparent, for example, in the context of SMSFs, discussed further below.[62]

The regulatory roles of ASIC and APRA

32. In addition to the legal complexity outlined above, the existence of multiple agencies that regulate the superannuation industry further complicates the framework governing superannuation. These agencies include ASIC, APRA, the ATO, and the Australian Transaction Reports and Analysis Centre. This section will focus on the role of ASIC and APRA as key regulators of the superannuation sector.

33. Australia's 'Twin Peaks' model, which was adopted following the recommendations of the Wallis Inquiry, involves the separation of prudential and conduct regulation through two separate and independent agencies — ASIC and APRA.[63] APRA's regulatory focus is on financial system stability, whereas ASIC'S regulatory objective is to promote consumer protection and financial market integrity.[64] As Professor Pearson notes, ASIC and APRA exist in

55 See, eg, Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) [6.36].
56 Australian Law Reform Commission, 'Initial Stakeholder Views' (Background Paper FSL1, June 2021) [30] citing the Association of Superannuation Funds of Australia.
57 See below [1.45]–[1.46].
58 See, eg, Australian Securities and Investments Commission, *MySuper Product Dashboard Requirements for Superannuation Trustees* (INFO 170, September 2022) <www.asic.gov.au/regulatory-resources/superannuation-funds/superannuation-guidance-relief-and-legislative-instruments/product-dashboard/mysuper-product-dashboard-requirements-for-superannuation-trustees/>.
59 See, eg, *Corporations Act 2001* (Cth) ss 911A(2)(g), (j); *Corporations Regulations 2001* (Cth) regs 7.6.01(b)–(da).
60 See below [1.60]–[1.70].
61 Australian Law Reform Commission, 'Complexity and Legislative Design' (Background Paper FSL2, October 2021) [112].
62 See below [1.71]–[1.76].
63 Andrew Godwin and Ian Ramsay, 'Twin Peaks - The Legal and Regulatory Anatomy of Australia's System of Financial Regulation' (2015) 26 *Journal of Banking and Finance Law and Practice* 240, 248.
64 Ibid.

> distinct spheres of regulatory authority. APRA is concerned with issues such as capital adequacy, whereas ASIC's focus is on whether the consumer is adequately protected such that she or he can make informed product choice and investment decisions.[65]

34. Although there are some considerations which are common to both regulators (such as competition and economic efficiency), the differences between the regulatory mandates of ASIC and APRA mean that

> their primary interest in a specific transaction or phenomenon within the superannuation system is quite likely to issue from a different pre-occupation. This in turn may suggest to ASIC and APRA a different level of priority and inspire a different regulatory response.[66]

35. Superannuation funds are commonly referred to as 'dual-regulated' entities as they are regulated by both APRA and ASIC.[67]

APRA as the prudential regulator

36. APRA regulates 'bodies in the financial sector in accordance with other laws of the Commonwealth that provide for prudential regulation or for retirement income standards'.[68] In the superannuation context, the most relevant of those 'other laws of the Commonwealth' is the *SIS Act*, the main object of which is 'to make provision for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts and for their supervision by APRA, ASIC and the Commissioner of Taxation'.[69] As provided by s 4 of the *SIS Act* (Simplified outline of supervision responsibilities):

> APRA is generally responsible for prudential regulation and member outcomes. It is also generally responsible for licensing and supervision of RSE licensees.
>
> ASIC is generally responsible for protecting consumers from harm, market integrity, disclosure and record keeping.
>
> The Commissioner of Taxation is generally responsible for self managed superannuation funds, data and payment standards, tax file numbers and the compassionate release of superannuation amounts.

ASIC as the conduct regulator

37. ASIC's regulatory powers and responsibilities with respect to superannuation derive from several sources, including the Australian financial services licensing regime ('AFSL regime') under the *Corporations Act*, the unconscionable conduct and consumer protection provisions in the *ASIC Act* as well as the *SIS Act*. The AFSL regime will be explored further below.[70] Section 6 of the *SIS Act* empowers ASIC to enforce certain provisions in the *SIS Act*.

38. Following the recommendations from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry ('FSRC'),[71] the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) ('*2020 Response Act*') amended section 6 of the *SIS Act* to confer greater powers for ASIC to take enforcement action against trustees under the

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65 Gail Pearson, *Financial Services Law and Compliance in Australia* (Cambridge University Press, 2009) 107.

66 M Scott Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (2020) 31 *Journal of Banking and Finance Law and Practice* 57, 64.

67 Cindy Davies, Samuel Walpole and Gail Pearson, 'Australia's Licensing Regimes for Financial Services, Credit, and Superannuation: Three Tracks Toward the Twin Peaks' (2021) 38(5) *Company & Securities Law Journal* 332, 338.

68 *Australian Prudential Regulation Authority Act 1998* (Cth) s 8(1)(a).

69 *Superannuation Industry (Supervision) Act 1993* (Cth) s 3(1); For discussion more generally, see Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66).

70 See below [1.473]–[1.506].

71 See Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (Volume 1, February 2019).

SIS Act, including the ability to enforce the covenants contained in sections 52 and 52A of the *SIS Act*, which were previously only enforceable by APRA.[72]

Co-regulation by ASIC and APRA in superannuation

39. To promote cooperation and consistency in approach, ASIC and APRA entered into an updated Memorandum of Understanding in 2019,[73] which includes 'strong in-principle commitments, a joint committee dedicated to overseeing cross-agency engagement and a greater level of detail than the 2010 memorandum it replaces'.[74] Both ASIC and APRA are members of the Council of Financial Regulators, which aims to

> facilitate co-operation and collaboration between member agencies, with the ultimate objectives of promoting stability of the Australian financial system and supporting effective and efficient regulation by Australia's financial regulatory agencies.[75]

40. The increased involvement by ASIC in superannuation has created challenges in preserving a clear delineation of responsibilities between ASIC and APRA. The unique nature of the 'financial promise' made by superannuation fund trustees to fund members has been noted by many.[76] As noted above, unlike other financial sectors, there is a trust relationship between the trustee and the member in a superannuation fund.[77] Thus, the trustee's primary duty is to adhere or give effect to the terms of the trust.[78] As returns under a defined contribution arrangement are market-linked, the promise of a trustee is not one of outcome.[79] Although recent years have seen an increased legislative focus on 'member outcomes',[80] it is challenging to measure performance and impact in superannuation because of the uniqueness of the financial promise involved.

