



Stronger Super  
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Dear Sir,

**STRONGER SUPER CONSULTATION – OFFICE OF TRUSTEE DIRECTOR**

I am pleased to enclose a submission prepared by the Superannuation Committee of the Law Council of Australia on the Stronger Super Consultation – Office of Trustee Director.

Due to time constraints this submission has not been considered by the Directors of the Law Council of Australia.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Bill Grant".

Bill Grant  
Secretary-General

21 June 2011

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# Stronger Super Consultation – office of trustee director

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## **The Treasury**

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

**21 June 2011**

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The Superannuation Committee is a committee of the Legal Practice Section of the Law Council of Australia. Its objectives include ensuring that the law relating to superannuation in Australia is sound, equitable and demonstrably clear. It fulfils this objective in part by making submissions and providing comments on the legal aspects of proposed legislation, circulars, policy papers and other regulatory instruments.

1. This submission confirms the views of the Superannuation Committee of the Law Council regarding the proposed changes to the duties and liabilities of directors of superannuation fund trustee companies.

## **Background**

2. In its 'Issues paper on trustee and director duties' dated March 2011 (**Issues Paper**), Treasury canvassed various issues arising from recommendations made in the Super System Review report (**Review Report**) delivered to the Government on 30 June 2010. In this submission, the Committee focuses on the comments made by Treasury regarding Recommendation 2.1, and in particular on its comments about the duty to give priority to the interests of members.
3. Recommendation 2.1 suggests that a distinct new office of 'trustee director' should be created with all statutory duties to be set out in the *Superannuation Industry (Supervision) Act 1993 (SIS Act)*, along with re-focused duties for trustees. It further recommends that the duties for trustee directors should include:

*'To act solely for the benefit of members, including and in particular:*

*(ii) to give priority to the duty to members when that duty conflicts with the trustee-director's duty to the trustee company, its shareholders or any other person'*

4. As regards the suggestion that there should be a statutory duty to 'act solely for the benefit of members', the Committee sent an email dated 20 May 2011 to Melissa Bray in which the Committee expressed its view as follows:

*There should not be an obligation to act 'solely' for the benefit of members. Trustees necessarily act for the benefit of other 'stakeholders' in the course of carrying out their duties. For example, the trustee of a defined benefit fund may need to take account of the interests of employers in terms of their contribution obligations, and may determine to select a course of action in respect of the fund that, all things being equal as regards the interests of the members, will result in less rather than more cost to the employers. Equally, every service contract entered into by a trustee will give rise to a benefit for the service provider, which will be remunerated for its work.*

5. The Committee understands that it is not now intended to proceed with the proposal to have a separate office of 'trustee director', but that the SIS Act may be amended to incorporate a statutory duty to give priority to the duty to members where that conflicts with duties owed to other persons. The Committee considers that such an amendment would be appropriate (although the Committee makes some comments below regarding the manner in which this duty might be expressed).
6. In the Issues Paper, Treasury states that:

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*APRA guidance on the requirement in section 48 of the Life Insurance Act (Prudential Practice Guide LPG 260) indicates that the Act is more stringent than the general duties of directors under the Corporations Act: each director individually owes this duty to policy owners; the duty is owed to the interests of those policy owners as a group; and the duty is not limited to owners of participating policies. A director of a life insurance company may be personally liable to compensate a life company for losses resulting from a breach of the duty by that director.*

*Recommendation 2.1(a)(ii) proposed a duty on a superannuation trustee director similar to that which the Life Insurance Act imposes on directors of a life insurance company, to give priority to the interests of the fund member where those interests conflict with the interests of shareholders.*

7. Treasury goes on to articulate questions as to the practical differences between adopting the Life Insurance Act provisions compared to the equivalent Corporations Act provisions, whether the Life Insurance Act provisions have given rise to practical issues for life company directors in respect of their responsibilities to policy owners, and what practical issues might arise if the Life Insurance Act model were adopted for trustees of superannuation funds.
8. Section 48(6) of the Life Insurance Act provides that in respect of any act or omission of a life company, a director of the company is guilty of a breach of the duty to give priority to the interests of policy owners, and the act or omission of the company results in a loss to a statutory fund of the company, the director is liable to pay the company the amount of the loss. Liability is joint and several where two or more people have a liability under section 48(6). Actions for recovery can be brought by the company or, with APRA's approval, by a policy owner.

