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SUBMISSION

Submission to Treasury — Consultation on 'Your Future, Your Super' exposure draft legislation

22 December 2020

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22 December 2020

Dear Sir/Madam,

'Your Future, Your Super' exposure draft legislation

The Association of Superannuation Funds of Australia (ASFA) is writing in response to your consultation on the 'Your Future, Your Super' exposure draft legislation released for feedback and comment on Thursday 26 November 2020.

ABOUT ASFA

ASFA is a nonprofit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 16 million Australians with superannuation.

GENERAL COMMENTS

ASFA supports the objective of ensuring good governance of super funds and addressing underperformance. It is important, however, that the performance of Australian superannuation funds is put into perspective. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) made the fewest number of recommendations with respect to superannuation – nine – of which one related to the regulators and not to superannuation fund trustees.

Need for draft regulations to be released to determine full effect of legislative change

Given that the detail of how the prohibition on specified payments and investments (proposed new section 117A) and the performance benchmarking methodology will be contained in regulations, it is difficult to assess the full effect of the amendments being proposed to be made through the exposure draft legislation. Accordingly, we submit that the draft bills should not be introduced into Parliament until draft regulations have been released, to enable the full effect of the changes to be evaluated.

Best interest obligation – proposed amendments

Commissioner Hayne examined the best interest obligation, in the context of conflicts of interest and duty, and concluded:

> ***'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'*** *(emphasis in original).*[1]

[1] *The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), Final Report, page 234*

Given this explicit finding by Commissioner Hayne, we query why the 'best interest' duty is being amended.

Best interest obligation – materiality

We note that, despite the amendment to paragraph 52(2)(c) being the insertion of the word 'financial' after the word 'best', the Exposure Draft Explanatory Materials (ED EM) states that:

> *The **identification of a quantifiable financial benefit** to members is a **threshold consideration** for trustees in assessing whether the proposed exercise of their power will fulfil the requirements of the duty. Trustees will need to have **robust quantitative and qualitative evidence to support their expenditures** (emphasis added).*[2]

While this may be a reflection of the practical outworking of the best interests obligation, we do not believe these to be accurate statements of the legal obligation under paragraph 52(2)(c).

That these are not legal obligations imposed by the legislation, but practical considerations as to how to evidence compliance, is acknowledged later in the ED EM where it states:

> *The amendments relating to the best financial interests duty **may encourage** trustees and directors to **keep better records** to demonstrate compliance with their duties (emphasis added).*[3]

Given the strength of the statements in the ED EM, notwithstanding that these obligations are not in the legislation itself, member funds have expressed concerns about the lack of materiality, especially with respect to small amounts of non strategic discretionary expenditure.

To the extent that trustees are expected by the regulators to identify a quantifiable financial benefit for every exercise of their power, duty or discretion and to have robust quantitative and qualitative evidence will mean that the industry could be overwhelmed with compliance activity and related costs.

Best interest obligation – regulations to prohibit specified payments

Of great concern is the proposal to amend the SIS Act to insert a new section 117A that will allow regulations to be made that can specify that certain payments are prohibited, or prohibited unless certain conditions are met, ***regardless of whether the payment is considered to be in the best financial interests of beneficiaries***.[4]

Trustees are already subject to considerable trust law duties and statutory obligations, including acting in the best interests of members. There is no justification for this overreach.

The Royal Commission made no adverse findings and in fact – in the context of a suggestion there should be a rule prohibiting funds from engaging in certain kinds of advertising – Commissioner Hayne stated that:

> *I **do not favour the adoption of a rule of that kind**. Even if a rule of that kind could be made (and I do not stay to examine how the implied freedom of political communication might apply) **it is not a rule that I consider should be made** (emphasis added).*[5]

Given this explicit finding by Commissioner Hayne, we query why draft section 117A is being proposed to be inserted into the SIS Act – in direct conflict with the express findings of Commissioner Hayne.

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[2] *BFIO Bill, Exposure Draft Explanatory Materials (ED EM) - paragraph 1.28*

[3] *BFIO Bill, ED EM - paragraph 1.64*

[4] *BFIO Bill, ED EM) - paragraph 1.3*

[5] *Op cit; page 234*

Best interest obligation – regulations to prohibit payments includes investment as well as expenditure

If it is decided that the regulation-making power is to be inserted into the SIS Act it is important that trustees are not fettered in their ability to make any investment they consider to be suitable and appropriate. Accordingly, should a regulation-making power be inserted into the SIS Act, it should be confined to the making of regulations to proscribe specified expenditure and should not extend to the prohibition of investments.

