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Dear Sir

**Consultation Paper – Strengthening APRA's Crisis Management Power**

Enclosed is a submission prepared by the Superannuation Committee of the Legal Practice Section of the Law Council of Australia regarding a review of Treasury's Consultation Paper on *Strengthening APRA's Crisis Management Power*.

This Submission has been lodged by the authority delegated by the Directors to the Secretary-General, but does not necessarily reflect the personal views of each Director of the Law Council of Australia.

The Superannuation Committee would welcome the opportunity to discuss its submission further. In the first instance, please contact the Chair of the Committee, Ms Heather Gray on (03) 9274 5321 or at [heather.gray@dlapiper.com](mailto:heather.gray@dlapiper.com).

Yours sincerely

A handwritten signature in black ink that reads "Sally Walker".

**Professor Sally Walker**  
**Secretary-General**

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# Consultation Paper – Strengthening APRA's Crisis Management Power

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## The Treasury

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

14 December 2012

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

1.1 The Law Council of Australia is the peak national representative body of the Australian legal profession; it represents some 60,000 legal practitioners nationwide. This submission has been prepared by the Law Council of Australia's Superannuation Committee (Committee), which is a committee of the Legal Practice Section of the Law Council. The Committee's objectives are to ensure that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. The Committee makes submissions and provides comments on the legal aspects of virtually all proposed legislation, circulars, policy papers and other regulatory instruments which affect superannuation funds.

## **2. Executive Summary**

2.1 In this submission, the Committee provides its comments in response to the proposals and discussion questions that concern the regulation of the Australian superannuation industry contained in Treasury's Consultation Paper - Strengthening ARRA's Crisis Management Powers, dated September 2012 (Consultation Paper).

2.1 The Consultation Paper contains ten sections which deal with various aspects of Australia's financial regulation. In this submission, the Committee's comments are directed to those sections which affect the regulation of the superannuation industry. Accordingly, this submission addresses the following aspects of the Consultation Paper:

(a) Section 2 - Enhancing APRA's Direction Powers - Scope and Efficacy:

(i) Paragraph 2.3 - New direction powers for superannuation;

(b) Section 8 - Simplification and Streamlining of Acts Administered by APRA:

(i) Paragraph 8.1 - Streamlining of authorisation provisions of the industry Acts;

(ii) Paragraph 8.2 - Simplification of provisions relating to obtaining information and investigation;

(iii) Paragraph 8.6 - Enhance APRA's ability to disqualify individuals from acting as responsible persons; and

(c) Section 9 - Proposals Specific to Acts Supervised by APRA:

(i) Paragraph 9.4 - Superannuation Industry (Supervision) Act.

2.3 Abbreviations and acronyms are, as far as possible, consistent with those used in the Consultation Paper (for example, the *Superannuation Industry (Supervision) Act 1993* is the SIS Act).

## **3. Section 2 - Enhancing APRA's Direction Powers - Scope and Efficacy**

3.1 Paragraph 2.3 - New direction powers for superannuation

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Sub-paragraph 2.3.1 - Potential new direction triggers

- (a) The Committee considers that more consideration is required as to the nature of the triggers which empower APRA to issue a direction.
- (b) The trigger of a breach or anticipated breach of 'the RSE Licensee Law or licence condition' presumably does not extend to general breaches of trust, which are not otherwise breaches of the SIS Act. Accordingly, APRA would not have the power to issue a direction in relation to an actual or potential breach of trust that is not otherwise a breach of the SIS Act (for example, for failure to comply with the strict terms of a trust deed). This outcome may cause uncertainty in the industry.
- (c) The Committee notes that other stated triggers, 'promoting instability in the Australian financial system' and 'conducting affairs in an improper or financially unsound way' are concepts already used in the banking industry. Further consideration therefore needs to be given to whether these concepts have settled meanings and whether they are appropriate in the superannuation context.
- (d) The proposed triggers do not wholly mirror the existing Banking Act triggers in respect of a direction. The Committee queries whether this distinction is necessary and appropriate (particularly given the desire for simplification and streamlining stated in Section 8 of the Consultation Paper).
- (e) The Committee considers that further certainty is required around
  - (i) the person or persons within APRA who can determine that a trigger has been met; and
  - (ii) the standard of proof (i.e. will the relevant person or persons from APRA need to have 'reason to believe' and, if so, is that standard appropriate).

