Superannuation Heatwave – Part One: regulatory oversight set to blister the super industry unless trustees take pre-emptive action

Michael O'Connor, Lawyer, Holding Redlich

Abstract

Consensus is that superannuation trustees (**Trustees**) should be held to the highest standard, but there is no consensus as to what that standard should be. Governments and regulators have tried to legislate their way to a solution and have created something of a regulatory heatwave rolling through the superannuation industry. To date, changes have been manageable; however, rising pressures of often complex, inconsistent changes—many yet to come—have the potential to supercharge into a perfect storm. Add into this super cycle the never-ending politicking, fragile post-pandemic recovery, war in Ukraine, rising inflation, and volatile markets, and the likelihood of some Trustees blistering from the regulatory heat seems inevitable. Given such trying conditions, Trustees will inevitably be required to keep one eye on a rapidly evolving complex legal system, while placing the other on maximising returns. To meet these challenges, this article identifies five regulatory hotspots to assist Trustees in taking pre-emptive to reduce operational risk.**

Catchwords

ANNUAL PERFORMANCE ASSESSMENT, BEST FINANCIAL INTERESTS COVENANT: REVERSE ONUS OF PROOF, REPORTABLE BREACHES, INTERNAL DISPUTE RESOLUTION GREENWASHING, SUPERANNUATION TRUSTEES

** This article is split into two Parts. Part One, this publication, highlights existing legislative hot spots, that if not planned for, may yet still burn some Trustees in 2023. Part Two will move on to a similar analysis with proposed legislation likely to impact Trustees in 2023/2024. While this two part article is intended for readers, well versed in the various legal topics examined, it should be noted that it does not cover the field on all the challenges that Trustees might face when attempting to meet these legal obligations. The purpose of this article is to demonstrate that even well-intentioned law reform can create pain points, raising serious operational risk for Trustees.

Contents

1 Introduction 3
2 Superannuation Hotspots 4
2.1 Hotspot One: annual performance assessment 4
2.1.1 Summary 4
2.1.2 The Assessment and SIS 4
2.2 Hotspot Two: reverse onus of proof 5
2.2.1 Summary 5
2.2.2 Evidentiary Burden 6
2.3 Hotspot Three: reportable breaches 6
2.3.1 Summary 6
2.3.2 Lack of clarity of what is and is not a reportable situation 7
2.4 Hotspot Four: internal dispute resolutions 7
2.4.1 Summary 7
2.4.2 A quagmire of obligations and guidance 8
2.5 Hotspot Five: greenwashing 8
2.5.1 Summary 8
2.5.2 Lack of uniformity 9
3 Next weather report 9

1 INTRODUCTION

Over the past decade, the superannuation industry has been subject to various "weather patterns" when it comes to legal reform.[1] On one hand, clear improvements in accountability and member protection have been evident and timely.[2] No longer is it easy for members to passively acquire multiple superannuation accounts.[3] Nor is it likely that disclosure breaches, misleading and deceptive conduct or charging fees to dead people, will continue to go unpunished.[4] On the other hand, the speed at which these regulatory reforms have occurred, the political heat and intensity in their implementation, has resulted in needless compliance complexity for superannuation trustees (**Trustees**).[5] This article coins this effect as the industry's "superannuation heatwave". Where, despite best intentions, the clear shortfalls in new or recently updated legal reform cumulatively radiates operational risk for Trustees.

Despite Trustees' best efforts to weather compliance complexity, for some, this heatwave is likely to soon burn, blister and, finally, painfully pop. The number of regulatory exposures for Trustees, all the while attempting to gain returns in a market dealing with a post-pandemic recovery, war, rising inflation and recession, is likely to result in instances of Trustees only fully understanding the regulatory environment once non-compliance has occurred. Undoubtedly, ongoing reform is essential for an industry overseeing 3.3 trillion dollars of Australians' hard-earned money.[6] But the pace and complexity of these reforms, and the heat they emit, must be examined holistically. To this end, this article highlights five "hot spots" relating to recently introduced law reform to assist Trustees in identifying the prickly parts of their obligations.[7]

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[1] Treasury, *Financial System Inquiry Final Report* (November 2014) (**Ramsay Review**); *Royal Commission Misconduct in the Banking, Superannuation and Financial Services Industry* (Final Report, 4 February 2019); see also Australian Prudential Regulation Authority (**APRA**), 'Law reform: Superannuation regulator roles' (Media Release, 14 February 2020).
[2] *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019* (Cth); *Treasury Laws Amendment (Putting Members' Interests First) Act 2019* (Cth); *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth).
[3] *Superannuation Guarantee (Administration) Act 1992* (Cth), section 32C(1A).
[4] *The Queen v Avanteos Investments* [2022] VCC 869 (1.7 million); *ASIC v MLC Nominees Pty Ltd* [2020] FCA 1306 ($57.5 million); *ASIC v Colonial First State Investments Ltd* [2021] FCA 1268 ($20 million); *ASIC v Aware Financial Services Australia Limited, VID551/2020* ($20 million); *ASIC v Westpac & BT Funds Management Ltd [2021]* FCA 1008 ($10.5 million); *ASIC v RI Advice Group Pty Ltd (No 3)* [2022] FCA 84 ($6 million); *ASIC v Statewide Superannuation Pty Ltd* [2021] FCA 1650 ($3.5 million); *ASIC v BT Funds Management Ltd* [2021] FCA 844 ($3 million).
[5] 'The superannuation system in Australia is ever-changing and becoming increasingly complex…' Danielle Press, Australian Securities Investment Commission (**ASIC**) Commissioner, 'Superannuation regulatory update: What to expect over the next five years' (Speech, AIST Conference, 7 September 2022).
[6] Association of Superannuation Funds of Australia (**ASFA**), 'Superannuation Statistics' (November 2022).
[7] While this paper pre-empts potential pain points for trustees in 2023, the rapid changing nature of legal reform may result in this article needing to be updated since its inception (9 January 2023). Furthermore, readers should note this essay is to be split into two parts. First Parts covers, annual performance assessment, reverse onus of proof (relating to best financial interests covenant), Reportable Breaches, Internal Dispute Resolutions & Greenwashing. Second Part will likely cover topics such as FAR, objective of super, Design Distribution Obligations, Conflicts, unresolved SFT corrupt benefit cases and proposed CPS 220 'Outsourcing'.

