8. Regulating the players: standards for operators

Introduction

8.1. The success of the Commonwealth's retirement incomes policy depends to a large degree on the quality and integrity of the participants in the industry. This chapter identifies the major participants in the superannuation industry and makes recommendations about the standards that ought to be required for their entry into, and continued presence in, the industry.

The responsible entity

The concept of a responsible entity

8.2. *Current confusion.* For all collective investments it is important for investors to know who is legally responsible for the management of their money and who will be held accountable if something goes wrong. Superannuation is no exception. In single employer sponsored and industry superannuation schemes it is clear that the trustee is the party responsible for the operation of the scheme. Identifying the responsible party in other cases, such as personal superannuation schemes and ADFs, is not, however, always so simple. These schemes are in many ways similar to other collective investments, such as unit trusts, in which the distinction between the duties owed by the trustee and those owed by the manager are not clearly understood by investors (nor, it seems in some instances, by trustees and managers). Invariably the manager promotes the scheme and plays a predominant role in investors' dealings with the scheme. The existence of the trustee and the identification of its role and responsibilities is more a background matter. Consequently, if a loss is suffered, it can sometimes be unclear which party is directly responsible to the investor or scheme member. This uncertainty about roles and responsibility can, and does, lead to mutual finger pointing by trustees and managers.

8.3. *Identifying the responsible party.* The party which bears primary responsibility to the investor, or member of a collective investment, should be able to be easily identified in all circumstances. This would be made easier if that party was referred to as the responsible entity. The responsible entity will be the party in control of the collective investment. In the case of superannuation, it will bear direct responsibility to members and take on the duties and obligations which this report proposes. In many cases, for example, single employer sponsored and industry superannuation schemes, the responsible entity will clearly be the trustee. In personal superannuation schemes, however, the responsible entity could be either the current manager or promoter, or the

trustee: the identity of the responsible entity will have to be made clear. The manager/promoter could take on the role of responsible entity and the duties and obligations that accompany that role. If that happened there would be no need for an independent trustee. The responsible entity would effectively be the trustee and would undertake the ultimate responsibility. Alternatively, the current manager may decide that the duties of a responsible entity are too onerous and that it will become merely a hired investment manager. Another party, adequately remunerated, will have to be the responsible entity and take ultimate responsibility for the scheme. Focusing attention on the responsible entity will clarify the issue of accountability, thereby empowering investors and providing a more effective framework for all parties to fulfil their responsibilities. Whoever the responsible entity of the scheme is, it should have obligations of the same kind as a trustee owes to beneficiaries.[1] These obligations should be owed to non-contributing members, such as pensioners, as well as contributing members. In DP 50 the Review proposed that the party which bears direct and ultimate responsibility to investors in any collective investment, including members of a superannuation scheme, should be clearly identified and referred to as the responsible entity.[2] This proposal received a great deal of support in consultations and submissions.[3] Accordingly, the Review recommends that a deed or other document constituting a superannuation scheme should be required to identify the responsible entity for the scheme.

Recommendation 8.1: Appointment of responsible entity

The law should provide that the conditions under which a superannuation fund, an ADF or a PST attracts a tax concession include a condition that the deed or other instrument establishing the fund, ADF or PST must appoint a person as the responsible entity for the fund, ADF or PST.

Recommendation 8.2: Acceptance of appointment by responsible entity

The appointment (including an appointment by election) of a person as responsible entity, or as a member of the board of

1. See further ch 9.
2. DP 50 proposal 5.1. In some employer sponsored and industry schemes, a board or committee of management controls the policies of a scheme. There may, in addition to that controlling board or committee, be a trustee. In that case the trustee will be a mere custodian. The board or committee of management (the responsible entity) will be required to have equal employer and employee representation, not the custodian.
3. eg ASFA *Submission* March 1992; ISC *Submission* March 1992; Australian Federation of Consumer Organisations *Submission* February 1992; ASC *Submission* March 1992.

management of a responsible entity, for a superannuation fund, ADF or PST should not be effective unless the person concerned accepts it in writing.

Custody of assets

8.4. The Review has given considerable thought to the question who should hold the assets of a superannuation scheme and whether an independent custodian ought to be required. In the context of employer related schemes, an independent custodian means independent of the employer(s). For schemes that have member representatives on the responsible entity, and whose assets are held by the responsible entity, not the employer, an independent trustee is, effectively, already in existence. Smaller schemes may have one or more trustee appointed by agreement between the employer and employees.[4] To the extent that member involvement in such 'agreements' is exercised freely, the trustee can be said to be independent of the employer. For responsible entities of personal schemes that are not related to an employer or industry, the Review is of the opinion that there is less potential for a conflict of interests. The trustee-like duties and obligations to which the responsible entity is subject and the responsible entity's interest in the commercial success of the venture will be sufficient to protect the assets of the scheme. A custodian independent of the responsible entity is not required. The funds of the scheme must, however, be held separately from any other funds the responsible entity may have as a result of other business it conducts.

Standards for responsible entities of superannuation schemes

Introduction

8.5. Responsible entities are responsible for administering and investing the assets of superannuation schemes, either directly or through an external administrator or investment manager. If they fail to perform their function efficiently, honestly and fairly, members are likely to suffer loss or be otherwise disadvantaged. Responsible entities should, therefore, be subject to appropriate entry requirements.

Pre-vetting of responsible entities

8.6. *Current controls on superannuation schemes.* OSSA imposes no restrictions on who may be appointed trustee of complying single employer sponsored or industry superannuation schemes, although they do prescribe the compo-

4. OSS Regulations reg 15.

sition of the trustee boards of those schemes.[5] It does, however, place restrictions on who may act as the trustee of a complying ADF. Trustees of ADFs must be one of the following[6]

- a life assurance company
- a bank
- a corporation to which the *Financial Corporations Act 1974* (Cth) s 8(1)(a) or (b) applies[7]
- a trade union
- a friendly society
- a corporation authorised by or under a law of a State or Territory to act as an executor, administrator and trustee
- the Bank of New South Wales Nominees Pty Ltd.

Superannuation schemes that fall within the definition of prescribed interest under the Corporations Law, that is, principally personal superannuation schemes and ADFs, are required to have trustees approved by the ASC.[8] The ASC requires trustees to be independent of the management company and to have the ability and resources to perform the duties required of it under the deed.[9]

8.7. *Proposal.* In DP 50 the Review proposed that the approval by the ASC of trustees of superannuation schemes that are prescribed interests should continue but that there be no additional requirements or pre-vetting imposed.[10] It also proposed that, for several reasons, including the considerable resources that would be required, the ability of members to participate in the operation of their scheme through member representation[11] and the possible industrial difficulties of pre-vetting member representatives, responsible entities of single employ-

5. Principally by prescribing the minimum number of employee representatives on the board of trustees or, if a corporate trustee is appointed, on the board of that company: OSS Regulations reg 13.
6. OSS Regulations reg 19.
7. These are foreign corporations, trading corporations formed within the limits of Australia or financial corporations whose sole or principal activities, in Australia, are the borrowing of money and the provision of finance and whose value of debts due to it, resulting from the provision of finance, exceeds 50% of the value of all assets of the corporation in Australia.
8. A deed is not an approved deed unless the trustee appointed under its deed has been approved: Corporations Law s 1066(b).
9. The procedure for approval by the ASC as trustee of a prescribed interest scheme was established by the ASC's predecessor, the NCSC, and is set out in Release 126.
10. DP 50 para 5.8.
11. Those with over 200 members. The Review recommends this be reduced to schemes with more than 50 members: see recommendation 12.4.