Proposed performance benchmark – conflict with best interests duty and member outcomes obligation

The common law fiduciary duty is for trustees to act in the best interest of members.

Further, the *Superannuation Prudential Guidance SPG 515 – Strategic and Business Planning,* with respect to articulating 'member outcomes', variously states that:

- *APRA expects … outcomes may include **achieving a certain level of investment performance …***[6]
- *APRA expects that an RSE licensee would take a broad approach to articulating outcomes, **including, but not limited to:***
    - *a) **risk-adjusted investment returns net of investment fees***[7]
- *For many members, **investment performance will be central to the outcomes sought**. However, in APRA's view, **relying solely on net returns as a measure of outcomes**, whether on a relative or absolute basis, **would not be sufficient**. In addition, **seeking to provide the lowest relative fees and costs may not necessarily provide better outcomes for members** over the long-term … **Similarly, improved outcomes may result from investments that involve higher investment costs but are expected to provide higher (risk-adjusted) investment returns** to offset these additional costs over time (emphasis added).*[8]

When it comes to trustee's making investment decisions, consideration of 'member outcomes', as per SPG 515, generally aligns with the trustee's duty to act in the best interests of members – especially when it comes to making investment decisions over a medium to long-term time horizon.

By way of contrast, ASFA has serious concerns that the proposed underperformance test, and the benchmarking methodology announced in the 2020/2021 Federal Budget, will have undesirable consequences of driving investment decision making that will be contrary to the objective of delivering good member outcomes over the medium to long term.

The conflict between these two competing 'tests' can be encapsulated in a scenario – a trustee has to decide between two investments:

- one is likely to have better medium to long term returns, aligning with producing good member outcomes, but has higher volatility and risk of lower/negative returns in the short term
- the other is likely to produce lower returns, with lower risk, but has a higher chance of enabling the product to meet the 'performance benchmark' in the short term.

Which investment is considered to be the 'correct' decision for the trustee to make?

[6] *Superannuation Prudential Guidance SPG 515 (SPG 515) - Strategic and Business Planning – paragraph 9*

[7] *Ibid, paragraph 11*

[8] *Ibid, paragraph 12*

Proposed performance test – trial run for two years to assess/address undesirable consequences

Given the concerns about the potential operation of the proposed underperformance test, the significance of the consequences of failure and the risk of there being unintended consequences in the outworking of the performance test, ASFA submits that that consideration should be given to there being a 'trial run' for a two year period, during which the benchmarking would operate but the consequences for a product that did not meet the benchmark would not be deployed. Instead, a trustee would effectively be 'put on notice' as to the product's performance, which would provide the opportunity for an orderly transition through a mechanism such as a successor fund transfer. Facilitating an orderly transition would be in the interests of fund members – by way of contrast the mechanisms proposed in the exposure draft legislation are likely to have undesirable consequences for members' benefits. This would allow the performance test and/or benchmark methodology to be refined if necessary, and will have the added benefit of measuring performance over a ten year period.

Proposed performance test – benchmark should include all fees deducted from members' accounts

It is important that if a single benchmark methodology is going to be employed then it should include all fees charged against members' accounts, (other than activity fees e.g. for a family law split), in particular administration fees. Like investment returns the deduction of administration and other fees from a member's account has a material effect on member outcomes and this effect should be reflected in any benchmarking methodology if a single metric is to be used.

Proposed performance test – if net returns then use only direct fees deducted from accounts

As net investment returns have already deducted investment fees/costs from gross investment returns in order to calculate the net return figures, this has had the effect of taking into account the effect of investment fees. Accordingly, if the formulas specified in the regulations – that will form the basis of ranking super products according to specified metrics – include fees, care will need to be taken to avoid double-counting the effect of investment fees.

SPECIFIC COMMENTS

Specific observations and issues with respect to the draft 'Your Future, Your Super' exposure draft legislation are outlined in the body of the submission.

Should you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4021 or via email to fgalbraith@superannuation.asn.au.