### **Superannuation trustee directors - the current regime**

9. It may be useful to compare these provisions with those which currently exist under the SIS Act. Section 52(8) provides that each of the statutory covenants applicable to a superannuation trustee company also operates as a covenant by each of the directors to exercise a reasonable degree of care and diligence for the purposes of ensuring that the trustee company carries out the covenants. Section 55(1) goes on to provide that a person must not contravene a covenant contained to be contained in the governing rules of a superannuation entity. A person who suffers loss or damage as a result of conduct of another person that was engaged in contravention of section 55(1) is entitled to recover the amount of the loss or damage by action against that other person or against any person involved in the contravention (section 55(3)).
10. Members who consider that they have suffered loss or damage because directors have not exercised a reasonable degree of care and diligence for the purposes of ensuring that the trustee company, for example, exercises its powers in the best interest of the beneficiaries, could therefore bring an action against the directors to recover their loss.
11. Section 52(8) importantly focuses on the directors acting so to ensure that the trustee carries out its duties. It brings directors into the net of liability, but still retains the trustee focus. It is the trustee, not each individual director, that is responsible for the proper management of a fund. Importantly, it should be noted that the trust structure under which superannuation funds are operated is not replicated in the life insurance environment.

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12. Section 315 of the SIS Act also empowers the Court to grant injunctions restraining a person from engaging in particular conduct, or requiring a person to do a particular act or thing, where a person has engaged, is engaging in or proposing to engage in conduct that has, does or would constitute a contravention of the SIS Act. The Court also has power to order the person involved in the contravention to pay damages to any other person (section 315(11)). These provisions also therefore provide an existing avenue under which action can be taken against directors of superannuation fund trustee companies.
  13. Of course, the *Corporations Act 2001 (Cth)* (**Corporations Act**) also imposes duties on directors, in particular sections 180, 181, 182 and 183. Directors who breach these duties can be subject to civil penalties, may have criminal proceedings brought against them, and may be subject to administrative action by the Australian Securities and Investments Commission. They may also have to account to the company for profits gained through a breach of fiduciary duty, and may have to compensate the company if their breach of fiduciary duty has caused loss. The Committee notes that section 185 of the Corporations Act specifically preserves the right of persons to bring civil proceedings in respect of breaches of duty.
  14. Directors can also be directly liable in respect of misconduct in relation to financial services (under Part 7.10 of the *Corporations Act* and Part 2 of the *Australian Securities and Investments Commission Act 2001*). As a result, directors can also be subject to class actions brought by shareholders, and there have been numerous such actions brought over recent years, with some high profile such matters before the Courts at present. Many such proceedings relate to actions by directors that have resulted in falls in the share price, where such actions are alleged to involve misleading and deceptive disclosure or failure to disclose material price-sensitive information to the market in a timely manner.

#### **Direct liability to members**

15. The comments made by Treasury in its papers and discussed at Working Group meetings have given rise to a concern that the proposed changes to the SIS Act might result in a position such that individual directors might owe duties directly to members and therefore face potential actions by members in circumstances additional to those which already exist.
16. In the Committee's view, that would be an undesirable result, for the following reasons:
  - 16.1. Boards make decisions collectively, and individual directors acting alone will not be in a position to make a decision in respect of any matter. Individual directors are not trustees. It should also be remembered that those Boards which are structured according to the SIS Act equal representation rules require a two-thirds majority for resolutions to be passed.
  - 16.2. The threat of direct member action over matters such as whether decisions on investments have been in the best interests of the beneficiaries may result in changed behaviour at board level, such as an increased reliance on expert reports and input (at further cost to members), an unwillingness to deviate from what is seen to be 'standard' practice among funds and to take measured and justifiable risks, and an increased demand by directors

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to take separate independent legal advice (again, in many cases ultimately at a cost to members).

- 16.3. Even a typical disputed disablement claim will generally involve an allegation of breach of trust by the trustee in failing to pay the claim in accordance with the trust deed. If such allegations could be made directly against the directors themselves, it seems likely that members would include directors in any proceedings brought against the trustee, simply to make sure that they 'cover the field'. This would most likely add to the cost to funds of dealing with member litigation, without providing any corresponding protection or benefit to members.
  - 16.4. A culture may develop in which members are encouraged to pursue actions against directors in situations where, for example, returns have been disappointing. Should that happen, directors and management will need to take time away from more productive matters to address these actions, to the potential detriment of members. It also seems likely that any damages ultimately awarded would be payable by the trustee from its own resources (in which case fees charged to members might have to rise) or from the fund (in which case there is a cost to all members). This may effectively result in a transfer of fund assets from one group of members to another, with resulting inequity arising as between members.
  - 16.5. Directors and Officers insurance premiums may rise to take account of the increased risks. Ultimately, such costs are passed on to members through higher fees or because costs are a direct expense of the fund.
  - 16.6. It has been suggested that exposure to personal liability which is not present in other financial institutions would make it harder for the superannuation industry to attract quality and suitable candidates for directorship. While the Committee has no basis on which to form a view as to whether or not this is correct, it notes that directors of a superannuation fund would be placed in an adverse position as regards liability when compared against, for example, directors of banks.
17. The Committee also notes that it is not aware of any research or other evidence suggesting that the avenues of redress already available if directors are thought to have breached their obligations are insufficient.

