

## 13. Powers of the regulator

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### Introduction

13.1. This chapter considers what powers the regulator will need to ensure the integrity of the system of prudential supervision and to provide an appropriate level of protection for members of superannuation schemes. It covers the powers that the current agencies have, such as the power to conduct audits, and those which the Review considers a regulator of superannuation should have, such as powers to enforce the deed or other instrument constituting a scheme and to issue stop orders. It also addresses the scope of the investigative powers that the regulator ought to have and what the regulator's role should be when superannuation schemes merge. Consideration is given to matters affecting the way criminal offences should be constructed and the possible use of civil penalties rather than criminal prosecutions. Finally, this chapter looks at the issue of funding of the regulator.

### The regulators' existing powers

#### *Introduction*

13.2. The present law, and the Review's proposals, impose a number of obligations on responsible entities and other relevant persons. The deed or other instrument constituting the scheme, together with the general law of trusts, will impose some of these obligations.<sup>1</sup> Others will be imposed by statute, such as OSSA, the Corporations Law and the *Life Insurance Act 1945* (Cth). These Acts also confer various powers on the regulators. The following paragraphs outline the statutory powers currently available to the regulators to enforce adherence to the regulations and what additional powers the Review considers the superannuation regulator requires to adequately supervise the industry.

#### OSSA

13.3. OSSA applies to all employer related schemes, ADFs, PSTs and, to a degree, other schemes that allow the transfer of benefits independently of current employment. It provides the ISC with the power, in respect of any scheme claiming concessional taxation treatment to

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1. For a discussion of the Review's view on the application of trust law see ch 9.

- require superannuation schemes, ADFs and PSTs to supply information to the ISC
- require the production of documents to, and the taking of copies or extracts by, the ISC
- exercise a discretion to treat a non-complying superannuation scheme, ADF or PST as a complying scheme, ADF or PST
- revoke the certificate of compliance necessary for a superannuation scheme, ADF or PST to obtain a tax concession.

### *Life Insurance Act*

13.4. The *Life Insurance Act 1945* (Cth) provides the ISC with its only powers in relation to DAs, as well as additional powers in respect of other superannuation schemes provided by life insurance companies. It does this by giving the ISC the power, in relation to any life insurance company,

- to cancel the company's licence to act as a life insurance company<sup>2</sup>
- to require the provision of information<sup>3</sup>
- to require the production of its books and other documents<sup>4</sup>
- to gain access to its premises to search for documents, and to inspect and copy them<sup>5</sup>
- to undertake an investigation of the company<sup>6</sup>
- to obtain information pursuant to an investigation of the company<sup>7</sup>
- to apply to the court for an order to place the company or a part of the business of the company under judicial management<sup>8</sup>
- to apply to the court for an order that the company be wound up<sup>9</sup>
- to transfer any or all of the business of the company to another life insurance company.<sup>10</sup>

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2. s 23A.

3. s 54.

4. s 54A.

5. s 54B.

6. s 55.

7. s 56.

8. s 59(1)(a).

9. s 59(1)(b).

10. s 65, 73–6.

### *Corporations Law*

13.5. Superannuation schemes, ADFs and PSTs, except where specifically exempt, are subject to the Corporations Law because they fall within the definition of 'prescribed interest'. The ASC has the following powers in relation to these schemes

- to revoke approval of a trust deed or a trustee<sup>11</sup>
- to refuse to register a prospectus<sup>12</sup>
- to issue a stop order on the issue of securities<sup>13</sup>
- to require a securities dealer to provide specific information and if directed have that information audited<sup>14</sup>
- to revoke a manager's dealers licence<sup>15</sup>
- to suspend a dealers licence<sup>16</sup>
- to issue a banning order.<sup>17</sup>

In addition, the ASC has broad investigative powers in relation to any of the powers it has under the Corporations Law.<sup>18</sup> These include the powers to inspect books,<sup>19</sup> to require persons to give assistance to the ASC and to appear for examination,<sup>20</sup> to require the production of books<sup>21</sup> and to require the disclosure of information relating to the acquisition or disposal of securities.<sup>22</sup>

### *Inadequacies in current powers*

13.6. As this outline demonstrates, the regulators' abilities to enforce the regulations vary considerably. The ASC's powers are confined to those activities of superannuation schemes falling within the Corporations Law. The most glaring deficiencies are in OSSA. In particular

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11. s 1067(5).

12. s 1020A(2).

13. s 1033.

14. s 788.

15. s 825, 826.

16. s 827.

17. s 828.

18. These are conferred by the *Australian Securities Commission Act 1989* (Cth).

19. *ASC Act* s 29.

20. *ASC Act* s 19.

21. *ASC Act* s 30.

22. *ASC Act* s 41.

- there is no power to prudentially supervise non-complying superannuation schemes
- the powers of the regulator are not targeted towards the responsible entity
- no penalties, other than removal of the tax concession available to complying funds, can be imposed on responsible entities that breach (intentionally or unintentionally) any of the standards.

This situation is inconsistent with the Commonwealth's clearly stated objective of having consistency in regulation of superannuation schemes whatever the institution providing the scheme. The following paragraphs discuss some additional powers that the Review considers the regulator will need for all superannuation schemes, ADFs, PSTs and DAs.

## Additional powers for the regulator

### *Surveillance and investigation*

13.7. *Background.* A successful regulatory system which is designed to provide prudential supervision requires that the regulator have adequate information gathering powers. It is essential that the regulator have appropriate powers to monitor compliance with the laws governing superannuation, including conducting surveillance programs, requiring the production of documents and the disclosure of the whereabouts of information not supplied, examining persons capable of giving relevant information and, ultimately, gaining access to premises where sought-after documents may be located. However, care needs to be taken in drafting such investigative powers to ensure that they are adequate to enable the regulator to enforce the regulations without being excessive or overly costly. The recommendations in this chapter do not cover all the detailed matters that will need to be addressed in the design of such powers, for example, whether they can be exercised without suspicion of a contravention.