Yours sincerely

Fiona Galbraith
Director, Policy

1. Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Best Financial Interests Obligation (BFIO Bill)

1. Discharging best financial interest duties obligation

ASFA supports the objective of ensuring good governance of superannuation funds.

It is important, however, that the performance of Australian superannuation funds is put into perspective.

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) made the fewest number of recommendations with respect to superannuation – nine – of which one related to the regulators and not superannuation fund trustees.

Most importantly – in this context of this draft legislation – the Final Report of the Royal Commission **made no recommendation** with respect to amending the 'best interest' obligations within superannuation – in fact quite the opposite.

Commissioner Hayne examined the best interest obligation, in the context of conflicts of interest and duty, and concluded:

> ***'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'*** *(emphasis in original).*[9]

Given this explicit finding by Commissioner Hayne, we query why the 'best interest' duty is being amended.

1.1. Best interests duty – common law

ASFA queries the need to amend paragraph 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) to require trustees, and directors of a corporate trustee, to perform their duties and exercise their powers in the best *financial* interests of the beneficiaries.

It is arguable that the BFIO bill does not add anything to the existing law as it has been a long held view that generally the obligation to act in the best interests of beneficiaries is a duty to prioritise their best financial interest. It is also considered that, so long as members' financial interests come first, the best interest obligation does not prevent trustees from taking other, non-financial, interests into account.

1.2. Best interests duty – subsection 52(12) of the SIS Act

Further to this, subsection 52(12) of the SIS Act already provides as follows:

> *(12) If the entity is a regulated superannuation fund (other than a regulated superannuation fund with fewer than 5 members),* ***the covenants*** *referred to in subsection (1)* ***include a covenant*** *by each trustee of the entity* ***to promote the financial interests of the beneficiaries of the entity who hold a MySuper product or a choice product****, in particular returns to those beneficiaries (after the deduction of fees, costs and taxes) (emphasis added).*

[9] *The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), Final Report, page 234*

1.3. Best interests duty – Productivity Commission recommendation 22 and Royal Commission finding

The BFIO Exposure Draft Explanatory Memorandum (ED EM) states that

> *[T]he amendments are the Government's response to recommendation 22 of the Productivity Commission review into superannuation by providing a clearer articulation of what it means for a trustee to act in members' best interests.*[10]

It is important to note that recommendation 22 of the Productivity Commission review states as follows:

> **Recommendation 22 Definition of the Best Interests Duty**
>
> *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 be informed by the findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry*** *(emphasis added).*[11]

Commissioner Hayne examined this obligation in the context of conflicts of interest and duty and found:

> ***'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'*** *(emphasis in original).*[12]

Recommendation 1

Given the common law, the existence of sub-section 52(12) of the SIS Act and Commissioner Hayne's finding, we submit there is no need to amend paragraph 52(2)(c).

1.4. Best financial interests duty – what it means to act in the best interests of members

The Exposure Draft Explanatory Materials (ED EM) for the BFIO Bill states that

> *The new best financial interests duty test is intended to* ***clarify*** *the existing best interest duty. By requiring trustees and directors of corporate trustees to* ***only*** *have regard to financial interests, it eliminates the possibility that trustees and directors of corporate trustees can act in a manner that they judge improves the non-financial interests of members but not their financial interests. The amendments clarify the standard trustees must meet when they make expenditure decisions and undertake actions in relation to the operation of the fund in the best financial interests of members. This is all the more important given the compulsory nature of superannuation so that Australians have confidence that the effort of trustees is* ***solely focussed*** *on improving their retirement incomes and not some subsidiary or ancillary purpose (emphasis added).*[13]

The first thing to note is that there is no need to clarify the existing best interests duty as it is commonly understood that to act in the best interests of members is to act in their best financial interests.

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[10] *Best Financial Interests Obligation (BFIO) Exposure Draft Explanatory Memorandum (ED EM) - paragraph 1.7*

[11] *Productivity Commission: Superannuation: Assessing Efficiency and Competitiveness: Inquiry Report No. 91, 21 December 2018, page 72*

[12] *The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), Final Report, page 234*

[13] *BFIO Bill, Exposure Draft Explanatory Materials (EDEM), paragraph 1.6*

Of concern are the statements in the ED EM

- *requiring trustees and directors of corporate trustees to **only** have regard to financial interests*
- *the effort of trustees [should be] **solely focussed** on improving … retirement incomes; and*
- *the range of interests covered by the obligation [are] **solely** … financial interests (not non financial interests (emphasis added).*[14]

We do not believe these to be accurate statements of the common law best interests duty – trustees must prioritise the interests of members but they are not confined to having regard only to members' best interests and they do not need to focus solely on members' best interests.