er sponsored and industry schemes should not be required to be approved by a government agency before being established.[12] Trustees of those superannuation schemes would continue to be exempt from approval by the ASC.[13]

8.8. *Response.* Submissions tended to support this proposal.[14]

> We consider that any pre-vetting of trustees in addition to that already required under the Corporations Law in respect of prescribed interests or the *Life Insurance Act* would be unnecessary and have unacceptable resource implications.[15]

The Review remains of the view that the pre-vetting of responsible entities of superannuation schemes would be too great a resource burden on the regulator for the benefit that would be achieved. Accordingly, it recommends that the responsible entities of single employer sponsored and industry schemes not have to be pre-vetted before being established. The pre-vetting by the ASC of trustees of schemes that are prescribed interests (effectively the personal schemes and ADFs) should continue so as to maintain consistency between investments that are offered to investors independently of their specific employment. Also, members of those schemes do not usually have the opportunity to become intimately involved in the administration of their scheme (by way of member representation on the responsible entity) so a preliminary approval by the ASC is even more appropriate. Any additional screening or pre-vetting by the regulator is, however, in the Review's opinion, not warranted.

Are larger schemes different?

8.9. *Pre-vetting for competence.* It was suggested in consultations that responsible entities of some of the larger single employer sponsored and industry schemes should be pre-vetted by the regulator, not merely for likelihood of breaching the law, but more comprehensively, for example, for competence to carry out the role of responsible entity. The suggestion is that the regulator should take into account the financial resources of the responsible entity, the qualifications and experience of it and its staff and its management and administrative capabilities and determine whether the responsible entity can carry out its duties efficiently, honestly and fairly. Such pre-vetting would be required if those larger schemes were removed from the definitions of 'excluded offer' and 'excluded issue' and were thereby made subject to the requirements imposed on prescribed interests under the Corporations Law. The

12. DP 50 proposal 5.3.
13. Corporations Regulations reg 7.12.05, 7.12.06.
14. Trust Company of Australia Limited *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992; ACTU *Submission* February 1992.
15. ISC *Submission* March 1992.

Review acknowledges the importance of ensuring that responsible entities are suitable. However, given the requirement for member representation, it is not convinced that approval by the ASC under the Corporations Law of responsible entities of employer related schemes is either realistic or necessary.

8.10. *Recommendation.* The Review recommends, therefore, that there be no approval by the regulator required for responsible entities of employer related superannuation schemes before they commence operation. Responsible entities of schemes subject to the Corporations Law should, however, continue to be approved by the ASC, on the same grounds as at present. There should be no additional pre-vetting of those schemes by the regulator.[16]

Recommendation 8.3: Pre-vetting of responsible entities

There should be no change to the law to require any further pre-vetting of responsible entities for superannuation funds, ADFs or PSTs or for the providers of DAs.

Prohibition against acting as a responsible entity

8.11. *Need for a barrier.* The Review does not recommend pre-vetting by the regulator for responsible entities of superannuation schemes.[17] It is important, therefore, that there be conditions imposed making certain individuals and corporations ineligible to act as responsible entities. A breach of the conditions should result in immediate disqualification. DP 50 contained proposals for the prohibition of certain corporations and individuals from acting as responsible entities.[18] The proposals included factors such as being an undischarged bankrupt, having a receiver appointed and being convicted within the previous 10 years of an offence involving dishonesty.

8.12. *Submissions.* Submissions generally supported the Review's proposals.[19] The ASC suggested that a corporation should be prohibited from acting as a responsible entity if a receiver has been appointed to *any* of its assets. The Review agrees. The importance of trying to ensure the safety of superannuation funds justifies this strict restriction.

16. The Review recommends that the regulator should be able to suspend a member or director of a responsible entity of any superannuation scheme or replace a responsible entity with a temporary responsible entity: see recommendation 13.12.
17. Beyond whatever pre-vetting may be required under another law, such as the Corporations Law.
18. DP 50 proposals 5.5, 5.6.
19. Jacques Martin Industry *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992.

8.13. *Recommendation.* The Review recommends that a body corporate should be unsuitable to act as a responsible entity in a number of circumstances. The first is that it is externally administered, as defined in the Corporations Law. This covers a body corporate that is being wound up or is under official management and a body corporate that has property to which a receiver has been appointed.[20] The second is that it, or one of its responsible officers,[21] has been convicted of serious fraud.[22] Although some submissions suggested otherwise,[23] the Review takes the view that offences are not relevant to a person's suitability to care for the funds of a superannuation scheme unless they are offences of dishonesty. The third case is that the entity, or one of its responsible officers, has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty. The final case is that one of its responsible officers is an insolvent under administration.[24] An individual should be ineligible to act as a responsible entity for a superannuation scheme or as a member, or director, of the board of management of a responsible entity if he or she is an insolvent under administration, has been convicted of serious fraud or has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.

Recommendation 8.4: What are bodies, and who are persons, unsuitable to act as responsible entity

1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as the responsible entity for a superannuation fund, an ADF or a PST if

- **it is an externally administered body corporate as defined in the Corporations Law or**
- **it, or one of its responsible officers as defined in the Corporations Law**
  - **has been convicted of serious fraud as defined in the Corporations Law**
  - **has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or**
- **one of its officers is an insolvent under administration.**

20. Corporations Law s 9.
21. Directors or persons who have control or substantial control of the body corporate.
22. As defined in the Corporations Law, serious fraud includes an offence involving dishonesty that is punishable by imprisonment for a period of at least three months: s 9. If a body corporate is convicted of serious fraud the *Crimes Act 1914* (Cth) s 4B(2),(3) provides a mechanism for the conversion of a prior sentence to a pecuniary penalty.
23. eg J Aitken *Submission* February 1992; Trustee Companies Association of Australia *Submission* February 1992.
24. As defined in the Corporations Law s 9.

2. The law should provide that an individual is not suitable to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST if he or she

- **is an insolvent under administration as defined in the Corporations Law or**
- **has been convicted of serious fraud as defined in the Corporations Law or**
- **has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.**

8.14. *Spent convictions.* The Review recommends, in relation to an individual or a body corporate being unsuitable to act as a responsible entity because of a conviction of serious fraud, that convictions that have become spent under the *Crimes Act 1914* (Cth) should, subject to one exception, not be counted. In most cases, a conviction is spent after 10 years have passed since the date of the conviction, provided the person was not sentenced to imprisonment or was sentenced to imprisonment for the offence for no more than two and a half years.[25] The regulator should, however, be able to apply to a court for a declaration that, despite a person's conviction being spent, he or she is unsuitable to act as a responsible entity or as a member or director of a responsible entity on the ground of the conviction. If the court forms the view that it is in the interest of the safety of the funds of a superannuation scheme that the person be declared unsuitable to act as a responsible entity or as a member or director of a responsible entity, it should declare that person unsuitable to so act. This view has been adopted because the Review sees the safety of the funds as paramount. In any event, being declared unsuitable to act as a responsible entity will not result in the loss of a person's livelihood.

