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Director, Superannuation, Efficiency and Performance Unit
The Treasury
Langton Cres
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via email: YFYS@treasury.gov.au

Dear Treasury

Your Future, Your Super review

Thank you for the opportunity to provide comments to the review of the *Your Future, Your Super* measures (**Review**).

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, with 49,000 members drawn from directors and leaders of not-for-profits, large and small businesses and the government sector.

1. Executive summary

Our submission focuses on the 'best financial interests duty' (**BFID**) aspect of the review, which is particularly relevant to AICD members that are directors of registrable superannuation entities (**RSEs**).

We provide comments in the following key areas:

- The AICD participated in the Government's previous consultation on the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* (**Your Future, Your Super Bill**) in 2021. At that time, the AICD did not consider the changes to the former best interests duty were necessary and opposed the introduction of the BFID.
- In feedback to the AICD since the reform's introduction, superannuation trustee directors have expressed some concerns about the impact that the BFID is having on RSE licensees' practices. Recording compliance with the BFID has led to significant additional costs and resources being spent and slowed both strategic and routine decision-making on expenditure. Some trustee directors report having had to withdraw a number of community sponsorships and grant funding arrangements with charities, due to concerns that those activities may not directly result in financial gain for the fund or for the financial gain of individual members.
- If the BFID is to be retained in its current form, further clarification and guidance on what is considered 'material' expenditure for the purposes of complying with the BFID would be welcome. More broadly, a clear articulation from government that incorporating ESG considerations into investment decision-making is consistent with the duty would be useful, and that there is no need for the fund to take a short-term approach.
- The AICD continues to have strong concerns about the reversal of the evidential burden on trustees which took effect in 2021. While the reversal emphasises to trustees that they need to

have strong systems and processes in place to ensure that all actions they take can be demonstrated to be in the best financial interests of beneficiaries, the requirement for strong systems and processes are already directly and specifically imposed on the trustees of registrable superannuation entities through the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**) and the Australian Prudential Regulation Authority's (**APRA**) prudential standards. The reversal of the evidential burden, together with the lack of a materiality threshold, increases the liability risk for trustee directors and is resulting in an excessive focus on documentation when RSE licensees are making routine spending decisions. We strongly encourage government to reconsider the changes that were made to reverse the evidential burden of proof.

2. Best financial interests duty

The Your Future, Your Super Bill introduced the new BFID in August 2021. The BFID requires trustees to assess whether their spending is in the best financial interest of their members, and reversed the onus of proof such that trustees must now provide evidence to demonstrate this fact in the event of civil proceedings against them.

In response to the Government's previous consultation on the Your Future, Your Super Bill, the AICD opposed amending the former 'best interests duty' contained in in s.52 of the SIS Act for the following reasons:

- The best interests of beneficiaries are normally considered by the courts to be their best financial interests. It was the submission of all parties in the Federal Court decision of *APRA v Kelaher* [2019] FCA 1521(**IOOF Case**) (including APRA), and accepted by Justice Jagot that "the best interests of the beneficiaries are normally their best financial interests";[1]

- In the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**), Commissioner Hayne recommended against a form of legislative reform that would result in a more prescriptive best interests duty or 'bright line test' for trustees of RSEs.[2] In his view, the former '*best interests convenant and sole purpose test set the necessary standards*';[3] and

- APRA has existing powers that enable it to 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.

It was therefore not clear to us why s.52 required amendment.

We recognise however that the focus of this Review is to consider whether there have been any unintended consequences and implementation issues arising from the introduction of this measure. Accordingly, we make the following comments based on feedback the AICD has received:

- **Compliance processes and procedures**: Trustee directors have reported that their funds are spending significant time and resources on recording compliance with the BFID – which are ultimately borne as administrative costs to members. This has included requiring external legal

[1] at [49] and [65].
[2] Volume 2, (2019), p. 249, available here.
[3] Final Report, *Royal Commission into Misconduct in the Banking Superannuation and Financial Services Industry*, Volume 1, (2019), p. 235, available here.

advice, as well as additional layers of internal review to ensure evidence of quantification modelling and business case assessment are documented appropriately. In some cases, trustee directors report the additional administrative burden has slowed down strategic decision-making and resulted in more conservative decisions.

- **Withdrawal of certain expenditure**: Some trustee entities report having withdrawn a number of community sponsorships and grant funding arrangements with charities since the introduction of the BFID, due to concerns that those activities may not directly result in financial gain for the fund or for the financial gain of individual members.