41. Rather, the promise is one of process.[81] Accordingly, there are criticisms that an orthodox prudential approach (in other words, a focus on adequate capital and liquidity) is inappropriate for this kind of promise.[82] As a result, prudential regulation must necessarily go beyond ensuring that entities are capable of meeting their promises — it must also contemplate the *propensity* of entities to fulfil their obligations.[83] This, however, brings prudential regulation closer to what would traditionally be perceived as conduct regulation, which is formally ASIC's role under the Twin Peaks model.[84]

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72 See *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) sch 9.

73 *Memorandum of Understanding Between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission*, signed 28 November 2019 <www.apra.gov.au/sites/default/files/APRA-ASIC%20Memorandum%20of%20Understanding%202019.pdf>.

74 Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 64.

75 See *Charter*, Council of Financial Regulators (at 5 July 2019) <www.cfr.gov.au/about/charter.html>.

76 See, for example, Davies, Walpole and Pearson (n 67) 337; Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 64; Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 71) 449–50.

77 Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 64.

78 *Youyang Pty Ltd v Minter Ellison Morris Fletcher* (2003) 212 CLR 484 [32]–[33] (Gleeson CJ, McHugh, Gummow, Kirby and Hayne JJ).

79 Davies, Walpole and Pearson (n 67) 337; Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 64; Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 71) 449.

80 See the amendments to the *SIS Act* brought about by the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Act 2019* (Cth). Among other things, schedule 1 of the Act amends the *SIS Act* to require trustees to conduct an annual assessment on whether the outcomes that are being delivered by MySuper products are promoting the financial interests of MySuper members.

81 *Manglicmont v Commonwealth Bank Officers Superannuation Corporation* (2010) 239 FLR 159 [51] (Rein J) in the context of the best interests duty of a trustee under the *SIS Act*. See also Margaret Stone, 'The Superannuation Trustee: Are Fiduciary Obligations and Standards Appropriate?' (2007) 1 *Journal of Equity* 167, 181.

82 Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 64–5.

83 Ibid 59–60.

84 Ibid 60.

42. Further, many factors that fall within market conduct regulation (such as trustee competence and related party transactions) have a direct impact on investment performance.[85] The FSRC acknowledged that the notion of conduct can have prudential connotations, including whether an institution is 'being administered with appropriate integrity, prudence and professional skill'.[86] The superannuation context, therefore, poses difficulties in achieving the clear divide between prudential and conduct regulation envisaged in the Twin Peaks model.

Superannuation and the *Corporations Act*

43. Following the Wallis Inquiry and the proposals of CLERP6, the *Financial Services Reform Act 2001* (Cth) amended the *Corporations Act* to insert a large number of provisions regulating entities providing financial services, including superannuation funds.[87] Complexity arises as a result of the ways in which the *Corporations Act* governs the superannuation sector,[88] particularly the way in which superannuation straddles the concepts of financial product and a financial service, which now includes providing a 'superannuation trustee service'.

Superannuation interests as financial products

44. Section 764A(1)(g) of the *Corporations Act* provides that 'a superannuation interest within the meaning of the *SIS Act*' is a financial product. Under s 10 of the *SIS Act*, a superannuation interest 'means a beneficial interest in a superannuation entity'. The 'products' that are defined under the *SIS Act* include a choice product and a 'MySuper product'. Both of these products are characterised as a 'class of beneficial interest'.[89] However, the interpretation of 'a class of beneficial interest' is an open question.[90] This is important, as the question of what is a financial product is relevant to the imposition of a range of obligations, including the obligations under the DDO regime.[91] As such, uncertainties around the meaning of superannuation interest under the *SIS Act* may translate into problems under the *Corporations Act*.

45. Relevantly, whether or when a new superannuation interest has been issued under the *Corporations Act* has been a source of confusion. This is especially pertinent in the context of product consolidation and rationalisation. A range of obligations are attached to the issue of a new superannuation interest, including the provision of a product disclosure statement ('PDS'), a new application form, and cooling-off requirements. The general rule under section 761E(3) of the *Corporations Act* is that a superannuation interest is issued to a person when the person becomes a member of the relevant fund. Nonetheless, the *Corporations Regulations* complicates this general rule. Under reg 7.1.04E, a superannuation fund is taken to issue a new superannuation interest when a member elects to move from the growth accumulation phase to a pension, but not vice versa.

46. Regulation 7.9.02(4) of the *Corporations Regulations* also prescribes circumstances where changing from one sub-plan to another sub-plan (often known as an intra-fund transfer) may constitute the issue of a new superannuation interest. A sub-plan is defined under the *Corporations Regulations* as 'a segment of the fund comprising a member or members of the fund, being a sub-plan that the trustee determines should be made'.[92] However, the term 'sub-plan' is

85 Ibid 65.
86 Commonwealth of Australia, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (n 71) 450.
87 For background, see Australian Law Reform Commission, 'Historical Legislative Developments' (Background Paper FSL4, November 2021) 18–19.
88 See Australian Law Reform Commission, 'Historical Legislative Developments' (Background Paper FSL4, November 2021).
89 *Superannuation Industry (Supervision) Act 1993* (Cth) s 10 (definitions of 'choice product' and 'MySuper product').
90 See, eg, Mills Oakley, 'The Joys of Ambiguity – Improving Accountability and Member Outcomes in Superannuation' <www.millsoakley.com.au/thinking/the-joys-of-ambiguity-improving-accountability-and-member-outcomes-in-superannuation/>.
91 *Corporations Act 2001* (Cth) pt 7.8A.
92 *Corporations Regulations 2001* (Cth) reg 1.0.02(1).

not defined under the *SIS Act* or the *SIS Regulations*. In fact, the term only appears once in the *SIS Regulations* in the context of non-member spouse payment splits.[93] Thus, it could be said that there is a lack of coherence between the *Corporations Act* framework and the *SIS Act* framework.