13.8. *The proposal.* In DP 50 the Review proposed that the regulator should have the same powers of investigation in relation to responsible entities of superannuation schemes, ADFs and PSTs and investment managers as the ASC has under the Corporations Law and the *Australian Securities Commission Act 1989* (Cth).<sup>23</sup> This proposal was supported in many submissions.<sup>24</sup> In

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23. DP 50 proposal 8.1.

24. eg Norwich Group *Submission* February 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992; LIFA *Submission* March 1992; National Australia Bank *Submission* March 1992.

response to submissions and consultations on this proposal, the Review recommends additional information gathering and investigative powers similar to those currently available to the ASC and ISC.

### *Investigation powers*

13.9. *Sources of information.* The regulator will receive from various sources information that may lead to investigative or enforcement action, including

- information lodged with the regulator under existing and proposed statutory reporting obligations
- complaints from scheme contributors or beneficiaries
- reports lodged by a scheme auditor
- random audits conducted by the regulator.

Comprehensive investigative powers are required to support this information gathering capacity and to ensure that the regulator can adequately and effectively respond to instances of uncertainty or suspected breach.

13.10. *Providing written information.* The ASC may, at any time and without any suspicion of a contravention, require a securities dealer to provide written information in relation to his or her securities business. The ASC can require specific information and require it to be audited.<sup>25</sup> The superannuation regulator should have similar compliance powers over responsible entities and investment managers, whether or not they hold dealers licences.

13.11. *Random audits.* There are over 100 000 superannuation schemes. It will be impractical for any regulator, no matter how well resourced, to pay close attention to each scheme. Moreover, the benefits gained from close supervision of all these schemes are almost certain to be outweighed by the additional costs. The disclosure measures already proposed by the Government and by the Review recognise this fact. The system must, therefore, rely on a high level of self regulation, reinforced by a strong program of random audits by the regulator and active involvement and interest by scheme members. A system of self assessment backed up by random audits is used by the Australian Taxation Office (ATO) to deal with its workload. It is proposed that the Australian Financial Institutions Commission (AFIC) will also use random audits as part of its prudential regulation of building societies and credit unions.<sup>26</sup> The Review

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25. Corporations Law s 788.

26. See Special Premiers' Conference Working Group on Non-Bank Financial Institutions, *Proposals for the Reform of the Supervisory Structure for Non-Bank Financial Institutions*, Information Paper, April 1991.

considers that the system of prudential supervision of superannuation schemes proposed in this report would be significantly enhanced by a vigorous program of random audits by the regulator.<sup>27</sup> Enough resources should be given to the regulator to enable it to carry out such a program of audits.<sup>28</sup>

13.12. *Production and explanation of documents.* OSSA<sup>29</sup> and the ASC Act<sup>30</sup> contain extensive provisions dealing with the power of the regulator to inspect and retain documents and, in the case of the ASC, to require an explanation of their contents. These powers may be exercised whether or not the ISC or ASC, respectively, has any suspicion of a breach of the law. Powers of this nature are essential to any form of prudential supervision of the superannuation industry. The ASC Act provisions are more comprehensive, particularly in respect of persons other than the responsible entity who may hold relevant information. The regulator's powers in the event of non-compliance could, with appropriate modifications, be modelled on the ASC Act Pt 3 Div 7 and 8. It will be especially important for the regulator to be able to require production of documents and the provision of information from superannuation scheme auditors, given the important role that they will have in the regulatory framework.

13.13. *Access to premises.* The powers to obtain documents could be defeated if the regulator is unable to ensure their security. The ISC has power of access to premises to search for and take possession of documents, but only in respect of life insurance companies.<sup>31</sup> The ATO and the TPC also have powers to enter premises to inspect, and take extracts from or copies of, appropriate documents.<sup>32</sup> A full access power should be available to the superannuation regulator. This will limit the possibility of persons destroying or altering documents in anticipation or in the face of a notice for their production.<sup>33</sup>

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27. The ISC currently conducts random audits of superannuation schemes that fall within its jurisdiction.

28. The Commonwealth has indicated that increased resources will be given to the ISC to allow it to increase its audit program for schemes for which it has regulatory responsibility: Treasurer's statement, paper 1 para 32.

29. s 11.

30. Pt 3 Div 3.

31. *Life Insurance Act 1945* (Cth) s 54B.

32. ITAA s 263; *Trade Practices Act 1974* (Cth) s 155(2). The ATO may exercise the access power for any of the purposes of the ITAA, whereas the TPC may so act only where it has reason to believe that a contravention may have taken place.

33. Such a power is available in other jurisdictions which prudentially supervise superannuation schemes eg see *Pension Benefits Act 1987* (Ont) s 107(3).

13.14. *Search warrants.* To complement the access powers, the superannuation regulator should be empowered to seek the issue and execution of search warrants. The ASC has these powers both under the ASC Act<sup>34</sup> and under the *Crimes Act 1914* (Cth).<sup>35</sup> The Review notes the extensive case law regulating the exercise of the search warrant powers.

13.15. *Examination of persons.* To ensure effective investigation, the regulator should be given appropriate powers to require persons to answer questions under compulsion. This power is given by the ASC Act<sup>36</sup> to the ASC where it reasonably suspects a contravention of the law. Comparable powers should be given to the superannuation regulator whenever it has 'reason to suspect' that a contravention of any relevant law may have been committed.