Given these statements in the ED EM, ASFA submits that, for the avoidance of doubt, there is a need to amend the BFIO Bill to confirm that the best interest covenant requires a trustee to prioritise the interests of members but the interests of members does not need to be the sole focus of the trustee and the trustee is not confined to having regard to the best interests of members alone.

Recommendation 2 The BFIO Bill be amended to insert a clause to the following effect: *(x) For the avoidance of doubt, when acting in the best interest of members* *(a) the trustee must prioritise the interests of members* *(b) the interests of members does not need to be the sole focus of the trustee; and* *(c) the trustee is not confined to having regard to the best interest of members only.*

1.5. Best financial interests obligation – need to identify and quantify benefit

The ED EM states that:

> *The identification of a quantifiable financial benefit to members is a threshold consideration for trustees in assessing whether the proposed exercise of their power will fulfil the requirements of the duty. Trustees will need to have robust quantitative and qualitative evidence to support their expenditures.*[15]

While this may be a reflection of the practical outworking of the best interests obligation, we do not believe this to be accurate statement of the legal effect of inserting the word 'financial' into paragraph 52(2)(c).

This is acknowledged later in the ED EM where it states:

> *The amendments relating to the best financial interests duty **may encourage** trustees and directors to **keep better records** to demonstrate compliance with their duties (emphasis added).*[16]

Trustees have a range of powers, duties and discretions granted under the trust instrument, common law and legislation. The best financial interests duty requires that the exercise of a particular power, duty or discretion must be in the best financial interests of members but the BFIO Bill (quite rightly) does not impose an additional obligation to assess a 'threshold consideration' to identify a financial benefit, and furthermore to quantify and evidence it, in order for the trustee to have discharged the duty.

Further, there will be a number of instances where the exercise of a power, duty and discretion does not produce a quantifiable financial benefit to members.

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[14] *Ibid – paragraph 1.27*
[15] *BFIO Bill, ED EM - paragraph 1.28*
[16] *BFIO Bill, ED EM - paragraph 1.64*

To the extent that identifying and quantifying benefits may be considered to be good practice - and that will not be in all instances where a power, duty or discretion is exercised - there will be particular practical issues with quantifying expected future benefits with respect to certain expenditures, such as on new marketing campaigns.

Furthermore, whether a trustee has exercised a power, duty or discretion in the best interests of members is determined at the time of the exercise – it is not assessed 'looking back with the benefit of hindsight'. The ED EM – in placing an undue emphasis on quantifying and evidencing a financial benefit – is suggesting that whether a trustee is considered to have acted in the best interest of the members will be determined by comparing the actual benefit with the forecast benefit. This is not an appropriate approach in the context of determining whether a trustee has acted in the best interests of members.

1.6. Best financial interests duty – expenditure

The ED EM addresses trustee expenditure in the context of the amendment to the best interests duty – to insert the word 'financial' before 'interests'.

There are three main issues with the treatment of expenditure in the ED EM:

1. the statements made are not a reflection of obligations under the legislation but are more in the form of guidance
2. the distinctions between the different types of expenditure are unclear and incomplete
3. there is no materiality threshold.

1.7. Best financial interest duty – explanatory materials not reflective of legislative obligation

The ED EM makes the following statement with respect to trustee expenditure:

> *So long as the expenditure is* ***essential to the prudent operation of a superannuation entity****, and* ***reporting and monitoring frameworks*** *for such expenditure* ***are put in place*** *by trustees to ensure that the expenditure is* ***necessary and competitively priced*** *… then the expenditure decision would* ***likely be regarded to be in the best financial interests of the beneficiaries*** *(emphasis added).*[17]

It is important to note that the best financial interests duty in the SIS Act does not impose a legislative obligation that expenditure be considered essential, or that a reporting and monitoring framework be put in place to ensure expenditure is necessary and competitively priced. At best this is guidance as to what may be considered to be good practice with respect to 'essential' expenditure, but it is not a statutory requirement.