2 SUPERANNUATION HOTSPOTS

2.1 HOTSPOT ONE: ANNUAL PERFORMANCE ASSESSMENT

2.1.1 Summary

Introduced in 2021, the Annual Performance Assessment (**Assessment**) triggers new covenants under section 52 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS**) if Trustees fail to meet the minimum performance threshold for Part 6A (for now, MySuper) products.[8] These covenants (i.e. sending prescribed letters to members to exit the fund, or, on consecutive fail, prohibiting Trustees from accepting members into the product) is likely to have already been a central focus for Trustees. On face value, the Assessment, which measures performance over a period of eight years, and contains a minimum performance baseline to which Trustees must meet, is a welcome inclusion to the industry. However, the inconsistencies and friction between the Assessment and other SIS provisions will also likely create stifling conditions for Trustees. Incorporate recent statements made by APRA on Trustees' performance and this new regulatory requirement begins to take on a white-hot molten quality that is likely to pose a serious risk for Trustees.[9]

2.1.2 The Assessment and SIS

Maximise members' retirement savings: that is the ultimate superannuation goal (albeit currently up for review and potentially to be updated by the current Government).[10] This goal, to a large degree, is achieved in two parts. Firstly, compulsory acquired savings from members' wages. Secondly, Trustees utilising this collective pool of compulsory savings and investing it over the long-term. To date, this compact between Trustees and members has trail-blazed into one of the most important investments Australians will ever make. However, given the compulsory nature of such investments, this relationship between Trustee and member—crucially—has been legislated to ensure additional obligations are placed on Trustees than otherwise prescribed under trust law. Yet, despite this goal, the special nature between Trustees and members and the additional legal requirements placed on Trustees, the Assessment has, unfortunately, the secondary effect of diverting Trustees to overlook all of the above. Specifically, the Assessment has the potential to pressure Trustees to make short-term riskier, or (conversely), overly cautious decisions in an endeavour to not fall short of the Assessment.[11] Such conduct, if carried out,

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[8] See Appendix A; see also *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS**), subsections 52(14), 60E(2)(c) & 60F(2); see also Revised Explanatory Memorandum, Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (Cth) 2.19-2.79.

[9] APRA 'APRA releases updated MySuper Heatmap' (Media Release, 15 December 2022); APRA 'Small and medium super funds face sustainability challenges' (29 March 2022); APRA Member Margaret Cole - Speech to the Investment Magazine Chair Forum, dated 28 March 2022; Margaret Cole, 'APRA Executive Board Member, Margaret Cole - speech to the Financial Services Council webinar' (FSC webinar, 20 October 2021).

[10] Stephen Jones MP, Assistant Treasurer and Minister for Financial Services, 'Transforming super, wealth and advice' (Speech, AFR Wealth and Super Summit, 8 November 2022); see also SIS, section 3.

[11] *Superannuation Industry (Supervision) Regulations 1994* (Cth) (**SIS Regs**), regulations 9AB.1 to 9AB.20; see also APRA, 'The Annual Superannuation Performance Test – 2022' (Media Release, 31 August 2022); see also Treasury, 'Review of Your Future, Your Super Measures' (Consultation Paper, 7 September 2022), which includes including the following questions posed to trustees: 1. Does the measurement of actual return using strategic asset allocation affect risk-taking behaviour by superannuation trustees?; 2. Does the current set of indices used to calculate benchmark returns unintentionally distort investment decisions or reduce choice for members? If so, is there a way to adjust the benchmark indices while maintaining a clear and objective performance test? 3. Does the calculation of actual RAFE and benchmark RAFE discourage non-performance related product features that members may value? If so, can this be addressed without diminishing the test's focus on performance? 4.

would likely place Trustees in contravention of several SIS requirements. For example, a Trustee who either adjusts its benchmark allocation to tinker with the performance line goalpost or makes riskier (or risk-averse) decisions, in a bid to avoid the Assessment covenants being triggered, could, inadvertently, risk contravening the following SIS provisions:

- **the duty to act honestly** in all matters concerning the entity: tinkering with benchmark/strategic allocations to not fail the Assessment, rather than basing allocations on relevant investment considerations, can, objectively, pose a risk of entering the realm of dishonest conduct;
- **the duty to act in the best financial interests of members** and duty to promote the best financial interests of members: making riskier investments to not fall short of the Assessment, thereby placing members' retirement savings at risk (for a non-investment related factor) is likely to not to be considered a reasonably justifiable decision made by the Trustee;
- **the duty to give priority to the duties and interests of the beneficiaries** over the duties to and interests of other persons: Trustees, giving priority to themselves, to not fail the Assessment, rather than members' best financial interests, is likely also to breach the conflicts covenant;
- **the duty to act fairly in dealing with beneficiaries within a class**: utilising current member savings and making riskier short-term decisions to increase Assessment performance is likely to prejudice those members compared to future members who did not have to carry such risk;
- **the duty to ensure the fund is maintained solely for the benefits of each member of the fund (sole purpose test)**: factoring in the Assessment over maintaining the fund for the payment of member benefits, is likely not to fall within the scope of the sole purpose test; and
- **giving effect to a Trustee's investment strategy:** if the Assessment is used as a factor for investments, which are unlikely to include preventing the Assessment as a relevant investment consideration, Trustees may fail giving effect to their implemented investment strategies.[12]

Principles of statutory interpretation can mean that particular constructions of legislative provisions can be interpreted in harmony with each other. However, it is clear that the text of each of the obligations above (and the primacy in statutory interpretation of giving effect to the text itself) results in no opportunity for the Assessment to be used as a defence for breaching such provisions of SIS.[13] Therefore, it is vital that Trustee's consider looking at the Assessment holistically, with other relevant legal obligations, to ensure they are not being sun smart in one area, but than forgetting another and inadvertently getting burnt by SIS law.

2.2 HOTSPOT TWO: REVERSE ONUS OF PROOF

2.2.1 Summary

In 2021, the best interests covenant was amended to clarify that 'best interests' meant 'best financial interests'.[14] The change can be classified as a clarification of the covenant's scope, ensuring no room for

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What are the longer-term impacts of the performance test on market dynamics and composition? How will these factors impact on long-term member outcomes?).

[12] SIS, sections 52(2)(d)(i)-(iii), 52(2)(c), 52(2)(e), 52(6), 52(12), 62; see also relevant Director provisions under SIS, s 52A

[13] *Federal Commissioner of Taxation v Consolidated Media Holdings Ltd* (2012) 250 CLR 503, [39] (the Court), quoting *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* (2009) 239 CLR 27, [47]; see also *Project Blue Sky Inc v Australian Broadcasting Authority* (1998); *SZTAL v Minister for Immigration and Border Protection* (2017) 262 CLR 362.

[14] *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth); *Re QSuper Board* [2021] QSC 276; see also *Australiansuper Pty Ltd v McMillan* (2021) SASC 147; *Australian Prudential Regulation Authority v Kelaher* [2019] FCA 1521;

argument that the obligation focuses on the financial interests of members.[15] Whilst this technical change was minor, the simultaneous and inextricably linked introduction of section 220A of SIS turned the impact of the covenant on its head by reversing the onus of proof and requiring Trustee's in civil proceedings to start from a presumption of guilt.[16]

2.2.2 Evidentiary Burden

Rarely is the position under law "guilty till proven innocent".[17] Given that this reverse onus of proof now applies to alleged contraventions of the best financial interests covenant, Trustees must now undertake a sweltering amount of record keeping and risk assessment to guard against proceedings alleging a breach of the best financial interests covenant.[18] Given that an alleged breach can be linked to any decision, or lack thereof, notably including spending and investing decisions, Trustees and directors are being asked to keep an impracticable amount of evidence when administrating their respective super funds. To this end, the Government has recently flagged a review of the reverse onus of proof, but, to date, no further proposed legislation has been put forward.[19] Include the fact that an alleged contravention of the best financial interests covenant can be adjoined to any other alleged contravention of SIS (such a breach of the conflicts covenant, sole purpose test, or duty to act honestly), the impact of s 220A begins to take on an incendiary quality that can surge on multiple legal obligations required of Trustees. The effect of this is that Trustees must constantly look for the next potential spot fire, which, once identified, requires them to defend from a position of wrongdoing until proven otherwise.

2.3 HOTSPOT THREE: REPORTABLE BREACHES

2.3.1 Summary

Division 3 of Pt 7.6 of the *Corporations Act 2001* (Cth) (**Corporations Act**) requires Australian financial services (**AFS**) licensees, including Trustees, to report certain breaches to the Australian Securities and Investments Commission (**ASIC**).[20] The obligation was updated in October 2021 after previous breach reporting requirements were considered too ambiguous, leading to inconsistent and delayed reporting within the required timeframes.[21] Notably for Trustees, the previous reporting regime was also in-line with RSE licensee requirements to notify APRA of certain breaches.[22] This previous reporting included, to a degree, a subjective assessment from the Trustee to assess whether certain breaches were

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Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd [2010] NSWSC 363; *Cowan v Scargill* [1985] 1 Ch 270.

[15] SIS Act, section 220A.

[16] Ibid; see also n above at [6].See Appendix B. In this Heatmap, Trustees should focus on the evidential burden definition and scope of the best financial interest covenant itself. While the reverse onus of proof creates headaches in records and documentations that need to be kept, it should be noted that there is also additional risk in not keeping the same level of evidence for other Trustee obligations.

[17] Australian Law Reform Commission, 'Traditional Rights and Freedoms—Encroachments by Commonwealth Laws (ALRC Interim Report 127, 31 July 2015), Chapter 11 'Burden of Proof; see also Australian Law Council, Your Future, Your Super package' (Submission, dated 23 December 2020), pages [9] – [11].

