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Manager
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via email: superannuation@treasury.gov.au

Dear Treasury,

Your Future, Your Super package: Exposure Draft – Best Financial Interests Duty

Thank you for the opportunity to provide a response to the Your Future, Your Super Package.

This submission is limited to the **Exposure Draft – Best Financial Interests Duty**[1] (**Exposure Bill**) and **Explanatory Materials – Best Financial Interests Duty** (**Explanatory Materials**).

The Australian Institute of Company Directors' (**AICD**) mission is to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. The AICD's membership reflects the diversity of Australia's director community, our membership of more than 45,000 is drawn from directors and leaders of not-for-profits, large and small businesses and the government sector. Our membership includes directors and leaders from the superannuation sector including retail, corporate, public and industry funds.

Executive Summary

1. The AICD does not support the amendments proposed in the Exposure Draft. The AICD supports strong accountability measures and robustly enforced duties for superannuation trustees. However, taken as a whole, we are not convinced that the proposals achieve the policy intent of increasing the accountability of superannuation trustees in relation to the execution of their fiduciary duties and clarifying the application of the best interests duty.

2. The AICD does not consider the proposed change to the existing best interests duty necessary. We are also concerned by potential complications that could arise from the proposals as drafted.

3. The AICD opposes the proposed reversal of the evidentiary burden on trustees and/or directors.

4. The AICD opposes the proposed power to ban third party payments via regulation.

5. The AICD is concerned that the measures proposed could unreasonably interfere with the reasonable discretion exercised by registrable superannuation entity (**RSE**) licensees and their directors. We encourage further consultation with the superannuation sector on the policy objectives outlined, rather than progressing with the proposals presented in the Exposure Draft.

[1] *Treasury Laws Amendment (Measures for a later Sitting) Bill 2020: Best Financial Interests Obligation Bill*

General comments

6. Directors of trustee companies and RSE licensees are already, appropriately, held to a higher legal standard than directors of other organisations. In feedback to the AICD, superannuation trustee directors have emphasised that these higher standards are appropriate and important, with the focus on trustees serving in the best interests of beneficiaries. Directors of superannuation funds also acknowledge that with higher standards comes higher levels of scrutiny.

7. We are concerned that the Exposure Draft appears to work from the premise that, in general, directors are not acting in the best financial interests of beneficiaries. The AICD does not consider this presumption to be justified. Australia can be proud of its superannuation system and its results; our superannuation system has for many years been internationally regarded as one of the best in the world.[2] This is not to say that there are not important areas for reform. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**) demonstrated the need for reforms in the sector and the requirement for a renewed focus on governance and management of the best interests duty by trustee boards.

8. The Financial Services Royal Commission made several recommendations to improve performance and governance in the superannuation sector. Importantly, the Royal Commission did not recommend the specific changes proposed in the Exposure Draft. Many of the Royal Commission's recommendations have been actioned by Government in the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* which has just passed the Parliament. This Act makes the Australian Securities and Investments Commission (**ASIC**) the conduct regulator for superannuation. It also subjects superannuation funds to the financial services licencing regime, so that the operations of a superannuation trustee will now be subject to the general obligations in the *Corporations Act 2001* (Cth) (**Corporations Act**).[3] This means for example, a breach of the obligation to provide financial services efficiently, honestly and fairly will be subject to civil penalty. The AICD supports the elevated regulatory focus on sector governance and standards.

9. In summary, there are significant reforms being made to superannuation funds' obligations in relation to the provision of services and fund regulation and supervision. The AICD recommends a focus on the effective implementation of these measures, rather than the additional legislative changes proposed in the Exposure Draft.