13.16. *Protection of examinees.* The proposed investigative and other information gathering powers will require persons to provide oral or written information under direction. The legislature has recognised the need for statutory coercive powers of this nature to accommodate the important 'right to silence' principles long recognised at common law. For instance, the ASC Act maintains the right of legal practitioners to claim legal professional privilege (or 'client legal privilege'), and the right of examinees to invoke an evidential immunity by claiming self-incrimination before answering questions under compulsion. The Review notes that these privileges are not absolute and that any evidential immunity arising in consequence of giving the information may be restricted. The Review supports the approach adopted in the ASC Act, subject to abolition of the 'derivative use' immunity, and the exclusion of corporations from claims of self-incrimination, as proposed in the *Corporations Legislation (Evidence) Amendment Bill 1992* (Cth).

#### **Recommendation 13.1: Random audits**

The regulator should conduct a program of random audits of responsible entities and investment managers for superannuation funds, ADFs and PSTs and the providers of DAs. Enough resources should be provided to the regulator to ensure that such a program can be established and maintained.

#### **Recommendation 13.2: Investigation powers**

In addition to any powers of investigation the regulator may have at present, the law should provide that the regulator has the power to

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34. s 36.

35. s 10.

36. Pt 3 Div 2.

- require from a responsible entity's external auditors information obtained by them in the course of the audit
- require from any person the production and explanation of documents relating to the affairs of a superannuation scheme and take copies or extracts of them
- enter upon and obtain full and free access within premises for the purpose of obtaining relevant information
- obtain and execute search warrants
- conduct examinations of relevant persons.

#### **Recommendation 13.3: Privileges**

The privileges from disclosure, the immunities from use in evidence and the liabilities for non-compliance should be similar to those applicable under the Corporations Law and the *Australian Securities Commission Act 1989* (Cth), as proposed to be amended by the *Corporations Legislation (Evidence) Amendment Bill 1992* (Cth).

## **Auditors**

### *Auditors to report*

13.17. *External auditor.* The external auditor of a superannuation scheme, ADF or PST plays a key role in their prudential supervision. Random audits by the regulator cannot alone effectively monitor compliance with prudential standards by all superannuation schemes. The external auditor is often best placed to ensure observation of the prudential controls over schemes, ADFs and PSTs and detect possible breaches.

13.18. *Proposal.* In DP 50 the Review noted that the Reserve Bank requires auditors as part of their audit of a bank to examine whether the bank's internal management systems for limiting risks to prudential levels set by the Reserve Bank are adequate. Similarly they are required to report on the efficacy of systems of credit control and data collection.<sup>37</sup> The Review considers a similar system of regulatory supervision for prudential purposes involving the auditors of superannuation schemes is essential if an adequate degree of safety for these schemes is to be provided cost effectively. Accordingly the Review proposed that auditors should be obliged to report to the regulator any breach, or suspected breach, of the prudential standards, or of any statutory or regulatory requirements, that comes to their notice in the course of their dealing with, or auditing of, a superannuation scheme. The Review also proposed that an auditor should be obliged to report to the regulator if, in its opinion, the responsible entity's

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37. See Reserve Bank of Australia, Prudential Statement H1, 1986.



management systems limiting risks to prudential levels are inadequate. The proposal added that auditors should receive appropriate protection for the contents of these reports.<sup>38</sup> Such a system could, for example, include a requirement for the auditor to check and report upon the efficacy of systems which were designed to ensure that

- the prohibition on borrowing is not breached
- the in-house investment limitation is not breached
- all assets worth more than 5% of the value of the scheme are identified
- the cash flow of the scheme is adequate to meet expected liabilities.

The regulator could, in addition, issue guidelines requiring superannuation auditors to determine, for instance, whether

- contributions have been properly paid into appropriate accounts
- fees have been charged and expenses allocated in accordance with the deeds or other instruments constituting the schemes
- superannuation payouts have been calculated in accordance with the deeds or other instruments constituting the schemes
- correct valuation procedures have been followed.

13.19. *Submissions.* There was considerable support for this proposal.<sup>39</sup> However, a number of submissions suggested that the auditor should have to discuss these items with the responsible entity before involving the regulator. They suggested that unless responsible entities are given an opportunity to rectify any problems first, reporting directly to the regulator could create an unnecessary workload for the regulator.<sup>40</sup> Some submissions opposed the proposal for notification on the ground that it was not the auditor's responsibility to report to the regulator.<sup>41</sup>

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38. DP 50 proposal 6.23.

39. eg Permanent Trustee Company Limited *Submission* February 1992; AMP Society *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; ASC *Submission* March 1992; National Australia Bank *Submission* March 1992.

40. Norwich Group *Submission* February 1992; LIFA *Submission* March 1992; National Mutual *Submission* February 1992; Westpac Financial Services *Submission* February 1992.

41. Shell Australia Ltd *Submission* February 1992; Australian Friendly Societies Association *Submission* February 1992. ASFA queried whether the auditing profession was well placed to furnish an appropriate report on the risk management activities of the responsible entity: ASFA *Submission* March 1992.

13.20. *Recommendation.* The Corporations Law obliges company auditors to draw possible irregularities to the attention of the ASC. They are given protection from civil liability.<sup>42</sup> The Review considers that this is an appropriate model to follow. Whether the auditor first approaches the responsible entity should be left to the discretion of the auditor. It should not be compulsory. To require the auditor to discuss the matter with the responsible entity first may impede the regulator's ability to respond quickly.

**Recommendation 13.4: Auditors to report suspected breaches etc.**

1. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation fund, an ADF or a PST, suspects on reasonable grounds that the responsible entity, or an investment manager engaged by the responsible entity, has contravened the laws governing superannuation, a prescribed law or the deed or other instrument constituting the scheme must report the matter without delay to the regulator. Failure to comply should be an offence.

2. The law should provide that an auditor who, in the course of dealing with, or auditing, a superannuation scheme, ADF or PST, forms the opinion that the steps taken by the responsible entity to limit the risk of loss to prudent levels are not achieving their apparent objectives must report the matter without delay to the regulator. Failure to comply should be an offence.

