Answer to question on notice and in writing:

HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON ECONOMICS

AUSTRALIA'S FOUR MAJOR BANKS AND OTHER FINANCIAL INSTITUTIONS: SUPERANNUATION SECTOR

APRA-S01QON:

CHAIR: Could you please provide to the committee the submissions that you made and the underlying legal advice on which you relied in making those submissions to the court cases?

Ms Cole: As regards to the legal advice, I believe that we would reserve our legal privilege in that. As regards submissions to the court, if they were made in an open-court process, I would certainly be in a position to provide them to you.

CHAIR: Indeed, this is one of the concerns of this committee—that a number of the judgements relied on confidential submissions. Did APRA provide confidential submissions in these court cases and, if so, why?

Ms Cole: I don't believe we did provide confidential submissions. We made our submissions—

CHAIR: So there's no reason—

Ms Cole: I believe you're right, unless there's a court restriction. In any case, I would be very happy to provide APRA's open-court submissions. I will get my legal colleagues to check that and ensure that's possible.

Answer:

In relation to the submissions made by APRA in the 10 applications, copies of these submissions are available via the respective court registries. Nine are attached for ease of reference. Certain parts of APRA's submissions are the subject of confidentiality and/or suppression orders made by the Courts and are redacted accordingly. Redactions to parts of APRA's submissions concern the Trustee's commercial in confidence information and were made at the insistence of the Trustee and following the Court being satisfied it was necessary to make orders for the redactions. APRA is not able to provide a copy of the Hostplus submission as the final judgement is yet to be delivered.

APRA's position is that the advice is the subject of public interest immunity privilege.

Form 90

To be inserted by Court	
Case Number: CIV-21-010073 Date Filed: 25 November 2021 FDN: 52	

WRITTEN SUBMISSIONS OF THE INTERESTED PARTY

SUPREME COURT OF SOUTH AUSTRALIA
CIVIL JURISDICTION
SPECIAL CLASSIFICATION LIST

AustralianSuper Pty Ltd ABN 94 006 457 987 as trustee of AustralianSuper ABN 65 714 394 898
First Applicant/Appellant

Samuel McMillan
First Respondent

Australian Prudential Regulation Authority
Interested Party

Lodging Party	Australian Prudential Regulation Authority Full Name (including Also Known as, capacity (eg Administrator, Liquidator, Trustee) and Litigation Guardian Name (if applicable))	
Name of law firm / solicitor if any	Australian Prudential Regulation Authority Law Firm	 Solicitor

Written Submissions

1. The Australian Prudential Regulation Authority (**APRA**) seeks to assist the Court by identifying the legal principles and discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief in AustralianSuper's application

2. The applicant (**Trustee**) seeks an order under s 59C of the *Trustee Act 1936* (**Trustee Act**) to vary the terms of the trust known as AustralianSuper (**AustralianSuper** or the **Fund**). The context of the amendments is the amendment of ss 56(2) and 57(2) of the *Superannuation Industry (Supervision) Act 1993* (**SIS Act**), which make void provisions of the governing rules of a superannuation entity in so far as they would have the effect of exempting or indemnifying the trustee, or its directors against certain specified liabilities.

3. The substantive question before the Court is whether it should exercise its powers under s 59C of the Trustee Act. The preconditions to the exercise of the power are that the Court must be satisfied of certain matters. Five matters are relevantly to be considered,[1] namely whether:

   (a) there is good reason to make the variation;[2]

   (b) the variation would be in the interest of beneficiaries of the trust;

   (c) the variation will not result in one class of beneficiaries being unfairly advantaged to the prejudice of another class;

   (d) the variation accords so far as reasonably practicable with the spirit of the trust; and

   (e) the variation will not disturb the trusts beyond what is necessary to give effect to the reasons justifying the variation.

Approach to the Trustee's application

4. APRA proposes to address the high level legal questions arising in connection with the application before turning to the specific issues in the parties' agreed list.

Would the proposed variation be void by operation of ss 56(2) or 57(2) of the SIS Act?

5. The preclusions in ss 56(2) and 57(2) are directed at provisions in the governing rules of a superannuation entity that would have the effect of exempting a trustee from, or indemnifying the trustee against, identified liabilities. The scope of the preclusion is to determined having regard to the text, context and purpose of the provision, applying familiar and well-settled principles of statutory construction.[3]

6. To *exempt* from a liability is to free from an obligation or liability.[4] At least *prima facie* this presupposes a liability has in point of analysis arisen in the first place.

7. The concept of an *indemnity* involves a promise or obligation to hold another party harmless against a particular loss or liability suffered. The basic concept is the provision of a suite of rights or remedies which can be availed of to reduce the personal exposure of the promisee in respect of identified losses and liabilities or species of loss and liability. Although in certain cases a promisee might obtain incidental relief which requires a promiser to set aside a fund to facilitate the indemnification,[5] the nature and extent of the right is ultimately a function of, and reflective of, the nature and extent of the ultimate loss or liability suffered or incurred by the promisee. The link between indemnity and loss was recognised in *Wallaby Grip Ltd v QBE Insurance (Australia) Ltd*, where, in the context of that case it was observed that the word "indemnity" implies payment for the loss suffered,

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1 *Trustee Act 1936* (SA) s 59C(3)(b)-(c). There is no issue that the application to the court is not substantially motivated by a desire to avoid or reduce the incidence of tax. Refer to parties' agreed list of issues, FDN 17.

2 This has been described as implicit in the requirement that the proposed exercise of powers would not disturb the trusts beyond what "is necessary to give effect to the reasons justifying the exercise of the powers" and to be "in the interests of beneficiaries": *Clarke v Ebdon* [2020] SASC 67 at [27] footnote 4.

3 *Certain Lloyd's Underwriters v Cross* (2012) 248 CLR 378.

