HERBERT SMITH FREEHILLS

SUPERANNUATION FUND GOVERNANCE POST-HAYNE: PART THREE

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Legal Briefings – By **Sarah Yu, Ally Crowther and Scott Donald**

THE PURPOSE OF SUPER, COMMUNITY EXPECTATIONS AND THE INTERESTS OF MEMBERS

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was charged with inquiring into, and reporting on, 'whether any conduct of financial services entities might have amounted to misconduct and whether any conduct, practices, behaviour or business activities by those entities fell below community standards and expectations.' Not surprisingly therefore, its Final Report contains considerable discussion on the contribution of the 'governance' of the entities under investigation towards the misconduct identified. It also contains a number of recommendations designed to render such misconduct less likely in the future.

This short article is the final in a series of three that considers the Commissioner's recommendations with respect to the governance of trustee companies in the superannuation context. Specifically, it evaluates what the Final Report had to say concerning the implications of the sole purpose test for governance of a modern superannuation fund in light both of community expectations and the trustees' obligation to 'act' (sic) in the best interests of members. Part One considered the topic of Institutional Structure and Part Two considered the minimum Standards of Conduct expected by the Commissioner.

THE ROYAL COMMISSION AND COMMUNITY EXPECTATIONS

For much of the middle months of 2018 the theatre of the hearings of the Royal Commission was centre stage in the newspapers and in TV news bulletins. Each day of hearings brought new allegations and new evidence to consider. This is not to diminish the importance of the proceedings to the community, nor their seriousness for the individuals called to appear before the Royal Commission. It does however underscore the way in which the Commissioner harnessed the attention and energies of the media and political classes to build community support for his call to the industry to raise standards. Most importantly, the case study approach pursued by the Royal Commission gave detail and texture to those expectations. In place of a general distrust of banks noted in many surveys of public trust leading up to the Royal Commission, members of the public now had comprehensible and memorable narratives of real people, real practices and real interactions between the regulators and those they sought to regulate. It was compelling stuff.

One element of those newly focused expectations that received intense attention were the duties on superannuation trustees and others in the industry to:

- act in the interests of members or customers; and
- act fairly towards members or customers.

Both appeared in the list of six norms articulated by the Commissioner (as to which see Part Two of this series) and recurred across a number of the Case Studies examined by the Commissioner. What was not fully excavated in the hearings, nor in the Final Report, was the complexity of those legal tests, and the nuanced way they were articulated in statutory form in difference contexts. Indeed the Commissioner noted in the Final Report in respect of the superannuation context that,

> ‘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’

With respect, if only it were so easy. There is considerable uncertainty about the way in which the best interests covenant, and similar statutory rules in analogous situations, applies. The same is true of the sole purpose test.

THE BEST INTERESTS OF MEMBERS

The unique attention given in the law of trusts to the word ‘interests’ is perhaps the crux of the matter. When lawyers talk about the ‘interests’ of the child in child welfare cases or the ‘interests’ of the company in corporations law cases, the word typically carries an open-ended, accommodating (or even ‘holistic’) meaning. It is different in the law of trusts. There is considerable richness to the concept, driven both by the accretion of case law and specific statutory initiatives. Thus when the *Superannuation Industry (Supervision) Act* 1993 (Cth) (**SIS Act**) speaks of a trustee covenanting to exercise its powers and perform its duties in the best interests of members, that is not a covenant to pursue the general pastoral welfare of members, but is rather a covenant to give effect to the trust on its terms. In the case of a superannuation fund, those terms relate to the provision of financial retirement benefits (or related life and/or disability insurance) that arise out of their employment relationship, and no more.

What that duty does not do, at least not yet, is create an obligation on super fund trustees to look generally after the welfare of the fund’s members, in quite the way that the Commissioner seems to be assuming. (Ironically given the Commissioner’s disdain for submissions made to him on this point, he misquotes the effect of Byrne J’s use of *Cowan v Scargill* in *Invensys* (at [107], which actually points to the troubled provenance of the best interests duty, and the uncertainty that flows from that.)

If the recommendation, therefore, that the standards should be applied ‘according to their terms and without more specific elaboration’ is accepted, there is a good chance that the effect will not be the one he expects. And to the extent that his recommendation either reflects or influences community expectations, those also will not be met.

THE DUTY TO ACT FAIRLY

Trustees have long had a duty to act fairly as between members. Only recently has a duty to act fairly as between themselves and a member been imposed by statute, and then only indirectly. One source of the duty arises from the jurisdiction of the AFCA to hear complaints in which the member alleges the trustee has acted unfairly. Another source is the responsibility of all AFSL holders to do all things necessary to ensure that they provide their services to clients ‘efficiently, honestly and fairly’. A third source is the requirement for a superannuation trustee that has opted into the Insurance in Superannuation Voluntary Code of Practice to act fairly in carrying out its commitments under the Code. Each of these, in effect, create a duty on the trustee to act fairly, albeit that the remedial consequences of breaching the duty are not those that would ordinarily flow from breach of a trustee duty.