3. The law should provide that an auditor who makes either such report has protection similar to that provided under the Corporations Law s 332(9)–(10) and s 1289.

*Qualifications for superannuation auditors*

13.21. Given the importance of auditors in the regulatory process and the specific requirements of superannuation accounting, the standard of superannuation auditors should be subject to regulatory supervision. Auditors for life insurance companies are presently required to be specially approved by the ISC.<sup>43</sup> The ISC is investigating similar licensing options for superannuation scheme auditors.<sup>44</sup> The Review does not, however, recommend a licensing scheme for auditors. The objectives of a licensing scheme can be achieved,

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42. s 332(9)–(10); s 1289. The Review also notes the House of Representatives Standing Committee on Legal and Constitutional Affairs report *Corporate Practices and the Rights of Shareholders* (November 1991) recommendation 18, concerning the pre-requisite requirement of suspicion by the auditor.

43. *Life Insurance Act 1945* (Cth) s 47.

44. ISC Submission March 1992.

without the administrative cost of licensing, if the law makes it an offence for an unqualified person to act as auditor for superannuation schemes without the permission of the regulator. The qualifications should be specified by the regulator by *Gazette* notice. There will also need to be provision for the regulator to step in and restrain an otherwise qualified auditor from auditing one or more specified schemes. The regulator should have power to give such a direction to an auditor. However, the direction ought to be based on the regulator's perception of the risk of a contravention of a relevant law if the auditor is not prevented from auditing the scheme in question, and the direction should be reviewable by the AAT.

**Recommendation 13.5: Qualified auditors**

**1. The law should provide that a person who does not have the proper qualifications must not**

- act or purport to act as auditor of a superannuation fund, an ADF or PST or
- hold himself or herself out as willing or able so to act.

**Non compliance should be an offence. A person should be taken to have the proper qualifications only if the person**

- has satisfactorily completed a course of instruction approved by the regulator by notice in the *Gazette* or
- has experience of a kind, gained over a period, specified by the regulator by notice in the *Gazette*

**or if the regulator is satisfied that the person has enough knowledge and experience to conduct such audits competently and so certifies in writing; the regulator may give a person such a certificate, with or without an application.**

**2. An application for a certificate should have to be in accordance with a form approved by the regulator. If an application does not contain enough information to allow the regulator to consider the application properly, the regulator should be able, by notice in writing given to the applicant, request the applicant**

- to give further information or
- to produce to the regulator a specified document.

**Non-compliance with a request should not be an offence, but the regulator should be able to decline to deal further with the application.**

**3. On an application, the regulator should grant or refuse to grant the certificate. The decision should be reviewable by the AAT.**

4. The regulator should notify the applicant in writing without delay after making the decision on the application. If the decision is unfavourable to the applicant, the notice should state the reasons for the decision. If the regulator has not notified the applicant in writing of the decision on an application

- within 28 days after the application was received or
  - if the regulator has given the applicant a notice under paragraph 2 — within 28 days after the notice is complied with
- the application should be taken to have been refused.

5. The regulator should be able to direct a qualified auditor not to act or to offer or hold himself or herself out as able to act as auditor of a particular superannuation scheme, ADF or PST. The direction should be in writing and should only be given if the regulator is satisfied that, because of the risk of a contravention of the law imposing prudential control over the scheme, ADF or PST, or the Corporations Law, the *Life Insurance Act 1945* (Cth) or a prescribed law, the direction ought to be given. A decision to give the direction should be reviewable by the AAT.

## Power to order actuarial certificates

### *Proposal*

13.22. Currently, an actuarial investigation of a defined benefit scheme must be carried out every three years.<sup>45</sup> The trustee is responsible for organising that investigation. The Review proposed in DP 50 that the regulator and a scheme's auditor should be able to require an actuarial certificate within a three year period.<sup>46</sup> It also proposed that the actuarial assumptions used in the preparation of actuarial certificates should be disclosed.<sup>47</sup>

### *Comments*

13.23. Both proposals received considerable support.<sup>48</sup> Several submissions suggested, however, that this is beyond the role of both the auditor and the regulator.

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45. OSS Regulations reg 17(1)(a).

46. DP 50 proposal 6.19, para 6.23.

47. DP 50 proposal 6.20.

48. eg Permanent Trustee Ltd *Submission* January 1992; Westpac Financial Services *Submission* February 1992; ASC *Submission* March 1992.

It is difficult to see how an auditor or even the regulator would know whether an actuarial certificate should be called for within the regular three year period. If there has been some sudden, dramatic event that would seem to indicate a need for an actuarial certificate, it is unlikely that an actuary would be able to make realistic assumptions until there has been some experience under the new conditions. If the event is simply a stockmarket crash or something similar, then its effect on the scheme could probably be estimated without an actuarial review.<sup>49</sup>

One submission suggested allowing an auditor to recommend to the trustees that an investigation be made, and requiring the auditor to report that recommendation to the regulator if the recommendation is not accepted. The regulator could then require the trustees to advise members that they had rejected the auditor's recommendation.<sup>50</sup> The Review understands from submissions that the Institute of Actuaries standards already require actuarial assumptions used in calculations to be disclosed.

### ***Recommendation***

13.24. The Review now agrees that it is not appropriate for an auditor to be able to require a trustee to obtain an actuarial certificate. An auditor could recommend to a trustee that a new actuarial certificate would be desirable. The Review considers it is important, however, that the regulator be able to require the responsible entity of such a scheme to arrange for an actuarial investigation to be done within three years.