Sub-paragraph 2.3.2 - Contents of a direction

- (f) The Committee notes that one of the proposed actions that a direction could require is the removal of a specific director or officer or a trustee; in the past APRA issued disqualification orders in relation to certain persons. However, following the AAT decision in *Re VBN and Ors and Australian Prudential Regulation Authority* (the AXA Staff Super case), APRA no longer issues disqualification orders. Disqualification orders are now made by the Federal Court of Australia, on application by APRA.
- (g) The Committee notes that the proposed direction powers appear to have the practical effect of re-instating APRA's power to issue disqualification orders; the Committee takes this view because of the broad range of triggers, and the express inclusion that APRA can specify the removal of an individual trustee, director, or officer as the action that an RSE licensee must take to effect rectification. If this is the case, consideration needs to be given as to how this would operate concurrently with section 126H of the SIS Act.

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Sub-paragraph 2.3.3 - Breach of a direction

- (h) A breach of a direction involves strict liability. The Committee suggests consideration be given to aligning the penalty with that which applies under the Banking Act.

Additional comments

- (i) The Committee make the following points, with respect to protection from liability as well as conflicts between directions and other obligations:
- (i) trustees should be protected from liability where that liability arises as a consequence of following an APRA direction. Trustees should also be protected from the consequences of breaching their governing rules and should be entitled to a right of indemnity from the trust assets even if the conduct undertaken to comply with the direction is beyond the terms of the indemnity (for example, because it involves a breach of the governing rules);
  - (ii) although the Consultation Paper foreshadows that there would be some protection from liability for breaching other laws as a result of complying with a direction by APRA, it is questionable whether Australian legislation could effectively protect a trustee from liability for breaching foreign laws, which might be relevant for some trustees;
  - (iii) in the event APRA directs the removal of a particular director, the other directors should be protected from the consequences of the removal, given that it could cause a breach of the constitution of the relevant trustee company, a breach of the trust deed, a breach of the basic equal representation rule and/or potentially of the individual's appointment agreement;
  - (iv) the proposal that directors be strictly liable for a failure by the trustee company to comply with directions (or for misleading an actuary) will be contentious, especially in the context of the Stronger Super reforms which have already increased the scope of trustee directors' personal liability. The Committee comments that, depending on the nature of the direction given, in some cases it would arguably be just to require that there be some degree of involvement by the director for personal liability to attach. Further, it is unclear as to the position of a director who resigns after a direction has been given, but before the time for compliance has arisen;
  - (v) there is a strong case to say that APRA should not have the power to, in effect, override the legislature/judiciary by imposing directions which take priority over complying with the law; and
  - (vi) APRA should not have the power to issue a direction that is inconsistent with a requirement of any applicable state or federal law.
- (j) The Committee comments that the Consultation Paper (at sub-paragraph 8.4.7) refers to the streamlining of the exculpatory provisions in the

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banking, insurance and life insurance legislation; the Committee questions why the same provisions are not to be extended to the superannuation industry.

- (k) Further, the Committee notes that the fact that a direction has been made by APRA could constitute an event of default under some agreements (such as ISDA agreements). Similarly, if a change of trustee were to occur as a result of a direction being given, this could also constitute an event of default. In the context of ISDA agreements, intervention by APRA could entitle a counterparty to an over-the-counter derivative to close out early and crystallise a substantial loss for the superannuation fund. It is questionable whether moratorium provisions (on recovering crystallised losses and liabilities) would be effective in the context of agreements governed by foreign laws. Accordingly, in the Committee's view, it would be appropriate to ensure that the consequences of making a direction (or of the direction being complied with) will be adequately considered by APRA before making the direction.
- (l) The Committee comments that there is a risk that the proposed direction power may raise constitutionality issues. The absence of any limitation on the 'catch all' power to give directions may conceivably result in directions being given to replenish a shortfall in a defined benefit division, or to contribute to an operational risk reserve, out of the personal assets of the trustee (or its directors), which could be an acquisition of property for the purposes of section 51(xxxi) of the *Commonwealth Constitution*.

#### **4. Section 8 - Simplification and Streamlining of Acts Administered by APRA**

##### 4.1 Paragraph 8.1 - Streamlining of authorisation provisions of the industry Acts

###### Sub-paragraph 8.1.1 - Enabling APRA to require a NOHC of a regulated entity to be authorised

- (a) In the Consultation Paper, a NOHC generally relates to a holding company with an ADI and/or an insurer as subsidiary. However, it is possible that the proposal may also impact the holding companies of superannuation trustee subsidiaries.
- (b) The Committee comments that the proposed change can be understood in relation to a financial conglomerate entity; but it may not be appropriate or practical in the context of industry funds which may in some cases be owned, or part owned, by an employer or union association. For example, sub-paragraph 8.1.1 includes the statement:

*'The NOHC ... is ... in a position to exert a substantial degree of control over the business decisions made in its subsidiaries and throughout the wider group.'*

While this may be the case in certain financial services groups, the application of the SIS Act and the Prudential Standards together with other applicable regulations, prevents this from being the case in the industry fund context.

