24 December 2020

Manager
Retirement Income Policy Division
Treasury
Langton Cres
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Treasury

Best Financial Interests Duty

Thank you for the opportunity to comment on the exposure draft of the Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Best Financial Interests Duty.

These are my own views given as an expert in superannuation, financial services and corporate law[1] and are not provided on behalf of or endorsed by any of the organisations with which I am professionally affiliated.[2]

I urge the Government not to proceed with this legislation, which is ill-conceived. It disregards the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (BFRC) and appears to be based on a misunderstanding of basic concepts of superannuation law. In its proposed form, the legislation:

- lessens the protections afforded to members by the current law, by apparently requiring trustees to act in disregard of the best interest of members in some situations

- unnecessarily complicates and obscures the legal duties of trustees and their directors, adding to the cost, risk and complexity of operating superannuation funds to the detriment of members, and

- reverses the burden of proof in civil penalty proceedings in a manner that is not justifiable under the Government's own legislative guidelines and is inconsistent with important and established legal principles protecting the rights of defendants.

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[1] https://www.business.unsw.edu.au/our-people/pamela-hanrahan.

[2] I am a Professor of the UNSW Business School Sydney, a Senior Fellow of the Melbourne Law School, a member of the Centre for Law Markets and Regulation at UNSW Sydney, and an associate of the Centre for Corporate Law at the University of Melbourne. I am a solicitor member of the Law Society of New South Wales and a Fellow of FINSIA. I am a member of the executive board of the Business Law Section (BLS) of the Law Council of Australia, a member of the Corporations Committee of the BLS, a member of the advisory board of the Conexus Institute, and a member of the National Corporate Governance Committee of the Australian Institute of Company Directors.

The best interests duty

The exposure draft legislation amends the statutory covenants in ss 52(2)(c) and 52A(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) by replacing the phrase 'best interests' with 'best financial interests', and by adding a new provision to the effect that the statutory obligation applies 'in respect of payments to a third party by, or on behalf of, the entity'. The latter appears under the (inaccurate) heading 'Payments to third parties must be in best financial interests of beneficiaries'.[3]

The explanatory memorandum indicates at [1.6] that these amendments are 'intended to clarify the existing best interest duty'. They do not – they alter it. The existing duties in SIS Act ss 52(2)(c) and 52A(2)(c) require the trustee and its directors to make decisions and act in the operation of the fund having regard solely to what is in the members' best interests overall. The nature of a superannuation fund (which is made clear by the sole purpose test in SIS Act s 62(1)) means that the members' best interests are generally equated to their financial interests but there are situations in which the best interests of members *having regard to the overarching purpose of the fund* may require the trustee and its directors to take into account other considerations. The effect of the amendment would be to require trustees and their directors to act otherwise than with regard to the best interests of the members when to do so would be inconsistent with a narrower concept of their 'financial' interests (however to be defined).

The proposed amendment suggests a misunderstanding of the existing duty. The operation of the existing best interest duty and its relationship to fiduciary and trust law principles is explained in *Background Paper 25: Legal framework governing aspects of the Australian Superannuation System* (July 2018) which I prepared on instructions from and for the purposes of the BFRC.[4] The duty does not require the trustee or its directors to achieve the best outcome for members. Instead, it goes to what motivates their decisions and actions. Under the trust model adopted for Australian superannuation law, the task of deciding where the members' interests lie - in a given fund in a given situation – is the trustee's. That is their job and purpose. The legal duty imposed on them is to focus their decision-making only on what is good for the members and not to allow other interests (for example, a collateral benefit to themselves or another person, or another cause or enthusiasm) to influence their thinking.

The Final Report of the BFRC acknowledged that the existing duty imposes a heavy burden on trustees and their directors, who must balance competing considerations and make decisions about future matters in conditions of uncertainty. But the duty itself is clear, as Commissioner Hayne (an eminent jurist) acknowledged. He said, 'the role of a professional trustee is complex…. But that does not make the covenant incomprehensible or its content unknowable. Assertions of complexity must not obscure or confuse the obligations imposed on a trustee. **The concept of acting in members' best interests is not hard to understand**' (emphasis added).[5] Commissioner Hayne did not recommend changes to the duty; only that it be properly enforced. In the context of payments out of the fund he went on to say, 'I consider that the existing rules, especially the best interests

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[3] The heading is inaccurate because it suggests that a trustee or director breaches the duty if a (so far unspecified) payment is not in the members' financial interests. As noted, the covenant is directed at the reasons behind the decision to make the payment, not the effect of the payment.

[4] Available at https://financialservices.royalcommission.gov.au/publications/Pages/default.html. See also, Pamela F Hanrahan, 'The relationship between equitable and statutory "best interests" obligations in financial services law' (2013) 7 *Journal of Equity* 46; Pamela F Hanrahan, 'A Singular Loyalty: Superannuation after the Hayne Royal Commission' (2019) 30 *Journal of Banking and Finance Law and Practice* 109 and the cases and articles referred to therein.

[5] BFRC Final Report (February 2019) Vol 1, 227.

covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration'.[6]

It is true, as the explanatory memorandum points out at [1.21], that the Productivity Commission was told that the law was unclear and recommended that the Government should 'decide whether to pursue legislative change, greater regulatory guidance, and/or proactive testing of the law by regulators'. But the Productivity Commission are not lawyers, the other options for clarifying the obligations suggested by the Productivity Commission have been ignored, and the case for legislative change is not otherwise made.