#### **Recommendation 13.6: Actuarial certificates**

**1. The law should provide that the responsible entity for a superannuation fund that is a defined benefit fund must have a current actuarial certificate no more than 3 years old. Failure to comply should be an offence.**

**2. The law should provide that the regulator may, by notice in writing given to a responsible entity for a defined benefit superannuation fund, require the responsible entity to obtain another actuarial certificate within such time as is specified in the notice, or such longer time as the regulator allows. Failure to comply with the requirement should be an offence.**

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49. Department of Finance (Cth) *Submission* February 1992.

50. Mercer Campbell Cook & Knight *Submission* February 1992.

**3. The law should provide that a certificate is not effective for the purposes of this recommendation unless it includes or has attached to it a statement of the assumptions on which the actuarial calculations to which it relates are based.**

## Enforcement

### *Types of enforcement powers*

13.25. Adequate enforcement powers are essential to create a deterrent against contravention of the law, to protect the interests of superannuation scheme members and to ensure, as far as practicable, compliance with the superannuation laws. Simply relying on the threatened withdrawal of tax concessions is not enough. The superannuation regulator should have an array of enforcement powers to ensure an effective enforcement strategy. These powers should comprise

- civil preservation actions
- civil recovery and representative proceedings
- administrative remedies
- criminal prosecutions.

### *Civil preservation actions*

13.26. These actions are designed to prevent or contain loss caused by wrongdoing, contraventions of the law or by a breach of a deed. In the case of superannuation they would permit the regulator to take civil proceedings to seek to preserve assets at risk or forestall actions by responsible entities, investment managers or others that appear to breach the laws governing superannuation schemes. The Review considers that the preservation powers available to the ASC are a suitable model for the powers that should be available to the superannuation regulator. Under its various powers the ASC may, by court order, obtain

- a Mareva injunction
- a statutory injunction and related orders
- an order for asset freezing, receivership and related remedies
- a dealers' restraining order
- provisional liquidations<sup>51</sup>
- an oppression order.

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51. cf judicial managers: *Life Insurance Act 1945* (Cth) s 59(1)(a).

**Recommendation 13.7. Preservation remedies**

The law should provide that the regulator have preservation powers, including the power to seek injunctions, similar to those now available to the ASC.

*Appointment of a judicial manager*

13.27. In DP 50 the Review suggested that there should be, for superannuation schemes, a power similar to a power that the ISC has, in the context of life insurance companies, to appoint a judicial manager.<sup>52</sup> An application for appointment could be made by the regulator, the responsible entity or a member of a superannuation scheme. This proposal received support in submissions.<sup>53</sup> The Review is satisfied that this is an important power for the regulator to have. The appointment should be of a temporary responsible entity. To exercise this power it should have to be of the opinion that the responsible entity is unable to fulfil its obligations. Because of the seriousness of the step, it should be under court control. Accordingly, the Review recommends that a court should have the power, on application by the regulator, the responsible entity or a member of a superannuation scheme, to appoint a temporary responsible entity for the scheme. The appointment should be on such terms and conditions as the court may specify, and should only be made if the court is satisfied that the responsible entity is unable to fulfil, or has failed to fulfil, its obligations.

**Recommendation 13.8: Temporary responsible entity**

1. The law should provide that the Federal Court, or the Supreme Court of a State or Territory, may, by order, on application by the regulator, the responsible entity for or a member of a superannuation fund, an ADF or a PST, appoint a temporary responsible entity for the scheme. The order should specify the powers of the responsible entity and be subject to such terms and conditions, including as to period of appointment, as are specified in the order.
2. Such an order should not be made unless the court finds that the responsible entity is not able to fulfil, or has not fulfilled, its obligations as responsible entity.

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52. DP 50 proposal 8.8.

53. eg Australian Shareholders' Association *Submission* February 1992; ASC *Submission* March 1992; ASFA *Submission* March 1992.

### *Civil recovery and representative proceedings*

13.28. *Introduction.* To further the goals of effective enforcement and to protect the interests of superannuation scheme members, the regulator should have suitable powers to take civil proceedings on behalf of, or for the benefit of, members. These civil powers should be exercisable independently of any possible criminal prosecutions. The regulator should be empowered to

- enforce the deed
- proceed against investment managers
- undertake representative actions against the responsible entity.

13.29. *Power to enforce the deed.* Currently, the deed of a superannuation scheme is enforceable against the responsible entity only by the scheme members. However, enforcing the deed through private litigation can be a time consuming and very expensive process.<sup>54</sup> Consequently, the power is unlikely to be used by members. The members' inability to take action is likely to be due to a lack of resources and cost effective remedies. The regulator simply lacks the requisite power. As the Review noted in IP 10, in a similar situation the law provided the NCSC with fewer powers in relation to unit trusts than were provided for members.<sup>55</sup> The Review proposed in DP 50 that the regulator should have the same power to enforce the deed against the responsible entity as the members have.<sup>56</sup> It proposed that the regulator should be able to stand in the shoes of the members to avail itself of the same rights, to enforce the deed and the obligations it and the general law impose, as the members do. This proposal was supported in many submissions.<sup>57</sup> Accordingly, the Review recommends that the regulator should have the same powers to enforce the deed against the responsible entity as the members have.

#### **Recommendation 13.9: Regulator may enforce members' rights**

**The law should provide that the regulator may, without the consent of the members of a superannuation fund, an ADF or a PST, take the same proceedings for relief against the responsible entity that a member of the scheme may take. "Relief" does not include damages or compensation.**

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54. See Treasurer's statement, paper 1 para 15.

55. IP 10 para 3.70. In 1990 the NCSC bought a small number of units in the Estate Mortgage trusts so that it could have available to it remedies that were available to the unitholders but not to the regulator.

56. DP 50 proposal 8.3.

57. eg Jacques Martin Industry Submission February 1992; Westpac Financial Services Submission February 1992; Australian Friendly Societies Association Submission February 1992.