[18] Revised Explanatory Memorandum, Treasury Laws Amendment (Your Future, You Super) Bill 2021 (Cth), 3.59-3.67.

[19] Treasury, Your Future, Your Super Review, Consultation Paper, dated 7 September 2022, question posed 'Is the reverse onus of proof the most appropriate way to achieve the objective of improving member outcomes?'..

[20] *Corporations Act 2001* (Cth) (**Corporations Act**), sections 912D to 912DAD.

[21] Explanatory Memorandum, Financial Sector Reform (Hayne Royal Commission Response) Bill 2020 (Cth); See also Financial Services Royal Commission (Final Report, 1 February 2019), recommendations 1.6, 2.8 and 7.2.

[22] SIS Act, section 29J;

significant.[23] While the RSE licence reporting has remained unchanged, the updated section 912D reporting obligations have now significantly broadened in scope to cover both the previous assessments made under the s 912D, deemed significant breaches, and investigations determining whether a breach has occurred.[24]

2.3.2 Lack of clarity of what is and is not a reportable situation

Friction arises under the new reporting regime as to what is and is not a reportable situation.[25] For example, one of the new reportable situations, investigations ongoing for more than 30 days, leaves the term 'investigation' undefined.[26] Ambiguity further arises in section 912D where it is unclear if such investigations include an investigation into a significant breach of a core obligation or all breaches of core obligations, which may or may not be deemed significant.[27] These ambiguities result in almost every possible error made by Trustees needing to be reviewed for a reportable situation, which, once completed, still leaves Trustees unsure whether the provisions have even been interpreted correctly.[28] The confusion is evidenced by an ASIC review on reportable breaches, stating that:

- only 6% of the AFS licensee population lodged a report during the regime's first nine months;
- AFS licensees are still taking too long to identify and investigate some breaches;
- more work needs to be done to appropriately identify and report the root cause of breaches; and
- in 18% of the reports received, it took the AFS licensee more than one year to identify and commence an investigation into an issue after it had first occurred.

2.4 HOTSPOT FOUR: INTERNAL DISPUTE RESOLUTIONS

2.4.1 Summary

For all AFS licence holders, new internal dispute resolution (**IDR**) requirements were implemented on 5 October 2021.[29] The updated requirements include:

- a broadening of the definition of complaint, which includes any expression of dissatisfaction;
- shortened timeframes to respond to complaints, including acknowledging a complaint within 24 hours; and
- IDR delay notifications for when a Trustee reasonably believes it cannot provide a resolution within the 45-day timeframe.[30]

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[23] SIS, section 29J(1A)(a)-(e)
[24] See Appendix C; see also ASIC, 'Reportable situations (previously breach reporting)' (Media Release, 7 December 2021); see also Corporations Act, subsections 912D(1)-(5).
[25] ASIC, 'Report 740 Insights from the reportable situations regime: October 2021 to June 2022 (**Report 740**), October 2022. The report highlights a large gap in consistency of reporting under the new regime; See also Regulatory Guide 78: Breach reporting by AFS licensees and credit licensees (**RG 78**), which summarises the number of reviews that must be taken in order to consider whether a reportable situation has occurred and is therefore reportable.
[26] Corporations Act, section 912D(1)(c); see also RG 78.52.
[27] Corporations Act, sections 912D(1)(a) to (c); see also RG 78, RG 78.34, which interprets the requirement as a 'significant breach of a core obligation' going with one of the two possible interpretations to section 912D(1)(c).
[28] Report 740, page 3 'Key insights from the reporting period'.
[29] Corporations Act, section 912A(2)(a)(i); SIS Act s101(1); Regulatory Guide 271 Internal Dispute Resolution **(RG 271)**, September 2021.
[30] RG 271, RG 271.27 to 271.44 (definition of complaint); RG 271, RG 271.51 (acknowledgement of complaint); RG 271, RG.156 to 271.106 (Maximum Timeframes); RG 271.66 (IDR Delay notification).

2.4.2 A quagmire of obligations and guidance

It is clear that the implementation of IDR has not been smooth.[31] ASIC recently stated that it had serious concerns that over 50% of Trustees it had reviewed did not comply with sending an IDR delay notification when required.[32] Further, one in three Trustees advised ASIC that there were varying degrees of process failures or errors in their IDR systems.[33] These included identifying or capturing complaints correctly, omitting mandatory content from IDR response letters or failing to send out IDR responses for some complaints. It is true that the previous complaint regime led to some members remaining in a "complaint limbo", and the new regime attempts to rectify this by placing more onus on Trustees to resolve complaints.[34] However, some challenges remain. Firstly, ASIC Regulatory Guide 271 'Internal dispute resolution' creates tension by containing both legal requirements imposed on Trustees and non-legal guidance that Trustees may choose to consider.[35] Whilst this merge of legal conditions and non-legal guidance is well-intentioned, the amalgamation has increased complexity as Trustees attempt to see through the searing haze of legal requirements versus the "nice to haves". Secondly, the scope of what is defined as a complaint, including any expression of dissatisfaction, creates a level of ambiguity and subjectivity that Trustees must individually assess each time. To date, these blisters have yet to be soothed with some Trustees '…failing to comply with fundamental obligations, which could lead to poor outcomes, such as consumers abandoning a complaint rather than seeing it through'.[36]

