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Senate Standing Committees on Economics
PO Box 6100
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Canberra ACT 2600

Dear Senators

Inquiry into the Treasury Laws Amendment (Your Future, Your Super) Bill 2021

Thank you for the opportunity to provide comments to the Senate Economics Legislation Committee on the Treasury Laws Amendment (Your Future, Your Super) Bill 2021 (**the Bill**). We will confine our submission to Schedule 3 of the Bill on the Bill on the best financial interests duty.

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.

Executive Summary

1. The AICD does not support the amendments proposed in the Bill. 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.

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.

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 Bill appears to work from the premise that, in general, trustees 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.[1] 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 Bill. Many of the Royal Commission's recommendations have been actioned by the Government in the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* which passed the Parliament in December 2020. 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**).[2] 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. These new substantial reforms may well have a significant effect on 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 Bill.

10. APRA has existing powers that enable it impose licence conditions on RSE licensees if it is concerned about decisions not being in their beneficiaries' best interests. This includes requiring licensees to better document how they consider and prioritise members' interests, improve conflict of interest governance and risk management practices, and strengthen accountability mechanisms. APRA has exercised these powers to impose licence conditions on AMP[3], Suncorp Group Ltd[4] and Colonial First State Investments Limited.[5] Accordingly, there already exist sufficient powers for regulators to "increase the accountability of superannuation trustees in relation to the execution of their fiduciary duties",[6] particularly given ASIC's new role as a conduct regulator, without the need for this legislation.

11. Finally, we note that directors of RSE licensees, almost more than any other type of director, have a very long-term decision-making horizon, where judgments must be made about investments and strategies that may only materialise decades into the future. In those circumstances, Parliament should be very reluctant to tinker with the duties which those directors hold, particularly when they are very long-standing and well-understood duties. It substantially increases risk if directors must anticipate changes to their obligations which did not exist at the time that a decision was made.

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

[2] s.912A

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

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

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

[6] Explanatory Memorandum, paragraph 3.8.

Individual liability for directors

12. We note that the draft legislation does not contain the individual liability clauses attached to directors that was contained in the Exposure Draft of the legislation released in December 2020. We acknowledge the sensible changes made by the Government following consultation on the Exposure Draft.

13. Australia already has a harsh and widespread regime of individual director liability for corporate conduct. Research conducted by Allens in 2020 for the AICD found that Australia's director liability environment is 'uniquely burdensome'.[7] Provisions for individual director liability do not necessarily appreciate the distinction between the role of the board and that of management; non-executive directors have an oversight role and must actively monitor the company, and bring an independent and experienced perspective to decision-making. Finally, excessive director liability settings have a number of adverse business and economic consequences including a chilling effect on risk-taking and innovation, a skewed focus on compliance and potential legal risks and an increase in compliance and administrative costs.

Best interests financial duty

14. This section responds to items 9, 13 and 16 of Schedule 3 of the Bill (and corresponding changes proposed).

15. 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".

16. 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 is also APRA's interpretation. 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.

17. The Explanatory Memorandum at paragraphs 3.21 to 3.23 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 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*

[7] https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-18-issue-2/australia-unique-burdensome-director-liability-environment

[8] at [49] and [65]

be informed by the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.[9]

18. 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.

19. 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]

20. 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]

21. In our view, Commissioner Hayne recommends against the kind of legislative change that is contained in the Bill. We support Commissioner Hayne's recommendations.

22. The proposals also 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. Example 3.3 set out at in paragraph 3.39 of the Explanatory Memorandum 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]

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

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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].

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

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. If, contrary to the arguments we have put above, the Government is of the view that the best interests duty does require further clarification then we caution about the possible effect of abandoning the current duty, a term well-known to trusts law. In this respect, we adopt the submission of the Law Council of Australia on the Exposure Draft of this legislation as follows:

> *The risk of changing the formulation of the covenant in a manner which deviates from the general trust law meaning is that the many advantages and benefits of the general law, currently applied to inform the best interests covenant, will be jettisoned. In so doing there is a risk that, instead of the legislative reform resulting in a better articulation of the best interests covenant, it will create further uncertainty.*[15]

Payments to third parties

26. This section responds to items 11, 15 and 17 of Schedule 3 of the Bill.

27. As the Explanatory Memorandum acknowledges, 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 3.56 of the Explanatory Memorandum 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 Memorandum seems to provide an expansive reading of the duty stating that trustees "could conduct reasonable due diligence when assessing payments to a third party". There is no materiality threshold for where that due diligence should take place and the role, for example, of a board in undertaking due diligence. Example 3.4 also 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.

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, while seeing no need for legislative change.

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 23 above.

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[15] at paragraph 14.

Reversal of evidential burden

31. This section responds to item 20 of Schedule 3 of the Bill.

32. As already stated, we are pleased that provisions in the Exposure Draft which provided for individual liability for directors have been removed. Nonetheless, we retain some concerns with the proposed reversal of the evidential burden on trustees.

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

34. The Explanatory Memorandum 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 the onus of proof however limited reasoning is provided as to why they are relevant in this matter. The same could be said with respect to nearly any example of corporate conduct where the regulator has the power to prosecute for an offence. It is not apparent why Parliament should take the unusual step of reversing the evidential burden in this matter, which should only be done rarely and where the case is compelling.

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".[16] 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 reversal of the evidential burden, and the lack of a materiality threshold, may lead to an excessive focus on documentation when RSE licensees are making routine spending decisions. It will also likely see matters pushed up the board for decision-making that are properly within the reasonable delegation of management. This may also lead to an excessive focus on compliance at the boardroom level, contributing to an overly conservative decision-making culture.

37. The increased liability risk for the trustee due to the existence of the reversal of the evidential burden also increases the liability risk for directors under the principle of "stepping stone liability". That is, if the trustee were found to have breached the covenants under the SIS Act, ASIC might bring a claim that a director contravened one or more of their statutory duties under the Corporations Act by exposing the entity to liability. This has the effect of increasing individual liability risk for directors which has adverse public consequences for the reasons set out in paragraph 13 above.

38. The AICD opposes the proposed reversal of the evidential burden on trustees.

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

Regulation to ban payments

39. This section responds to item 18 of Schedule 3.

40. 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 Memorandum other than that it "is appropriate to ensure there is sufficient flexibility for the Government to respond quickly to evolving industry practice as needed" and "regulations can be made to prohibit certain payments and investments where they are considered to be unsuitable expenditure by trustees in any circumstance."

41. 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.

42. 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.

43. 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.[17] In particular:

    - 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.

44. In the AICD's view, this section should be removed from the Bill.

45. It should be noted that directors of RSE licensees are required to make judgements on investments in which the return on investment may often need to be calculated over decades, for example, investment in infrastructure. If the Executive retains the power to prescribe investments, even when the board judges that are in the best interests of its members, then this provides an additional risk when making those investments and may also affect their valuation. For example, an asset that the Government of the day has told all RSE licensees that they must divest from, is likely to be significantly less valuable. This would be a sub-optimal position for long-term investment decision making to take place.

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

Next steps

We hope our submission 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,

[redacted]

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