13.30. *Proceedings against an investment manager.* The responsible entity has the right to proceed against an investment manager in both contract and tort. Responsible entities of some schemes may find their resources insufficient to launch such an action, or may otherwise decline to act. Therefore, it may be necessary in such cases for the regulator to take action. The Review proposed in DP 50 that the regulator should be empowered to ensure that the investment manager complies with its contractual and other obligations to the responsible entity.<sup>58</sup> However, this power should not relieve responsible entities of any fiduciary obligations to act in the interests of members. Submissions generally supported this proposal.<sup>59</sup> Some submissions expressed their support with the reservation that the regulator act with the consent of members of the responsible entity.<sup>60</sup> The Review considers that to allow the regulator to act only with the consent of the responsible entity may limit the effectiveness of this remedy. However, in practice, it would be unlikely that the regulator would act in the face of serious opposition by members of the scheme or by the responsible entity. The Review does not, therefore, propose such a restriction on this power.

**Recommendation 13.10: Regulator may enforce contracts against investment managers**

1. The law should provide that the regulator may, without the consent of the responsible entity or, or members of, a superannuation fund, take, in the name and on behalf of the responsible entity, the same proceedings for relief against an investment manager engaged by the responsible entity as the responsible entity may take. "Relief" includes damages and compensation.
2. The law should provide that the regulator is to be bound, in taking such proceedings, by the same obligations to the members as bind the responsible entity.
3. The law should provide that the regulator's taking those proceedings is not to affect any liability of the responsible entity for a breach of fiduciary obligation in failing to act.

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58. DP 50 proposal 8.4.

59. eg Permanent Trustee Company Ltd *Submission* February 1992; Commonwealth Bank Group Financial Services *Submission* February 1992; Australian Shareholders' Association *Submission* February 1992.

60. eg, National Mutual *Submission* February 1992; LIFA *Submission* March 1992; Pelham Webb & Co *Submission* February 1992; D Knox *Submission* February 1992. ASFA *Submission* March 1992 and DSS *Submission* February 1992 argued that the regulator should act only on the request of a responsible entity.

13.31. *Power of the regulator to undertake representative actions against the responsible entity.* In DP 50, the Review proposed that the regulator should be able to take proceedings against the responsible entity as the representative party under the enhanced representative procedure provided for in the *Federal Court of Australia Act 1975 (Cth)*<sup>61</sup> as if it were a member of the scheme.<sup>62</sup> This would enable the regulator to recover damages on behalf of the members. The importance of this power lies not just in its ability to reduce the legal costs associated with members enforcing their rights. It is also an important tool in the enforcement strategy regulators may adopt. Under that procedure, the regulator would not have to obtain the consent of the members being represented. However, if fewer than seven members are involved, the court may order that the proceedings no longer continue as an enhanced representative proceeding. In these cases the regulator should still be able to sue on behalf of the members, but only with the consent of the members.<sup>63</sup> There was support for this proposal in submissions.<sup>64</sup> The Review suggests that the regulator may act with the consent of one or more members. However, any requirement for majority member support would unduly limit representative actions. This civil representative power should not be used to bypass, or as a substitute for, external dispute resolution procedures between members and the responsible entity.<sup>65</sup>

**Recommendation 13.11: Regulator may sue for compensation for members**

- 1. The law should provide that the regulator has the power to take proceedings on behalf of a member of a superannuation fund, an ADF or a PST for compensation for loss or damage suffered by the member by conduct of the responsible entity that constitutes a contravention of the law regulating superannuation funds, ADFs and PSTs or the deed or other instrument constituting the scheme.**
  
- 2. The law should provide that such an action may not be taken on behalf of a member except with the written consent of the member.**

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61. See *Federal Court of Australia Act 1976 Pt IVA*. The amendment was made following the ALRC's report *Grouped Proceedings in the Federal Court* (ALRC 46).

62. DP 50 proposal 8.5.

63. This is similar to the power of the Trade Practices Commission under *Trade Practices Act 1974 (Cth)* s 87(1B).

64. eg Jacques Martin Industry *Submission* February 1992; Women's Economic Think Tank *Submission* February 1992; Securities Institute of Australia *Submission* February 1992; National Australia Bank *Submission* March 1992.

65. See para 12.33–12.42.

3. The law should provide that such a proceeding may be commenced in respect of an alleged contravention even though another proceeding has been commenced against the responsible entity in respect of the alleged contravention.

4. The law should provide that the court may find on the balance of probabilities, for the purposes of the proceeding, that a contravention has occurred.

#### *Administrative remedies*

13.32. *Banning orders and freezing transactions.* There is an obvious public interest in ensuring that dishonest or incompetent persons are precluded from controlling or managing superannuation schemes. Action by the regulator through banning or removal orders to curtail the activities of these persons may obviate or lessen reliance on later civil preservative or recovery remedies. Likewise, the capacity of the regulator to freeze transactions through stop orders may prevent or minimise detriment caused through incompetent or dishonest behaviour by such persons. In part this policing function is currently exercised by the ASC through the licensing requirements of the Corporations Law,<sup>66</sup> which apply to all persons dealing in securities, the suspension, revocation and banning order provisions<sup>67</sup> and the stop order capacity concerning prospectuses.<sup>68</sup> The Review supports and assumes the continued application of these provisions to the superannuation industry. However, these regulatory controls need further supplementation given, for instance, that the licensing provisions do not apply to responsible entities or investment managers that do not deal in securities, and the stop order power applies only in the context of prospectuses.

13.33. *Removal and banning orders — responsible entities.* Notwithstanding that the regulator will not have a pre-vetting or approval role in relation to the formation of a responsible entity,<sup>69</sup> the Review proposes that the regulator be able to remove or suspend a responsible entity, or a member or director of a responsible entity, of any superannuation scheme. In DP 50 the Review argued that, because these persons control other people's money, it is important that the regulator be able to act quickly to remove them if the regulator forms the opinion that this is necessary.<sup>70</sup> The regulator should be entitled to act if, in its opinion, a person ought to be removed or suspended having regard to the risk posed of their non-compliance with the relevant law, or where the person is

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66. Pt 7.3 Div 1.

