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**FINANCIAL SECTOR REFORM (HAYNE ROYAL COMMISSION RESPONSE—  
PROTECTING CONSUMERS (2020 MEASURES)) BILL 2020: RSE LICENCE  
CONDITION—NO OTHER DUTY (FSRC REC 3.1)**

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**EXPOSURE DRAFT EXPLANATORY MATERIALS**



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# Glossary

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Bill	Financial Sector Reform (Hayne Royal Commission Response—Protecting Consumers (2020 Measures)) Bill 2020: RSE licence condition—no other duty (FSRC rec 3.1)
Financial Services Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SIS Regulations	<i>Superannuation Industry (Supervision) Regulations 1994</i>



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# **Chapter 1**

## ***Implementing Recommendation 3.1 of the Financial Services Royal Commission***

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### **Outline of chapter**

1.1 Schedule [3.1] to the Bill amends the SIS Act to impose a new condition on RSE licences held by a body corporate trustee. The new licence condition prohibits such trustees from having a duty to act in the interests of another person, subject to exceptions that enable trustees to undertake their ordinary functions as RSE licensees. This will minimise the risk of unmanageable conflicts of duties arising and promote improved outcomes for beneficiaries of registrable superannuation entities.

1.2 The amendments implement the Government's response to recommendation 3.1 of the Financial Services Royal Commission.

### **Context of amendments**

1.3 Section 52 of the SIS Act imposes covenants on trustees of registrable superannuation entities. Relevantly, these covenants require each trustee to:

- perform their duties and exercise their powers in the best interests of the beneficiaries;
- give priority to the duties to and interests of beneficiaries over the duties to and interests of other persons where there is a conflict; and
- not enter into any contract or do anything else that would prevent the trustee from properly performing or exercising the trustee's functions and powers.

1.4 While these covenants contemplate that conflicts can arise between the duties to and interests of the beneficiaries and the duties to and interests of other persons, it requires trustees to develop an appropriate conflicts management framework that gives priority to the interests of the beneficiaries

1.5 The Financial Services Royal Commission considered various conflicts management frameworks developed by trustees of registrable superannuation entities to comply with the above covenants. Commissioner Hayne concluded that these frameworks and related

policies were often ineffective, as trustees rarely sought to avoid conflicts of interests and duties where appropriate.

1.6 In particular, Commissioner Hayne considered that a trustee of a registrable superannuation fund should avoid being the responsible entity of a managed investment scheme because of the potential conflict of duties that arises when the trustee ‘wears two hats’. Such entities are referred to as dual regulated entities, as trustees of registrable superannuation entities are generally regulated by APRA, and responsible entities of managed investment schemes are regulated by ASIC through the Australian financial services licence framework in the *Corporations Act 2001*.

1.7 A potential conflict of duties arises in this context as a dual regulated entity is required to act in the best interests of the beneficiaries of the registrable superannuation fund, and is also required to act in the best interests of the members of the managed investment scheme. The conflict materialises when a person who is not a beneficiary of the registrable superannuation fund invests in the managed investment scheme, and the interests of the beneficiaries of the registrable superannuation fund are in conflict with the interests of the other members of the managed investment scheme. As the trustee owes a best interests duty to two different classes of members, the trustee may be unable to discharge its duty to both.

1.8 Recommendation 3.1 of the Financial Services Royal Commission goes beyond prohibiting dual regulated entities and states that a trustee of a registrable superannuation entity should be prohibited from assuming any obligations other than those arising from or in the course of its performance of the duties of a trustee of a superannuation fund.

1.9 Schedule [3.1] gives effect to the Government’s response to recommendation 3.1 of the Financial Services Royal Commission.

## **Summary of new law**

1.10 Schedule [3.1] to the Bill creates an additional condition on RSE licences held by a body corporate trustee. The new condition prohibits RSE licensees from having a duty to act in the interests of another person, subject to exceptions that enable trustees to undertake their ordinary functions as RSE licensees.



## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>From 1 July 2020, an RSE licensee that is a body corporate cannot, as a condition on its licence, have a duty to act in the interests of another person, except in the course of:</p> <ul style="list-style-type: none"><li>performing the RSE licensee's duties and exercising the RSE licensee's powers as a trustee of a registrable superannuation entity; or</li><li>providing personal advice.</li></ul>	<p>No equivalent.</p>

### Detailed explanation of new law

1.11 Schedule [3.1] to the Bill amends the SIS Act to create an additional condition on RSE licences held by a body corporate trustee. The condition prohibits the RSE licensee from having a duty to act in the interests of another person, except in the course of:

- performing the RSE licensee's duties and exercising the RSE licensee's powers as a trustee of a registrable superannuation fund; or
- providing personal advice.

1.12 The new licence condition aims to improve outcomes for beneficiaries of registrable superannuation funds by minimising the risk of unmanageable conflicts of duties arising from competing duties owed by a trustee of a registrable superannuation fund to beneficiaries of the fund and to other persons.