  This is a disappointing consequence. There is a legitimate expectation that large financial institutions, including superannuation funds, contribute to the communities in which their members live and work. Some trustee directors have highlighted that the need to support vulnerable members of the community is an important part of every fund's operations, and that funds should not be put into the position of having to justify this type of expenditure.

- **Materiality threshold**: Should the BFID be retained in its current form, some trustee directors suggest a materiality threshold would be beneficial. While not seeking a prescriptive monetary threshold to be legislated, some further clarification and guidance about what expenditure is considered to be 'material' would be welcomed. This guidance could include, for example, commentary around whether expenditure related to initiatives such as community sponsorship and grant funding are permissible in light of the BFID.

ESG considerations

In addition, while it remains early days since the new BFID formulation took effect, the AICD has concerns that the inclusion of the word 'financial' in the BFID could create challenges for investment in 'environmental, social, governance' (**ESG**) aligned activities. For example, funds are and will continue to be confronted with the decision on whether to invest in assets that may achieve a higher return for the fund and its members, at least over the short term, but ultimately may be unsustainable over the longer term.

In our view, the BFID does not *require* trustees to take a short term view of members' financial interests. Rather, taking a longer term view, consistent with the retirement horizon of fund members, is generally appropriate. Accordingly, there may be value in having clearer government guidance that investment decision-making that incorporates ESG considerations is consistent with the BFID, and that there is no need to take a short term approach. Such guidance would be particularly useful in the context of funds wishing to harness the, often longer term, opportunities presented by the move to a low carbon economy, in Australia and more globally.

Reversal of evidential burden

In response to the Government's consultation on the Your Future, Your Super Bill in 2021, the AICD also opposed the reversal of the evidential burden on trustees.

There was no recommendation from either the Financial Services Royal Commission or the 2018 Productivity Commission Inquiry, *Superannuation: Assessing Efficiency and Competitiveness,* that the evidential burden on trustees needed to be reversed.

At the time, the Explanatory Memorandum to the Your Future, Your Super Bill justified 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, and they should therefore be able to readily point to evidence to justify their conduct. These are the common justifications generally used for reversing the onus of proof and 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. In our view, there was limited reasoning provided as to why the former Government took the unusual step of reversing the evidential burden in this matter, which should only be done rarely and where the case is compelling.

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".[4] This has been subject to modification over the years with respect to trustee companies that are RSE licensees. However, reversing the onus so that it is presumed that the trustee exercised their discretion improperly is a very significant reversal of trusts law jurisprudence, and broader natural justice principles.

In feedback to the AICD, trustee directors accept and endorse the high standards and levels of scrutiny that apply to them. However, the requirement for strong systems and processes are already directly and specifically imposed on the trustees of registrable superannuation entities through the SIS Act and APRA's prudential standards.

Further to the above comments, in practice the newly formulated BFID and reversal of the evidential burden, together with the lack of a materiality threshold, is resulting in an excessive focus on documentation when RSE licensees are making routine spending decisions.

<u>Increased liability risk for directors</u>

We further note that the reversal of the evidential burden, where compliance with the BFID is assessed with the benefit of hindsight, increases the liability risk for the trustee and consequently, 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 may bring a claim that a director contravened one or more of their statutory duties under the Corporations Act by exposing the entity to liability.

By way of general comment, Australia has a harsh and widespread regime of individual director liability for corporate conduct. Research conducted by Allens Linklaters in 2020 for the AICD found that Australia's director liability environment is 'uniquely burdensome' when compared with other jurisdictions.[5] 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.

In light of the increased liability risk, there is a real possibility that super funds will, in the future, encounter difficulties in obtaining and retaining good, well qualified directors, which runs counter to APRA's desire to upgrade the quality of super fund directors through a stricter application of the fit and proper test.

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[4] Re Beloved Wilkes Charity (1851) 3 Mac & G 440; 42 ER 330.
[5] https://aicd.companydirectors.com.au/membership/the-boardroom-report/volume-18-issue-2/australia-unique-burdensomedirector-liability-environment

3. Next steps

We hope our submission will be of assistance to Treasury's Review. If you would like to discuss any aspects further, please contact Christian Gergis, Head of Policy, at cgergis@aicd.com.au, or Laura Bacon, Senior Policy Adviser, at lbacon@aicd.com.au.

Yours sincerely,

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