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Dear Sebastian

Carbon offset payments and the best financial interests covenant (BFID)

1. Overview

- 1.1 The Association of Superannuation Funds of Australia Ltd (**ASFA**) Research Team is considering the implications and methodologies for superannuation fund trustees aiming to achieve carbon neutrality in their business operations through the use of carbon offsets.
- 1.2 The Climate Active program is managed by the Australian Government's Department of Climate Change, Energy, the Environment and Water, and is responsible for publishing the 'Climate Active Carbon Neutral Standard' (**Standard**) and certifying that entities have achieved carbon neutrality under the Standard.
- 1.3 The Standard includes *Appendix A: Eligible offset units*, which lists five 'eligible' offset units under the Standard, including Australian Carbon Credit Units (**ACCUs**) issued by the Clean Energy Regulator under the *Carbon Credits (Carbon Farming Initiative) Act 2011* (Cth).
- 1.4 ACCUs are tradeable financial products managed through Australian National Registry of Emissions Units accounts. One ACCU represents one tonne of carbon dioxide equivalent that would have otherwise been released into the atmosphere. ACCUs may be 'earned', traded on a secondary market or sold to the Australian Government.
- 1.5 ACCUs may be 'cancelled' voluntarily by the holder of the ACCU (also referred to as 'surrendering' the ACCU) where the holder wishes to offset their direct 'scope 1'¹ emissions or reduce their indirect 'scope 2' emissions.
- 1.6 You have asked for our advice as to whether the best financial interests duty (**BFID**) in section 52(2)(c) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) would prevent trustees from buying ACCUs and then voluntarily cancelling them for the purpose of the trustee offsetting its direct 'scope 1' emissions produced in its own operations (**Trustee Emissions**).
- 1.7 An initial issue is what is meant by the reference to the trustee's 'own operations'. We take this to refer to the activities associated with maintaining the trustee's office and the trustee's workforce. It would not include the operations of third parties such as administrators or investment managers, nor would it include operations associated with the assets of the fund.
- 1.8 To be clear, buying ACCUs for the purpose of offsetting emissions produced by the portfolio assets in which the trustee invests is outside the scope of this advice.

¹ 'Scope 1' greenhouse gas emissions are emissions released into the atmosphere as a direct result of the entity's activities.

- 1.9 We make no comment on the appropriateness of using offsets (as distinct from any other approach) to reduce carbon emissions – this issue is beyond the scope of our advice.
- 1.10 Our advice is intended to be based on general principles only and is not intended as legal advice with respect to any particular fund or trustee. Our focus is on APRA-regulated superannuation funds operated by registrable superannuation entity (**RSE**) licensees.
- 1.11 Although ASFA intends to make our advice available to its superannuation trustee members, this is to be on the basis that it will be accompanied by a warning that trustees should seek their own advice that takes account of their particular circumstances and should not rely on our advice.

2. Summary

- 2.1 In our view, for the reasons explained in this advice, BFID would not prevent trustees from buying ACCUs and then voluntarily cancelling them for the purpose of the trustee offsetting its Trustee Emissions.
- 2.2 Whether or not a trustee is entitled to be reimbursed from assets of the fund for costs incurred in buying and voluntarily cancelling ACCUs to offset Trustee Emissions is determined by reference to the fund's trust deed and in particular, the breadth of the provisions governing reimbursement of expenses.
- 2.3 When a trustee seeks to exercise its right of reimbursement from assets of the fund for costs incurred in buying and voluntarily cancelling ACCUs to offset Trustee Emissions, BFID does not apply.