APRA's regulatory approach

10. We note that the Australian Prudential Regulation Authority (**APRA**) has elevated its supervisory approach on the best interests duty. For example, APRA is reported to be currently "investigating online publication The New Daily's commercial relationships with superannuation funds". According to the reporting:

> *This review will consider the frame-work and decision-making process of boards pertaining to certain areas of expenditure, including a review of the metrics and approach to assessment of benefits to members…*[4]

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[2] See https://www.mercer.com/newsroom/global-pension-index-reveals-who-is-the-most-and-least-prepared-for-tomorrows-ageing-world.html

[3] s.912A

[4] See https://www.smh.com.au/business/companies/apra-is-now-awake-prudential-regulator-investigating-the-new-daily-20201211-p56mo1.html

11. The review process, and the evidence of due diligence and metrics in the decision-making process that APRA is requiring, appears to be very similar to that contemplated in the Exposure Draft.

12. APRA already has the ability to impose licence conditions on RSE licensees if it is concerned about decisions not being in their beneficiaries' best interests. In 2019, AMP was issued with a direction to improve "conflicts of interest management, governance and risk management practices, breach remediation processes, addressing poor risk culture and strengthening accountability mechanisms."[5]

13. In July 2020, APRA imposed conditions on Suncorp Group Ltd (**Suncorp**) and Colonial First State Investments Limited (**CFSIL**). Suncorp is required to, inter alia, "document how it considers and prioritises members' interests when it makes decisions that materially affect their interests."[6] For CFSIL, APRA imposed a licence condition:

> *… requiring CFSIL to record how it considers members' best interests and members' priority covenants when making decisions that materially affect their interests. This measure will improve CFSIL's practices and also ensure APRA is better able to assess whether members' best interests are being sufficiently considered and prioritised by CFSIL in future.*[7]

14. It is within APRA's current powers and abilities to increase the accountability of superannuation trustees in relation to the execution of their fiduciary duties. Altering the nature of duties and changing presumptions appears unnecessary (noting also ASIC's new role of conduct regulator).

Best financial interests duty

15. This section responds to items 5, 7 and 9 of the Exposure Draft (and corresponding changes proposed).

16. The existing best interests duty contained in s.52 of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) was recently considered by Justice Jagot of the Federal Court in in *APRA v Kelaher* [2019] FCA 1521(**IOOF Case**). It was the submission of all parties in that case (including APRA), and accepted by Justice Jagot[8] that "the best interests of the beneficiaries are normally their best financial interests".

17. The AICD understands that the current effect of s.52 is that the best interests of beneficiaries are normally considered by the courts to be their best financial interests. This construction of the best interests duty is taken from what is regarded as the leading case in this area of trusts law, the English case of *Cowan v Scargill* [1985] Ch 270, 287–8 and is reflected in relevant case law. It is therefore unclear why the section requires amendment.

18. The Explanatory Materials at paragraphs 1.19 to 1.21 reference the 2018 Productivity Inquiry Report Superannuation: Assessing Efficiency and Competitiveness as justification for the amendment, noting Recommendation 22 which states:

> *The Australian Government should pursue a clearer articulation of what it means for a trustee to act in members' best interests under the Superannuation Industry (Supervision) Act 1993 (Cth). The definition should reflect the twin principles that a trustee should act in a manner consistent with*

[5] https://www.apra.gov.au/news-and-publications/apra-imposes-directions-and-conditions-on-amp-super-rse-licensees

[6] https://www.apra.gov.au/news-and-publications/apra-issues-directions-and-imposes-new-licence-condition-on-suncorp-portfolio

[7] https://www.apra.gov.au/news-and-publications/apra-imposes-new-licence-condition-on-colonial-first-state-investments

[8] at [49] and [65]

what an informed member might reasonably expect and that this must be manifest in member outcomes. In clarifying the definition, the Government should decide whether to pursue legislative change, greater regulatory guidance, and/or proactive testing of the law by regulators. It should be informed by the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[9]

19. The Productivity Commission suggested that the Government be informed by the Financial Services Royal Commission on this matter. In so far as this issue was considered by the Royal Commission, it was largely in the context of a conflict of interest between the best interests duty and the other duties, including the duty to the company and its shareholders in a for-profit superannuation fund.