Recommendation 8.5: Spent convictions

The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of recommendation 8.4. The court should not be able to make such an order unless it is satisfied that

25. If the person was dealt with as a minor the conviction is spent after five years: *Crimes Act 1914* (Cth) s 85ZM.

- **the person is or proposes to become the responsible entity, or a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST and**
- **it is necessary to make the order to protect the interests of the members of the scheme.**

Enforcement of suitability requirements

8.15. *Appointment to be void.* The appointment of an individual or a body corporate as a responsible entity, or as a member or director of a responsible entity whilst unsuitable, should be void. The regulator should be able to appoint a temporary responsible entity (if the whole responsible entity is unsuitable to act) to act until either a new responsible entity is appointed or the scheme is wound up. The aim of specifying conditions for unsuitability to act as a responsible entity or as a member or director is to try to prevent such individuals or corporations from becoming responsible entities. An action done by an unsuitable responsible entity is, nevertheless, not to be invalid or ineffective on that ground alone.[26]

8.16. *Becoming unsuitable.* If, however, a body corporate or an individual becomes unsuitable whilst acting as a responsible entity or as a member or director of a responsible entity, the appointment should terminate immediately and the matter reported to the responsible entity and to the regulator. As in the situation above, the regulator should be able to appoint a temporary responsible entity if necessary.

8.17. *Offence created.* Acting as a responsible entity or as a member or director of a responsible entity whilst unsuitable should be an offence for an individual and for a body corporate.

Recommendation 8.6: Persons etc. not to act as responsible entity while unsuitable

1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as, or as a member of the board of management of, the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

26. See recommendation 8.18.

3. The law should provide that a purported appointment of an unsuitable body corporate or an unsuitable person as a responsible entity for a superannuation fund, an ADF or a PST, or of an unsuitable person as a member of the board of management of the responsible entity for a superannuation fund, an ADF or a PST, is of no effect.

4. The law should provide that, if a responsible entity, or a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or an unsuitable person

- **the matter must be reported to the regulator without delay — the body corporate or person commits an offence if the matter is not so reported and**
- **the body corporate's or person's appointment as responsible entity, or as member of the board of management of a responsible entity, thereupon ceases.**

8.18. *Individuals to make written declaration.* It is obviously better to try to prevent unsuitable individuals from acting than to have to remove them after they have commenced to act. Thus there needs to be a mechanism to make it more difficult for unsuitable individuals to be appointed to, or elected as responsible entities or as members or directors of responsible entities. Accordingly, the Review recommends that an individual who stands for election, or offers himself or herself for appointment, for such positions should be required to declare in writing that he or she is not unsuitable. Failure to make a declaration should disqualify a person from standing. Making a false declaration should be an offence. If an election is being held, declarations should be given to the returning officer; if appointments are being made, declarations must be given to the persons making the appointment. This requirement will considerably lessen the possibility of an unsuitable person becoming a responsible entity, or member or director of a responsible entity.

Recommendation 8.7: Declaration as to suitability

1. The law should provide that it is an offence for a person to offer himself or herself for appointment or election as the responsible entity, or as a member of the board of management of a responsible entity, for a superannuation fund, an ADF or a PST without first making a written declaration stating that he or she is not an unsuitable person. The declaration is to be given to

- **in the case of an election — the returning officer for the election**
- **in the case of an appointment — the person making the appointment.**

2. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to offer itself for appointment or election as the responsible entity for a superannuation fund, an ADF or a PST unless it, and each of the members of its board of management, have made written declarations stating that it, he or she is not unsuitable. The declarations are to be given to

- **in the case of an election — the returning officer for the election**
- **in the case of an appointment — the person making the appointment.**

3. It should be an offence knowingly to make a false declaration.

Training in the duties of responsible entities

8.19. ***The need for training.*** It is essential that members and directors of responsible entities are aware of their responsibilities and duties. However, no specific qualifications are prescribed for the approval of trustees of superannuation schemes that are subject to the Corporations Law. Nor are qualifications prescribed for schemes that do not come within the Corporations Law. The Review is conscious of the difficulties which may arise in filling positions on the board of the responsible entity if educational qualifications were prescribed by law. However, given the importance and complexity of the role of responsible entity, it seems reasonable to suggest that all responsible entities (if individuals) and all members and directors of responsible entities, whether representing members or employers, complete some form of training. Training courses designed specifically for trustees are available and more are being developed.[27]

8.20. ***Proposal to encourage training.*** In DP 50 the Review proposed that all individuals who are responsible entities, or members or directors of responsible entities, should be encouraged to undertake training in their responsibilities and obligations.[28] It also noted the view that the importance of this role is such that training should be compulsory. All submissions that commented on this issue indicate support for training.[29] Several submissions favour mandatory training.[30] The majority of submissions, however, whilst agreeing that it is most important that responsible entities be aware of their duties and responsibilities,

27. Organisations which currently offer trustee training courses include ASFA and TCA.
28. DP 50 proposal 5.9.
29. eg ISC *Submission* March 1992; TCA *Submission* February 1992.
30. eg ASC *Submission* March 1992; LIFA *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992.

do not favour mandatory training.[31] In chapter 9, the Review recommends that the principal duties and responsibilities of responsible entities should be clarified. This will make the task of learning to be a responsible entity easier. In the light of that, and the submissions favouring mere encouragement of training, the Review recommends that members of responsible entities be strongly encouraged, by both industry organisations and the government, to undertake appropriate training.

Standards for investment managers of superannuation funds

Introduction

8.21. The integrity and security of the superannuation industry will continue to depend significantly on the quality and integrity of investment managers used by superannuation schemes. The Government has indicated that it is considering measures to control entry to the superannuation industry.[32] For the Review, the relevant question is what disqualifying factors should apply and whether there should be conditions of entry.

Prohibitions against acting: disqualifying factors[33]

8.22. ***The proposals.*** As is the case with responsible entities, there are certain corporations that should not be permitted to act or offer to act as the manager of funds belonging to a superannuation scheme. DP 50 proposed that they be those to which a receiver has been appointed, which are in liquidation and which have been convicted of dishonesty offences in the past 10 years.[34] The Review proposed that the regulator should be able to take direct action to stop a corporation with any of those characteristics from acting or continuing to act as an investment manager for a superannuation scheme. Unincorporated investment managers should be subject to similar barriers to acting or offering to act as the manager of funds belonging to a superannuation scheme. In DP 50 the

31. eg ASFA *Submission* March 1992; ACTU *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Limited *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; Shell Australia Limited *Submission* February 1992.
32. Treasurer's statement, paper 1 para 31.
33. For the grounds on which the regulator should be able to remove an investment manager (as distinct from becoming unsuitable to act) see recommendation 13.13.
34. DP 50 proposal 5.11.

