



Super reform — enhanced duties and prudential standards have arrived

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- Amending legislation introduces a distinct set of duties that are imposed on directors of superannuation funds under new s 52A(2) of the SIS Act and a revised set of duties that apply to trustees under s 52(2) of the SIS Act
- Directors of a corporate trustee will also need to exercise a reasonable degree of care and diligence to ensure the trustee complies with additional duties for MySuper products
- It is prudent for directors and key management staff of superannuation trustees to familiarise themselves with the new obligations and to seek advice on changes to their funds' structures and governance arrangements

- expansion of the general duties of registrable superannuation entity (RSE) licensees
- the application of new trustee duties for RSE licensees of RSEs offering a MySuper product
- the application of personal duties to directors of corporate trustees and
- the granting APRA the power to make prudential standards for the superannuation industry.

Expansion of duties of trustees and directors

The amending legislation significantly expands the trustee covenants set out in s 52 of the SIS Act and increases the standard applicable under s 52(2)(b). It also prescribes detailed requirements regarding conflicts and the treatment of beneficiaries, and prescribes specific covenants in the areas of investment, insurance, and risk.

Increased standard of care

The amending legislation heightens the current standard applicable to s 52(2)(b) by replacing the 'ordinary prudent person' with the 'prudent superannuation trustee'. This term is defined as a person 'whose profession, business or employment is or includes acting as a trustee of a superannuation entity and investing money on behalf of beneficiaries of a superannuation entity'.

Conflicts

Trustees are now required to do 'all things reasonably practicable' to avoid conflicts where there is a conflict:

- between the interests of the beneficiaries and the duties of the trustee to another person, or the interests of the trustee or an associate or

The *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act 2012* (the amending legislation) was passed by the Federal Parliament on 14 August 2012 and received Royal Assent on 8 September 2012. The amending legislation clarifies and expands the duties of directors of superannuation funds, as well as the duties of the trustees of those funds, and provides the Australian Prudential Regulation Authority (APRA) with the power to issue prudential standards for superannuation.

The amending legislation makes substantial changes to the *Superannuation Industry (Supervision) Act 1993* (SIS Act). The key changes implemented by the legislation include:

- between the duties of the trustee to the beneficiaries and the duties of the trustee to another person, or the interests of the trustee or an associate.

Where such a conflict exists, the trustee must give priority to the interests of the beneficiaries. The legislation also provides that the duty to give priority to beneficiaries overrides any conflicting duty a director of the trustee has under Pt 2D.1 of the *Corporations Act 2001*.

Fair treatment of beneficiaries

The amending legislation introduces a requirement that the trustee act fairly in dealing with all classes of beneficiaries within the entity, and not to give beneficiaries of one class an unfair advantage over another. The trustee must also act fairly when dealing with all beneficiaries within a class, and must not give a beneficiary of the class an unfair advantage over another beneficiary of the class.

Investment covenant

Previously, the investment covenant sought to ensure that trustees gave effect to an investment strategy that had regard to the whole of the entity. In addition to this, under the amending legislation the trustee must also have regard to:

- whether reliable valuation information is available in relation to the investments covered by the strategy
- the expected tax consequences for the entity in relation to the investments covered by the strategy
- the costs that might be incurred by the entity in relation to the investments covered by the strategy and
- any other relevant matters.

The trustee is also required to covenant to exercise due diligence in developing, offering and reviewing regularly each investment option, and must ensure that investment options offered to each beneficiary allow adequate diversification.

Insurance covenant

The amending legislation deems an insurance covenant into the governing rules of a superannuation entity. The trustee must covenant to formulate, review regularly and give effect to an insurance strategy for the benefit of the beneficiaries of the entity that includes provisions addressing each of:

- the kinds of insurance to be offered
- the levels of insurance cover to be offered

- the basis for the decision to offer those kinds of insurance with cover at those levels, having regard to the demographic composition of the beneficiaries of the entity and
- the method by which the insurers are to be determined.

The trustee must also covenant to:

- consider the cost to all beneficiaries of offering insurance of a particular kind or at a particular level
- only offer such insurance if the cost does not inappropriately erode the retirement income of beneficiaries and
- do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if the claim has a reasonable prospect of success.

Risk covenant

The amending legislation also deems a risk covenant to be included in the governing rules of the superannuation entity. The trustee must covenant to formulate, review regularly and give effect to a risk management strategy that relates to:

- the activities, or proposed activities, of the trustee, to the extent that they are relevant to the exercise of the trustee's powers, or the performance of the trustee's duties and functions, as trustee of the entity and
- the risks that arise in operating the entity.

The trustee must also covenant to maintain and manage, in accordance with the prudential standards, financial resources to cover the operational risk that relates to the entity.

Trustee and director duties

The amending legislation introduces a distinctly new set of duties that are imposed on both trustees and directors. While some of these duties are not unlike those imposed by the *Corporations Act*, the restatement of the duties in the context of trustees and directors of superannuation funds has profound implications.