20. In the context of why he did not think superannuation fund "political advertising" should be banned, Commissioner Hayne said:

> *I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration.*[10]

21. In the Second Volume of his report, when making further findings on advertising by superannuation funds Commissioner Hayne said:

> *I should add that while I have no doubt at all that judging what is and is not an appropriate use of members' funds for advertising will in many cases be difficult, I am not persuaded that some more prescriptive law should be made to provide some 'bright line' test. It is better that the tests be those that are now to be applied: best interests and sole purpose. And as a general rule I would expect that most trustees would rightly err on the side of caution. Especially will that be so if regulators properly monitor compliance with the obligations.*[11]

22. In our view, Commissioner Hayne recommends against the kind of legislative change that is contained in the Exposure Draft. The proposals appear to breach the Government's principle of "don't legislate if you don't have to" that is intended to apply to policy makers, instructing agencies and drafters when developing legislation.[12]

23. The Example 1.3 set out at in paragraph 1.33 of the Explanatory Materials appears to be a relatively expansive reading of the best financial interests duty that may go further than the view a court might express. In the IOOF Case, Justice Jagot said:

> *It will frequently be the case that there is more than one course of action* [by a trustee] *which may be regarded as being in the best interests of the beneficiaries. The test is objective and is to be applied prospectively, that is, from the position of the trustee at the time of the decision, without impermissible hindsight.*[13]

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[9] p.611

[10] p.235

[11] p.249

[12] See https://www.ag.gov.au/legal-system/access-justice/reducing-complexity-legislation or Commonwealth of Australia, Department of the Prime Minister and Cabinet, *Legislation Handbook* at paragraph 1.21

[13] at [55].

24. Although the Explanatory Memorandum would not form part of the legislation it is extrinsic material that may be relied on in the interpretation of the Act.[14] If legislated, it would be preferable if this example did not appear in the Explanatory Memorandum and that APRA and the courts were allowed to interpret the duty on the relevant fact base without the Parliament providing prescriptive guidance. It would be concerning if APRA or other regulators attempted to use impermissible hindsight when supervising trustee companies and their directors.

25. The AICD believes this amendment is unnecessary.

Payments to third parties

26. This section responds to items 6, 8 and 10 of the Exposure Draft.

27. As the Explanatory Materials acknowledge, a trustee cannot avoid their duties and obligations merely by making payments to third parties. As such, it is unclear what mischief this amendment is intended to remedy. Paragraph 1.42 of the Explanatory Materials says:

> *As with the existing best interests duty, the new best financial interests duty will continue to apply to an exercise of a trustee's powers in making payments to third parties by, or on behalf of the entity or fund.*

28. Again, the Explanatory Materials seems to provide an expansive reading of the duty stating that trustees "should conduct reasonable due diligence when assessing payments to a third party" and that if there is concern that a payment might not be legit "the trustee should not make the payment". Example 1.4 provides an expansive reading of the duty and possibly implies a duty on a board to supervise expenditure post-payment to a third party - this seems unrealistic and uncommercial. For the reasons set out in paragraph 24 of this submission, we suggest that it would be better for this not to appear in the Explanatory Memorandum.

29. We note that this proposal was not a recommendation of the Financial Services Royal Commission. The Royal Commission examined payments made to third parties by trustee companies and whether this breached trustee duties at length and made recommendations for prosecutions under current legislation.

30. The AICD opposes the introduction of this new requirement as adding unnecessary confusion to the existing duty exacerbated by including an unhelpful interpretation of the duty. We consider this a further example of the issue discussed in paragraph 22 above.

Reversal of evidential burden

31. This section responds to items 1 and 13 of the Exposure Draft.

32. We note that there is no recommendation, from either the Productivity Commission or the Royal Commission, that the evidential burden on trustees and/or directors needs to be reversed.

33. The Explanatory Materials justifies the reversal of the onus on the basis that the knowledge of whether a person has acted in the best financial interests is peculiarly in the knowledge of the trustee, they should readily be able to point to evidence to justify their conduct and the potentially serious and widespread impact of an offence. These are the common justifications generally used for reversing

[14] s.15AB(2)(e) *Acts Interpretation Act 1901*

the onus of proof. Limited justification is provided as to why they are relevant to the discharge of this particular duty. The same could be said with respect to nearly any example of corporate conduct.