4 *Miller v Miller* (1995) 16 ACSR 73 at 88.

5 *Rankin v Palmer* (1912) 16 CLR 285 at 289-290.

which is to say the whole loss, notwithstanding that in a given case, there may be a cap or limit on the right or extent of recovery pursuant to a right of or entitlement to indemnity.[6]

8. The Trustee contends[7] that ss 56(2) and 57(2) are concerned with an indemnity or a provision in the nature of an indemnity which would afford the holder of the right a proprietary interest in the trust assets, rather than merely contractual rights. In *Carter Holt Harvey Woodproducts Australia v Commonwealth,*[8] each member of the High Court accepted that a trustee's right of exoneration or recoupment of liabilities to third parties gave the trustee a proprietary interest in the trust fund.[9]

9. However, the scope of "provision[s] [that] would have the effect of exempting from, or indemnifying … against" likely embraces a wider class of provisions than those conferring the rights of exoneration or indemnity considered in *Carter Holt Harvey*. At general law, the trustee's right of indemnity only attaches to expenses and liabilities properly or reasonably incurred.[10] The provisions precluded by ss 56(2) or 57(2) include provisions that would (but for the preclusion) allow indemnities which a trustee acting properly or reasonably could not incur, such as liabilities in respect of dishonest breaches of trust,[11] intentional or reckless failures in meeting the standard of care and diligence, and penalties including of a criminal nature.[12]

10. Further, APRA notes that the concept of indemnity appears to be used in a broader sense in s 57(2), which is concerned with provisions in governing rules of a superannuation entity that would have the effect of indemnifying a director of the trustee, apparently without requiring that the indemnity involves a call upon the assets of the fund (with or without any particular priority).

11. That said, it is relevant to observe that although each of ss 56(2) and 57(2) speak simply of a provision which indemnifies a trustee or director against identified liabilities, ss 56(1) and 57(1) provide relevant context when they speak of an indemnity "out of the assets of the entity" and, given that a trust is essentially a relationship and not a distinct form of legal personality, it is difficult to conceive of the superannuation fund (notwithstanding its description as an "entity") as entering into an arrangement pursuant to which it might owe purely personal obligations to the trustee.

12. At all events, whether or not in this context the concept of an indemnity necessarily entails there being a right in respect of trust assets with any particular priority or status, APRA respectfully contends that the concept of indemnification entails a right which responds to a loss or liability. A right to levy a fee has a different legal status. Notwithstanding that its formulation and purpose might be to put the trustee in a position to avoid a risk

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6 (2010) 240 CLR 444 at [32] (French CJ, Gummow, Hayne, Heydon and Kiefel JJ). See also *Wardley Australia Ltd v State of Western Australia* (1992) 175 CLR 514. Although the case turned on the construction of a particular indemnity, it was held that for relevant purposes damage was not suffered merely by entry into the indemnity; it was only when the relevant loss to which the indemnity responded was crystallised that the indemnity bit and loss and damage was relevantly suffered.

7 Written submissions of the Applicant filed 18 October 2021 (FDN 24) (**A subs**) at [4.45.1].

8 (2019) 268 CLR 524 (***Carter Holt Harvey***).

9 *Carter Holt Harvey Woodproducts Australia Pty Ltd v Commonwealth* (2019) 268 CLR 524 at 544 [32] (Kiefel CJ, Keane and Edelman JJ) and 562 [84] (Bell, Gageler and Nettle JJ) and at [139] (Gordon J).

10 *Carter Holt Harvey* (2019) 268 CLR 524 at 578 [132] (Gordon J). By s 7 of the SIS Act, "governing rules", in relation to a fund, means "any rules contained in a trust instrument, other document or legislation, or combination of them; or (b) any unwritten rules" governing the establishment or operation of the fund.

11 Sub-paragraphs 56(2)(a), 57(2)(a).

12 Sub-paragraphs 56(2)(b), 57(2)(b).

of insolvency in the event that it incurs a relevant liability, the right is anterior to and independent of the incurring of any such loss or liability.

13. It may be noted that the concepts of exemption and indemnification are also found in s 199A of the *Corporations Act 2001* (Cth) (**Corporations Act**). In that context, it has been found that they are concerned with "blank cheque" indemnification and exemption, as distinct from ratification, which involves a specific release for specific and properly disclosed breaches.[13] That is, the preclusion in s 199A does not prevent a company releasing an officer as part of a bona fide compromise of a disputed claim,[14] or ratification by shareholders of what would otherwise be a breach of duty.[15]

14. Whilst ss 56(2) and 57(2) are wider than s 199A in that they avoid provisions that would "have the effect of" exempting or indemnifying a trustee or a director of the trustee, the prohibited effect is in each case anchored to a concept with an accepted technical meaning.

15. APRA respectfully submits that a provision in the governing rules of a superannuation entity that authorises the trustee to charge a fee in order to build up a reserve (which is limited both as to the amount that may be levied in a year and which must be suspended where and to the extent that it would result in the balance of a reserve exceeding particular levels) does not in form or effect involve *indemnifying* the trustee against the identified liabilities in the relevant sense. A fee levied pursuant to such a power may prove insufficient, or excessive, to cover some future liability, but the right to charge a fee would not be tied to the extent of a certain liability, and indeed it is possible that no relevant liability will ever be incurred.

16. It may be accepted that the consequence of levying a fee (as distinct from the existence of the provision that entitles the Trustee to levy the fee) may tend to have the effect of defraying and meeting the posited liabilities if and when they arise, particularly where for reasons associated with the trustee's constitution those funds will not be directed towards dividends, and where, by reason of the adoption of a policy (and other regulatory requirements which limit the activities of a trustee) they will not be directed to other ends. Despite those limitations, in point of law, the moneys receipted as fees would constitute the unencumbered legal property of the trustee and, in all likelihood, a source available to creditors with a claim on the trustee should a liablity (apart from one identified in s 56(2) or 57(2)) somehow arise.