Review proposed that individuals who are undischarged bankrupts or who have been convicted of a serious offence involving dishonesty in the past 10 years should be disqualified from offering to act or continuing to act as an investment manager for a superannuation scheme.[35]

8.23. ***Submissions and comment.*** Widespread support was received for these proposals.[36] Some modifications were suggested to bring this proposal into line with the Corporations Law.[37]

8.24. ***Recommendation.*** The Review does not recommend that investment managers be subject to any pre-vetting in addition to the vetting that they may be subject to in relation to their actually dealing with funds.[38] The Review recommends that a body corporate be unsuitable to act as an investment manager for a superannuation scheme on the same grounds as those on which a body corporate is unsuitable to act as a responsible entity, namely, that it is a body corporate

- externally administered
- it, or one of its responsible officers has been convicted of serious fraud or has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty and
- one of its officers is an insolvent under administration.

The Review recommends that the same factors that it recommends should make an *individual* unsuitable to be a responsible entity or a member or director of a responsible entity should also make an individual unsuitable to be an investment manager.[39]

Recommendation 8.8: Unsuitability to act as investment manager
1. The law should provide that a foreign corporation or a trading or financial corporation is not suitable to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST, if
- **it is an externally administered body corporate as defined in the Corporations Law or**

35. DP 50 proposal 5.12.
36. eg Australian Friendly Societies Association *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992; Mercer Campbell Cook & Knight *Submission* February 1992; ASC *Submission* March 1992; J McEachern *Submission* February 1992.
37. ASC *Submission* March 1992.
38. eg the 'pre-vetting' required to obtain a dealer's licence under the Corporations Law.
39. See recommendation 8.4.

- it, or one of its responsible officers as defined in the Corporations Law
  - — has been convicted of serious fraud as defined in the Corporations Law
  - — has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty or
- one of its responsible officers is an insolvent under administration.

2. The law should provide that an individual is not suitable to act as an investment manager for the responsible entity for a superannuation fund, an ADF or a PST if he or she

- **is an insolvent under administration as defined in the Corporations Law or**
- **has been convicted of serious fraud as defined in the Corporations Law or**
- **has been subject to a civil penalty imposed under a State, Territory or Commonwealth law for an act of dishonesty.**

3. The law should provide that the Federal Court or the Supreme Court of a State or a Territory may, on application by the regulator, declare, by order, that despite the *Crimes Act 1914* Pt VIIIA (*spent convictions*), a conviction for a particular offence may be taken into account in determining whether a person is an unsuitable person for the purposes of this recommendation. The court should not be able to make such an order unless it is satisfied that

- **the person is acting or proposes to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST and**
- **it is necessary to make the order to protect the interests of the members of the fund, ADF or PST.**

8.25. ***Consequences of unsuitability to act.*** As with a responsible entity, the appointment of an unsuitable body corporate or individual as an investment manager should be void and the body corporate or individual should be guilty of an offence. If a body corporate or individual becomes unsuitable, it should have to report this to the responsible entity and to the regulator immediately. The engagement should thereupon be terminated. A consequence of that termination will be that the investment manager will have to return the assets it was managing to the responsible entity. It would be inappropriate for an

investment manager to profit from such a situation. The Review recommends that the investment manager in such circumstances not be able to charge any fees in connection with the return of money or assets to the responsible entity.

Recommendation 8.9: Persons etc. not to act as investment managers while unsuitable

1. The law should provide that it is an offence for a foreign corporation or a trading or financial corporation to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while it is an unsuitable body corporate.

2. The law should provide that it is an offence for an individual to act as investment manager for the responsible entity for a superannuation fund, an ADF or a PST while he or she is an unsuitable person.

3. The law should provide that a purported engagement by the responsible entity for a superannuation fund, an ADF or a PST of an unsuitable body corporate or an unsuitable person as investment manager is of no effect.

4. The law should provide that, if a foreign corporation or a trading or financial corporation or a person is acting as investment manager for the responsible entity for a superannuation fund, an ADF or a PST becomes an unsuitable body corporate or person:

- **the matter must be reported to the responsible entity without delay — the body corporate or person commits an offence if the matter is not so reported and**
- **the body corporate's or person's engagement as investment manager thereupon ceases.**

5. The law should provide that it is an offence for an investment manager for the responsible entity for a superannuation fund, an ADF or a PST who becomes unsuitable to charge the responsible entity a fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

6. 'Acting as investment manager' means dealing with the assets of the fund, ADF or PST by exercising a judgment as to their investment that is independent of the judgment of the responsible entity but is authorised by the responsible entity.

Standards for funds management

Introduction

8.26. The preceding paragraphs have dealt with the prohibitions on bodies corporate and individuals acting as responsible entities and investment managers. The following paragraphs deal with the required standards for those who invest the funds of a superannuation scheme.

Requirements for responsible entities

8.27. *Responsible entities dealing in securities.* There are many possible levels of involvement by a responsible entity in the investment of a superannuation scheme's funds, from direct investment of all the funds to engaging an investment manager to invest all the scheme's funds without any direction from the responsible entity. At present, trustees of employer related schemes do not have to hold a dealers licence to deal in securities for the scheme.[40] It is unlikely that trustees of superannuation schemes would carry on a business of dealing in securities because they would usually deal through a licensed agent.[41] Nevertheless, responsible entities should not automatically be exempted from the requirement to hold a dealers licence. Nor should they automatically have to hold a dealers licence simply because investment in securities is an option they may choose. The need for a licence should depend on whether they propose to deal in securities. Consequently, the Review proposed in DP 50 that, if a responsible entity deals in securities,[42] it should have to hold a dealers licence and should face the same barriers to entry as any other dealer.[43] This proposal received widespread support.[44]

8.28. *Recommendation.* The Review recommends that a responsible entity that deals in securities should have to hold a dealers licence. The ASC will be responsible for imposing conditions on that licence, including capital requirements,[45] appropriate to the activity to be carried out by the responsible entity in the same

40. Provided they only deal in securities as trustee of a superannuation scheme: Corporations Regulations reg 7.3.13(1).
41. Dealing in securities through an agent who is a licensed dealer does not constitute a business of dealing in securities: Corporations Law s 93(5).
42. As defined by the Corporations Law.
43. DP 50 proposal 5.7.
44. Permanent Trustee Company Limited *Submission* January 1992; ISC *Submission* March 1992; LIFA *Submission* March 1992; AMP Society *Submission* February 1992; ASC *Submission* March 1992.
45. The capital requirements for security dealers are under review at the international level: see para 8.36.

way that it imposes conditions on the issue of any other dealers licence.[46] This recommendation will require the repeal of Corporations Regulation 7.3.13(1).[47]

Recommendation 8.10: Dealing in securities

The Corporations Regulations reg 7.3.13 should be amended by omitting sub-regulation (1).

8.29. *Responsible entity not dealing in securities to obtain advice.* A responsible entity that invests superannuation funds itself but not at any time in securities will not need a dealers licence and will not be subject to the conditions which might apply. In DP 50 the Review proposed that a responsible entity not dealing in securities should have to seek professional advice, for example, by entering into a consultancy arrangement with an appropriately qualified person.[48] The Review sought suggestions as to how precise requirements of this nature might be formulated. Considerable concern was expressed in submissions about what 'advice from an appropriately qualified professional' means.[49] LIFA opposed this proposal on the grounds that trustees may already have sufficient expertise to make investment decisions and that the fiduciary responsibilities of trustees, such as the duty to act in the interest of members and with care and diligence, afford sufficient guidance to trustees to act prudently and to seek professional investment advice where needed.[50] The Review remains of the view that it is inappropriate to require a responsible entity that is not dealing in securities to obtain a dealers licence. It agrees that, as part of its fiduciary duties, a responsible entity should in such a case ensure that it has obtained proper advice. This requirement has been more fully elaborated and incorporated in the clarification of the duties of responsible entities in chapter 9.