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- (c) The Committee comments that, although it is unclear as to the precise intention, if the proposal is to extend to superannuation funds, it would require more detailed analysis and consultation. In those circumstances, the proposal would create another burden and disincentive for maintaining corporate funds (for example, if the principal employer group that owns the trustee company must obtain authorisation from APRA). This could result in the parent company of a corporate defined benefit fund being directed to guarantee or replenish a vested benefit index shortfall.

4.2 Paragraph 8.2 - Simplification of provisions relating to obtaining information and investigating

Sub-paragraph 8.2.2 - Modification to grounds for conducting an investigation

- (a) The Committee considers this proposal to be appropriate because of the current incompleteness of APRA's investigative powers. However, the simplification may be more appropriately achieved by consolidating APRA's investigative powers in the APRA Act (as is the case with the ASIC Act).
- (b) In addition to the streamlining suggested, careful consideration needs to be given to the adequacy of APRA's investigative powers under the SIS Act itself. Currently, section 263 of the SIS Act empowers APRA to conduct an investigation into the whole, or part, of the affairs of the superannuation fund if it appears to APRA that a contravention of the SIS Act may have occurred, or be occurring, in relation to the fund. This wording leaves gaps. In the Committee's view, APRA should also have the power to conduct an investigation if it appears to APRA that a breach:
- of a license condition that is not otherwise a breach of the SIS Act;
  - of a trustee's general trust law duties (for example, to comply with the terms of the trust deed) that is not a breach of the SIS Act; or
  - by an individual director of his or her duties under the SIS Act,

may have occurred, or be occurring, in relation to the relevant fund.

- (c) Another issue that requires clarification, with respect to section 263 of the SIS Act, is whether, if an investigation is commenced because it appears to APRA a breach of the SIS Act has occurred, or is occurring, the whole of the affairs of the fund can be investigated for the purpose only of determining whether that breach has, or is occurring or whether the investigation can cover the fund more generally. Clarification may serve to avoid future litigation.

Sub-paragraph 8.2.7 - Persons not to disclose information obtained during an investigation

- (d) The Committee is of the view that, although it is arguable that the proposal can already be achieved, it is nonetheless desirable to have a provision in the SIS Act which expressly addresses this issue.

Sub-paragraph 8.2.12 - Requirements regarding investigation reports

- (e) The Committee considers that the removal of the requirement to attach transcripts to a report has the following benefits:

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- (i) it will increase the confidentiality of the examination;
  - (ii) it may encourage examinees to provide additional information beyond the specific questions asked; and
  - (iii) it may avoid the cost and time involved in APRA asking examinees to review and sign off on transcripts (section 280 SIS Act).
- (f) However, consideration will need to be given to the impact of this change on the obligations of procedural fairness, given the current SIS Act requirement to include in the report the evidence and other material on which findings were based (section 284(2)(b) of the SIS Act).
- (g) The Committee considers that the ability of APRA to decide whether a report needs to be issued, in the event that an investigation is discontinued, is appropriate.
- (h) The Committee notes that it is already the case in the SIS Act that a copy of the report should be provided to the entity being investigated (section 284 of the SIS Act).

8.2.16 - Ensure that the whistleblower protection provisions apply to former employees, directors, etc

- (i) The Committee agrees with the proposal.

4.3 Paragraph 8.6 - Enhance APRA's ability to disqualify individuals from acting as responsible persons

Sub-paragraph 8.6.1 - Streamlining the definition of 'disqualified person'

- (a) The Committee considers the streamlining across the various Acts as sensible. However, consideration needs to be given as to whether section 20 of the Banking Act is appropriate for superannuation purposes and whether any other changes (such as whether the SIS Act provision should retain the reference to a civil penalty order) are required for superannuation purposes.

Sub-paragraph 8.6.2 - Court to consider prudential standards in disqualification proceedings

- (b) The Committee agrees with this proposal.

Sub-paragraph 8.6.3 - Extend disqualification in one regulated industry to disqualification in other regulated industries

- (c) The Committee agrees with this proposal.

**5. Section 9 - Proposals specific to Acts supervised by APRA**

5.1 Paragraph 9.4 - Superannuation Industry (Supervision) Act

Sub-paragraph 9.4.1 - For APRA to be given discretionary power to appoint an acting trustee in circumstances where APRA has taken all reasonable steps to identify or locate a trustee



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- (a) The Committee considers that, to effectively regulate superannuation entities, it is necessary for APRA to be able to identify and locate the trustee of each entity which it regulates. For this reason, the Committee considers it appropriate for APRA to be given the proposed power.
  - (b) The safeguard appears to be APRA's obligation to use 'all reasonable steps' to identify and locate the trustee. The Committee comments that consideration should be given to whether this is a sufficiently onerous safeguard.