17. To conclude that in those circumstances the *provision* would have the effect of indemnifying the Trustee against particular liabilities simply because it would have the tendency and purpose of ensuring that if and when such liabilities are incurred the Trustee is in a position to meet them from its own resources would involve giving the preclusion a very broad construction, and it is respectfully submitted that it is not apparent from the context or the scheme of the Act that the purpose of the provision is so wide.

18. First, if such a broad purpose was evident, it would seem logically also to extend to a preclusion on a trustee obtaining insurance against any and all of the identified liabilities where such premiums are funded by the

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13 *Miller v Miller* (1995) 16 ACSR 73 at 87-88.
14 *Eastland Technology Australia Pty Ltd v Whisson* [2005] WASCA 144 at [39].
15 *Miller v Miller* (1995) 16 ACSR 73 at 87-88.

entity's assets. That seems an unlikely objective, particularly given the absence of a provision similar to s 199B of the Corporations Act.

19. Secondly, if the preclusion were engaged wherever the levying of a fee had the likely *effect* or tendency or putting a trustee in a better position to fund a future liability, it might render void any fee charging power (which would be plainly inconsistent with the scheme of the SIS Act). The SIS Act recognises that the earning of fees by a superannuation trustee is permissible and consistent with the regulatory scheme it establishes. Indeed, various elements of the SIS Act are designed to regulate the commercial realities of a superannuation industry in which various trustees operate on a for-profit basis. Thus Part 2C of the SIS Act makes various provisions for the offering of MySuper products with controlled fees. Division 5 sets out various fees that can be charged and charging rules. Part 3 of the SIS Act authorises the making by regulation of operating standards which may extend to the charging and calculation of fees and the attribution of costs between classes of members: SIS Act, s 31.

20. Thirdly, if the preclusion were engaged wherever the *purpose* of the fee was to put a trustee in a better position to a fund a future liability, that appears an equally unlikely legislative design in circumstances where a degree of financial resilience is obviously desirable and consistent with a prudential approach to acting as a trustee, given the potential financial consequences for members of a superannuation fund were the trustee to become insolvent.[16] (Additionally, adopting that view of the legislative design would rather tend to undermine the likelihood that other regulatory agencies would be able to recover penalties.)

21. It is acknowledged that one might legitimately pose the question: if the introduction of a fee which will have the purpose and effect of enabling a trustee to meet future liabilities including of the kind set out in ss 56(1) and 57(2) is permitted, what is the purpose of rendering void a provision which confers an indemnity in respect of those liabilities? In both circumstances, perhaps in varying ways, members may bear the economic cost of the trustee's conduct. One answer to that question may be that the primary focus of the preclusion is upon "blank cheque indemnification and exemption", both because of the moral hazard that the existence of such rights may create, and because it is in the nature of the levying of a fee that it is prospective and requires disclosure. The scheme of the SIS Act, as augmented by the SIS Reguations, ensures the portability of a member's superannuation entitlements or interests. The levying of a fee in advance of relevant liabilities being incurred and met by a trustee gives members at least some capacity to make an informed choice whether to continue to participate in a scheme in which such fees are to be levied, and it tends also to avoid the economic cost being imposed unpredictably and potentially unfairly on a cohort of members at a moment in time (when a significant liability is incurred). By contrast, although there may be difficulties in smoothing the economic burden of such a fee, there would seem to be a greater prospect of its achievement if the trustee augments its resources by means of a fee, rather than by having a right of indemnity.

22. That being said, there is an obvious risk of disadvantage to members if substantial fees are levied and prove excessive for the purpose of ensuring financial resilience.

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16 Whilst standards made pursuant to the SIS Act cannot dictate the construction of the Act, see also SPS 220 and PPG 515, which are consistent with the proposition that a trustee must actively manage any risk of its own insolvency.

23. Ultimately, it is submitted that the proper means by which this balancing of interests is mediated is by the application of the statutory covenants and the general law duties of the trustee. For these reasons, APRA respectfully agrees with the answer given to this issue in *Re QSuper Board*.[17]

Statutory covenants and general law duties on trustees

24. A proposal for a Trustee to levy a fee against the assets of a superannuation fund for the purposes of building up a reserve to address a risk of insolvency must be evaluated in the context of the statutory and general law duties on trustees – in particular, the duty to act in the best financial interests of beneficiaries and the duty to avoid conflicts of interest and duty. As the Court found in *Re QSuper Board*,[18] a proposal to levy such a fee may well be justified as in the best interests of the beneficiaries of the Fund and not fail to give priority to the duties to and interests of beneficiaries.

Duty to act in the best financial interests of the beneficiaries of the Fund?

25. Section 52(2) deems the governing rules of a registrable superannuation entity to include the covenant in s 52(2)(c) as follows:

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

26. In *APRA v Kelaher*,[19] Jagot J considered the covenant in s 52(2)(c) in a form prior to the replacement of the words "best interests" with the words "best financial interests".[20] Justice Jagot accepted the following propositions relevant to assessing whether a trustee's decision complies with the duty.

(a) The test whether a decision is in the best interests of beneficiaries is objective and is to be applied prospectively, from the position of the trustee at the time of the decision and without impermissible hindsight.[21]

(b) The relevant question is whether the decision, assessed objectively, is reasonably justifiable as in the best interests of the beneficiaries, assessed by reference to the circumstances as they in fact existed at the time.[22]

(c) An exception is where it is proved that the trustee's subjective purpose or object in acting was contrary to the best interest of beneficiaries.[23]

27. APRA considers that the following propositions can be made about the content of the best financial interests of beneficiaries:

(a) a relatively broad and practical approach may be adopted;[24]

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17 [2021] QSC 267.
18 [2021] QSC 267.
19 (2019) 138 ACSR 459.
20 The word "financial" was inserted in the covenant on 1 July 2021 by the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* No 46 of 2021.
21 *APRA v Kelaher* (2019) 138 ACSR 459 at 481 [55].
22 *APRA v Kelaher* (2019) 138 ACSR 459 at 482 [62] and 483 [64].
23 *APRA v Kelaher* (2019) 138 ACSR 459 at 483 [63].
24 *Re QSuper Board* [2021] QSC 276 at [36].