Superannuation as a financial service — the AFSL regime

47. As mentioned previously, the AFSL regime under the *Corporations Act* is a key source of ASIC's authority to regulate the superannuation sector.[94] The AFSL regime in Part 7.6 of the *Corporations Act* requires all entities that '[carry] on a financial services business' in Australia to hold an AFSL 'covering the provision of the financial services', subject to exceptions in the *Corporations Act* and the *Corporations Regulations*.[95] Acting as a trustee of a SMSF is one of those exceptions.[96] A range exemptions are also found in reg 7.6.01(b)–(da) of the *Corporations Regulations* in respect of dealing in a financial product as a trustee of a pooled superannuation trustee service or providing a superannuation trustee service in particular circumstances. Interim Report A observed that, across the legislative hierarchy, the exclusions or exemptions in respect of the obligation to hold an AFSL are a 'significant driver of complexity'.[97]

48. Prior to the *2020 Response Act*, most RSEs were required to hold an AFSL in specific circumstances. Under the *Corporations Act*, a person provides a financial service if they 'provide financial product advice',[98] or 'deal in a financial product'.[99] As discussed above, a financial product includes a superannuation interest within the meaning of the *SIS Act*.[100] Therefore, the definition of 'financial services' (as it applied to superannuation) was largely confined to financial product advice in respect of, and 'dealings' in, superannuation interests. The meaning of 'dealing' is specific — it typically involves 'the offer, variation or disposition of superannuation products but not the ongoing administration of the fund'.[101] Further, a superannuation fund trustee that deals in a financial on their own behalf, whether through an agent or other representative,[102] does not deal in a financial product. In addition, although providing a custodial or depository service is a financial service, the operation of a superannuation fund is not a custodial or depository service for the purposes of the *Corporations Act*.[103]

49. However, because of the legislative amendments made by the *2020 Response Act*, a 'person' (including a body corporate)[104] provides a financial service if they 'provide a superannuation trustee service'.[105] Relevantly, 'a person provides a superannuation trustee service if the person operates a registrable superannuation entity as trustee of the entity'.[106] As a result, by virtue of being an RSE licensee, all trustees of RSEs are required to hold an AFSL license.[107]

50. These amendments mean that a very broad scope of superannuation activities now fall within the ambit of the AFSL regime. The Explanatory Memorandum to the *2020 Response Act* indicated that the amended definitions are intended to capture 'all activities involved in operating a superannuation fund … including "fee charging practices, investment selection, product changes, oversight of service providers, insurance claims handling, and transfer, payment and rollover

93 *Superannuation Industry (Supervision) Regulations 1994* (Cth) reg 2.36C(1)(g).
94 See above [1.37].
95 *Corporations Act 2001* (Cth) 911A(1).
96 Ibid s 911A(1)(j).
97 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [8.31].
98 *Corporations Act 2001* (Cth) s 766A(1)(a).
99 Ibid s 766A(1)(b).
100 Ibid s 764A(1)(g).
101 Donald, 'Regulating Superannuation in the Shadows of the Twin Peaks' (n 66) 60; *Corporations Act 2001* (Cth) s 766C(1).
102 This excludes products issued by the superannuation fund trustee: *Corporations Act 2001* (Cth) s 766C(3).
103 Ibid s 766A(1)(e); s 766E(3)(c).
104 *Acts Interpretation Act 1901* (Cth) s 2C.
105 *Corporations Act 2001* (Cth) s 766A(1)(ec).
106 Ibid s 766H(1).
107 Davies, Walpole and Pearson (n 67) 339.

practices"'.[108] In addition, as noted by Austin and Black, a superannuation trustee service is normally provided to beneficiaries of a fund, which constitutes the provision of a financial service to a retail client.[109] The provision of a financial services to a retail client engages certain additional protections and obligations under Chapter 7 of the *Corporations Act*, which will be explored further below.[110]

Financial product advice in the superannuation context

Financial product advice

51. The definitions of 'financial product advice', 'general advice', and 'personal advice' act as gateways for the application of many conduct and disclosure obligations.[111] As discussed above, the provision of financial product advice constitutes a financial service. Under section 766B(1) of the *Corporations Act*, financial product advice means a recommendation, opinion, or a report of either of those things, that is intended to either:

- influence a person in making a decision in relation to a financial product (for example, a superannuation interest); or
- could reasonably be regarded as being intended to have such an influence.

52. However, there are various exclusions and exemptions in the *Corporations Act* and the *Corporations Regulations* that create complexity in the framework governing financial product advice.[112] Interim Report A observed that

> advice-related activities may be exempted from any of:
>
> - the definition of financial product advice;
> - the definition of financial service;
> - the requirement to hold an AFS Licence; [and]
> - specific conduct or disclosure obligations applying to AFS Licensees.[113]

53. For example, the provision of an exempt document, such as a PDS, does not constitute giving financial product advice.[114] Regulation 7.6.01 of the *Corporations Regulations* also prescribes certain exemptions from the requirement to hold an AFSL, even where financial product advice is provided. For instance, an exemption applies where general advice is provided by product issuers in the media (subject to certain disclosure requirements).[115] The advice-related exclusions and exemptions as highlighted in Interim Report A are relevant to superannuation.[116]

54. Financial product advice is either 'personal advice' or 'general advice'.[117] Personal advice is defined as advice where a person's objectives, financial situation and needs have been taken into account; or where a reasonable person might expect the provider of advice to have considered one or more of those matters.[118] General advice is 'financial product advice that is not personal advice'.[119] The distinction between personal advice and general advice is critical, as