> *There are other kinds of expenditure that might be considered* ***discretionary or non-essential*** *to the ongoing operation of the superannuation entity.* ***Some of these expenditures could be strategic in nature*** *…. A* ***business case,*** *supported by technical analysis …* ***and quantifiable metrics to reflect expected financial outcomes would be expected*** *to support trustee decision making on strategic expenditure (emphasis added).*[18]
>
> ***Other strategic discretionary expenditure****, such as expenditure relating to building a brand, promoting awareness of the fund or supporting external activities,* ***which are not supported by an identifiable and quantifiable financial benefit to members****, articulated in a clear business case, are* ***unlikely to satisfy the requirements of the best financial interests obligation*** *(emphasis added).*[19]

[17] *BFIO Bill, ED EM - paragraph 1.30*

[18] *BFIO Bill, ED EM - paragraph 1.31*

[19] *BFIO Bill, ED EM - paragraph 1.32*

Again, these are not requirements of the legislative best financial interests obligation but are more akin to guidance as to what may be considered to be good practice.

1.8. Best interests duty – explanatory materials distinctions are unclear and incomplete

The ED EM guidance makes a distinction between expenditure that is

1. 'essential to the prudent operation'
2. 'discretionary…[that] could be considered strategic in nature'
3. 'other strategic discretionary expenditure'.

There are two main issues with these distinctions:

- it is not clear as to what is the distinction between 'discretionary strategic expenditure' (2) and 'other strategic discretionary expenditure' (3)
- the ED EM does not address discretionary expenditure that is not strategic.

1.9. Best interest duty – no materiality threshold

We note that, despite the amendment to paragraph 52(2)(c) being the insertion of the word 'financial' after the word 'best', the Exposure Draft Explanatory Materials (ED EM) states that:

> *The **identification of a quantifiable financial benefit** to members is a **threshold consideration** for trustees in assessing whether the proposed exercise of their power will fulfil the requirements of the duty. Trustees will need to have **robust quantitative and qualitative evidence to support their expenditures** (emphasis added).*[20]

While this may be a reflection of the practical outworking of the best interests obligation, we do not believe these to be accurate statements of the legal obligation under paragraph 52(2)(c).

That these are not legal obligations imposed by the legislation, but practical considerations as to how to evidence compliance, is acknowledged later in the ED EM where it states:

> *The amendments relating to the best financial interests duty **may encourage** trustees and directors to **keep better records** to demonstrate compliance with their duties (emphasis added).*[21]

Given the strength of the statements in the ED EM, notwithstanding that these obligations are not in the legislation itself, member funds have expressed concerns about the lack of materiality, especially with respect to small amounts of non strategic discretionary expenditure.

To the extent that trustees are expected by the regulators to identify a quantifiable financial benefit for every exercise of their power, duty or discretion and to have robust quantitative and qualitative evidence will mean that the industry could be overwhelmed with compliance activity and related costs.

1.10. Best financial interest duty – third party payments

The ED EM states that:

> *The trustee **should be able to produce evidence supporting its decision**, and **have oversight that monies paid are being used by third parties for the intended purpose**.*

[20] *BFIO Bill, ED EM - paragraph 1.28*

[21] *BFIO Bill, ED EM - paragraph 1.64*

> *In order to meet this duty, trustees should* ***conduct reasonable due diligence when assessing payments to a third party****. If, after having conducted this reasonable due diligence, the trustee knows* ***or ought reasonably to know*** *that the payment to the third party is not in the best financial interests of beneficiaries,* ***or there is a concern that they might not be****, the trustee should not make the payment (emphasis added).*[22]

Again, what the ED EM is stating is not an obligation under the legislation but is more in the form of guidance as to what could be considered to be good practice.

Importantly, there is no express requirement in the legislation, or trustee duty, to 'look through' payments made to third parties to ensure that monies 'are being used by third parties for the intended purposes'. Payments to third parties often are made in exchange for a good or service provided to the fund, or for an indirect benefit provided to the fund. The trustee's obligation is to assess whether the good or service, or the indirect benefit, has been provided to the fund – it is not to oversight how monies paid are being used by the third party.