(b) the interests of beneficiaries are informed not only by the purposes of the trust, but by the existing rights of the trustee under the trust deed and the commercial and practical realities of the superannuation industry generally;[25]

(c) the interests of beneficiaries include both present and future beneficiaries, and a balancing between the interests of different classes of beneficiaries may be required;[26]

(d) in considering whether a proposed course of action is in the best interests of beneficiaries, a wide view can be taken (rather than evaluating in isolation each step in the course of action);[27]

(e) consideration may be given to the position that the beneficiaries will find themselves in the future if the course of action is not pursued.[28] That is to say, it is permissible to consider a future counter-factual and it is artificial and inappropriate simply to compare the position of members before and after the levying of a fee and to conclude thereby that members' financial interests would therefore necessarily be adversely affected.

28. In the present context, the content of the best financial interests covenant largely aligns with the precondition in s 59C(3)(b) of the Trustee Act. When approaching the question posed by the application whether "the proposed variation would be in the interests of beneficiaries", the Court's focus will be on the members' financial interests because the nature of the trust is that of an accumulation superannuation fund.

29. In evaluating the impact of the proposed variation on members, APRA respectfully submits that the principal issues for resolution by the Court will be:

(a) the magnitude of the risk of a trustee insolvency event materialising (which in turn requires some prognostication as to the risk of relevant liabilities being incurred and their potential quantum);

(b) the magnitude of the financial impact on the interests of beneficiaries if a trustee insolvency event were to arise;

(c) whether any alternatives to the establishment of the proposed Trustee Risk Reserve offer a preferable and/or satisfactory way of managing the risk of a trustee insolvency event;

(d) whether the financial impact of the proposed Trustee Risk Reserve Fee is an acceptable cost of managing the risk of a trustee insolvency event.

Avoiding conflicts of interest and duty

30. Section 52(2) deems the governing rules of a registrable superannuation entity to include the covenant in s 52(2)(d) as follows:

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25 *Re QSuper Board* [2021] QSC 276 at [45]

26 *Cowan v Scargill* [1985] Ch 270 at 286-7 cited in *Invensys Australian v Austrac Investments* (2006) 15 VR 87 at 108 [107].

27 *Invensys Australian v Austrac Investments* (2006) 15 VR 87 at 111 [118], Byrne J noting a proposed payment of a surplus to employers was "part of a package" which included a payment to members regarded as a "substantial benefit". See also *Re Van Gruisen's Will Trusts; Bagger v Dean* [1964] 1 All ER 843.

28 R Sackville "Duties of Superannuation Trustees: From equity to statute (2013) 37 Australian Bar Review 1 at 14.

> *(d) where there is a conflict between the duties of the trustee to the beneficiaries, or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee:*
>
> *(i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons; and*
>
> *(ii) to ensure that the duties to the beneficiaries are met despite the conflict; and*
>
> *(iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and*
>
> *(iv) to comply with the prudential standards in relation to conflicts;*

31. Section 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, the covenant presupposes the existence of a conflict in that it applies "where there is a conflict". It requires the trustee in that case to give priority to the duties to and interests of the beneficiaries over the duties to and interests of other persons. But s 52(2)(d) does not compel the trustee to select the course contrary to its personal interest in the case of a conflict. Rather, the trustee must give priority to the duties and interests of the beneficiaries over its own interests if and to the extent they point in different directions.

32. As Justice Sackville, writing extra-judicially, has observed, the covenant in s 52(2)(d) is to be construed in the context of the SIS Act as a whole.[29] APRA acknowledges that that context presently includes:

(a) an explicit statutory recognition that a corporate trustee of a superannuation fund ordinarily conducts a businesss for reward;[30]

(b) detailed requirements for the offering of a MySuper product with controlled fees;[31]

(c) a power to make operating standards by regulation, covering:

i. the manner of charging and calculation of fees[32]

ii. the attribution of costs between classes of members;[33]

iii. portability of a member's superannuation benefits;[34]

(d) a regime under which APRA is to conduct annual performance assessments of MySuper products and other prescribed products offered by regulated superannuation funds.[35] Under the regime, trustees are to notify beneficiaries if APRA has determined that the product has not met specified standards, including as to investment returns net of fees and/or tax.[36] The consequence of two consecutive failures is that a fund cannot admit new beneficiaries to the product.[37]

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29 R Sackville "Duties of Superannuation Trustees: From equity to statute (2013) 37 Australian Bar Review 1 at 14.
30 SIS Act, s 52(3).
31 SIS Act, Part 2C.
32 SIS Act s 31(2)(d).
33 SIS Act, s 31(2)(da) and (db). The operating standards are binding on trustees of superannuation entties by force of s 34 of the SIS Act.
34 SIS Act s 31(2)(i) and SIS Regs, regulations 6.33 and 6.34.
35 SIS Act, Part 6A, introduced by the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) (No 46 of 2021) commenced 23 June 2021.
36 SIS Act s 60D.
37 SIS Act s 60F.

33. The SIS Act contemplates that the charging of a fee does not, in and of itself, amount to preferring the trustee's interests over those of the beneficiaries. The SIS Act contemplates trustees operating for profit and indeed includes features designed to incentivise performance by promoting disclosure of fees, underperformance and by facilitating portability.