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108 See RP Austin and Ashley Black, LexisNexis, *Austin & Black's Annotations to the Corporations Act* (at 15 December 2022) [7.766H] citing Explanatory Memorandum to the Financial Sector Reform (Hayne Royal Commission Response) Bill [9.15].
109 Ibid [7.766H].
110 See below [1.61].
111 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) [11.2].
112 Ibid 455–8.
113 Ibid 445 [11.43].
114 *Corporations Act 2001* (Cth) s 766B(1A).
115 *Corporations Regulations 2001* (Cth) reg 7.6.01(1)(o).
116 For an outline of these exclusions and exemptions, see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 455–8.
117 *Corporations Act 2001* (Cth) s 766B(2).
118 Ibid s 766B(3).
119 Ibid s 766B(4).

more onerous obligations are imposed on providers of personal advice. These are summarised in **Table 2** below:[120]

Table 2: Obligations attaching to general advice compared with personal advice

Corporations Act provision(s)	Obligation	Personal advice	General advice
Part 7.6 Divs 8A–8C	Requirements for 'relevant providers' to have and maintain certain education and training standards, and to comply with a Code of Ethics	✓	✗
Part 7.7 Div 2	Provision of a Financial Services Guide (FSG) to a retail client	✓	✓
Part 7.7 Div 3	Provision of a Statement of Advice (SoA) to a retail client	✓	✗
s 949A	Provision of a prescribed 'general advice warning'	✗	✓
Part 7.7A Div 2	Best interests obligations, including obligations that advice be 'appropriate' for clients, and that priority be given to a client's interests	✓	✗
Part 7.7A Div 3	Requirements to periodically notify a client of ongoing fee arrangements and renewal	✓	✗
Part 7.7A Divs 4, 5	Prohibition of certain kinds of remuneration, including 'conflicted remuneration', certain 'volume-based shelf-space fees' and certain 'asset-based fees'	✓	✓
s 1012A	Requirement to provide a PDS	✓	✗
s 1020AI	Requirement to provide an information statement for CGS (Commonwealth Government Securities) depository interests	✓	✗

55. A recent case on the distinction between personal advice and general advice in the context of superannuation is *Westpac Securities Administration Ltd v Australian Securities Investments Commission* (2021) 270 CLR 118. In this case, Westpac Securities and BT Funds Management Ltd (collectively, 'Westpac') telephoned existing Westpac members to encourage them to roll over their external superannuation accounts into their pre-existing Westpac accounts. Although Westpac had given its members a general advice warning, expressly stating that they would not take into account the members' personal circumstances, the High Court unanimously held that a reasonable person in the position of each of the members called by Westpac might have expected Westpac to have taken into account at least one aspect of the member's objectives, financial situation or needs, and that Westpac had therefore provided personal advice.

Intra-fund advice

56. Many superannuation fund trustees provide intra-fund advice. The term 'intra-fund advice' does not have a legal definition. However, intra-fund advice is considered to be advice that is paid for through the collective fees of fund members rather than by the individual member:

> [F]inancial product advice provided to a member by or on behalf of a trustee of a superannuation fund about the member's interest in the superannuation fund, at no additional fee to the member.[121]

120 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 442–3.
121 Nathan Hodge and Maysha Kabir, 'Quality of Advice Review and the Future of Intra-Fund Advice' (2022) 33(10) *Australian Superannuation Law Bulletin* 136, 136.

57. As the recent Quality of Advice Review noted:

> Intra-fund advice is not a term defined in *the Corporations Act*. It is not a special category of financial product advice and no special rules or relief apply to intra-fund advice. Its genesis is in section 99F of the *SIS Act*. That section is entitled: 'Cost of financial product advice – collectively charged fees'.[122]

58. Although intra-fund advice can be general or personal financial product advice, it is often personal advice.[123] Accordingly, it can attract the more onerous obligations outlined above in Table 2.[124] The proposed changes in the Quality of Advice Review (such as the extension of the definition of personal advice, the removal of section 99F of the *SIS Act* on collective charging, the duty to give 'good advice', and changes to personal advice disclosure) will potentially affect the way in which trustees provide intra-fund advice.[125]

59. The submission to the ALRC from the Law Council considers that it is important that intra-fund advice continue to be offered under any new reforms, and that the various types of robo-advice also need to be accounted for in this context.[126]

The distinction between retail client and wholesale client

60. The distinction between retail clients and wholesale clients is pivotal to the operation of Chapter 7 of the *Corporations Act*.[127] The rationale behind this distinction is that retail clients need more protection because they are less informed and less able to assess financial risks compared to wholesale clients.[128]

61. A range of obligations are triggered when a financial service is provided or a financial product is offered to a retail client, including obligations that arise in the following areas:

- financial services disclosure, such as the requirement to provide an FSG and SoA (Part 7.7);
- conduct, including the 'best interests' obligations that apply to the provision of financial product advice, and the ban on conflicted remuneration (Part 7.7A);
- DDO (Part 7.8A);
- financial product disclosure, including the provision of PDSs (Part 7.9); and
- external dispute resolution (Part 7.10A).[129]

62. Further, Part 7.9A of the *Corporations Act* empowers ASIC to make product intervention orders in certain situations where a financial product may result in significant detriment to retail clients.[130] Additional professional and ethical standards are also imposed on providers of personal advice to retail clients.[131]

63. Section 761G(1) of the *Corporations Act* contains the definition of retail client:

> For the purposes of this Chapter, a financial product or a financial service is provided to a person as a ***retail client*** unless subsection (5), (6), (6A) or (7), or section 761GA, provides otherwise.

122 Michelle Levy, *Quality of Advice Review* (Final Report, 2023) 111.
123 Hodge and Kabir (n 121) 136. By contrast, the *Quality of Advice Review* final report states that intra-fund advice is 'strictly, only personal advice': Levy (n 122) 111.
124 Hodge and Kabir (n 121).
125 See ibid. For a detailed discussion on financial advice and superannuation see Levy (n 122) ch 7.
126 Law Council of Australia, *Submission 49* 23 [119].
127 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 469.
128 See, eg, Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.25].
129 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 469.
130 Ibid.
131 See *Corporations Act 2001* (Cth) pt 7.6 divs 8A-8C.

64. Subsection (5) relates to general insurance products, subsection (6A) is relevant to traditional trustee company services, and subsection (7) contains other exceptions where a financial product or service is provided to a person as a retail client.