3. Context

- 3.1 There are no longer any RSE licensees made up of individual trustees. All RSE licensees are now bodies corporate.
- 3.2 Trustees of all kinds of trust, including superannuation funds, have a right of indemnity from trust assets under general law and State trustee legislation. Invariably, in our experience, superannuation trust deeds contain an express indemnification right which is tailored to reflect section 56(1) of the SIS Act. For this reason, we do not discuss the scope of the indemnities provided to trustees by general law or trustee legislation in this advice.
- 3.3 In this advice, we consider the position of for-profit and profit-to-member funds.
- 3.4 Neither trust law nor the SIS Act sets different rules or standards for 'for-profit' funds versus 'profit-to-member' funds. These categories are not recognised for any regulatory purposes. The different business models can, however, give rise to differences in the application of those laws.
- 3.5 The trust deeds of profit-to-member funds typically contain a broadly expressed right or entitlement for the trustee to pay or recover its expenses from the fund (**Expense-Based Fee Model**). For example, such clauses might allow reimbursement for "*expenses incurred by the Trustee in and about the provision to the Fund of its services as Trustee*".
- 3.6 Some for-profit fund trust deeds also include similar broadly-expressed expense recovery provisions (although typically for-profit trustees rarely rely on those provisions, preferring instead to pay such expenses from their fixed fee entitlement).
- 3.7 The trustee of a for-profit fund typically has a defined right to remuneration, ordinarily in the form of a fee up to a percentage of the value of the fund assets (**Defined Fee Model**), with the details of how this is calculated set out in the trust deed.
- 3.8 Some profit-to-member fund trust deeds allow the trustee to charge administration fees using a Defined Fee Model where the level of fee is set by reference to the trustee's expected overall operating costs.
- 3.9 Another distinctive feature of profit-to-member funds is that typically, the trustee of these funds is a special purpose entity with no function or role beyond that of acting as trustee of the fund. This is also true to an extent for for-profit funds (particularly following the introduction of RSE licence conditions that in broad terms prevent trustees from taking on other roles) however trustees of these funds are often part of a corporate group and will have relationships with other entities in

that group, in particular with their parent entity. Further, trustees of profit-to-member funds are not seeking a commercial return from their activities to fund dividend payments or other forms of financial return for their shareholders.

- 3.10 These features mean that the trustee of a profit-to-member fund exists solely to act as trustee of the fund and for this reason, might consider that it has no separate personal (or corporate) capacity. Certainly, this structure provides limited scope for conflict between the trustee's commercial objectives and its duties to beneficiaries. While this is understandable from a practical perspective, it is an important tenet of trust law that a trustee has both capacities. Even if a trustee is not conscious of its personal capacity outside its trustee role, this does not mean that these basic trust law concepts don't apply.
- 3.11 Recognising the existence of a separate personal capacity for all superannuation trustees is critical to understanding our advice. For example, when a trustee sets directors' fees for its board members, decides to pay premiums for D & O insurance or pays ASIC fees related to its registration as a company, these are all matters pertaining to the trustee as a body corporate (as opposed to the trustee acting in its capacity as trustee of the fund). It is important for a trustee of a profit-to-member fund to ensure that the fund's trust deed provides for remuneration that, at a minimum, covers 'personal' expenses of this kind.

4. Does BFID apply to buying and voluntarily cancelling ACCUs to offset Trustee Emissions?

- 4.1 BFID is set out in section 52(2)(c) of the SIS Act which imports the following covenant by each trustee into the fund's governing rules:

... to perform the trustee's duties and exercise the trustee's powers in the best financial interests of the beneficiaries...

- 4.2 The word, 'financial', was inserted by the *Treasury Laws Amendment (Your Future, Your Super) Act 2021 (Cth) (YFYS Act)*. The YFYS also placed the initial evidential burden in civil proceedings on a trustee, where breach of BFID was alleged. At the time of this change, it was already understood that the best interests of superannuation fund beneficiaries were normally their best financial interests.² It was also understood that the legislative best interests duty did not materially add to the existing best interests duty under general law.³

- 4.3 The YFYS Act also inserted a new subsection 52(3) to the SIS Act, headed "*Payments to third parties must be in best financial interests of beneficiaries*", which reads:

To avoid doubt, the obligations of the trustee under [BFID] apply in respect of payments to a third party by, or on behalf of, the [fund].

- 4.4 In relation to this provision, the Revised Explanatory Memorandum to the YFYS Bill says in paragraph 3.54:

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, for example, payments for the provisions of goods and services to the fund or an investment.