34. When examining whether the proposed course of action would be contrary to the Trustee's duties, it is also necessary to consider the general law position. In that respect, APRA considers that it is doubtful that the equitable requirement to avoid being in a conflict situation is abrogated by s 52(2)(d). The insertion by s 52 of covenants into the governing rules of a registrable superannuation entity does not affect the other obligations imposed upon trustees whether by the deed of trust or by general principles except, perhaps, to the extent of some inconsistency.[38] This is consistent with s 350 of the SIS Act, which provides:

> *It is the intention of the Parliament that this Act is not to apply to the exclusion of a law of a State or Territory to the extent that that law is capable of operating concurrently with this Act.*

35. APRA broadly agrees with the proposition[39] that both the general law obligations respecting conflict and the statutory covenants are affected by the terms of a trust deed, which is to say that where a trust deed provides for the levying of a fee, the charging of the fee is not to be seen as involving a breach of any duty to avoid conflict.[40]

36. The position is therefore different where a fee-charging power is sought to be introduced.[41] At that stage, the general law obligation to avoid conflict therefore potentially presents a greater obstacle than s 52(2)(d). In that respect, however, APRA agrees that a trustee may properly overcome the apparent conflict by approaching the Court for approval.

37. Against the background of these general propositions of principle, APRA makes the following responses in respect of certain of the identified issues. (In circumstances where the member representative is avowedly acting as a contradictor, and where APRA may elect or be called upon to participate in a significant number of applications by trustees to seek to address the potential implications of the amendments to ss 56 and 57, APRA does not propose to make detailed submissions as to matters involving fact and degree.)

Issue 1 – should the power in s 59C of the *Trustee Act 1936* (SA) be exercised given the existence of the conflict of interest?

38. The existence of a conflict of interest is not a reason for the Court declining to exercise the power in s 59C of the Trustee Act. It is appropriate for a trustee to approach the Court where there is a prima facie conflict of interest and duty.[42] Moreover, the procedure required by s 59C(2) of the Trustee Act, including by the joinder of a member representative and the appointment of counsel, relieves the trustee of the decision and ensures that the trustee's interests do not cloud a proper evaluation of the interests of beneficiaries.

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38 *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* (2006) 15 VR 87 at [106].

39 A Subs [4.19].

40 Sackville, "Duties of superannuation trustees: From equity to statute" (2013) 37 Australian Bar Review 1 at 4, citing *Cowan v Scargill* [1985] Ch 270 at 290 and *Lock v Westpac Banking Corporation* (1991) 25 NSWLR 593 at 609-610.

41 Cf. A Subs [4.21]. Respectfully, APRA would submit that that paragraph may conflate the position applying as between the introduction and exercise of a fee-charging power.

42 See *Re QSuper Board* [2021] QSC 276 at [9]; *Re Cuesuper Pty Ltd* [2009] NSWSC 981 at [21]-[22] and *Re Retail Employees Superannuation Pty Ltd* [2013] NSWSC 1681 at [16].

39. For the Trustee to seek a variation to introduce a fee charging power *prima facie* suggests a conflict. However, as set out above, the existence of a conflict does not mean that a course of action cannot be in the best financial interests of beneficiaries. To the extent the form of the variation is such as to set up a conflict, the existence or extent of the conflict does not outweigh the reasons justifying the exercise of the power to make the variation.

40. The general law position is that the trust deed may exclude or modify the content of the trustee's obligation to avoid conflicts,[43] provided that the exclusion or limitation is not such as to destroy the irreducible core of obligations that make a person a trustee.[44] The proposed variation would, if ordered, entrench the Trustee's right to charge the fee despite the conflict.

41. It follows that neither the covenant in s 52(2)(d) nor the general law duty to avoid conflicts is a barrier to the Court exercising the power in s 59C of the Trustee Act to vary the terms of the trust, if the Court is satisfied that the variation is in the interests (including the best financial interests) of beneficiaries. The procedure required by s 59C is apt to manage the conflict. The issue is whether the Court is satisfied in respect of the preconditions in s 59C(3).

Issue 2 – could the variation be made under the power in rule 35 of the Trust Deed of the Fund?

42. APRA notes the Trustee's position that it is an Employer Sponsor within the meaning of the Trust Deed,[45] and agrees that rule 35.4 of the Trust Deed appears to precludes the power in rule 35 being exercised to vary the terms of the trust in the manner proposed.

43. Respectfully, APRA doubts whether, as a matter of construction, rule 35.4 could be limited to rules authorising the making of a payment to an "Employer Sponsor" in that *capacity*, since a payment, unless received on trust (which it is not proposed or submitted to be the case here) is not, in legal terms, held in any capacity. Nevertheless, for reasons stated in respect of issue 1, whether or not the variation could be made under the power in rule 35 of the Trust Deed of the Fund, it is appropriate for the Trustee to seek approval for the variation under s 59C. APRA does accept that the apparent mischief which rule 35.4 is likely designed to address would not be engaged by the proposed amendment and that is a consideration that would go to whether to permit the introduction of rule 4A (despite rule 35.4) would alter the spirit or substratum of the trust.

Issue 3 – would the proposed amendment comply with statutory covenants and general law duties on the Trustee?

44. For reasons set out above,[46] APRA accepts that a variation to the terms of a trust to permit the trustee to levy a fee to build a reserve to manage insolvency risk is capable of being in the best financial interests of beneficiaries from the perspective of the trustee (viewed prospectively), and need not offend against the duty in s 52(2)(d) to give priority to the interests of beneficiaries.

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43 *Australian Securities and Investments Commission v Citigroup Global Markets Australia Pty Ltd* [No 4] (2007) 160 FCR 35 at 77 [278]-[279], *Chan v Zacharia* (1984) 154 CLR 178 at 196, *Woolworths Ltd v Kelly* (1991) 22 NSWLR 189 at 225.