Dealers licence for investment managers

8.30. *Dealing in securities.* Investment managers that deal directly in securities must be licensed under the Corporations Law.[51] In granting a dealers licence, the ASC must be satisfied that the responsible officers of the manager

46. Clearly, the more stringent the capital requirements imposed on the holders of dealers licences, the less likely it will be that responsible entities of smaller superannuation schemes intending to deal in securities on behalf of their scheme will be able to meet the requirement.
47. This will mean that life insurance companies will be the only exception to the requirement to hold a dealers licence when dealing in securities: Corporations Regulations reg 7.3.13(2). This may well be appropriate given the other standards required of life companies. This issue will be addressed in a later stage of the Collective Investments Review.
48. DP 50 proposal 5.8.
49. D Knox, *Submission* February 1992; AMP Society *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; National Mutual *Submission* February 1992.
50. LIFA *Submission* March 1992.
51. Corporations Law s 780.

have adequate educational qualifications and experience, and it must have no reason to believe that the manager will not perform its duties efficiently, honestly and fairly. It must consider whether an officer is an insolvent under administration, has had a serious fraud conviction in the previous 10 years or is not of good fame and character.[52] These requirements will be considered by the Review as part of its review of other collective investment schemes.[53] In any case, the Review does not recommend any change to the current requirement that investment managers who deal in securities must hold a dealers licence.

8.31. *Managers who do not deal in securities.* Although investment managers will almost always invest in securities as part of their management strategy, there may be some that will not, for example, investment managers who invest only in property. In DP 50 the Review noted that such managers ought to be subject to some form of approval process before they may act on behalf of a superannuation scheme and, in the absence of any alternative screening process, proposed that they also be required to hold a dealers licence.[54] This proposal was made on the basis that, although it would impose a burden on the ASC by way of an increased need for resources and expertise, the alternative of leaving the responsibility for assessing the competence of an investment manager entirely to the responsible entity seemed too onerous. Requiring all managers, even though they may not be planning to deal in securities, to hold a dealers licence would ensure a certain level of competence.

8.32. *Submissions.* A number of submissions did not support this proposal.[55] The ASC, for example, stated that investment managers that do not deal in Corporations Law securities (for example, property managers) should be subject to their ordinary regulation, not the Corporations Law licensing provisions.[56] Others took the view that requiring managers who do not deal in securities to hold a dealers licence is not an adequate solution to the problem of trying to ensure a certain level of competence in investment managers.

8.33. *Conclusions.* In practice, it seems that most investment managers will deal in securities and will, therefore, hold a dealers licence. There will be few

---

52. Corporations Law s 784.
53. The Review understands that the ASC intends to review the capital punishment requirements for securities dealers as a consequence of proposals currently being developed by the International Organisation of Securities Organisations (IOSCO): see, eg, Memorandum from IOSCO's Technical Committee to the Basle Committee on Banking Supervision, (1991) 1 *ASC Digest*, Reports and Speeches, 140.
54. DP 50 proposal 5.10.
55. eg Norwich Group *Submission* February 1992; Trust Company of Australia *Submission* February 1992; D Knox *Submission* February 1992; National Mutual *Submission* February 1992; ISC *Submission* 1992.
56. ASC *Submission* March 1992.

managers who do not require a dealers licence. Following its consultations on this issue, the Review has come to the view that the most effective way to regulate those managers is to highlight, and then rely upon, the obligation of responsible entities to take appropriate advice when dealing with an investment manager that does not hold a dealers licence. This obligation is dealt with in chapter 9. Accordingly, the Review does not propose that managers that do not deal in securities should be required to have a dealers licence.

Recommendation 8.11: Investment managers who do not carry on the business of dealing in securities

Investment managers for responsible entities for superannuation funds, ADFs or PSTs should not have to hold a dealers licence under the Corporations Law if they do not carry on the business of dealing in securities within the meaning of the Corporations Law s 93.

Additional requirements of investment managers

8.34. ***Proposal for minimum capital requirement.*** In DP 50 the view was put that the requirement to hold a securities dealers licence alone is not an adequate qualification for a corporation or individual to act as an investment manager of superannuation funds. The Review took the view that there needs to be some demonstration by a corporation that its shareholders have a substantial commitment to operations or by an individual that he or she is capable of undertaking the task.[57] The Treasurer has also indicated that consideration is being given to imposing a minimum capital requirement on investment managers of superannuation funds.[58] The Review proposed that an investment manager should be required either to have net assets of $5m or be a member of a professional indemnity fund with cover of at least $5m.[59]

8.35. ***Submissions.*** The response to this proposal was extremely varied. Some considered that the professional indemnity option was no substitute for a net asset requirement.[60] Others felt that $5m was too high a barrier to entry.[61] The Trustee Companies Association felt that both a net asset *and* professional indemnity should be required.[62] Others expressed the view that neither having $5m net assets nor professional indemnity insurance were any indication of competence or commitment.[63]

57. DP 50 para 5.21.
58. Treasurer's statement, paper 1 para 31.
59. DP 50 proposal 5.14.
60. IFA *Submission* February 1992.
61. ASC *Submission* March 1992; John A Nolan & Associates *Submission* February 1992.
62. TCA *Submission* February 1992; Permanent Trustee Company Ltd *Submission* January 1992.
63. See, eg, BT Asset Management *Submission* February 1992.

8.36. *Conclusion: no recommendation on this issue.* The Review agrees that neither requirement will necessarily guarantee the performance or integrity of an investment manager yet may operate to keep out of the industry small but talented investment managers. The Review is aware that IOSCO, in conjunction with the Basle Committee on Banking Supervision, is currently developing proposals for minimum capital requirements for securities dealers, which may be based on the riskiness of the dealer's transactions. If a risk weighted capital requirement for securities dealers is proposed by IOSCO and implemented in Australia, additional minimum capital and net asset requirements would almost certainly be unnecessary.[64] The Review recommends that any capital adequacy or net assets requirement be addressed through dealers licence requirements.[65] These will be looked at in detail at a later stage of the Collective Investments Review. The Review realises that this leaves a 'gap' in relation to investment managers that do not deal in securities and, therefore, do not require a dealers licence. However, given the refined duties of responsible entities to take appropriate advice[66] the Review is satisfied that this will not be a significant problem.