34. The Explanatory Materials claim that "it is difficult for the regulator to prove that the trustee failed to take certain matters into account in determining whether a decision or payment was in the best financial interests of beneficiaries." This claim can be subject to a number of criticisms. First, and self-evidently, no claim has been undertaken under the yet to be legislated best financial interests duty. Secondly, only one case (the IOOF case) has been run in the last decade by the regulator where it attempted (unsuccessfully) to argue that a trustee had breached this duty, so there is only one evidence point for this statement. Thirdly, ASIC has now been given the ability to regulate the sector, including under the financial services licencing regime, with expanded powers. Fourthly, this justification is in breach of the principles contained in the Guide to Framing Commonwealth Offences (which applies to criminal offences, infringement notices, and enforcement provisions).

35. It has long been the view of the courts examining trusts law that they should not interfere with the exercise of a trustee's discretion, so long as the discretion is exercised "with an entire absence of indirect motive, with honesty of intention, and with fair consideration of the subject".[15] This has been subject to modification over the years with respect to trustee companies that are RSE licensees. As already stated, in consultation with the AICD, trustee directors accept and endorse the higher standards and higher levels of scrutiny that apply to them. However, reversing the onus so that it is presumed that the trustee exercised their discretion improperly is a very significant reversal of centuries of trusts law jurisprudence and not one to be taken lightly.

36. The AICD opposes the proposed reversal of the evidential burden.

Regulation to ban payments

37. This section responds to item 11of the Exposure Draft.

38. We note that this was not a recommendation of either the Productivity Commission or the Royal Commission. There is no explicit justification of this proposal in the Explanatory Materials other than "regulations can be made to prohibit certain payments and investments where they are considered to be unsuitable expenditure by trustees in any circumstance."

39. The clause would allow the Government of the day to fetter the discretion of superannuation funds and their directors to make legitimate expenditure that is in the best interests of beneficiaries. It would be a prescriptive interference in management, director and trustee discretion with no clear public policy rationale.

40. In the AICD's opinion, this would be an inappropriate delegation of legislative power to the executive. The executive would be able to override s.52 of the SIS Act, directing where payments could be made by RSE licensees and the circumstances of those payments.

41. We submit that this clause contradicts the scrutiny principles for delegated legislation set out by the Senate Standing Committee for the Scrutiny of Delegated Legislation.[16] In particular:

[15] *Re Beloved Wilkes Charity* (1851) 3 Mac & G 440; 42 ER 330.

[16] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Scrutiny_of_Delegated_Legislation/Role_of_the_Committee

- it makes rights, liberties, obligations or interests unduly dependent on insufficiently defined administrative powers;
- it trespasses unduly on personal rights and liberties;
- it unduly excludes, limits or fails to provide for independent review of decisions affecting rights, liberties, obligations or interests; and
- it contains matters more appropriate for parliamentary enactment.

42. In the AICD's view, this section should be removed from the Exposure Draft.

Record Keeping

43. We are neutral on the change to record keeping, although we question the need for a strict liability offence and additional director liability.

44. Even without this amendment, regulations can be made relating to record keeping obligations. These could require RSE licensees to, for example, keep clear records of the decision-making process showing how they have assessed "the costs and benefits of actions, including quantifiable metrics to demonstrate what the anticipated financial outcome is and the reasonable basis for that expectation."[17] This would seem to meet the intention of the legislation to increase the accountability of superannuation trustees in relation to the execution of their fiduciary duties.

45. The AICD is not aware of whether there have been failures in compliance with record keeping obligations that require a strict liability offence and additional director liability. Examples of poor practice are not supplied in the Explanatory Materials. It would be useful if some further justification could be provided as to why there needs to be a change of liability arrangements to achieve compliance.

Next steps

We hope our response will be of assistance. If you would like to discuss any aspects further, please contact David McElrea, Senior Policy Adviser at [redacted] or Christian Gergis, Head of Policy, at [redacted]

Yours sincerely,

Louise Petschler GAICD
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[17] Paragraph 1.49 of the Explanatory Materials