44 *Armitage v Nurse* [1998] Ch 241 at 255; *ASIC v Drake (No 2)* (2015) 340 ALR 75 at [284]-[285].

45 A Subs at [4.11] and [4.13]-[4.14].

46 Paragraphs 25-37.

45. The question is whether the trustee's decision that the fee should be introduced (on the basis, and in view of the decision-making process, evidenced by the evidence) is "reasonably justifiable" as being in the members best financial interests. In the end, that is a question of evaluation, fact and degree, and it may be affected by any further evidence adduced during cross-examination.

Issue 3(c) – would the proposed amendment ensure that the interests of beneficiaries of the Fund are not adversely affected by the conflict?

46. As set out above,[47] APRA considers that the prima facie conflict in the Trustee seeking a fee charging power is appropriately managed by the procedure required for an application under s 59C of the Trustee Act.

47. If the proposed variation is made, there will be no conflict of interest and duty in that the scope and incidents of the Trustee's duties will be those established under the Trust Deed as varied. It follows that the relevant question for present purposes is whether the variation would be in the best interests of the beneficiaries.

Issue 3(d) – would the proposed amendment enable the trustee to meet its obligation to act fairly in dealing with classes of beneficiaries and to act fairly in dealing with beneficiaries within a class?

48. The Trustee proposes to pay the Trustee Risk Reserve Fee out of an existing reserve in the Fund known as the Administration Reserve. The Trustee says:

a. The Trustee Risk Reserve Fee could be charged to the administration reserve without the need to increase the administration fees charged to members or reduce planned expenditure on other items.[48]

b. Currently, administration fees being charged to members are calculated on the same basis irrespective of investment option and account balance,[49] although there is a variation in the structure of the administration fee, depending on whether the member is in accumulation or retirement/pre-retirement mode.[50]

c. The Trustee's view is that the administration reserve is unlikely to fall below its target cash level but that if the administration reserve were to prove inadequate to meet the forecast financial requirements of the Trustee including the Trustee Risk Reserve, it would be necessary to re-price the administration fee.[51]

49. On balance, APRA accepts it is open to conclude that charging the Trustee Risk Reserve Fee to the administration reserve in this way is reasonably likely to balance the impact of the fee as between current and future members. There would be no change to the fee burden on members' benefits in the Fund, although members of longer standing might be seen as suffering a reduction in the value of the administration reserve funded by administration fees paid out of their accounts over time.

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47 Paragraph 36.

48 Supplementary Affidavit of I Silk, 29 Spetember 2021, exh ISS-30: Memorandum 20 September 2021 from M Harrington to P Schroder TB760 at 761.

49 Ibid TB 760.

50 Affidavit of P Schroder filed 3 September 2021, [22.1] p 6 TB768.

51 Ibid TB762.

Issue 4 – if the answer is 'no' to either 2 or any of the sub-paragraphs in 3, should the Court decline to grant the orders sought?

If the proposed variation cannot be passed under the amendment power in rule 35 of the Trust Deed

50. APRA does not consider that exercise of the power in s 59C is precluded if it be the case that the proposed rule could not be passed under the amendment power in rule 35 of the Trust Deed.

51. As presently advised, APRA does not regard current rule 35.4 of the Trust Deed as precluding the proposed variation, or relevantly militating against the exercise of the power in s 59C of the Trustee Act to make the proposed variation.

If the answer is no to any of the sub-paragraphs in issue 3

52. The Court should decline to grant the order sought if it concludes that the proposed exercise of powers would not be in the interests of beneficiaries of the trust. It is likely the Court would arrive at that conclusion if it answered sub-issue 3(a) in the negative.

53. A negative answer to issues 3(b), 3(c) or 3(d) might, depending on the reasons for the answer, also mean that the preconditions to the exercise of the power in s 59C are not satisfied (in their terms).

54. Further, a question may arise as to whether the Court has power to authorise an amendment to a trust deed if the pursuit of the amendment would involve a contravention by the trustee of a mandatory statutory covenant. That question need not be resolved because it is submitted that even if that is not the case, the Court ought to be reluctant to grant relief in the exercise of its discretion in that circumstance.

Issue 5 – if the answer is "yes" to 2, should the Court decline to grant the orders sought on the basis that the exercise of the amendment power in the Trust Deed is a more appropriate path to make the amendment?

55. APRA is of the view that the prima facie conflict in the Trustee seeking a fee charging power is appropriately managed by the procedure required for an application under s 59C of the Trustee Act.

Issue 6 – pursuant to s 52A(2)(c) and (d) of the SIS Act, the questions asked at issue 3 have to be asked but by reference to the interests of the directors of the Applicant

56. APRA considers that the proposed variation engages similar considerations when evaluated by reference to the statutory covenants and general law duties applying to directors of the Trustee.

Issue 7 – would proposed rule 4A be void by operation of subsections 56(2) or 57(2) of the SIS Act?

57. The answer to this issue is "no". The reasons are set out above at paragraphs 5-23.

Issue 8 – if "yes" to issue 7, should the Corut refuse to make the proposed amendment?

58. If the provision to be inserted by the proposed variation would be void by operation of either s 56(2) or 57(2), the Court should refuse to exercise the power in s 59C of the Trustee Act including because the variation would be futile.

Issue 9 – if "no" to issue 7, should the Court refuse to make the proposed amendment on the basis that it is, or may be, contrary to the presumed legislative intent?

59. APRA's view is that the legislative intent is to be discerned first by construing the words actually used in ss 56(2) and 57(2). As discussed above, those subsections target the specific legal concepts of exemption and indemnity. They preclude a trustee or its directors being insulated from identified personal liabilities by reason of exemption or indemnity out of the trust assets. They do not prohibit a trustee using resources derived from disclosed and levied fees the initial economic burden of which has been borne by members in discharging a personal liability. For reasons explained earlier, if the prohibition were broader, it would appear to be inconsistent with the existence of for-profit superannuation trustees which the scheme of the SIS Act clearly contemplates.