67. Pt 7.3 Div 5.

68. s 1033.

69. Recommendation 8.3.

70. DP 50 para 5.10.

unable to fulfil his or her functions and duties. This may happen, for example, if a director of a responsible entity acts dishonestly or fails to exercise a reasonable degree of care and diligence in performing his or her duties.<sup>71</sup> This power should be able to be exercised in relation to all directors or members of a responsible entity including those elected or appointed as member representatives and employer representatives. The Review proposed that the regulator not be required to obtain a court order before removing a member or director from his or her position with the responsible entity.<sup>72</sup> Rather, the regulator should have an immediate stop order capacity,<sup>73</sup> subject only to the right of the affected person to seek a review under the *Administrative Appeals Tribunal Act 1975* (Cth).

13.34. *Recommendation.* This proposal received support in various submissions.<sup>74</sup> There were a number of submissions, however, that disagreed with the proposal.<sup>75</sup>

ASFA considers that measures which are aimed at giving the regulator some or all of the powers of a member run the risk of producing complacent members with the result that we end up with the 'worst of all worlds'; no one is watching the responsible entity. We recognise that the Review intends many of these powers to be 'reserve powers' to be used only when the system of member supervision breaks down. We are concerned, however, that this is not the way it will be perceived by members. For example, if the regulator has the power to remove or suspend a person it is not unreasonable to assume that, if there had been a need, the regulator would have done so. The implication of non exercise is that the regulator does not see a need — a member who has concerns could be excused for believing that, if there had been a significant problem, the regulator would have exercised the powers given to it.<sup>76</sup>

The Review concedes that some members may take that approach. However, it does not accept the proposition that the mere existence of such a power will lead to a significant decline in the level of members' interest in the administration of superannuation schemes. It has concluded that, on balance, the advantages of

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71. Those grounds can provide the basis for a court order prohibiting a person from managing a corporation: *Corporations Law* s 230(1)(d).

72. DP 50 proposal 5.4.

73. cf the ASC's interim stop order power in relation to the issue of securities under the *Corporations Law* s 1033(4).

74. eg Jacques Martin *Industry Submission* February 1992; Australian Shareholders' Association *Submission* February 1992; ASC *Submission* March 1992.

75. Trust Company of Australia *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992.

76. ASFA *Submission* March 1992.

the regulator having this power outweigh the disadvantages. The removal powers are a crucial element of any effective regulatory scheme, and are essential for the protection of the interests of contributors and beneficiaries of superannuation schemes.

**Recommendation 13.12: Removal and banning orders**

The law should give the regulator powers to ban or remove a responsible entity, a member of an unincorporated responsible entity or a director of an incorporated responsible entity. The law should provide that the regulator is able to suspend, indefinitely or for such period as it may specify, a person who is a director or member of a responsible entity of a superannuation scheme from the board of the responsible entity. This power should be exercisable if, in the regulator's opinion

- the person ought to be removed having regard to the risk posed of non-compliance with the relevant law, either by the director or the member of the responsible entity or
- the person is unable to fulfil, or has failed to fulfil, his or her duties or functions under the law or under the deed or other instrument constituting the scheme.

13.35. *Removal and banning orders — investment managers.* For similar protection reasons, the regulator should have the power to ban a corporation or an individual from acting as an investment manager for a superannuation scheme. In DP 50 the Review proposed that the regulator should have the power to remove an investment manager if, in the regulator's opinion, it ought to be suspended having regard to the risk posed of non-compliance with the relevant law or the apparent inability of the investment manager to fulfil its duties and functions. As with the removal of responsible entities, the regulator should not have to obtain a court order first; rather, the action of the regulator should be reviewable under the *Administrative Appeals Tribunal Act 1975* (Cth).<sup>77</sup>

13.36. *Recommendation.* The Review received submissions in support of this proposal.<sup>78</sup> Some submissions expressed concern about disruption to investment and management that could arise from the exercise of this removal power.<sup>79</sup> The Review recognises this concern, but considers that the regulator

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77. DP 50 proposal 5.13, para 5.20.

78. eg John A Nolan & Associates *Submission* February 1992; Permanent Trustee Company Ltd *Submission* February 1992; LIFA *Submission* March 1992.

79. AMP Society *Submission* February 1992; Mercer Campbell Cook & Knight *Submission* February 1992; ASFA *Submission* March 1992.

nevertheless needs this power to be effective. The Review anticipates that the regulator would act only in cases of necessity, and where protection of the scheme clearly outweighs these possible disruptions.

**Recommendation 13.13: Regulator may direct investment managers not to act**

1. The law should provide that the regulator may, by notice in writing served on a person, direct the person not to act or to continue to act as investment manager for the responsible entity for a superannuation fund. Non-compliance with the direction should be an offence. The direction should be reviewable by the AAT.

2. The law should provide that the regulator is not to serve such a notice unless it is of the opinion that

- having regard to the risk of non-compliance with the law, the regulations or the deed or other instrument constituting the fund, the person ought not to act as investment manager for the fund or
- the investment manager has not fulfilled or cannot fulfil its duties and functions as investment manager.

3. The law should provide that, if such a notice is served, the person on whom it is served is not to charge the responsible entity any fee in connection with the repayment or return of funds or assets to the responsible entity (that is, no exit fees).