65. Most relevantly, section 761G(6) prescribes certain situations where products and services relating to superannuation and RSAs will be provided (or will not be provided) to a person as a retail client. Section 761G(6) states:

> (6) For the purposes of this Chapter:
>
> (a) if a financial product provided to a person is a superannuation product or an RSA product, the product is provided to the person as a retail client; and
>
> (aa) however, if a trustee of a pooled superannuation trust (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) provides a financial product that is an interest in the trust to a person covered by subparagraph (c)(i), the product is not provided to the person as a retail client; and
>
> (b) if a financial service (other than the provision of a financial product) provided to a person who is not covered by subparagraph (c)(i) or (ii) relates to a superannuation product or an RSA product, or is a superannuation trustee service, the service is provided to the person as a retail client; and
>
> (c) if a financial service (other than the provision of a financial product) provided to a person who is:
>
> (i) the trustee of a superannuation fund, an approved deposit fund, a pooled superannuation trust or a public sector superannuation scheme (within the meaning of the *Superannuation Industry (Supervision) Act 1993*) that has net assets of at least $10 million; or
>
> (ii) an RSA provider (within the meaning of the *Retirement Savings Accounts Act 1997*);
>
> relates to a superannuation product or an RSA product, or is a superannuation trustee service, that does not constitute the provision of a financial service to the person as a retail client.

66. A wholesale client is defined as the opposite of a retail client — section 761G(4) of the *Corporations Act* states that 'a financial product or a financial service is provided to, or acquired by, a person as a *wholesale client* if it is not provided to, or acquired by, the person as a retail client'. Accordingly, beneficiaries of superannuation funds[132] and prospective members of funds are generally treated as retail clients.[133]

67. The Revised Explanatory Memorandum to the *Financial Services Reform Bill 2001* (Cth) stated that because superannuation products are complex and long-term in nature, a person will always be deemed to be a retail client where the relevant financial product is a superannuation product or an RSA product to ensure that appropriate disclosure is provided.[134] This policy rationale appears to be widely accepted.[135]

132 Austin and Black (n 108) [7.766H].
133 (n 10) [43,060].
134 Revised Explanatory Memorandum, Financial Services Reform Bill 2001 (Cth) [2.27].
135 Association of Financial Advisers, *Submission 45*; Financial Services Institute of Australasia, *Submission 53*.

68. However, the need for the superannuation-specific exclusions in section 761G(6) has been questioned. For example, the submission from MinterEllison observed that:

> It is quite anomalous to require financial services providers to treat the same person as a retail client in relation to their superannuation investments and a wholesale client in respect of their other investments. In our experience, this also causes some significant difficulties which easily trip up even sophisticated financial services providers.[136]

69. The submission from Kit Legal similarly echoed this:

> We believe the superannuation product exclusion causes significant confusion and should be removed from all wholesale client tests. It does not make sense that a client can be treated as wholesale for advice on their investments within superannuation but then retail when they want to make a superannuation contribution.[137]

70. Further, the definition of retail client was criticised by Wigney J in *Australian Securities Investments Commission v Westpac Banking Corporation* as 'tortuous' as it is over five pages long and requires 'one to go to the detailed definitions of various other words or expressions, including … "superannuation product" (see ss 761A and 764A(1)(g))'.[138]

SMSFs as 'misfits'?

71. There are many uncertainties that have arisen in the context of SMSFs that demonstrate the complexity and navigability issues in Chapter 7 of the *Corporations Act*. What constitutes a 'financial product' in the SMSF context has been 'the source of intense disagreement for many years'.[139] For instance, it is unclear whether (and, if so, how) an SMSF investment strategy constitutes a financial product.[140] This affects the determination of whether advice given in respect of the SMSF is *financial product* advice, and, accordingly, whether a financial service is being provided and whether an AFSL must be obtained.

72. Strategic advice plays a significant role in the SMSF industry. Many SMSF trustees demand strategic advice from advisers as opposed to advice on specific financial products.[141] The submission from the Institute of Financial Professionals Australia, for example, noted that because SMSFs are complex structures, specialist taxation expertise is often required in SMSF advice.[142] However, it is currently unclear whether such advice is financial product advice or taxation advice and therefore whether an AFSL is required.[143]

73. Various submissions have also indicated that there is considerable confusion about the application of the wholesale/retail client test to SMSFs.[144] As the SMSF Association stated:

> The current framework is complex and requires the review of several sections of the *Corporations Act* 2001 and multiple regulations. As noted in the Interim Report, how the rules apply in the context of a self-managed superannuation fund are unclear. Appropriate guidance is severely lacking. Indeed, there are differing legal opinions on the operation of these rules where an SMSF is involved.[145]

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136 MinterEllison, *Submission 55*.
137 Kit Legal, *Submission 50*.
138 *Australian Securities and Investments Commission v Westpac Banking Corporation* [2019] FCA 2147 [12]. See also Allens, *Submission 54*.
139 Chartered Accountants Australia and New Zealand, *Submission 40*.
140 See, eg, Daniel Butler and Bryce Figot, 'SMSF Investment Strategies: Are They a Financial Product?' (2019) 54(5) *Taxation in Australia* 265.
141 Chartered Accountants Australia and New Zealand, *Submission 40*. See also SMSF Association, *Submission to Department of Treasury (Cth), Quality of Advice Review* (23 September 2022).
142 See Institute of Financial Professionals Australia, *Submission 69*.
143 Ibid.
144 B Ethical Funds Management, *Submission 37*; Australian Banking Association, *Submission 43*; Law Council of Australia, *Submission 49*; Kit Legal, *Submission 50*.
145 SMSF Association, *Submission 28*.

74. Recall that under sections 761G(6)(b) and (c) of the *Corporations Act*, if a financial service (other than the provision of a financial product) 'relates to' a superannuation product or an RSA product, the service is provided to a person as a retail client, unless the service provider is a trustee with net assets of at least $10 million or is an RSA provider. Under these provisions, it is uncertain whether a financial service 'relates to' a superannuation product. In 2004, ASIC issued QFS 150 which stated that a financial service would typically 'relate to' a superannuation product if a financial service was provided to a SMSF trustee.[146] Therefore, generally speaking, an SMSF trustee was classified as a retail client, except where the $10 million asset test is satisfied.