60. In providing that trustees may charge fees for their services, so long as the charging rules are complied with, and powers with respect to charging are exercised having regard to the requirements to act impartially between classes of members, the SIS Act clearly recognises that the earning of a return by a superannuation trustee is permissible and consistent with the statutory scheme.

61. Whilst ss 56 and 57 preclude the governing rules affording the trustee or directors a blanket right of indemnity or exemption in respect of particular liabilities, there is no preclusion on a trustee meeting those liabilities from its own capital derived from the charging of a fee to members. In that sense, therefore, members may bear an economic cost of liabilities that cannot be the subject of an indemnity.

62. An important difference between permitting a trustee to charge a margin to cover contingencies in the form of unrecoverable liabilities, and between allowing a general right of indemnity, is that a fund is required to disclose to members the existence and amount of fees they will be charged. This permits members to make an informed choice about whether the level of fees is acceptable, including by taking advantage of portability. In other words, even where there is a unilateral power to impose a fee under the governing rules, the legislative scheme affords members a measure of autonomy. Further, although it is accepted that the practical content of the statutory covenants is affected by the terms of the trust deed, those duties remain as a source of protection to members and as a limit on the exercise of powers and discretions by the trustee.

Issues 10 to 14 – Insurance

63. Issues 10 to 14 raise a number of questions in connection with insurance.

64. APRA considers that the issue whether insurance is a viable alternative to the establishment of the proposed Trustee Risk Reserve is a matter weighing in the analysis of the trustee's application for variation of the Trust Deed.

65. The evidence as to current insurance arrangements is as follows:

a. The Trust Deed requires the Fund to maintain adequate levels of insurance against liabilities incurred as a result of breach of professional duty as trustee,[52] and authorises the Trustee to pay the premiums out of the Fund.[53]

b. [redacted]

c. [redacted]

d. [redacted]

e. The Trustee states that it is concerned that insurance is becoming difficult to obtain or difficult to obtain at a reasonable cost.[60]

66. With respect to the possibility of captive insurance arrangements, the evidence is:

a. members of the Fund's Finance and Audit Committee considered the possibility of establishing a pooled captive insurance arrangement in April 2021, but indicated that it did not support such an arrangement in circumstances where the other contributors to the pool and the pool itself would not be within the Fund's control.[61]

b. Mr Schroder accepts that a pooled captive insurance arrangement is a possibility but it would not achieve the objective of managing the insolvency risk that the Fund perceives it will face from 1 January 2022.[62] The possibility of a pooled captive insurance arrangement has been considered by the

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52 Trust Deed, ISS-26, cl 15.6(2) TB681.
53 Trust Deed, ISS-26, cll 15.2 TB681, 31.1 TB693.
54 Affidavit of Paul Schroder dated 3 September 2021, [25.1] TB769.
55 Affidavit of Paul Schroder dated 3 September 2021, [25.2] TB769.
56 Letter fromT Ferguson to P Schroder dated 1 September 2021, PJS-13, TB979.
57 Affidavit of Paul Schroder dated 3 September 2021, [25.3] TB769.
58 Letter fromT Ferguson to P Schroder dated 1 September 2021, PJS-13, TB979.
59 Letter fromT Ferguson to P Schroder dated 1 September 2021, PJS-13, TB979.
60 Affidavit of Paul Schroder dated 3 September 2021, [52] TB776.
61 Affidavit of Paul Schroder dated 18 October 2021, [6] TB 1050.
62 Affidavit of Paul Schroder dated 18 October 2021, [8] TB 1050.

superannation industry at a preliminary level, but there are various hurdles to be overcome before Mr Schroder would be prepared to recommend the Fund pursue it.[63]

c. The Fund has received some information from its broker, Aon, in relation to protected cell captives, but it has been unable properly to consider the regulatory implications, risks and costs relating to such an arrangement and is therefore unable to determine whether a protected cell arrangement would meet its needs. Mr Schroder says the option of a protected cell captive will not be available by 1 January 2022.[64]

67. [redacted]

68. The Trustee has, however, recently amended the limits in its constitution on indemnification of officers.[69] The effect of one of the amendments is to permit the Trustee to indemnify its officers for liability arising out of conduct involving lack of good faith or in breach of the Relevant Requirements.[70]

Issues 15 and 16 – impact of trustee capital on the Court's discretion when fixing civil penalties

69. The Trustee states that the modelling it commissioned in order to determine the amount of the Trustee Risk Reserve did not assign a different risk weighting to penalty provisions affected by ss 1311A and 1317G of the Corporations Act and ss 93C and 12GBB(5)(e) of the *Australian Securities and Investments Commision Act 2012*. APRA accepts that there is an inherent difficulty in quantifying the potential exposure to civil and criminal penalties given the discretionary nature of the penalties. Even where a Court is required to have regard to the impact the penalties might have on beneficiaries, the penalty fixing process remains discretionary. Civil penalties are imposed for essentially deterrent or compensatory purposes,[71] and the need to achieve deterrence, including general deterrence, will limit the extent to which the Court may have regard to the financial circumstances of the offender in mitigation of penalty.[72]

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63 Affidavit of Paul Schroder dated 18 October 2021, [9] TB 1050.
64 Affidavit of Paul Schroder dated 18 October 2021, [10]-[13] TB1051.
65 A sample Deed is exhibit ISS-18, TB535
66 ISS-18, TB535.
67 ISS-18, cl 3.1 TB593.
68 ISS-18, cl 3.10.1 TB540.
69 First affidavit of Ian Silk, [38] and amended constitution, ISS-14 cl 39, TB 428.
70 Ibid, clause 39.1, TB 428.
71 *Commonwealth v Fair Work Building Industry Inspectorate* (2015) 258 CLR 482 at [59].
72 *ACCC v High Adventure Pty Ltd* [2005] FCAFC 247 at [11].