*Stop orders*

13.37. *Prevent further sales.* To complete the range of appropriate administrative remedies, special provision needs to be made for personal superannuation schemes. The Review has concluded that the regulator should have 'stop order' powers, that is, power to issue an interim and, subject to a hearing, a final order preventing a responsible entity for a personal superannuation scheme from issuing further units or interests in the scheme to members of the public. The grounds on which an interim order could be issued should accord with those for which the ASC, under the Corporations Law,<sup>80</sup> can prevent the issue of further securities: that is, that, in its opinion, any information issued by the responsible entity concerning the scheme is false, misleading or deceptive.

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80. s 1033.

**Recommendation 13.14: Stop orders**

The law should provide that the regulator may issue a stop order preventing the responsible entity for a personal superannuation scheme or an ADF or the provider of a DA from issuing further units or interests in the scheme. Subject to a hearing requirement, the regulator should be able to issue a final stop order. The provision should be modelled on the Corporations Law s 1033.

13.38. *Cancel dealers licence.* In DP 50 the Review proposed that the regulator should be able to cancel or suspend a dealers licence or issue a stop order against a life insurance agent, so far as it relates to his or her superannuation activities.<sup>81</sup> Many submissions supported this proposal.<sup>82</sup> One submission went further to suggest that all life insurance agents should be required to come under the same licensing requirements as those prescribed by the Corporations Law and that the regulator should have the same powers to discipline agents as it does licensed dealers, representatives and advisers.<sup>83</sup> Another submission supported the proposal, but believed that the regulator should deal through the life insurer for any action against an agent.<sup>84</sup> The Review will consider the general question of licensing of life insurance agents in its later report. In practice, any stop order would have to be issued against both the insurance company and the particular agent.

**Recommendation 13.15: Stop orders: life agents**

The law should provide that the regulator may issue a stop order to a life insurance company preventing the company from continuing to use a particular life insurance agent in so far as the agent is involved in selling superannuation. If the regulator does not seek to confirm the order within a specified period the order should lapse.

*Criminal prosecutions*

13.39. *Taking proceedings.* Enforcement of the superannuation law through criminal proceedings is a central function of the regulator. The ASC undertakes this task under the Corporations Law, in conjunction with the Director of Public Prosecutions (Cth).<sup>85</sup> A similar power should reside with the superannuation regulator.

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81. DP 50 proposal 8.9.

82. eg Australian Investment Managers' Group *Submission* February 1992; ASC *Submission* March 1992; Jacques Martin Industry *Submission* February 1992.

83. Securities Institute of Australia *Submission* February 1992.

84. AMP Society *Submission* February 1992.

85. Corporations Law s 1315; *Australian Securities Commission Act 1989* (Cth) s 49.

**Recommendation 13.16: Instituting prosecutions**

**An information, charge, complaint or application in relation to any proceedings for an offence against a superannuation law may be laid or made by the regulator or a delegate of the regulator.**

13.40. *Grounds of liability.* The Review has not identified in detail all the necessary elements of offences under its recommended superannuation laws, or the level or nature of appropriate penalty. However, in relation to breaches of fiduciary obligations, the Review considers that such offences should be based on the principle that criminal liability should not apply in the absence of criminality.<sup>86</sup> The *Corporate Law Reform Bill 1992* proposes that, in the context of directors' duties, only contraventions committed knowingly, intentionally or recklessly constitute an offence, and then only if committed dishonestly, intending to gain an advantage for themselves or some other person or with intent to deceive or defraud someone.<sup>87</sup> The same principles should apply to members of responsible entities who contravene the superannuation law.

**Recommendation 13.17: Issues of criminal liability**

The criteria for criminal liability of individuals, or directors of bodies corporate or members of the board of the responsible entity for breach of duty should, in principle, be the same as is proposed in the *Corporate Law Reform Bill 1992*. An act or omission of an individual, a director or member of a responsible entity that would, if done or omitted by a director of a company, attract the civil penalty orders provisions proposed to be inserted in the Corporations Law by the *Corporate Law Reform Bill 1992* (proposed Pt 9.4AA, Div 2) should attract similar liability under the proposed new law.

## Merger of superannuation schemes

13.41. The Review considers that the process of merger should be left to the relevant responsible entities and scheme members, and that it would be inappropriate to authorise the regulator to compel mergers. Rather, the regulator should have a monitoring role. The Review recommends that the regulator should have a supervisory power to monitor merger proposals and, if necessary, impose an interim stop order, subject to court confirmation. This mechanism of

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86. Breaches of merely regulatory laws, such as laws requiring reporting to the regulator, are in a different category.

87. *Corporate Law Reform Bill 1992* (Cth) proposed s 1317AT(1).



residual regulator and judicial involvement is preferred over the more complex procedures governing mergers and reconstruction of companies under the Corporations Law.<sup>88</sup>

**Recommendation 13.18: Merger of superannuation schemes**

- 1. The law should not require the prior approval of a court or the regulator for mergers of superannuation schemes.**
- 2. The law should provide that a proposed merger should have to be notified to the regulator, who should be able to issue, within 21 days, an interim stop order to prevent the merger proceeding. The regulator should be required to initiate court proceedings within 14 days of issue to have the order confirmed.**

## **Funding the regulator**

13.42. Effective prudential supervision of superannuation schemes is too important to be jeopardised by insufficient funding of the regulator. The ASC is funded from parliamentary appropriation and registration fees levied on corporations. Currently the ISC is funded indirectly through a system of industry levies. The Review considers that, given the importance of superannuation for a number of Commonwealth policies, the regulator should be publicly funded rather than industry funded, wholly or partly, directly or indirectly. Unless it is publicly funded, conflicts of interest may arise or may be seen to arise between the regulator's public duty and the interests of the industry which, directly or indirectly, funds it.

**Recommendation 13.19: Funding the regulator**

**The regulator should be funded solely from Consolidated Revenue. The funding should be fully independent of any levy that government may choose to impose on the superannuation industry.**

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88. Pt 5.1.