2.5 HOTSPOT FIVE: GREENWASHING

2.5.1 Summary

'Greenwashing' is a term used to describe the giving of false information on financial products that relate to environmental, sustainable and ethical standards.[37] Regulators have begun to take action on such conduct, stating that the practice of greenwashing is a serious concern for a sector set to grow to 53 trillion dollars (USD) by 2025.[38] Despite this increasing concern on greenwashing, to date no uniform legal regime has been imposed on Trustees.[39] Instead, the following disclosure requirements and misleading prohibitions attempt to cover the field:

- Corporations Act prohibitions on misleading and deceptive conduct;[40]
- AFS licensee obligation: to do all things necessary to ensure that the financial services covered by the license are provided efficiently, honestly and fairly;[41]

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[31] ASIC, 'Disputes and deficiencies: A Review of complaints handling by superannuation trustees' (Report 751, December 2022)
[32] ASIC, '22-347MR Superannuation trustees on notice to uplift complaints handling', April 2017.
[33] Ibid.
[34] ASIC, '22-071MR ASIC releases final internal dispute resolution data reporting requirements' (Media Release, 30 March 2022); see also EDR Panel 'Review of the financial system external dispute resolution and complaints framework' (Ramsay Review), April 2017.
[34] Ibid.
[35] See Appendix D; RG 271.
[36] ASIC, 'Superannuation trustees on notice to uplift complaints handling' (Media Release, 9 December 2022).
[37] Cathie Armour, ASIC Commissioner 'What is "greenwashing" and what are its potential threats?' (ASIC Review, dated July 2021)
[38] ASIC, '22-141MR How to avoid 'greenwashing' for superannuation and managed funds' (Media Release, 14 June 2022)
[39] See Appendix E; cf Treasury 'Climate-related financial disclosure' (12 December 2022), where treasury have begun to consider whether uniform disclosure requirements are needed for final products.
[40] Corporations Act, sections 1041E, 1041G and 1041H; Australian Securities and Investments Commission Act 2001 (Cth), sections 12DA and 12DB.
[41] Corporations Act, section 912A.

- Superannuation Trustee and Director obligations: to act honestly in all matters concerning the entity;[42]
- Product Disclosure Statement requirements.[43]

2.5.2 Lack of uniformity

The increased regulatory oversight related to greenwashing comes after ASIC published Information Sheet (INFO 271) 'How to avoid greenwashing when offering or promoting sustainability-related products'.[44] While INFO 271 is a welcome guide on how Trustees may navigate the legal requirements to avoid greenwashing, the mishmash of obligations across a number of different legislative acts, instruments and guides has created ambiguity on the precise requirements required when issuing and advertising ESG related financial products. Given there has been no uniform expectations for Trustees to date, the current expectation is that for every issue, disclosure, advertisement or representation made surrounding ESG, Trustees must each time navigate this candescent and blurry set of obligations. As a result of these various legal requirement, "ESG products" being considered to be issued by Trustees take on a new storm of complexity. That is, as Trustees offer ESG superannuation products/investment options they must look at different angles of the law, rather than in unified location, to ensure they have met all of obligations.

3 NEXT WEATHER REPORT

Much of what has been highlighted above focuses on current legislative obligations that has the potential to presently singe Trustees. With further heatwaves predicted (proposed legislation, regulations and prudential standards) Trustees must ensure that they not only take pre-emptive action on avoiding these current hot-spots, but also plan for what is to come. Only by preparing for such weather events will Trustees be able to minimise the impact of regulatory reform that consistently includes sultry pain points. To this end, Part Two, to be published in t 2023, will focus on proposed reform set to be introduced in 2023/2024.