Managers who have custody of assets

8.37. In the majority of situations the custody of the assets of a superannuation scheme will be with the responsible entity. This will not always be the case. An investment manager could be hired on the basis that the custody of the assets that the manager is working with are held neither by the responsible entity nor by the investment manager but by an independent custodian. In such a case, the independent custodian would be instructed by the responsible entity as to when and how to release assets to the investment manager. This would be set out in a contract between the responsible entity and the independent custodian.[67] Alternatively, the manager may have custody of the assets it is

64. The implementation of significantly higher capital requirements for security dealers under the IOSCO proposals obviously has implications for proposal 5.7 that responsible entities that deal in securities be required to hold a dealers licence.
65. See Balanced Equity Management *Submission* 11 March 1992.
66. See ch 9.
67. The Review has not proposed any net asset or other requirement for independent custodians. It considers that the most important matter to be addressed is the restrictions on custodians who have control over the investment of the assets of a superannuation scheme, as opposed to merely holding the assets as custodian. The ASC has suggested that a custodian appointed by a responsible entity must be an Approved Depository: *Submission* March 1992. The Review will examine the issue of standards for custodians and their licensing, if necessary, in the remainder of the Collective Investments Review.

managing. The Review is concerned to ensure that in that case the manager is able to demonstrate some substance by having net assets of $5m. To ensure that such a requirement is complied with, responsible entities should be required to ensure that investment managers meet that standard. The Review recommends

- that an investment manager that has custody of any assets of a superannuation scheme should be required to have net assets of $5m
- that it be an offence for a responsible entity to hire an investment manager under an agreement which allows the manager to have custody of assets of the scheme unless the manager has net assets of $5m
- that it be an offence for a responsible entity to hire an investment manager under a contract that permits the investment manager to deal in securities, unless the investment manager has a dealers licence.

Recommendation 8.12: Investment managers not to hold assets

The law should provide that, if

- **the responsible entity for a superannuation fund, an ADF or a PST enters into an agreement or arrangement with a person or with a body corporate under which the person or body corporate is to act an investment manager for the responsible entity and**
- **under the agreement or arrangement, the person or body is to hold or have custody of some or all of the assets of the fund, ADF or PST and**
- **at the time of entering into the agreement or arrangement and at all times while the agreement or arrangement is in effect, the person or body corporate had less than $5m in net tangible assets**

the responsible entity and the investment manager should each be guilty of an offence. The responsible entity should have a defence that it made reasonable inquiries, and exercised due diligence, in relation to the matter. There should be no similar defence for the investment manager.

Contracts between responsible entities and investment managers

8.38. *Duties owed to the responsible entity.* Under the Review's recommendations, the responsible entity will bear ultimate responsibility to members. The responsibilities owed by investment managers will primarily be owed to the responsible entity and will be contractual. There has been considerable attention paid to the question whether investment managers retained by responsible entities owe fiduciary duties directly to members or only to the responsible entity. For example, the NCSC took the view, in relation to property trusts, that

unless the trust deed expressly provided for a direct relationship and for fiduciary duties between members and a hired investment manager, the members had no right to deal directly with the management company.[68] In DP 50 the Review asked whether a similar approach should be taken for superannuation schemes and suggested that managers do, and should continue to, owe fiduciary duties to members because they are managing superannuation funds, that is, funds that are already held on trust by the responsible entity. The Review suggested these duties would be similar to those owed to members by the responsible entity but will not be as extensive.[69] Several submissions disagreed with the Review on this point.[70] The main thrust of those submissions was that the relationship between the responsible entity and a hired investment manager is purely contractual and that this excludes any fiduciary duty being owed to the members. The Review is now of the view that the duties owed by an external hired investment manager are owed to the responsible entity principally under the contract between them. This does not, however, mean that the manager may not owe a fiduciary duty to the members. It may be argued that the benefit of the fiduciary duty owed by the hired investment manager to the responsible entity is held by the responsible entity on trust for the members of the scheme.[71]

8.39. *Unconscionable or other inappropriate contracts.* Although the likelihood of a manager putting pressure on a responsible entity to enter into an inappropriate contract should be far less under the Review's recommendations than under present arrangements, the possibility needs to be addressed. A particularly serious example concerns contracts in which the manager's liability for negligence is limited. This type of contract will, hopefully, become less common when responsible entities are, by the Review's recommendations, placed in the controlling or dominant position. Nevertheless, the Review considers that contracts of this kind should be unenforceable. This additional safeguard would be to make contracts of this kind subject to the provisions of the Trade Practices Act against unconscionable conduct.

---

68. Release 121.
69. DP 50 para 5.27.
70. ASFA *Submission* March 1992; ASC *Submission* March 1992; LIFA *Submission* March 1992; Department of Finance (Cth) *Submission* February 1992; BT Asset Management *Submission* February 1992; County Natwest *Submission* February 1992; Department of Finance (Cth) *Submission* February 1992; ISC *Submission* March 1992.
71. It has, in some circumstances, been held that contracts for the benefit of third parties import a trust; see eg *Re Schebsman* [1944] Ch 83; Meagher & Gummow, *Jacobs' Law of Trusts in Australia* 24–7. It would seem likely that in the circumstances of superannuation, where there already exists a trust, that there would be a trust imported into a contract between a responsible entity and a hired investment manager.

8.40. *Recommendation.* The Review recommends that agreements between investment managers and responsible entities that unreasonably exclude the investment manager's liability for negligence should be prohibited, and that the operation of the *Trade Practices Act 1974* (Cth) s 52A should apply to all contracts between responsible entities and investment managers, or other advisers, in respect of a superannuation scheme.[72]

Recommendation 8.13: Contracts for investment managers

1. The Federal Court or the Supreme Court of a State or Territory should be able, on application by the responsible entity for a superannuation fund, an ADF or a PST, to vary, by order, a contract between the entity or provider and another person under which the other person is to act as investment manager for the entity so as to ensure that the contract does not unreasonably exclude or limit or unreasonably provide for indemnity in relation to, the manager's liability for negligence or breach of contract.

2. The *Trade Practices Act 1974* (Cth) s 52A should extend to such contracts.

3. The responsible entity for a superannuation fund, ADF or PST should have to be a foreign corporation or a trading or financial corporation formed within the limits of the Commonwealth, or the fund should have, as its substantial or dominant purpose, the provision of old-age pensions.

Superannuation intermediaries

Introduction

8.41. The quality of advice given to people who are contemplating joining a personal superannuation scheme, investing in a single contribution superannuation scheme or rolling over superannuation benefits is an important factor in an individual's choice in relation to superannuation. The regulation of people who give such advice and sell these products will also be an important element in the success of the Government's retirement incomes policy. These people include financial planners, investment advisers, stockbrokers, accountants and insurance agents. A general review of quality control of financial advisers and agents has been recommended in a recent report by the House of Representatives Standing Committee on Finance and Public Administration.[73] The general issues of the

72. The ISC supports this recommendation: *Submission* March 1992.
73. Martin Report, recommendation 17.

standards, qualifications and licensing of these superannuation intermediaries will be given close consideration during the course of the Collective Investments Review. The time constraints on this report have not, however, allowed for a comprehensive review of this area to be included in this report.

Securities dealers licence

8.42. Dealers in securities, whether or not they are also life agents, must be licensed under the Corporations Law. The Review is satisfied at this preliminary stage that the Corporations Law standards are adequate for intermediaries selling superannuation. Consequently, the Review does not propose any additional entry restrictions on those intermediaries. However, the prerequisites for dealers licences will be dealt with more thoroughly in the general Collective Investments Review.