- 4.5 Section 52(3) does not, in our view, have any application to payments associated with buying and voluntarily cancelling ACCUs to offset Trustee Emissions because, as explained further below, these transactions do not involve transactions undertaken '*by or on behalf of the fund*'.

- 4.6 The application of BFID depends on a threshold question – would the trustee be buying, and then voluntarily cancelling, an ACCU in the performance of its duties or the exercise of its powers as trustee?

² *Cowan v Scargill* [1984] 2 All ER 750, 760 (Megarry VC). APRA's submission citing this proposition was accepted by Jagot J in *Australian Prudential Regulation Authority v Kelaher* [2019] FCA 1521 at [49].

³ *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167, [121] (Giles JA). This is consistent with the second reading speech by the Parliamentary Secretary to the Treasurer for the *Superannuation Industry (Supervision) Bill 1993* (Cth), who said:

In the SI(S) Bill, what we have done is simply to transcribe trust law – already existing trust law that will govern the behaviour of these people – codify it and write it down. This is perhaps the first time an effort has been made to make nice and clear the way in which we expect these people to act – the meaning of acting properly, carefully and prudently.

- 4.7 In our view where a trustee buys an ACCU with the intention of voluntarily cancelling the ACCU to offset its Trustee Emissions, it does so in its personal (or corporate) capacity. This is because the object of the exercise is to reduce the carbon footprint of the trustee itself (as opposed to that of the fund).
- 4.8 We say this based on an assumption that the trust deed does not impose any specific obligation on the trustee, as an aspect of administering the superannuation fund, to take steps to reduce its own carbon footprint. In the absence of such a provision, we do not consider it to be an aspect of the role of a superannuation trustee (as generally understood and as ordinarily reflected in superannuation trust deeds) to do so. Superannuation trust deeds typically confer extremely broad powers on superannuation trustees however these powers are only given to the trustee to enable the trustee to carry out its defined role as trustee of a particular fund.
- 4.9 It is implicit in this characterisation that the ACCU would not be an asset of the fund because the purchase by the trustee would not be made pursuant to any power of investment, and the cancellation of the ACCU would not be done pursuant to any power to dispose of fund assets (both of which would clearly attract BFID).

Is there scope to argue that buying ACCUs in these circumstances would be a trust expense?

- 4.10 In our opinion, absent provisions in the fund's trust deed requiring the trustee to take action of this kind, the better legal view is that these activities would be undertaken by the trustee in its personal capacity. We recognise, however, that some might argue for a broader view of the trustee's role and for the notion that buying ACCUs to offset Trustee Emissions is undertaken by the trustee in its trust capacity. Conventional legal analysis would look to the fund's trust deed to ascertain whether or not it supports such an expansive view of the trustee's role.
- 4.11 There might well be differences between the role of a trustee as circumscribed by the fund's trust deed (where typically, the trustee's role is a relatively narrow one of simply receiving contributions, administering member accounts, investing the contributions and paying benefits) and broader 'community expectations' of the role of superannuation trustees. Given the significant role superannuation funds now play in the economy and society, it is quite conceivable that the law may evolve to accommodate these expectations.
- 4.12 A good example of this is the lively and ongoing debate about the extent to which expenditure incurred to market and improve the brand of the fund, such as sponsorship arrangements and the like, are properly incurred trust expenses.⁴ Buying ACCUs to offset Trustee Emissions could be viewed as an important measure to enhance the reputation of the trustee (and therefore, the fund), which could be seen as a way to attract further investment into the fund. From a practical perspective, these arguments appear reasonable, however in our experience, most fund trust deeds do not confer a responsibility on the trustee to promote the fund and this can make it challenging to argue that when doing so, they are acting in their trustee capacity as strictly understood.