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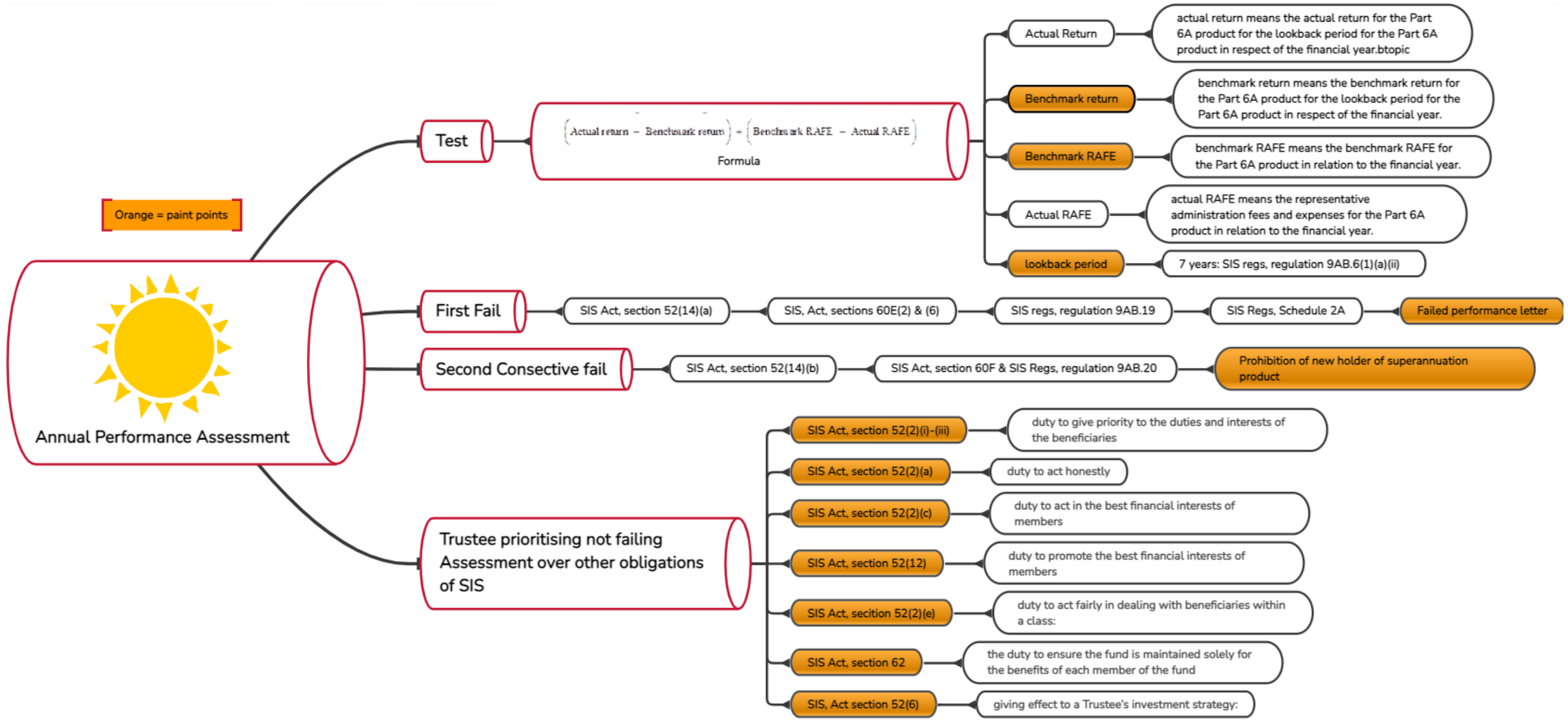
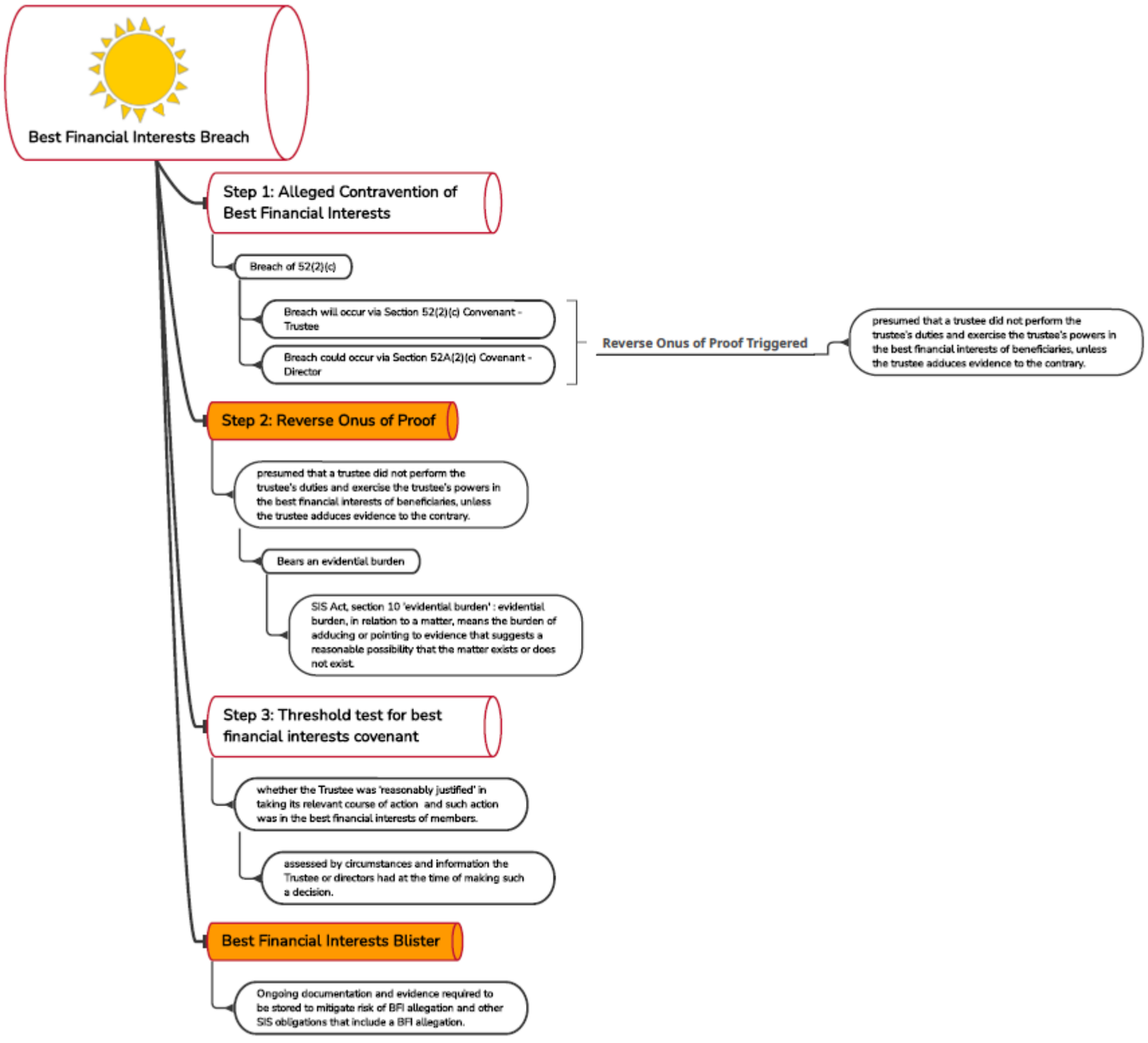
[42] SIS Act, sections 52(2)(a) & 52A(2)(a).
[43] See Appendix E; see also Corporations Regulations 2001 (Cth), Sch 10D, regulation 7(9)(c).
[44] above n 37.