Standards for life agents

8.43. *Trade Practices Commission inquiry.* Life agents are another class of superannuation intermediary. They sell superannuation but do not require a dealers licence under the Corporations Law.[74] The Trade Practices Commission has been asked by the Minister for Justice and Consumer Affairs, Senator Michael Tate, to conduct empirical research into various aspects of the conduct and operations of life insurance agents. They include whether existing regulation is adequate to ensure fair and competitive conduct by life insurance agents, the availability to consumers of impartial financial advice in relation to life insurance and personal superannuation services and the extent to which current levels of disclosure may affect information and advice or contribute to unfair or anti-competitive conduct. The inquiry, which is to report by 30 November 1992, is to consult with the Review where relevant. The Review will maintain a close liaison with the Inquiry and take close note of the results of the Trade Practices Commission's empirical research. In the meantime, however, the Review makes several recommendations aimed at achieving, at least, a level playing field between financial advisers.

8.44. *Proposals for uniform requirements.* DP 50 made several proposals in relation to the standards that should be required of life agents when they sell superannuation.[75] The rationale for those proposals was to ensure a level

74. See discussion at para 8.45.
75. DP 50 proposals 5.18, 5.19, 5.20.

playing field for all sellers of superannuation, whether they are subject to the Corporations Law or the *Insurance (Agents and Brokers) Act 1984* (Cth). The Review remains of the view that standards should be the same across the board wherever possible.

8.45. *Extending Corporations Law standards to life agents.* Persons who deal in securities or carry on an investment advice business must be licensed under the Corporations Law. Superannuation is a prescribed interest and, therefore, a security.[76] In principle, therefore, it would seem that an intermediary selling superannuation that is not an excluded offer should have to have a dealers licence. However, intermediaries involved in dealing in or advising on life insurance based products (including personal superannuation schemes offered by life companies) are generally not treated as subject to these provisions.[77] Instead they are regulated, indirectly, under the *Insurance (Agents and Brokers) Act 1984* (Cth). This provides that a life company is responsible for the acts of its agents in relation to any matter relating to insurance, whether or not the agent acts within the scope of his or her authority.[78] There are no minimum professional standards set down. In DP 50 the Review proposed that intermediaries selling superannuation on behalf of life companies ought to be subject to the standards required of intermediaries under the Corporations Law.[79] Those standards require that the person be of good fame and character, not be an insolvent under administration and have educational qualifications and experience adequate for a licence of the kind applied for. Additionally, the ASC must have no reason to believe that the person will not perform his or her duties efficiently, honestly and fairly.[80] Regard is to be had to any conviction in the past 10 years for serious fraud.[81] This proposal was made subject to any changes that may be made to the Corporations Law standards at a later stage of the review.

8.46. *Submissions.* The Review's proposal received wide support in submissions.[82] Several submissions pointed out that standards for life agents are

76. There are exemptions, eg, for trustees of superannuation funds and 'exempt dealers', which include dealers of 'excluded offers'.
77. Presumably because they argue that the superannuation policies they offer are in reality life insurance and do not, therefore, fall within the definition of securities.
78. This Act is currently being reviewed by the ISC.
79. DP 50 proposal 5.18.
80. Corporations Law s 783.
81. Corporations Law s 783(4). 'Serious fraud' means an offence involving fraud or dishonesty against an Australian or any other law, punishable by imprisonment of at least 3 months: Corporations Law s 9.
82. eg Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; DSS *Submission* February 1992; ASC *Submission* March 1992; Securities Institute of Australia *Submission* February 1992.

currently being reviewed by LIFA and the Australian Lifewriters Association in conjunction with the ISC, with a view to establishing a self regulatory code of conduct that will include matters relating to the selection of agents by life insurance companies.[83]

8.47. *Recommendation.* The Review is concerned primarily to ensure that standards for superannuation intermediaries, whether they be securities dealers, financial planners or life agents, are adequate and uniform. It recommends, therefore, that all superannuation intermediaries should be required to be solvent, of good fame and character, be in a position to perform his or her duties efficiently and honestly and have adequate educational qualifications and expertise. Life insurance companies should not be able to enter into agency contracts with persons to sell superannuation products for the company unless the company is satisfied, after proper inquiry, that the person is solvent, there is no reason to believe that the person is not of good fame and character and that the person will not perform his or her duties efficiently, honestly and fairly and the persons' educational qualifications and experience are adequate. This should be achieved by amending the *Insurance (Agents and Brokers) Act 1984* (Cth). Likewise, intermediaries selling or advising on, superannuation either as a securities dealer or a financial advisor will be required to meet those standards under the Corporations Law.

Recommendation 8.14: Standards for insurance intermediaries

1. Amend the *Insurance (Agents and Brokers) Act 1984* s 10 to provide that an insurer must not enter into an agreement for the purposes of s 10 under which the insurance intermediary is authorised to offer membership of a superannuation fund or DA for which the insurer is the responsible entity or provider as agent of the insurer unless the insurer is satisfied, after proper inquiry, that the intermediary

- **is of good fame and character[84] and**
- **will be able to act as agent honestly**
- **has adequate educational qualifications and expertise**
- **is not an undischarged bankrupt.**

Failure to comply should be an offence by the life insurance company.

The 'know your client' rule

8.48. *Proposal.* A person offering financial advice will be best able to offer good advice if he or she knows the needs and circumstances of the client. In

83. LIFA *Submission* March 1992; ISC *Submission* March 1992.

84. Although this is the formulation appearing the Corporations Law, it may be more precise to express it as 'unlikely to contravene, or cause a contravention of, the law'.

DP 50, the Review proposed that people selling or advising on superannuation should be under an obligation to make appropriate inquiries of a person before advising them about, or selling to them, superannuation and that all such people, including life agents selling superannuation policies on behalf of life insurance companies, should be subject to a requirement to know the needs and circumstances of their clients.[85] Such a requirement exists under the Corporations Law[86] although, as the Review pointed out in DP 50, the current wording imposes no positive obligation on a person to conduct an appropriate investigation to ensure that the advice fits the client's investment objectives, financial situation and needs.[87] The majority of submissions that commented on this issue strongly supported the proposal.[88] The Review remains convinced that such a requirement is an important means of improving the level of service of intermediaries and ensuring an appropriate matching of clients and financial services.

8.49. *Recommendation.* Accordingly, the Review recommends that all superannuation intermediaries should be subject to a 'know your client' requirement. The Corporations Law s 851 provides a good model but it, and any other relevant legislation,[89] should be amended to impose a positive obligation to ask clients about a client's investment objectives, financial situation and personal needs.

---

85. DP 50 proposal 5.19.
86. Under the Corporations Law s 851(2) a dealer is liable to pay damages to a client who loses money after acting on that dealer's recommendation if the dealer did not have a reasonable basis for making the recommendation. A dealer does not have a reasonable basis for making a securities recommendation unless

    > in order to ascertain that the recommendation is appropriate having regard to the information the [dealer] has about the person's investment objectives, financial situation and particular needs, the [dealer] has given such consideration to, and conducted such investigation of, the subject matter of the recommendation as is reasonable in all the circumstances; and the recommendation is based on that consideration and investigation.

87. DP 50 para 5.32. Although the section does not expressly require the dealer to ask the client for information, the NCSC issued a release in 1990 saying that the equivalent to the Corporations Law s 851 under the old regime, the *Securities Industry Act 1980* (Cth) s 68E, imposed a positive duty on advisers to ask clients for such information if it was clear that the client needed to rely totally on advice sought from an adviser in relation to a particular matter: NCSC Release No 352, April 1990.
88. ASC *Submission* March 1992; Jacques Martin Industry *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; Westpac Financial Services *Submission* February 1992; Permanent Trustee Company Limited *Submission* January 1992. The ISC noted that it has already accepted the need for this requirement. 'Circular 276 issued in April 1989 noted its intention that the new Life Insurance Act include a 'know your client' requirement': ISC *Submission* March 1992.
89. eg *Insurance (Agents and Brokers) Act 1984* (Cth).