### Who will need to comply with the new licence condition?

1.13 The new licence condition only applies to an RSE licensee that is a body corporate. This includes an RSE licensee that is a constitutional corporation. *[Schedule [3.1], item 1, subsection 29E(5A) of the SIS Act]*

1.14 The new licence condition does not apply to individual trustees, groups of individual trustees or individual directors of body corporate trustees. This approach is reasonable given the various types of duties to act in the interests of another person an individual may be subject to, for example as trustee of a family trust or as part of their professional employment.

1.15 The new licence condition only applies in respect of the duties that the licensee has. It does not matter if another entity in the same corporate group has a duty that would be in conflict with the new licence condition.

### **Having a duty to act in the interests of another person**

1.16 An RSE licensee may have a duty to act in the interests of another person because the duty arises under legislation (for example, under the *Corporations Act 2001*), under a contract or deed, under a rule of common law or equity (such as a fiduciary duty), or is imposed by a court.

1.17 For the purposes of the new licence condition, it is not relevant how the duty arises. A duty to act in the interests of another person that is voluntarily assumed, or is imposed on the RSE licensee would therefore be captured. An RSE licensee will also have a duty to act in the interests of another person if the licensee holds an office or role that gives rise to a duty to act in the interests of another person.

1.18 While this approach may appear broad, it is limited to duties to act in the interests of another person, and is subject to the broad exemptions discussed in the following section.

1.19 Further, only legally enforceable duties to act in the interests of another are captured by the new licence condition.

1.20 While it is not possible to exhaustively list the situations or relationships that give rise to a duty to act in another person's interest, such a duty may arise in the context of an RSE licensee:

- being a responsible entity of a registered managed investment scheme or an investor direct portfolio services-like scheme, as this would give rise to a statutory duty to act in the best interests of the members under paragraph 601FC(1)(c) of the *Corporations Act 2001*;
- being a trustee of an unregistered managed investment scheme, as this would give rise to a fiduciary duty to act in the interests of the members;
- acting as an agent of another person, as this would give rise to a fiduciary duty to act in the interests of the principal;
- being the trustee of a traditional trust, as specified in Chapter 5D of the *Corporations Act 2001*, as this would give rise to a fiduciary duty to act in the interests of the beneficiaries of the trust estate; or

- providing personal advice to a person as a retail client, as this would give rise to a statutory duty to act in the best interests of the person under section 961B of the *Corporations Act 2001*.

1.21 The new licence condition would not prohibit an RSE licensee from having a duty that does not involve acting in the interests of another person. Subject to any contractual considerations, this may for example allow an RSE licensee to provide trustee administration services to other entities in exchange for fees as this would likely involve a contractual duty to provide a service to the entity, rather than a duty to act in the interests of the entity.

### **Exemptions from the licence condition**

1.22 The exemptions in paragraphs 29E(5A)(a) and (b) allow an RSE licensee to effectively carry out its duties and exercise its powers as a trustee of a registrable superannuation entity in the best interests of its beneficiaries.

1.23 In addition to the exemptions listed in the new licence condition and discussed below, APRA has broad powers of exemption and modification under Part 29 of the SIS Act. It is expected that these powers will only be exercised in relation to the new licence condition on an exceptional basis if APRA is satisfied that the interests of the beneficiaries will not be adversely affected by another duty that falls outside the scope of the prescribed exceptions.

#### ***Performing the RSE licensee's duties and exercising the RSE licensee's powers as a trustee of a registrable superannuation fund***

1.24 This exemption ensures that an RSE licensee can effectively perform its duties and exercise its powers as trustee of a registrable superannuation fund.

1.25 Duties imposed on the RSE licensee under the RSE licensee law are clearly within the scope of this exemption. RSE licensee law is defined in section 10 of the SIS Act and includes, but is not limited to, the SIS Act, the SIS Regulations and prudential standards.

1.26 Other duties that are considered to be within the scope of the exemption include:

- duties imposed on the RSE licensee under the common law by virtue of the RSE licensee being a trustee of a superannuation fund;
- duties arising from the RSE licensee operating investment vehicles, such as managed investment schemes, special purpose vehicles and pooled superannuation trusts, that are

only open to members of the registrable superannuation entity;

- duties arising from the RSE licensee holding an ‘Australian financial services licence’ under the *Corporations Act 2001* in relation to its superannuation activities that are ‘financial services’; and
- duties arising under Commonwealth, State or Territory legislation, or more generally under the common law, that relates to the business operation of the registrable superannuation fund. For example, duties under work health and safety legislation in relation to staff of the RSE licensee.

1.27 Additionally, under this exemption an RSE licensee will be able to act as a trustee for more than one registrable superannuation fund. The Financial Services Royal Commission expressly recognised that acting as a trustee of another superannuation fund is unlikely to give rise to an unmanageable conflict of duties that would adversely affect beneficiaries of those superannuation funds.