75. In 2014, however, ASIC departed from its position in QFS 150. In Media Release 14-191MR, ASIC announced that it will not take action where a SMSF trustee is treated as a wholesale client under the general test in section 761G, even if the relevant financial service provided may 'relate to' a superannuation product and the $10 million net asset threshold is not met.[147] Despite this, ASIC noted that their no-action position does 'not affect the private rights of action that may be available to third parties'[148] and providers of financial services to SMSF trustees must make their own commercial decisions after considering the legal risks.[149] The submission from the Law Council commented that:

> While ASIC's no-action position was welcome at the time, it is unsatisfactory that industry participants still need to choose whether to rely on that position almost eight years later, when it may not actually reflect the law … This Inquiry provides an opportunity to make the law on this topic clear, and the Law Council submits that the ALRC should make a recommendation accordingly.[150]

76. ASIC has also acknowledged that:

> [L]egal uncertainty – particularly in relation to an issue as important as whether clients should receive the benefit of the retail client consumer protections – is undesirable and supports a review of the test to ensure that it is both clear and appropriate.[151]

Obligations under the AFSL regime and the RSE licensing regime

77. There are a range of obligations imposed upon licensees by the AFSL regime pursuant to ss 912A and 912B of the *Corporations Act*, including to:

(a) do all things necessary to ensure that the services provided by the fund are provided efficiently, honestly and fairly;
(b) have in place adequate arrangements for the management of conflicts of interest that may arise in relation to financial services activities undertaken by the licensee or a representative as part of the financial services business of the licensee or a representative;
(c) comply with the conditions of the licence;
(d) comply with the financial services laws;
(e) take reasonable steps to ensure that its representatives comply with the financial services laws;
(f) have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements;
(g) maintain the competence to provide the services of the fund;

146 See Australian Securities and Investments Commission, (Market Supervision Update Issue 50, 30 March 2021) <www.asic.gov.au/about-asic/corporate-publications/newsletters/asic-market-supervision-update/asic-market-supervision-update-previous-issues/asic-market-supervision-update-issue-50/>.
147 Australian Securities and Investments Commission, 'Statement on Wholesale and Retail Investors and SMSFs' (Media Release 14-191MR, 8 August 2014).
148 Ibid.
149 Ibid.
150 Law Council of Australia, *Submission 49* [150].
151 Australian Securities and Investments Commission (n 147).

(h) ensure that its representatives are adequately trained, and are competent to provide the financial services;
(i) have a dispute resolution system that complies with the standards … ;
(j) have adequate risk management systems;
(k) have in place an arrangement for compensating members for loss or damage suffered because of breaches of the obligations of the licensee; [and]
(l) comply with any other obligations that are prescribed by the regulations.[152]

78. To minimise the overlap between the obligations imposed by the AFSL regime and the obligations imposed by the RSE licensing regime, section 912A of the *Corporations Act* provides that certain AFSL obligations do not apply to RSEs (subject to exceptions). Primarily, the obligations to have adequate resources,[153] and to have adequate risk management schemes,[154] are excluded. Section 915I of the *Corporations Act* also imposes some restrictions on ASIC's ability to suspend or cancel the AFSL of a RSE licensee. However, despite these modifications to the AFSL regime, a number of AFSL obligations continue to overlap with the *SIS Act*.[155]

79. Davies, Walpole, and Pearson acknowledge that there is some scope to consolidate the two regimes, including the provisions on internal dispute resolution (which are 'moving toward integration').[156] However, for various reasons, the authors ultimately contend that it would not be prudent to amalgamate the two regimes and to adopt a single licensing framework.[157] First, retirement savings are involved in superannuation, and thus the prudential objectives of safety and stability 'should remain to the fore'.[158] Secondly, the 'foundational trust structure of RSEs' and the 'emphasis on standards of governance and obligations…all favour retaining the RSE licensing regime'.[159] Although all RSEs are now required to hold an AFSL (since the enactment of the *2020 Response Act*) which creates two sets of conduct obligations, not all of the obligations have an 'AFSL analogue'.[160] For example, 'the sole purpose requirement, the obligation to have a strategy for prudential management of reserves, and the prohibition on entering contracts that would hinder a trustee in that role' do not have an AFSL analogue and are prudential in nature.[161] The authors assert that:

> Providing both regulators with power to enforce the [covenants under the *SIS Act*] preserves the unique aspects of superannuation regulation, while upholding the broad spirit of the Twin Peaks model. As each regulator provides details and this power-sharing evolves, those covenants similar to AFSL and ACL licence obligations, over time, may come to resemble each other more closely. The intention of the *2020 Response Act* is consumer protection, but in some instances it risks overlap and complexity. For all RSEs to hold an AFSL may create a burden, but it will also tend towards similarity while preserving necessary differences in the obligations.[162]

80. The next part of this Background Paper will analyse two specific areas in the *Corporations Act* which have been said to overlap with the *SIS Act*:

- the requirement to provide financial services 'efficiently, honestly and fairly', and
- provisions that ensure loyalty, including the best interests duty (or best financial interests duty) and managing conflicts of interest under both Acts.

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152 *Law of Superannuation in Australia* (n 10) [43,040].
153 *Corporations Act 2001* (Cth) 912A(1)(d).
154 Ibid s 912A(1)(h).
155 See, eg, Law Council of Australia, *Submission 49* 28 [157]. For a table comparing the obligations under the AFSL regime and the obligations under the RSE licensing regime see Davies, Walpole and Pearson (n 67) 349–52.
156 Davies, Walpole and Pearson (n 67) 353.
157 Ibid.
158 Ibid.
159 Ibid.
160 Ibid.
161 Ibid.
162 Ibid.