The question arises, what does fairly mean in each of these circumstances? The Federal Court in *Pope v Lawler* has stated that 'fair' means ‘just, unbiased, equitable, impartial’ and that this must be in the operation of the decision rather than the decision making process. Determinations of the SCT, precursor to the AFCA, are not precedents, but a general pattern can be discerned in which a balance is struck between a strict application of the legal rules (which are usually taken to frame the issue) and a more member-friendly position in which the member’s subjective expectations are afforded weight.

On the other hand, ASIC has apparently been reluctant to instigate cases on the AFSL duty in the superannuation context, although recent announcements suggest that this may be changing. However, the courts have held that "efficiently, honestly and fairly" is a compendious phrase and requires competence and a standard of performance. In addition, it has an ethical element that requires "not just of even handedness in dealing with clients but a less readily defined concept of sound ethical values and judgment in matters relevant to a client's affairs'" (*Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (In Liq)* [2012] FCA 414; (2012) 88 ACSR 206 at [69]-[70]).

Again, then, the Commissioner's confidence about the clarity of the fairness standard may be unwarranted. There will be cases at either end of the spectrum in respect of which there is a consensus. As always, the challenge comes in the middle, in respect of which there may well not be consensus in the community. The courts, though, are not unused to this challenge. They deal on a daily basis with notions of reasonableness, for instance, for which there is no precise and unambiguous measure.

In that sense, perhaps fairness will be simply another way in which community expectations come to be infused into the regulatory regime, just as reasonableness and the standard of care arguably both have connection to contemporary values, beliefs and technologies.

THE SOLE PURPOSE TEST

As was noted above, the Commissioner felt there was no need for clarification of or adjustment to the sole purpose test. He was no doubt presented with a range of situations in which the sole purpose test might have applied, but chose two to investigate in detail in the hearings: political advertising by industry funds and spending to encourage employers to nominate a fund as a default fund for their employees. The latter issue was disposed of by reference to the new s68A of the SIS Act, which purports to deal directly with such issues (but that's a matter for another day). In contrast, most of the cases before the courts on the sole purpose test deal with transactions enabling early release of the benefits, for instance by purchase of assets (including properties and club memberships) enjoyed prior to retirement or by loans or other forms of financial assistance afforded to related parties.

The Commissioner's finding that the political advertising (the Fox in the Henhouse advertising and the investment in the *New Daily* newspaper) was not a contravention of the sole purpose test came as a surprise to many, not least because APRA had itself asserted in its 1998 guidance on the sole purpose test that such advertising certainly was a breach. He said, apparently in respect of the Fox in the Henhouse campaign:

> Not every form of political advertising by a superannuation fund will satisfy the trustee's obligations. Conversely, not every form of political advertising by a superannuation fund constitutes a failure to act in the best interests of members or a use of members' funds other than in satisfaction of the sole purpose test. Nice questions of judgment are required.

The Commissioner does not detail how he exercised his judgment to come to the view that the Fox in the Henhouse campaign and the investment in the *New Daily* was not a breach of the sole purpose test. However, the Commissioner's finding, together with the surprising decision of Moshinsky J in the Federal Court in the *Aussiegolfa* case, appears to have inspired APRA to announce that it will update its guidance on the sole purpose test. Whether that update will seek to accommodate these new perspectives, or to counter them, remains to be seen. Either way it seems safe to say that the Commissioner's confidence in the clarity of the obligations imposed by the sole purpose test also seems misplaced.

CONCLUSION

There has been much debate in recent years about the purpose of the superannuation system: is it to accumulate savings to self-fund retirement; does it extend to administering the wealth so accumulated after retirement; or is it simply a tax-advantaged form of saving in which we are all expected to participate? The inarticulateness of the sole purpose test in section 62 of the SIS Act contributes to this lack of clarity. Were section 62 only a rule designed to limit early release of benefits, it could have been written in that way expressly. Its open texture suggests a broader role, one alluded to by the Commissioner. It could act reinforce the best interests covenant, and the conflicts covenants in sections 52(2)(d) and 52A(2)(d). But the question then would be, why does it need to? Those covenants have their own complexities and uncertainties, but would be no more clear if understood to be reinforced by section 62. So the sole purpose test belies its name and fails to deliver on its promise. The community expects the trustee of superannuation funds to administer their savings carefully, skillfully and with an undistracted focus on the interests they worked hard for and legitimately expect as employees in the workforce, an objective beyond the current wording of section 62 but within the ambit of the covenants in section 52.

Click here to read Superannuation Fund Governance Post-Hayne: Part One

Click here to read Superannuation Fund Governance Post-Hayne: Part Two

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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