Recommendation 8.15: Know your client rule

The law should apply the Corporations Law s 851 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of the insurer, membership of a scheme for which the insurer is the responsible entity or provider. The provision should require the person to make reasonable inquiries as to the client's circumstances.

Commissions

8.50. *Commission generally.* Most life agents earn commission on the sale of policies, including superannuation policies. In some cases, commissions are their sole source of income. There has been much discussion in recent years as to whether this system of remuneration leads to distortions in the market, poor quality advice and unnecessary rearrangement of policies.[90] This issue impacts on the area of superannuation and on collective investments generally. The Review will deal with this issue when considering collective investments generally. It expects that the research being done by the Trade Practices Commission inquiry will be of assistance in this area.

8.51. *Proposal.* In the meantime, the Review considered the issue of the disclosure of commissions. Under the Corporations Law a securities dealer or investment adviser must give clients particulars of any commission, fee or other benefit or advantage he or she will receive from making a recommendation or from a dealing in securities resulting from a recommendation.[91] A dealer or adviser must also advise a client of any other interest he or she has that may reasonably be expected to be capable of influencing a recommendation. This requirement is designed to ensure the integrity of the service provided by dealers and advisers licensed under the Corporations Law. The Review proposed in DP 50 that life agents selling superannuation policies should also be required to reveal such information to their clients.[92] At present, both single and regular premium superannuation policies sold by life companies must be accompanied by a disclosure statement. However, only the disclosure statement for single premium policies is required to disclose commissions.[93] Neither requirement, being embodied in ISC circulars only, is mandatory.

90. Commonly referred to as 'twisting'.
91. Corporations Law s 849.
92. DP 50 proposal 5.20.
93. ISC circulars 276, 290, 291.

8.52. *Submissions.* Most submissions supported the Review's proposal.[94] Several life insurance companies disagreed with it, principally on the grounds that the most meaningful disclosure is that of total fees and charges and the effect they have on a person's benefit, that the disclosure of commission may lead to restricting agents' remuneration without necessarily reducing costs and that a low commission does not necessarily equate with the best value policy.[95]

8.53. *Recommendation.* The Review is not convinced that the possible disadvantages of disclosure outweigh the advantages. It can only assist people to be aware when buying a policy of any sort what the benefit is to the seller. Accordingly, the Review recommends that life agents selling superannuation should be subject to requirements similar to the Corporations Law s 849, that is, to advise the client of any interest he or she has that may reasonably be expected to be capable of influencing a recommendation, and of any benefit that will flow to the agent from that recommendation.

Recommendation 8.16: Disclosure of interests etc.

The law should apply the Corporations Law s 849 to all persons who sell membership of superannuation funds, ADFs, PSTs and DAs, including insurance intermediaries authorised to offer, as agent of an insurer, membership of a superannuation fund or DA for which the insurer is the responsible entity or provider.

Education and training of sellers of superannuation

Qualifications for dealers and life agents

8.54. At present, securities dealers must have education and experience to gain a dealers licence under the Corporations Law, but exact requirements are not specified.[96] Nor are they specified in the Review's recommendation that life companies only contract with agents who have adequate education and experience.[97] In DP 50 the Review proposed that, in the longer term, the required educational qualification and experience for licensed dealers and life agents

94. See, eg, Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992; ASC *Submission* March 1992; Westpac Financial Services *Submission* February 1992.
95. AMP *Submission* February 1992.
96. In 1985, the NCSC proposed the establishment of prescribed educational standards for licence holders through the introduction of a Securities Industry Licence examination: *A Review of the Licensing Provisions of the Securities Industry Act and Codes.* No educational requirements have, however, been prescribed.
97. Recommendation 8.14.

should be prescribed. This proposal received general support.[98] The Securities Institute of Australia suggested that it be implemented as soon as possible rather than in the longer term and believes that it is appropriate to prescribe professional entry qualifications on fund managers, investment advisers and life agents.[99] It also noted that there are already appropriate educational courses available.[100] The Review remains of the opinion that the appropriate standards should be prescribed, at some stage, to provide consistency and to increase public confidence in the standards of intermediaries. It recommends that educational qualifications and experience should be prescribed for all superannuation intermediaries. To the extent that standards for life agents are prescribed separately under the *Insurance (Agents and Brokers) Act 1984* (Cth) instead of under the Corporations Law, it will be crucial to ensure consistency of the requirements prescribed under both pieces of legislation.

Continuing education

8.55. In DP 50 the Review proposed that a program of continuing education should be introduced for licensed dealers and life agents. The Review noted that the concept of training is not foreign to the Corporations Law. One of the conditions on which dealers licences are issued is that any representative of the holder is sufficiently trained in the duties he or she will be required to perform and keeps up to date by continuing training programs. The Corporations Law does not, however, specify which programs. The Securities Institute of Australia pointed out that it presents a continuing education program for its members, which may facilitate implementation of this proposal.[101] The Review understands that continuing education is already a requirement for the Australian Lifewriters Association accreditation scheme. The Review sees continuing education as a complement to initial education and a vital part of maintaining the standards of industry participants. Accordingly, it recommends that superannuation intermediaries should be required to undertake continuing education.

98. Norwich Group *Submission* February 1992; Jacques Martin Industry *Submission* February 1992; Permanent Trustee Company Ltd *Submission* January 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992.
99. Securities Institute of Australia *Submission* February 1992.
100. eg courses offered by the Financial Planning Association of Australia and the Securities Institute of Australia.
101. Securities Institute of Australia *Submission* February 1992.

Recommendation 8.17: Continuing professional education for dealers and life agents

1. The law should provide that it is a condition of holding a dealers licence that authorises the dealer to offer membership of a superannuation fund, an ADF or PST that the dealer satisfactorily complete courses or other training prescribed in the regulations.

2. The law should provide that each agreement for the purposes of the *Insurance (Agents and Brokers) Act 1984* s 10 under which an insurance intermediary is authorised to offer, as agent of an insurer, membership of a superannuation fund, ADF, PST or DA for which the insurer is the responsible entity or provider, that the intermediary will satisfactorily complete courses or other training prescribed in the regulations.

Validity of acts done

8.56. The recommendations in this chapter provide for certain individuals and body corporates to be unsuitable to act on various grounds. To avoid chaos it is necessary to guarantee the validity of acts done by a person who is unsuitable. The Review therefore recommends that, subject to some exceptions, for example, in the case of fraud, acts done by unsuitable responsible entities and unsuitable investment managers not be invalid or ineffective on that ground alone.

Recommendation 8.18: Preserving acts done

The law should provide that a third party who acts in good faith and without notice of the unsuitability of

- **the responsible entity for a superannuation fund, ADF or PST**
- **a member of the board of management of a responsible entity of a superannuation fund, ADF or PST**
- **an investment manager for a superannuation fund, ADF or PST**

is not affected by the unsuitability.