Providing financial services 'efficiently, honestly and fairly'

81. The obligation to provide financial services 'efficiently, honestly and fairly' under section 912A(1)(a) of the *Corporations Act* coincides with the provisions on honesty and fairness in the *SIS Act*; namely, the covenants to act fairly in dealing with classes of beneficiaries within the entity, to act fairly in dealing with beneficiaries within a class, and to act honestly in all matters concerning the entity (ss 52(2)(a),(e),(f) and 52A(2)(a) respectively).[163]

82. However, the notion of 'fairly' is arguably treated differently in each respective context.[164] Section 51A of the *SIS Act* expressly states that the s 52 obligations are intended to be cumulative. As a result, the fairness obligations in the *SIS Act* are imposed simultaneously with the other requirements contained in s 52 — for instance, to exercise due care, skill and diligence,[165] and to exercise powers and perform duties in the best financial interests of members,[166] *inter alia*. The fairness covenants under the *SIS Act* obligations also appear to be centred on the notion of impartiality — these covenants could be described as little more than a statutory restatement of the familiar duty of impartiality imposed in the general law of trusts.[167]

83. The obligation to provide financial services 'efficiently, honestly and fairly' under s 912A(1)(a) of the *Corporations Act* is to be interpreted as a single, compendious requirement and the words are to be read together.[168] Nonetheless, the concept of fairness does not appear to be restrained by the surrounding terms ('efficiently' and 'honestly') in the same way that the fairness obligations under the *SIS Act* are constrained; and the idea of impartiality does not seem to feature in this context.[169] Instead, it has been suggested that the 'efficiently, honestly and fairly' requirement seems to invoke a more general and open-textured norm.[170]

84. Commentators have also discussed the relationship between the misleading, deceptive, or unconscionable conduct provisions and the 'efficiently, honestly and fairly' requirement. For example, some have considered that the provisions on misleading, deceptive, or unconscionable conduct under the *Corporations Act* and the *ASIC Act* overlap with the requirement to provide financial services 'efficiently, honestly and fairly'. Latimer has asserted that false or misleading representations as well as misleading or deceptive conduct will unavoidably involve a failure to provide financial services 'efficiently, honestly and fairly'.[171] Zarkovic has pointed out that the courts have held that unconscionable conduct means that the conduct must be, perhaps at a minimum, unfair.[172] The ALRC (and various stakeholders) have expressed the view, however, that there should not be sole reliance on the 'efficiently, honestly and fairly' requirement.[173]

85. The ALRC's **Background Paper FSL9** has presented some possible reform options for simplifying the unconscionable and misleading or deceptive conduct provisions under the *ASIC Act* and *Corporations Act*. The frequency with which misleading or deceptive conduct issues arise

163 See, eg, ibid 349; Law Council of Australia, *Submission 49*.
164 See M Scott Donald, 'Regulating for Fairness in the Australian Funds Management Industry' (2017) 35(7) *Company and Securities Law Journal* 406; Leif Gamertsfelder, 'Efficiently, honestly and fairly: A norm that applies in an infinite variety of circumstances' (2021) 50 *Australian Bar Review* 345.
165 *Superannuation Industry (Supervision) Act 1993* (Cth) s 52(2)(b).
166 Ibid s 52(2)(c).
167 Donald, 'Regulating for Fairness in the Australian Funds Management Industry' (n 164) 416.
168 *Story v National Companies and Securities Commission* (1988) 13 NSWLR 661, 672 (Young J). See also Austin and Black (n 108) [7.912A] and cases cited therein.
169 Donald, 'Regulating for Fairness in the Australian Funds Management Industry' (n 164) 417.
170 Ibid.
171 Paul Latimer, 'Providing Financial Services "Efficiently, Honestly and Fairly"' (2006) 24(6) *Company and Securities Law Journal* 362, 376.
172 Jessica Zarkovic, 'Are the "Efficiently, Honestly and Fairly" and Unconscionable Conduct Civil Penalty Provisions Equally as Effective in Combating Unfair Practices by Licensees?' (2020) 48(3) *Australian Business Law Review* 272, 278.
173 Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 532–4; Australian Law Reform Commission, 'All roads lead to Rome: unconscionable and misleading or deceptive conduct in financial services law' (Background Paper FSL9, December 2022) [17].

in superannuation cases suggests that simplification could make a meaningful difference in the regulation of superannuation.[174]

Loyalty regimes in the *Corporations* Act *and SIS Act*

86. Walpole, Donald and Langford adopt the term 'loyalty regimes' to refer to rules that 'attempt to require the service provider to prefer the interests of the customer over their own', 'whether they are expressed to be directed towards addressing "conflicts of interest" or to requiring pursuit of the customer's "best interests"'.[175] Drawing on these ideas, this section of the Background Paper will consider the similarities and differences between the loyalty regimes in the *Corporations Act* and the *SIS Act*.

Corporations Act

87. Section 961B of the *Corporations Act* provides for a 'best interests' duty, which applies to the providers of personal advice to a retail client.[176] Section 961B(1) states that 'the provider [of personal advice] must act in the best interests of the client in relation to the advice'. A 'safe harbour' is contained in section 961B — if the provider can prove that they have fulfilled the requirements in ss 961B(2)(a)–(g), then the best interests duty in section 961B(1) is satisfied.[177] While the specificity in sections 961B(2)(a)–(f) could suggest a checklist approach to compliance, it is tempered by the open-ended nature of s 961B(2)(g),[178] which stipulates that provider must take 'any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances'.

88. Section 961G is also relevant. This section provides that the provider must 'only provide the advice to the client if it would be reasonable to conclude that the advice is appropriate to the client, had the provider satisfied the duty under s 961B'. Courts have established that section 961B is typically concerned with the process or procedure, while section 961G relates to the substance of the advice.[179] Other relevant loyalty rules include the duty imposed upon financial advisers to give priority to the client's interests,[180] as well as the prohibition on financial services licensees (or their representatives) against accepting conflicted remuneration.[181]

SIS Act

89. The covenants in s 52 of the *SIS Act* contain a range of loyalty obligations. Crucially, s 52(2)(c) imposes an obligation on trustees to perform their duties and exercise their powers in the 'best financial interests of the beneficiaries'. The word 'financial' was inserted into the provision through the Your Future Your Super reforms in 2021.[182] This amendment further aligned the statutory provision with the common law position that the concept of 'best interests' is normally equated

174 See, eg, *Australian Securities and Investments Commission v Westpac Banking Corporation (Omnibus)* [2022] FCA 515; *Australian Securities and Investments Commission v Colonial First State Investments Limited* [2021] FCA 1268; *Australian Securities Investments Commission v MLC Nominees Pty Ltd* [2020] FCA 1306. For a discussion on the frequency of cases more generally, see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 146–7; 532 [13.133].