2. Prohibition of prescribed payments and investments – proposed new section 117A

Of great concern is the proposal to amend the SIS Act to insert a new section 117A that will allow regulations to be made that can specify that certain payments are prohibited, or prohibited unless certain conditions are met, ***regardless of whether the payment is considered to be in the best financial interests of beneficiaries***.[23]

Trustees are already subject to considerable trust law duties and statutory obligations, including acting in the best interests of members. There is no justification for this overreach.

The Royal Commission made no adverse findings and in fact – in the context of a suggestion there should be a rule prohibiting funds from engaging in certain kinds of advertising – Commissioner Hayne stated that:

> *I* ***do not favour the adoption of a rule of that kind****. Even if a rule of that kind could be made (and I do not stay to examine how the implied freedom of political communication might apply)* ***it is not a rule that I consider should be made*** *(emphasis added).*[24]

Given this explicit finding by Commissioner Hayne, we query why draft section 117A is being inserted into the SIS Act, in conflict with the express findings of Commissioner Hayne.

The ED EM states

> *The power has been drafted to broadly cover any payments and investments from a superannuation entity, including payments relating to expenses associated with running the entity or investments made by the entity.*
>
> *This ensures that regulations can be made to prohibit certain payments and investments* ***where they are considered to be unsuitable expenditure by trustees in any circumstance*** *(emphasis added).*[25]

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[22] *BFIO Bill, ED EM - paragraph 1.43*

[23] *BFIO Bill, ED EM - paragraph 1.3*

[24] *Op cit; page 234*

[25] *BFIO Bill, ED EM – paragraphs 1.60 & 1.61*

If it is decided that the regulation-making power is to be inserted into the SIS Act it is important that trustees are not fettered in their ability to make any investment they consider to be suitable and appropriate. Accordingly, should a regulation-making power be inserted into the SIS Act, it should be confined to the making of regulations to proscribe specified expenditure and should not extend to the prohibition of investments.

Recommendation 3

The SIS Act should not be amended to allow regulations to be made that can specify that certain payments and investments are prohibited.

Recommendation 4

If the regulation-making power is inserted into the SIS Act it should be confined to the making of regulations to proscribe specified expenditure and should not be extended to investments.

3. Evidential burden of proof reversed – proposed new section 220A

3.1. Reversal of evidential burden of proof

Under the FBIO Bill proposed new section 220A provides that – with respect to civil proceedings for an alleged contravention of subsection 54B(1), in relation to a covenant set out in paragraph 52(2)(c), or of subsection 54B(2), in relation to a covenant set out in paragraph 52A(2)(c) – it is presumed that a trustee did not perform its duties or exercise its powers in the best financial interests of beneficiaries, unless the trustee adduces evidence to the contrary.

As noted by the Standing Committee for the Scrutiny of Bills (Standing Committee) in its most recent Scrutiny Digest, in a different context:

> *At common law, it is ordinarily the duty of the prosecution to prove all elements of an offence. This is an important aspect of the right to be presumed innocent until proven guilty. Provisions that reverse the burden of proof and require a defendant to disprove, or raise evidence to disprove, one or more elements of an offence, interferes with this common law right.*[26]

The Standing Committee goes on to note that:

> *[T]he Guide to Framing Commonwealth Offences provides that a matter should only be included in an offence-specific defence (as opposed to being specified as an element of the offence), where:*
>
> - *it is peculiarly within the knowledge of the defendant; and*
> - *it would be significantly more difficult and costly for the prosecution to disprove than for the defendant to establish the matter.*[27]

The Standing Committee went on to observe that:

> *While … the defendant bears an evidential burden (requiring the defendant to raise evidence about the matter), rather than a legal burden (requiring the defendant to positively prove the matter), the committee expects any such reversal of the evidential burden of proof to be justified.*[28]

[26] *Standing Committee for the Scrutiny of Bills, Scrutiny Digest 18 of 2020, 9 December 2020 – paragraph 1.95*

[27] *Ibid – paragraph 1.96*

[28] *Ibid – paragraph 1.97*

The ED EM states:

> *Trustees should assess the **costs and benefits of actions, including quantifiable metrics to demonstrate what the anticipated financial outcome is** and the reasonable basis for that expectation. Actions taken by trustees **differ in quantum, complexity and duration**, and the detail in supporting analysis would be expected to reflect these aspects of a particular action (emphasis added).*[29]

What the ED EM does not address is that the actions taken by trustees differ in **nature** – that there is a range of trustee powers, duties and discretions and a variety of decisions made by trustees. It is implicit that the actions that are being contemplated here are with respect to expenditure, but there is a number of decisions made by trustees that are not with respect to expenditure.