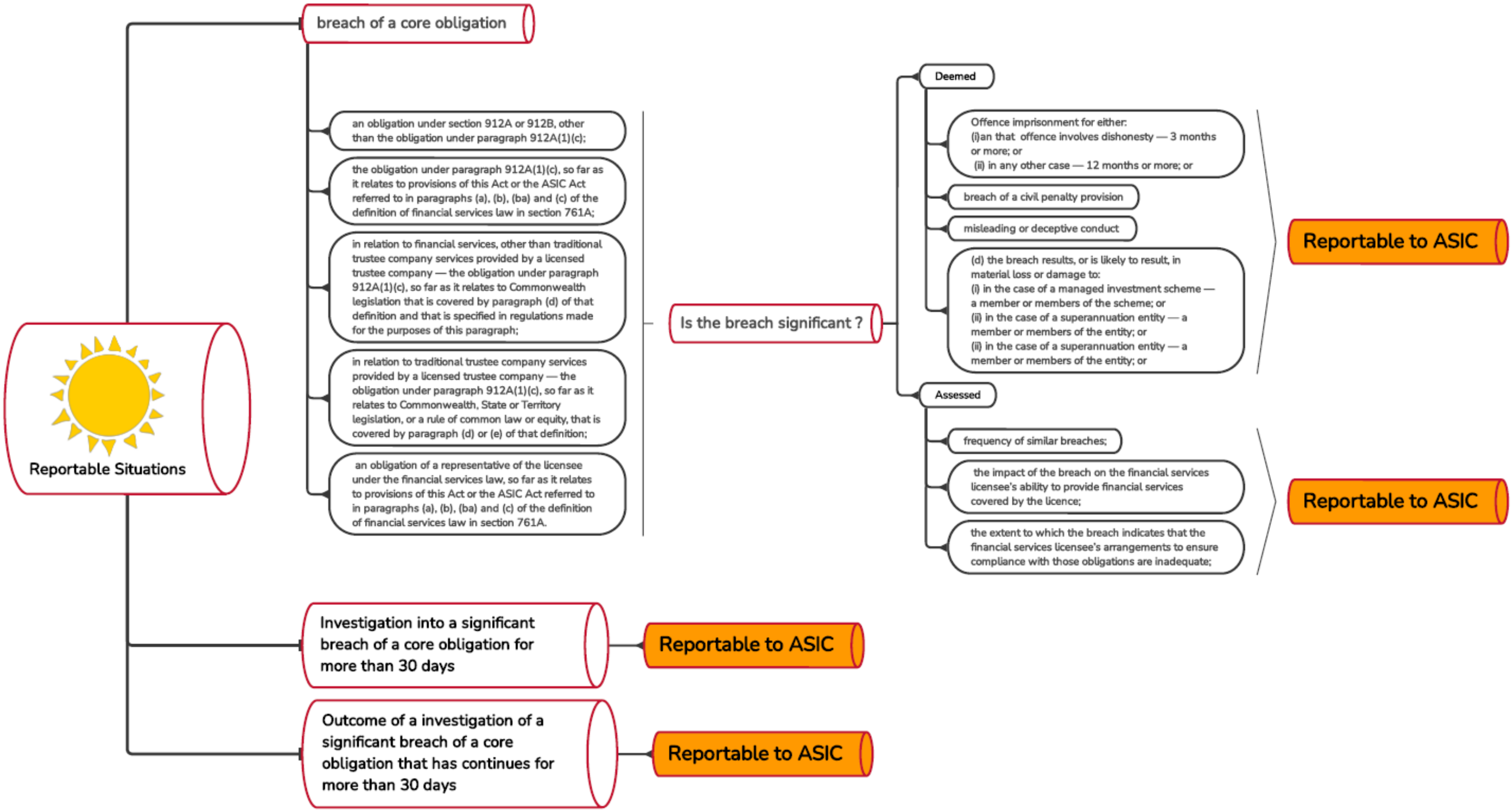
Appendix A: Annual Performance Assessment Heatmap