The principle underlying the restatement of duties in the *SIS Act* is simply that all the duties which those directors ought to be aware of should be identified in one legislative source. Although this sounds good in theory, in practice the directors will still need to be mindful of their obligations under other statutes (such as the *Corporations Act*), as well as their general law and regulatory obligations.

Specific duties

In addition to the expanded general duties of RSE licensees outlined above, the amending legislation prescribes further duties for RSEs offering a MySuper product. Trustees must:

- promote the financial interests of MySuper product members, in particular, net returns
- determine on an annual basis whether the assets of the fund attributable to the MySuper product, and the number of MySuper product members, are sufficient to ensure the financial interests of the MySuper product members are not disadvantaged in comparison to the financial interests of MySuper product members within other funds
- include these determinations in the investment strategy for the MySuper product
- update each year in the investment strategy the investment return target for a ten-year period and the appropriate level of risk, taking into account the demographic composition of the class of beneficiaries who hold a MySuper product.

Covenants that apply to directors

The amending legislation means that directors of a corporate trustee will need to exercise a reasonable degree of care and diligence to ensure the corporate trustee carries out its specific duties in relation to MySuper products, in addition to retaining the current duty with respect to the s 52 covenants of the trustee.

The amending legislation goes a step further — deeming certain covenants to apply to individual directors of the trustee, a hugely different position from the previous regime. In particular:

- the covenants under s 52(2)(a), (b), (c) and (e) have been expanded to apply to both directors and trustees
- the new standard for s 52(2)(b) also applies to directors
- the 'ordinary prudent person' has been replaced by the 'superannuation entity director', defined as a person 'whose profession, business or employment is or includes acting as director of a corporate trustee of a superannuation entity and investing money on behalf of beneficiaries of the superannuation entity' and
- the new duties in relation to managing conflicts apply to directors such that a director must give priority to the interests of the beneficiaries of the entity.

Overrides conflicting duties

The amending legislation also provides that the duty applicable to directors overrides any conflicting duty an executive officer or employee of the corporate trustee has under Pt 2D.1 of the *Corporations Act*.

Section 54A of the SIS Act makes allowance for further covenants to be prescribed in the relevant superannuation regulations.

APRA prudential standards making power

The amending legislation provides APRA with the power to make 'prudential standards' for the superannuation industry. The prudential matters in relation to which APRA may determine a prudential standard are broad, and include regulating the conduct of RSE licensees (including particular classes of RSE licensees):

- to protect the interests of the beneficiaries of the RSE
- to meet the reasonable expectations of the beneficiaries of the RSE
- to keep the RSE in a sound financial position
- to promote stability in the Australian financial system
- in the appointment of auditors and actuaries.

There is also provision for APRA to exercise special powers to exclude particular RSE licensees from being subject to some or all of the prudential standards for a set length of time.

Prudential Standards

APRA has announced the following draft prudential standards for superannuation:

- Governance (SPS 510)*
- Operational Risk Financial Requirement (SPS 114)
- Defined Benefit Matters (SPS 160)
- Conflicts of Interest (SPS 521)*
- Insurance in Superannuation (SPS 250)
- Investment Governance (SPS 530)
- Risk Management (SPS 220)
- Outsourcing (SPS 231)
- Business Continuity Management (SPS 232)
- Audit and Related Matters (SPS 310) and
- Fit and Proper (SPS 520).*

The first five of the prudential standards are prudential standards specific to superannuation. The remaining six seek to harmonise regulatory requirements for superannuation with those that

already apply to other APRA-regulated industries such as insurance and banking.

Prudential practice guides

Draft prudential practice guides (PPGs) will be finalised towards the end of 2012 and early 2013. APRA anticipates that the PPGs will support the draft prudential standards and that there will be a consultation period to ensure that the PPGs support the aim of the reforms.

The majority of provisions in the prudential standards take effect on 1 July 2013. There will be transitional provisions in respect of outsourcing, business continuity management and insurance prudential requirements.

Effect of the prudential standards

If existing contractual arrangements do not comply with the prudential standards, APRA will expect RSE licensees to take all reasonable steps to renegotiate the contract. If the RSE licensee determines that it would not be in the best interests of members to renegotiate the contract, APRA will require the RSE licensee to demonstrate why the arrangement should continue.

Next steps

Now that the Stronger Super reforms have entered the legislative sphere, trustees and directors of

superannuation funds will need to ensure they are comfortable with the new regime.

Education

We consider it would be prudent to establish awareness of the enhanced duties and obligations through the implementation of a program that properly briefs directors and trustees, and those acting for them, on the impact of the amending legislation.

Professional advice

We also suggest that directors and those in key management positions obtain the appropriate support to ensure that the directors and the trustee entity are complying with the new statutory duties and APRA prudential standards.

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Note

* For more detail about these standards, see Cleary P, 2012, 'Stronger super — new responsibilities of boards and directors of trustees', *Keeping good companies*, Vol 64 No 1, pp 47–51

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