The litmus test for the proposed reform must be whether the interests of fund members have been demonstrably harmed by a trustee or its directors taking a decision in the best interests of members (that is, in conformance with the existing duty) that disregarded or de-prioritised their financial interests. If this could be established, then (assuming the members' financial interests can be disentangled from their broader interests, and that their narrow financial interests are all that matter) the proposed amendment might be justified. There is simply no evidence to suggest this is so – the findings of the BFRC suggest that where members interests have been harmed, it has been because the trustee has contravened the existing duty with apparent impunity, not because the existing duty was insufficient to protect members. The examples given in the explanatory memorandum are not compelling and take an overly simplistic view of both the scope of the duty and the nature of different classes of members' 'financial' interests in a superannuation fund. Some examples given would contravene the existing duty. And it is worth noting that it is clearly in the financial interests of members for superannuation trustees to take seriously their investment stewardship obligations and to manage the physical, transitional and litigation risks of climate change, however unpalatable that may be for some.

Altering the statutory duty so that it no longer reflects the overarching equitable obligation of trustees to act in the best interests of their beneficiaries – which is in turn the foundation of its fiduciary duties – will obscure and confuse, rather than clarify, the duties. This will increase cost and uncertainty to the detriment of members.

It is always open to government to prohibit payments by superannuation trustees with which it does not agree, and exposure draft ss 117A, 117B and 117C appear to be directed at that result. This is regrettable and likely to increase partisan political meddling in the superannuation system by the government of the day, but at least it has the benefit of being transparent and capable of being implemented by trustees and their directors without exposing them to hindsight litigation based on unclear and subjective standards. If (against Commissioner Hayne's recommendations) controlling more tightly how superannuation trustees use member funds is the end policy goal, then in this limited respect this measure is preferable to the proposed amendments to the covenants in SIS Act ss 52 and 52A.

Burden of proof

Exposure draft s 220A reverses the burden of proof in civil penalty proceedings for breach of the best interest covenant. This reversal is to apply to both corporate and individual defendants. It is said to reverse the evidential rather than legal burden, without apparently grasping the significance of the distinction in the context of the duty as framed.

[6] Ibid, 235.

The explanatory memorandum asserts at [1.53] that 'this reversal of the evidential burden of proof is proportional, necessary, reasonable and in pursuit of a legitimate objective'. I strongly disagree. Nothing set out in the explanatory memorandum justifies this conclusion.

Just to be clear, exposure draft s 220A(1) provides that 'it is presumed that a trustee did not perform the trustee's duties and exercise the trustee's powers in the best financial interests of beneficiaries, unless the trustee adduces evidence to the contrary'. Draft s 220A(2) provides that 'it is presumed that a director of a corporate trustee of a registrable superannuation entity did not perform the director's duties and exercise the director's powers as director of the corporate trustee in the best financial interests of beneficiaries, unless the director of the corporate trustee adduces evidence to the contrary'.

The proposed reverse onus goes to the **essential elements of the contravention itself**, rather than to the existence of a defence.[7] It interferes directly with the presumption of innocence to which the defendant would otherwise be entitled. The rationale for imposing the burden of proof on the prosecution, and the circumstances in which it might justifiably be abandoned, are addressed at length by the ALRC in its inquiry into traditional rights and freedoms and again its recent inquiry on corporate criminal responsibility.[8] In both cases the ALRC acknowledged the relevance of these concepts to the framing of civil penalty provisions.

Although labelled as 'civil' and therefore treated as such in matters of evidence and procedure, civil penalty provisions involve enforcement proceedings by the State against both corporations and individuals. The same considerations that underpin the importance of the presumption of innocence in the criminal context apply here.

Civil penalty provisions may be regarded as criminal for the purposes of international human rights law, given the nature, purpose and severity of the penalties for contravention.[9] As the Parliament has itself acknowledged, 'If a civil penalty is assessed to be 'criminal' for the purposes of human rights law … it simply means that the civil penalty provision in question must be shown to be consistent with the criminal process guarantees set out the articles 14 and 15 of the [International Covenant on Civil and Political Rights]'.[10] This includes the right to be presumed innocent until proven guilty according to law. Reversing the burden of proof – particularly as to the elements of the contravention – interferes with that right. While legislation may reverse the burden of proof, it should only be done in exceptional circumstances. 'Claims of greater convenience or ease for the prosecution in proving a case will be insufficient, in and of themselves, to justify a limitation on the defendant's right to be presumed innocent'.[11]

Yours faithfully

Dr Pamela Hanrahan
Professor of Commercial Law and Regulation
UNSW Business School, Sydney

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[7] See Australian Law Reform Commission, *Traditional Rights and Freedoms—Encroachments by Commonwealth Laws* (Interim Report No 127, 2015) [11.110]–[11.111].
[8] Australian Law Reform Commission, *Traditional Rights and Freedoms—Encroachments by Commonwealth Laws* (Report No 129, 2016) Ch 9 and Australian Law Reform Commission, *Corporate Criminal Responsibility* (Report No 136, 2020) [4.109] – [4.118].
[9] See Parliamentary Joint Committee on Human Rights *Guidance Note 2: Offence provisions, civil penalties and human rights* (December 2014)
[10] Ibid.
[11] Ibid.