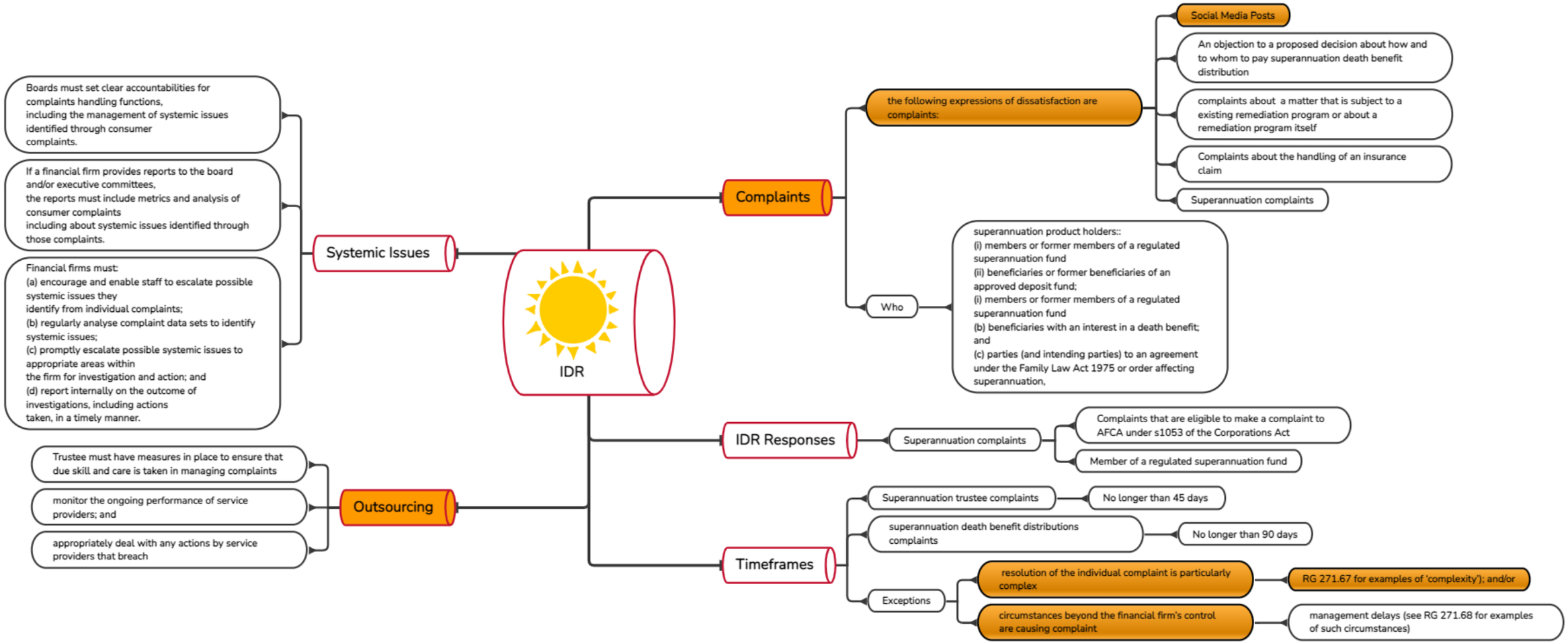
Appendix B: Reverse onus of proof Heatmap



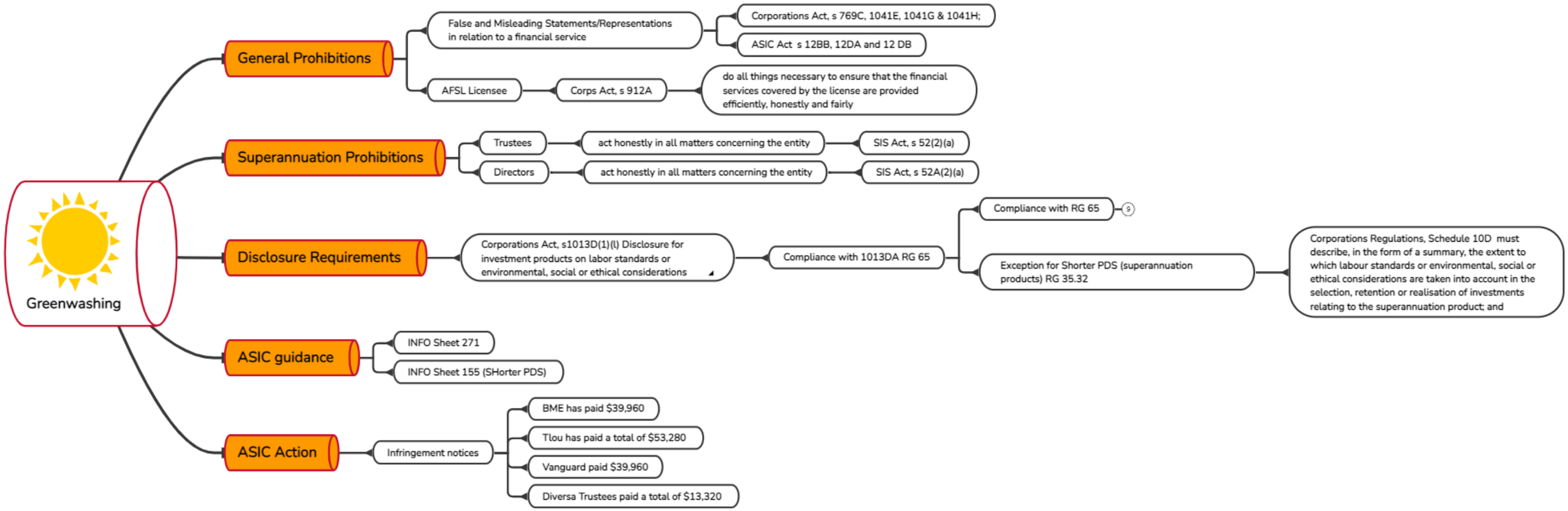
Appendix C: Reportable Breaches Heatmap



Appendix D: IDR Heatmap



Appendix E: Greenwashing Heatmap



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