### **Priority to the duty to members**

18. If there is to be legislation that mandates that trustee directors give priority to the duty owed to members, the Committee considers that this should be drafted in a way that reflects the existing principle that a director's duties are owed to the trustee company (as per section 58(8) of the SIS Act discussed above), and that in turn the trustee company's duties are owed to the members and other beneficiaries. A 'priority rule' as proposed would then require the directors to ensure that the trustee company's duties to members are given priority over any conflicting duties that the trustee company may have. Conflict issues affecting directors themselves could usefully be addressed in the industry Code of Governance or perhaps in a Prudential Standard.
19. It should be remembered that the covenant contained in section 52(2)(c) of the SIS Act currently requires each trustee to covenant to ensure that its duties and powers are performed and exercised in the best interests of the beneficiaries (rather than



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the members). The Committee is not aware of any reason why the proposed 'priority rule' should be addressed toward members only, rather than beneficiaries (being a larger group). For example, the Committee queries how such a priority rule in favour of members would operate to affect the exercise of discretions involving non-members, such as decisions regarding dependants of a deceased member and decisions which affect the rights of members after they cease to be members (e.g. the period and conditions on which total and permanent disablement and total and temporary disablement insurance continues)?

20. It may be the case that some sophistication along the lines seen in Chapter 5C of the Corporations Act would be helpful, such as recognising that there may be different classes of members or beneficiaries, in which case the duty is to treat members or beneficiaries of the same class equally and members of different classes fairly.
21. The Committee also considers that there should be a clear and unambiguous statutory defence and/or statutory safe harbour, especially with regard to duties under the Corporations Act and other legislation which, on their face, specifically require directors to give priority to other stakeholders, such as shareholders in a corporate trustee or creditors in an insolvency context. Trustee-directors could potentially be placed in an impossible position otherwise, for example, if torn between acting in the interests of members and avoiding personal liability for insolvent trading or uncommercial transactions.
22. There should also be clarity around matters such as whether a trustee director can be paid - arguably, any action taken by a director as regards the payment and receipt of remuneration would breach a duty to give priority to the interests of members/beneficiaries. The Committee assumes that this would not be intended.
23. Further, consideration should be given to the interaction of such a duty with the broader rules around conflicts of interest. For example, a person may hold the office of director of a superannuation fund trustee company and, all other things being equal, be in a position to exercise their vote to further the interests of members. If, due to a conflict of interest, that director absents themselves from the decision or resigns, on one view it might be argued that they failed to give priority to the interests of those members because, as a matter of fact, they did not. It will be important to ensure that directors who need to step aside from decisions regarding particular matters for conflict reasons are not inadvertently caught up in allegations of breach of a 'priority rule'.

## **Conclusion**

24. For these reasons, and given the existing breadth of individual director liabilities, the Committee considers that care should be taken in the drafting of any amendments to the SIS Act intended to clarify matters such as the duty to give priority to member interests, so as to ensure that there is not a widening of the circumstances in which members might be able to take direct action against directors, and that the imposition of any new duty does not have unintended consequences.
25. The Committee would be happy to make representatives available to discuss these issues further or to answer questions. At first instance, please contact Heather Gray, who is the Law Council's representative on the Stronger Super Governance Working Group. Heather's contact details are as follows:

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

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The Law Council of Australia is the peak national representative body of the Australian legal profession. The Law Council was established in 1933. It is the federal organisation representing approximately 50,000 Australian lawyers, through their representative bar associations and law societies (the “constituent bodies” of the Law Council).

The constituent bodies of the Law Council are, in alphabetical order:

- Australian Capital Territory Bar Association
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society of the Australian Capital Territory
- Law Society of the Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar Association
- The Victorian Bar Inc
- Western Australian Bar Association
- LLFG Limited (a corporation with large law firm members)

The Law Council speaks for the Australian legal profession on the legal aspects of national and international issues, on federal law and on the operation of federal courts and tribunals. It works for the improvement of the law and of the administration of justice.

The Law Council is the most inclusive, on both geographical and professional bases, of all Australian legal professional organisations.