#### ***Provision of personal advice***

1.28 Where a representative of an RSE licensee provides personal advice to a person as a retail client, the representative has a duty to act in that person’s best interests under section 961B of the *Corporations Act 2001*.

1.29 ASIC Report 639 *Financial advice by superannuation funds* found that of the superannuation funds surveyed, the majority of personal advice provided by an RSE licensee is to its members in respect of their superannuation accounts. This advice often covers topics such as member investment choice and contributions. In these cases, the provision of advice would arguably be captured by the exemption in paragraph 29E(5A)(a), as the advice is provided in connection with the RSE licensee’s role as a licensee.

1.30 However, certain types of personal advice may not be captured by the exemption in paragraph 29E(5A)(a), including:

- personal advice given to or involving a person who is not a beneficiary of the registrable superannuation fund, such as a spouse or relative of a member; or
- personal advice given to a beneficiary of the superannuation fund that does not meet the requirements of the sole purpose test in section 62 of the SIS Act and is therefore paid for directly by the member (rather than from their superannuation account). For example, where the advice is

about a member's assets outside super or age pension entitlement.

1.31 The provision of these types of personal advice is unlikely to adversely affect beneficiaries of the superannuation fund as a whole.

1.32 The exemption in paragraph 29E(5A)(b) therefore ensures RSE licensees and their representatives are not restricted from providing comprehensive personal advice. This recognises the important role superannuation funds play in meeting the financial advice needs of members wanting to build their retirement income.

1.33 This exemption is not limited to the provision of personal advice to a person as a retail client. It therefore allows an RSE licensee to provide personal advice to wholesale clients, such as a trustee of another superannuation fund.

### **Failure to comply with the new condition**

1.34 There are a range of existing enforcement tools for APRA to enforce compliance with licensing conditions. Under the existing licensing condition framework, if an RSE licensee fails to comply with a licence condition, APRA can issue directions requiring the RSE licensee to comply. In exceptional circumstances, APRA might also cancel the licence.

1.35 Failure to comply with directions made by APRA under section 131D or 131DA of the SIS Act is an offence with a maximum penalty of 100 penalty units. If a body corporate RSE licensee is convicted of an offence, subsection 4B(3) of the *Crimes Act 1914* allows a court to impose a fine of up to 500 penalty units.

1.36 Additionally, if an RSE licensee becomes aware that it has breached or will breach the new licence condition, and is of the view that the breach is or will be significant, the RSE licensee must report that to APRA. Failure to comply with this requirement is an offence with a maximum penalty of 50 penalty units.

1.37 As the requirement is imposed by way of a licence condition, a failure to comply with the licence condition by having another duty to act in the interests of another person does not have any consequences for the validity or performance of the other duty.

#### **Example 1.1**

Company A is an RSE licensee that becomes a trustee for an unregistered managed investment scheme. The scheme is open to beneficiaries of the registrable superannuation entity and members of the public. Company A subsequently does not invest monies pooled in the scheme properly.

Company A has breached the licence condition in subsection 29E(5A) of the SIS Act. However, Company A cannot rely on that breach to argue that subsection 29E(5A) has the effect that the appointment as trustee for the unregistered managed investment scheme was invalid, or that it does not need to comply with duties in relation to the scheme (including the duty to invest monies properly).

## **Interaction with the *Corporations Act 2001***

1.38 Subsections 912A(4) and (5) of the *Corporations Act 2001* contemplate the existence of an RSE licensee that is also the responsible entity of registered managed investment scheme. These provisions have not been amended because it is possible for a corporate entity to be both the responsible entity of a managed investment scheme and the trustee of a registrable superannuation fund, where the arrangement is exempt from the new licence condition. In order for this arrangement to be exempt, the managed investment scheme would need to be open only to members of the registrable superannuation fund or other superannuation trustees that are investing superannuation fund assets (or both).

## **Application and transitional provisions**

1.39 Schedule [3.1] to the Bill commences on 1 July 2020.

1.40 The amendments made by Schedule [3.1] apply in relation to any duty that is had before, on or after 1 July 2020. Registrable superannuation entities will therefore need to consider whether their existing structures are compliant with the new licence condition and may need to restructure by 1 July 2020 in order to comply with the new licence condition.

1.41 The amendments have prospective application as it has a future effect on rights and obligations. Any breaches of the new licence condition will only occur prospectively, on and after 1 July 2020.

1.42 It is expected that APRA will use its exemption and modification powers in Part 29 of the SIS Act to grant extensions to RSE licensees to comply with the new licence condition where appropriate. These powers will be exercised on a case by case basis, taking into account each RSE licensee's circumstances.

1.43 The Government is considering providing some relief to an RSE licensee that needs to transfer the responsible entity function to another entity within the same corporate group for the purposes of complying with the new licence condition. This relief would modify the operation of section 601FL of the *Corporations Act 2001* so that a members' meeting is not required for a responsible entity to retire and a new responsible

entity to be chosen. We welcome comments from stakeholders on whether this relief is required, and if so, what the scope of that relief should be.