This is evident in the ED EM when it states:

> *The reversal of evidential burden is reasonable as a trustee should be readily able to point to evidence that they considered the likely financial impact on beneficiaries **of a decision to make a payment to a third party** and **how such payment** was in the best financial interests of beneficiaries (emphasis added).*[30]

Most importantly in this context, superannuation funds are regulated and supervised by APRA and ASIC and the regulators are able to request, or even demand, the production of documents during the course of that supervision.

Accordingly, it is neither necessary nor reasonable to reverse the evidential burden of proof in legal actions with respect to an alleged breach of the best interests duty, that could be alleged in respect to any one of a multitude of trustee decisions. It is manifestly inappropriate to presume, legally, that a trustee did not perform its duties or exercise its powers in accordance with the best interests duty.

Recommendation 3
As there is not sufficient justification for the reversal of the evidential burden of proof, section 220A should not be inserted into the SIS Act.

3.2. Applicability of reverse evidential burden of proof

The ED EM states

> *The reverse onus would not apply to actions to recover loss or damage under section 55 of the SIS Act. This means that it will only apply to actions brought by a regulator and not private actions against trustees brought by beneficiaries (such as class actions).*[31]

ASFA submits that, for the avoidance of doubt, the FBIO Bill amend the SIS Act to clarify that the reverse onus would not apply to actions to recover loss or damage under section 55 of the SIS Act but only to actions brought by a regulator.

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[29] *BFIO Bill, ED EM - paragraph 1.49*

[30] *BFIO Bill, ED EM - paragraph 1.54*

[31] *BFIO Bill, ED EM - paragraph 1.52*

B. TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL 2020: ADDRESSING UNDERPERFORMANCE IN SUPERANNUATION (Underperformance Bill)

ASFA supports the objective of ensuring good governance of superannuation funds and addressing underperformance.

It is important, however, that the performance of Australian superannuation funds is put into perspective.

4. The proposed performance test

4.1. Proposed performance benchmark – as announced in 2020/2021 Federal Budget – in conflict with best interests and member outcomes

The common law fiduciary duty is for trustees to act in the best interest of members.

Further, the *Superannuation Prudential Guidance SPG 515 – Strategic and Business Planning,* with respect to articulating 'member outcomes', variously states that:

- *APRA expects … common outcomes may include* ***achieving a certain level of investment performance*** *… APRA also expects that* ***targeting achievement of certain retirement benefit levels*** *would be a key consideration…in articulating member outcomes.*[32]
- *APRA expects that an RSE licensee would take a broad approach to articulating outcomes, including, but not limited to:*
  - *a)* ***risk-adjusted investment returns net of investment fees***[33]
- *For many members,* ***investment performance will be central to the outcomes sought****. However, in APRA's view,* ***relying solely on net returns as a measure of outcomes****, whether on a relative or absolute basis,* ***would not be sufficient****. In addition, seeking to provide the lowest relative fees and costs may not necessarily provide better outcomes for members over the long-term. An RSE licensee may conclude, for example, that members would benefit from short-term increases in costs where this will support appropriate investment in systems and services that are expected to deliver enhanced outcomes over time.* ***Similarly, improved outcomes may result from investments that involve higher investment costs but are expected to provide higher (risk-adjusted) investment returns to offset these additional costs over time*** *(emphasis added).*[34]

When it comes to trustee's making investment decisions, consideration of 'member outcomes', as per SPG 515, generally aligns with the trustee's duty to act in the best interests of members – especially when it comes to making investment decisions over a medium to long-term time horizon.

By way of contrast, ASFA has serious concerns that the proposed underperformance test, and the benchmarking methodology announced in the 2020/2021 Federal Budget, will have unintended consequences in that it will drive investment decision making that will be contrary to the objective of delivering good member outcomes over the medium to long term.