5. **Could the trustee be reimbursed from assets of the fund for costs incurred in buying and voluntarily cancelling ACCUs to offset Trustee Emissions?**

- 5.1 A separate but related question is whether the trustee would be entitled to be reimbursed from the assets of the fund for costs incurred in buying and voluntarily cancelling ACCUs to offset Trustee Emissions. The answer to this question is to be found in the precise wording of the relevant provisions in the fund's trust deed.
- 5.2 A trust is not a separate legal entity. Rather, the trustee is responsible for administering the trust and performing its role in accordance with the provisions of the trust deed which define the trustee's role. If, in performing its obligations as trustee, the trustee enters into contracts (for example for the investment of fund assets) for the benefit of the trust beneficiaries, acting within the powers conferred on it by the trust deed, the trustee is acting in its capacity as trustee. Despite this capacity, the trustee is nonetheless personally liable to third parties under each relevant contract.

⁴ This debate generally assumes these expenses are trust expenses, with the focus of debate being whether the activities and associated expenditures satisfy BFID (rather than whether the activities are undertaken in the trustee's personal or trustee capacity).

- 5.3 Under general law, a trustee has a right of indemnity from the assets held on trust for liabilities incurred by the trustee in the course of the proper administration of the trust (and this right is protected against anything inconsistent in the governing rules for superannuation trustee under section 56(1) of the SIS Act). This right of indemnity may be exercised by the trustee applying the trust property to satisfy the liability, or the trustee reimbursing itself from the trust property where the trustee has discharged the liability from its personal property.⁵
- 5.4 Absent express provisions in the trust deed, a trustee would not be entitled to exercise its right of indemnity for the costs of acquiring an ACCU to be held by the trustee in its personal or corporate capacity. This is because the trustee's liability in respect of the ACCU would not be a liability incurred in the course of administering the trust but rather, the liability is incurred in the course of the trustee undertaking its own operations as a corporate entity.
- 5.5 The trustee might, however, be entitled under the trust deed to recover (or pay) expenses which would not otherwise be recoverable or payable from the fund at general law. This entitlement would be in the nature of a right to trustee remuneration. In other words, just because the expense is a personal expense of the trustee does not prevent the trustee from being reimbursed for the expense as some trust deeds make provision for a trustee to recover expenses of this kind.
- 5.6 There is nothing in the SIS Act which might act to limit any such entitlement.
- 5.7 The general rule is that trustees are not entitled to remuneration unless the trust instrument expressly or impliedly provides for that right. This general rule is an incident of the fiduciary obligations applying to trustees, that a trustee may not profit from his office and may not place himself in a position of conflict, without the fully informed consent of the beneficiaries. An express entitlement to remuneration in the trust deed allows the trustee to both profit from his office and be in a position of conflict vis-à-vis the beneficiaries, when exercising that entitlement.
- 5.8 Remuneration may take many forms and historically has included a wide variety of trustee benefits including (by way of example), for a trust established by a will, a legacy conditional on acceptance of the office of trustee, a fixed or variable annuity, or professional charges (such as where the trustee is a solicitor or accountant). In the commercial trust context, a remuneration clause is commonly expressed as an entitlement for the trustee to an annual amount up to a percentage of the value of the trust assets. Another form of remuneration is a provision which entitles the trustee to interest earned on trust money deposited with a bank.
- 5.9 Remuneration and expense recovery provisions in a superannuation trust deed should not be construed narrowly but rather in a “*practical and purposive, rather than detached and literal*” way.⁶ This practical and purposive approach should take account of the context in which a trustee of a profit-to-member fund operates, including that the trustee might have no or a very limited entitlement to charge fees and whose sole purpose as an entity is to act as trustee of the fund. If there is ambiguity in a remuneration or expense recovery provision, the trustee may approach the court for clarification by way of an application for judicial advice.
- 5.10 Under the Expense-Based Model, expense recovery clauses in a trust deed for a profit-to-member fund might be intentionally broader than the general law because it is recognised that the trustee does not have alternative sources of capital available from which to pay for such expenses.
- 5.11 In other words, such expense recovery clauses might be designed to put the trustee in funds for everything and anything required for its existence as a corporation, in recognition that the trustee of such funds is typically a special purpose entity with only nominal shareholder capital, meaning that it is dependent on its remuneration entitlement to fund its own operations. In such cases, ACCU related expenses would be able to be paid from the fund, relying on a broad reimbursement provision.