Sub-paragraph 9.4.2 - To treat Limited Liability Partnerships consistently with body corporates in relation to investment managers

- (c) The Committee is concerned that the proposal will not achieve its intended purpose of streamlining private equity investing. The Committee is of the view that Treasury's comments about investment managers and limited liability partnerships are not accurate. The Committee makes the following points.
  - (i) An investment in a limited liability partnership (such as a private equity fund) does not constitute the appointment of an investment manager. It is an investment, which is therefore not subject to the outsourcing requirements.
  - (ii) The reason why superannuation funds invest in private equity funds via special purpose trusts is not related to the requirement that investment managers be bodies corporate. Special purpose trusts are used for various reasons, including to avoid breaching the prohibitions against borrowing and creating charges over fund assets. For example, when investing in partnerships, there is a risk that a borrowing by the (general) partner may be imputed to each of the other partners in the partnership, which could be problematic for partners who are prevented from borrowing (such as superannuation funds).
- (d) Notwithstanding the above comments, the Committee considers that it may be nonetheless appropriate to permit limited liability partnerships to be appointed as investment managers. However, the Committee notes that this would require a proper assessment of the purpose of section 125 of the SIS Act. The Committee understands that the original purpose of section 125 was to ensure that investment managers were constitutional corporations over which the Commonwealth Legislature has power; but the Committee notes that, if this remains the intention of the provision, the proposal would appear to be inconsistent. However, if this is no longer the intention, a question arises as to whether section 125 should be repealed in its entirety.
- (e) The Committee comments that it is arguable that the outsourcing requirements supersede section 125. That is, if a trustee has complied with the outsourcing requirements, a question arises whether it is necessary to be concerned about the legal structure that has been adopted by the investment manager. The Committee is of the view that, if the intention of the proposal is to limit the kinds of pooled investments in which superannuation trustees may invest, it would be controversial and detailed

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consideration would need to be given to other common structures such as registered schemes and unit trusts.

Sub-paragraph 9.4.3 - To extend APRA's powers so that it can investigate any contravention as far as it relates to a superannuation interest, superannuation entity or an RSE licensee

- (f) As noted above, there are gaps in APRA's investigative powers which should be dealt with to ensure consistency and certainty regarding APRA's investigative powers.
- (g) In relation to the specific proposal to allow the investigation of an employer's failure to remit superannuation contributions to the trustee of a superannuation fund, the Committee is concerned about the constitutionality of the proposed amendment. Given the Commonwealth Legislature does not have specific power under the *Commonwealth Constitution* to make laws regarding superannuation and that it has relied on the powers contained in section 51 of the *Constitution*, in respect of taxation (51(i)), corporations (51(xx)) and pensions (51 (xxiii)), to legislate with respect to superannuation, the Committee queries whether APRA can investigate actions of an employer (as distinct from actions of a trustee which has elected to be bound by the SIS Act and treated as a complying fund under tax legislation).
- (h) The Committee notes that it appears inappropriate that section 64 of the SIS Act caters for members' post-tax member contributions to be deducted by the employer and remitted to the fund, but there is no equivalent provision catering for salary sacrifice arrangements.

Sub-paragraph 9.4.4 - To expand APRA's disqualification powers under section 126H of the SIS Act

- (i) The Committee agrees with this proposal, subject to its comments above regarding the implications of increasing APRA's direction power in respect of section 126H.

The Committee would welcome the opportunity to discuss its submission further and to provide additional information to Treasury in respect of the comments made. In the first instance, please contact the Chair of the Law Council of Australia's Superannuation Committee, Heather Gray on (03) 9274 5321 or at [heather.gray@dlapiper.com](mailto:heather.gray@dlapiper.com).

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## **Attachment A: Profile of the Law Council of Australia**

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

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

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

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

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

The Law Council is governed by a board of 17 Directors – one from each of the constituent bodies and six elected Executives. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive, led by the President who serves a 12 month term. The Council's six Executive are nominated and elected by the board of Directors. Members of the 2012 Executive are:

- Ms Catherine Gale, President
- Mr Joe Catanzariti, President-Elect
- Mr Michael Colbran QC, Treasurer
- Mr Duncan McConnel, Executive Member
- Ms Leanne Topfer, Executive Member
- Mr Stuart Westgarth, Executive Member

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