[32] *Superannuation Prudential Guidance SPG 515 (SPG 515) - Strategic and Business Planning – paragraph 9*

[33] *Ibid, paragraph 11*

[34] *Ibid, paragraph 12*

4.2. Performance test – initial trial of to allow unintended consequences to be addressed

Given the concerns about the potential operation of the proposed underperformance test, the significance of the consequences of failure and the risk of there being unintended consequences in the outworking of the performance test, ASFA submits that that consideration should be given to there being a 'trial run' for a two year period, during which the benchmarking would operate but the consequences for a product that did not meet the benchmark would not be deployed. Instead, a trustee would effectively be 'put on notice' as to the product's performance, which would provide the opportunity for an orderly transition through a mechanism such as a successor fund transfer. Facilitating an orderly transition would be in the interests of fund members – by way of contrast the mechanisms proposed in the exposure draft legislation are likely to have undesirable consequences for members' benefits. This would allow the performance test and/or benchmark methodology to be refined if necessary, and will have the added benefit of measuring performance over a ten year period.

4.3. Proposed benchmark methodology – fees deducted directly from members accounts

The Underperformance Bill ED EM states as follows: -

It is expected that the regulations will be made for this purpose that include, but are not limited to the following matters:

- *specifying requirements in respect of* ***investment returns (net of fees)****; and*
- *specifying requirements that depend on the exercise of a discretion by APRA; and*
- *specifying matters that APRA may, must, or must not take into account in exercising such a discretion; and*
- *allowing APRA to make specified assumptions in exercising such a discretion (emphasis added).*[35]

It is important that any benchmark methodology employed should include all fees charged against members' accounts, (other than activity fees e.g. for a family law split), in particular administration fees. Like investment returns, the deduction of administration and other fees from a member's account has a material effect on member outcomes and this effect should be reflected in any benchmarking methodology.

There is some complexity in using total fees for products that have different average balances and we would be willing to discuss how this could be addressed further.

It should be noted that the inclusion of total fees may be challenging for products that have different average balances – in particular products that have higher average balances may be disadvantaged if fees are calculated by reference to a lower balance, such as the 'representative member balance of $50,000).

4.4. Performance test – net investment returns and investment fees deducted from returns

As net investment returns have already deducted investment fees/costs from gross investment returns to calculate the net return figures, this has had the effect of taking into account the effect of investment fees. Accordingly, if the formulas specified in the regulations – that will form the basis of ranking super products according to specified metrics – include fees, care will need to be taken to avoid double-counting the effect of investment fees.

[35] *Underperformance Bill – Exposure Draft Explanatory Materials (ED EM) – paragraph 1.22*

4.5. Performance test – recognition of improvement in returns when applying test / review mechanism

The Underperformance Bill ED EM states:

> *The amendments allow APRA to determine that the prohibition be lifted where the requirements to be specified in regulations have been met. This will allow the regulations to specify the criteria for when a superannuation product may re-open to new beneficiaries based on when the product's performance has improved.*[36]

While this provides for lifting the prohibition when a product's performance has improved, given the significance of the consequences of not meeting the performance test, there is a need for the performance test to contain an element that would allow APRA to recognise where there have been recent improvements in performance or delivery, as well as a review mechanism.

Proposed new subsection 60(2) provides that:

(2) regulations made for the purposes of subsection (1) may:

(a) specify requirements in respect of:

(i) investment returns (net of fees); and

(ii) any other related matter

When specifying requirements ASFA submits that a 'balanced scorecard' approach be adopted in respect of investment returns such that the regulations include, as a 'related matter', a metric that would allow a product to demonstrate improvement in risk adjusted returns over the shorter term.

4.6. Performance test – prohibition on accepting new beneficiaries – consequences

Where a product has failed the performance test in two consecutive years, the trustee is prohibited from accepting new beneficiaries into that product.

There are some unintended consequences of this prohibition that will need to be addressed:

- family law splits – where a member of a fund serves a family law spitting order or agreement on a trustee, the trustee must effect a family law spilt, which necessitates the creation of an interest for the 'non member spouse'
- remediation program – where a member has exited a product and subsequently there is a remediation program, in order to facilitate the payment of compensation for that exited member an interest must be created for that member in that product while awaiting instructions as to payment or roll-over.

[36] *Underperformance Bill ED EM – paragraph 1.45*