⁵ *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, [47]. This right of indemnity is also found in the various state Acts applying to trustees (such as the *Trustee Act 1925* (NSW) – see section 59 of this Act).

⁶ *Brady v Nulis Nominees (Australia) Ltd in its capacity as trustee of the MLC Super Fund (No 4)* [2024] FCA 1374, [417] (Markovic J), citing *Vision Super Pty Ltd v Poulter* [2006] FCA 849, [66] (Young J).

5.12 Trustees should ensure their trust deed's expense recovery provisions are broad enough to cover the purchase of ACCUs in the trustee's personal capacity before relying on such provisions when recovering or paying those costs from the fund. While we do not express a view on the scope of any particular form of expense recovery provisions, we note that phrases such as 'in connection with' and 'in respect of' and 'of and incidental to' are generally construed broadly.

5.13 If a trustee considers that the remuneration provided for in the fund's trust deed is inadequate, it can apply to the court for judicial advice to authorise an amendment to enlarge the scope of the clause. For example, in *Re Queensland Coal and Oil Shale Mining Industry (Superannuation) Ltd* [1992] 2 Qd R 525, the trust deed did not contain a remuneration clause and the trustee sought court approval to vary the deed to insert one. In granting the approval, the court recognised that in the modern superannuation landscape, "*the task of administering this trust is now beyond the capacity of people who were originally envisaged as being appropriate directors of the trustee*".

6. When seeking to exercise its right of reimbursement from assets of the fund for costs incurred in buying and voluntarily cancelling ACCUs to offset Trustee Emissions, does BFID apply?

6.1 A trustee's exercise of its right of indemnity for expenses incurred in the administration of the trust is not subject to any restrictions (including any best interests duty at general law) other than that the expenses be properly incurred.⁷ The right of indemnity is defined by the fund's trust deed and the restrictions set out in subsections 56(2) and (2A) of the SIS Act, which modify the indemnity in the deed to the extent of any inconsistency.

6.2 This is because in this situation, the trustee is exercising a personal right rather than exercising a trust power. It is self-evident that when a trustee exercises a right conferred on it in its personal capacity, it is not constrained by its trust law duties, as these would be in direct conflict with its personal interest.

6.3 A trustee's powers are discretions given to a trustee in dealing with the property of the trust, including in administering the trust property and ensuring beneficiaries receive their entitlements from the trust. Examples are a trustee's power of investment and power to appoint agents, such as investment managers and custodians. A trust power is distinguishable from a right (which the trustee may also exercise in its discretion) – a right is exercisable by a trustee for the trustee's personal benefit, whereas the exercise of a power is subject to trust law and SIS Act duties which, broadly speaking, prescribe standards for the manner of exercise of the trustee's powers.

6.4 Although there is some confusion around the classification generally (including in trust deeds, although we doubt this would be determinative), a trustee's personal *rights* are understood to include the following (among others), as distinguishable from trustee *powers*:

- (a) the right to indemnification for liabilities properly incurred;
- (b) the right to benefit under a remuneration provision in the trust instrument;
- (c) the right of contribution or indemnity from co-trustees;
- (d) the right to retire from holding the office of trustee; and
- (e) the right to seek the advice of the court in the administration of the trust.

In exercising any of these rights, the trustee is not constrained by BFID.

7. Application of principles to for-profit and profit-to-member funds

Trustees of for-profit funds

7.1 Where the trustee uses its own personal funds to purchase the ACCU, and does not seek to recoup its costs of doing so from the fund, the answer is straightforward – there is no scope for BFID to apply. We expect that this would ordinarily be the case for most for-profit funds as they would collect their fee under a Defined Fee Model. The trustee may freely put that remuneration

⁷ *Re Exhall Coal* (1866) 35 Beav 449, 452–3 (Lord Romilly MR).

to use as it sees fit, without restriction or application of BFID, or the SIS Act generally for that matter.⁸