175 Samuel Walpole, M Scott Donald and Rosemary Langford, 'Regulating for Loyalty in the Financial Services Industry' (2021) 38 *Company and Securities Law Journal* 355, 355–6.

176 *Corporations Act 2001* (Cth) s 961.

177 *Australian Securities and Investments Commission v NSG Services Pty Ltd* (2017) 122 ACSR 47 [17].

178 Han-Wei Liu et al, 'In Whose Best Interests? Regulating Financial Advisers, the Royal Commission and the Dilemma of Reform' (2020) 42(1) *Sydney Law Review* 37, 56–7. See also Paul Latimer, 'Protecting the Best Interests of the Client' (2014) 29(1) *Australian Journal of Corporate Law* 8, 20.

179 See Walpole, Donald and Langford (n 175) 363–4 and cases cited therein.

180 *Corporations Act 2001* (Cth) s 961J. The ALRC has suggested that section 961J seems to fully overlap with the best interests duty contained in section 961B: see Australian Law Reform Commission, *Interim Report A: Financial Services Legislation* (Report No 137, 2021) 539–40.

181 See *Corporations Act 2001* (Cth) pt 7.7A div 4,5.

182 *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) sch 3, item 9.

with the best financial interests of beneficiaries.[183] Trustees are also required to prioritise their duties to, and the interests of, the beneficiaries above all others under s 52(2)(d) of the *SIS Act* (which is buttressed by the additional requirements in ss 52(2)(d)(ii)–(iv)).

90. In 2019, the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Act 2019* (Cth) inserted ss 52(9)–(11) into the *SIS Act*. These provisions require RSE trustees to determine whether the financial interests of the beneficiaries are being promoted by undertaking an annual outcomes assessment. The assessment involves a comparison with other MySuper products or comparable choice products based on various factors and against benchmarks specified in regulations.

Differences in the loyalty regimes

91. Despite the superficial similarities between the best interests and conflicts duties under the *Corporations Act* and the *SIS Act*, 'the nuances and subtleties present in the different ways in which the various loyalty regimes are articulated do lead to substantive differences'.[184] In particular, the nature of the 'interests' in each context differs. In the superannuation context, members' interests arise from, and are shaped by the terms of the trust.[185] In the financial advice context, ss 961B(1) and (2) (when read together) prescribe specific elements that constitute 'best interests' in relation to the advice.[186]

92. The class of persons protected by the obligations also varies. Under the *Corporations Act* the obligations are generally owed to a single, individual client; but in superannuation, trustees must 'depending on the circumstances … serve the interests of members and in respect of the payment of death benefits, a broader and somewhat indeterminate class of "beneficiaries"'.[187] There are also contextual differences between the two regimes. Overall, the obligations under the *SIS Act* are influenced by the trust relationship between members and trustees, and the significant powers and discretions conferred upon trustees.[188] On the other hand, financial advisers generally do not have the same control over client assets.[189]

93. Therefore, although the loyalty regimes under the *Corporations Act* and the *SIS Act* may appear similar on the surface, the obligations differ in structure, expression, and form. It should not be assumed that analogous provisions will have the same application — it is necessary to have close regard to both the statutory and practical context.

Conclusion

94. The complexities in the superannuation sector highlight the need to achieve greater coherence, adaptiveness, efficiency, and navigability in the current legislation for financial services and products. Doing so will assist both regulators and participants in the superannuation industry. It is hoped that the proposed reforms arising out of this Inquiry will help achieve appropriate outcomes in this regard. Interim Report B has proposed a legislative model that could be used to better 'manage legislative complexity, maintain regulatory flexibility and address unforeseen circumstances or unintended consequences of regulatory arrangements'.[190] A streamlined

183 *Cowan v Scargill* [1984] 2 ER 750 760 (Megarry V-C). See also Phillip Turner, 'Clarifying the Best Interest Covenant' (2021) 32(9) *Australian Superannuation Law Bulletin* 147.
184 Walpole, Donald and Langford (n 175) 367.
185 Matthew Conaglen, *Fiduciary Loyalty* (Hart Publishing, 2010) 57.
186 Walpole, Donald and Langford (n 175) 367–8.
187 Ibid 368. See also Michael Vrisakis, 'The Best Interests of Beneficiaries Viewed as a Whole' (2009) 20(5) *Australian Superannuation Law Bulletin* 71.
188 Walpole, Donald and Langford (n 175) 368.
189 Ibid.
190 Australian Law Reform Commission, *Interim Report B: Financial Services Legislation* (Report No 139, 2022) [2.1].

legislative model should assist in identifying and reducing the complexities and result in greater navigability.

95. Nonetheless, because the framework governing superannuation consists of an intermingling matrix of general law principles, legislation, and self-regulatory regimes, any reform will require a thorough consideration of whether, and if so how, other sources of superannuation law and regulation may be affected. In particular, consideration should be given to those areas in which alignment might be appropriate between the obligations of RSEs and those of AFS licensees, and those areas in which bespoke regulation in respect of superannuation should be maintained.[191]

96. Finally, submissions have noted that, like the *Corporations Act*, the *SIS Act* has been subject to many complex amendments and demonstrate complexity and sub-optimal design.[192] Accordingly, a similar review into the *SIS Act* may be beneficial.[193]

191 Davies, Walpole and Pearson (n 67) 353–4.
192 Australasian Society for Computers and Law, *Submission 51*.
193 See, eg, Allens, *Submission 54*.