Trustees of profit-to-member funds

- 7.2 Some profit-to-member fund trust deeds allow the trustee to charge administration fees using a Defined Fee Model, in which case, the trustee could pay for ACCUs and their cancellation from those fees in the same way as described above in relation to for-profit funds. In those circumstances there would similarly be no scope for BFID to apply.
- 7.3 The situation can appear to be more complex for profit-to-member trustees where remuneration is determined using an Expense-Based Fee Model because when relying on a broad reimbursement right, there might be an expectation that the entitlement extends only to trust expenses.
- 7.4 In our view, however, while BFID does apply to the exercise of a trustee's powers (and performance of its obligations as trustee) it does not apply to a trustee's exercise of a right of indemnity, irrespective of whether that right is being exercised with respect to expenses incurred in its trustee or personal capacity. The words of section 52(2)(c) are clear that the duty applies only to the trustee's exercise of a power or performance of a duty. This is consistent with the understanding that BFID and its predecessor covenant were consistent with and in any event did not materially add to the general law best interests duty.
- 7.5 A trustee does not have to justify the exercise of a right to remuneration on the basis that it would be in the best financial interests of beneficiaries for the trustee to be paid what it is entitled to be paid from the fund.
- 7.6 An Expense-Based Fee Model is more transparent and more granular than a Defined Fee Model due to the requirement to account for each relevant expense in order to establish the entitlement. On the other hand, the Defined Fee Model is more certain because it imposes an outer boundary on the fee that may be charged, whereas an Expense-Based Fee Model is potentially open-ended.
- 7.7 The ability to set fees without any specific constraint enshrined in the law is a key element of competition in the superannuation industry. Regulatory requirements to disclose and report fees, the performance test regime and APRA's heat map all facilitate consumer awareness of the costs of different funds. From a consumer's perspective, the most important issue is the overall level of fees and costs, rather than whether recovery of any particular expense is permitted under an Expense-Based Fee Model.

8. Other considerations

- 8.1 APRA appears to take a broader view of the application of BFID and, in some of its publications, suggests that it applies to all expenditure from fund assets. For example, in its letter to superannuation trustees dated 22 October 2024, an 'initial focus' of APRA in supervising expenses for compliance with BFID includes "*Discretionary expenditure categories such as travel, entertainment and conferences*". Such expenditure would likely be incurred by trustees in their personal capacity only – i.e. this expenditure would be incurred in the trustee's own internal operations as a corporate entity and even where such expenditure was reimbursed from fund assets, as explained above, in our view, BFID would not apply to the trustee's decision to incur the expense or to reimburse itself.
- 8.2 The Revised Explanatory Memorandum to the YFYS Bill also appears to proceed on the footing that trustee operational expenditures would fall within BFID. In our opinion, a court would be unlikely to take much, if any, notice of these comments in the Explanatory Memorandum when construing the scope of BFID on the basis that there was no substantive change to the covenant itself in the YFYS Bill. Paragraph 3.7 of this Explanatory Memorandum says:

*The intent of these amendments is to increase the accountability of superannuation trustees in relation to the execution of their fiduciary duties in relation to the many actions trustees take in operating a superannuation entity: **which include incurring day-to-day***

⁸ Subject to the covenant to keep the money and assets held by the trustee personally separate from those held for the fund in section 52(2)(g)(i) of the SIS Act. See *Re HEST Australia Ltd* [2021] VSC 809, [81] (Button J).

essential operational expenditure and investing the beneficiaries' money, to less frequent strategic decisions and discretionary expenditures. (Emphasis added.)

8.3 Further examples of regulators and legislators assuming that BFID applies to all expenditures from a superannuation fund may be found without much difficulty. In our view this approach is overly simplistic for the reasons given above.

9. Benefit of our advice

This letter:

- (a) is addressed to and may be relied upon by ASFA and its directors and officers and may not, without our prior written consent, be relied on by another person for any purpose;
- (b) may be published by ASFA so that it is available for access by ASFA Members. Any person who obtains a copy of this letter should seek their own legal advice as required; and
- (c) is given in respect of the laws of the Commonwealth of Australia which are in force at 9.00am (Sydney time) on the date of this letter. We express no opinion on the application of any law not in force at that time.

Yours faithfully
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