Issues 17 and 18 – Is the figure of 0.015% per annum of the net assets of the Fund an appropriate amount? Is the total Trustee Risk Reserve cap the appropriate amount?

70. APRA observes that the Trustee has given consideration to the appropriateness of the amount the Trustee proposes to levy by way of the Trustee Risk Reserve Fee, and the quantum of the Trustee Risk Reserve that the Trustee proposes to establish by charging the Trustee Risk Reserve Fee.

71. APRA has not formulated a position or standards in relation to financial resilience of trustees of superannuation funds.

Issue 19 – should the concept of applying amounts currently in the Administration Reserve to the Trustee Risk Reserve Fee be reflected as a power in the proposed variation? If not, should further amendments to the Trust Deed be made?

72. APRA does not contend that a more prescriptive duty must be articulated in any variation to the Trust Deed. Whenever the Trustee exercises its powers under its governing rules, the Trustee will be subject to the statutory covenants and general law duties already considered in this outline of submissions, including the duty to act in the best financial interests of beneficiairies and the duty to avoid conflicts. These duties would attend any exercise of the powers in proposed cl 4A of the Trust Deed, including the debiting of the Trustee Risk Reserve Fee to the Fund and exercising the discretion to reduce, waive, suspend or postpone the Trustee Risk Reserve Fee,

Issues 20-28 – establishment and management of the Trustee Risk Reserve, and protections for beneficiaries

73. On the current application, APRA does not propose to take a position in respect of questions concerning the prospective management of the Trustee Risk Reserve that is to be established if the Court orders the proposed variation. APRA indicates, however, that it agrees with the submission that if the Trustee Risk Reserve were to be framed or constructed in terms which gave rise to some residual beneficial interest in favour of members, because this might be seen as having the consequence that the funds remain assets of the trust, this would raise a question whether, if and when a liability is met from the fund, it amounts to an indemnity out of the assets of the trust.

Issue 29 – sufficiency of the proposed Trustee Risk Reserve

74. As set out above in response to issues 17 and 18, APRA observes that the Trustee has given consideration to the appropriateness of the amount the Trustee proposes to levy by way of the Trustee Risk Reserve Fee, and the quantum of the Trustee Risk Reserve that the Trustee proposes to establish by charging the Trustee Risk Reserve Fee.

75. APRA has not formulated a position or standards in relation to financial resilience of trustees of superannuation funds.

Issue 30 – to what extent has the Trustee considered the possibility that the Trustee Risk Reserve Fee might only be deducted in the first three years and if so, might operate unfairly with respect to current beneficiaries when compared with future beneficiaries

76. APRA's position with respect to the balancing of the interests of present and future beneficiaries of the Fund have been set out above under issue 3(d).

Issue 31 – how does the proposed amendment accord with the spirit of the trust, being a "profit to member" fund?

77. APRA observes that the Trustee's constitution does not permit the payment of dividends to its shareholders.[73] If the description of the Fund as a "profit to member" is intended to refer to that feature of the Trustee's constitution, the first question raised is whether that feature may be regarded as an aspect of the spirit of the trust. In any event, APRA observes that there is no proposal to change the constitution.

Issue 32 – Whether Mr Schroder is aware of any matter that may give rise to the possibility of a substantial liability pursuant to ss 56(2) and 57(2) of the SIS Act

78. APRA is not in a position to address this issue.

17 November 2021

Ben Doyle QC

Sam Ure

Counsel for APRA

Accompanying Documents
Mark with an 'x' if applicable

Accompanying these submissions is:

[ ] [*identify additional documents*]

73 Affidavit of I Silk dated 3 September 2021, exhibit ISS-14, cl 94.1, TB 452.

SUPREME COURT OF QUEENSLAND

REGISTRY: Brisbane
NUMBER: 8365/21

Applicant: **QSUPER BOARD ABN 32 125 059 006**

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. On 27 July 2021, the applicant (**QSuper Board**) served the Australian Prudential Regulation Authority (**APRA**) with its Originating Application dated 22 July 2021 (**Application**).

2. The Application, brought pursuant to subsection 96(1) of the *Trusts Act 1973* (Qld) (**Trusts Act**), seeks the Court's advice and direction that the QSuper Board is justified in consenting to an amendment of the *Superannuation (State Public Sector) Deed 1990* (Qld) (**QSuper Deed**) that would enable it to charge a fee from the assets of the QSuper Fund (**Fund**) in relation to services it provides as Trustee of the Fund (**Proposed Amendment**).

3. The Application is supported by a Statement of Facts and an Amended Statement of Facts (**Statement of Facts**) which was prepared following discussions between representatives of the QSuper Board and APRA concerning the Application.

4. The Proposed Amendment, set out in paragraph 97 of the Statement of Facts, would provide the QSuper Board with a broad power to charge, and retain for its own benefit, remuneration which it determines to be reasonable and to deduct such remuneration from the assets of the Fund.

5. As is apparent from the Statement of Facts, the justification provided by the QSuper Board for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**). These amendments prohibit a trustee from indemnifying itself out of the assets of a fund for a criminal, civil or administrative penalty imposed by Commonwealth legislation or for the payment of any amount payable under an infringement notice given under Commonwealth legislation, including the SIS Act (**SIS Indemnification Amendments**).

APRA's position on the Application

6. In making the following submissions, APRA's intention is to assist the Court by identifying the legal principles and the discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application.

7. At the outset, it is important to note that, as recognised in paragraph 9.5 of the

Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**) which introduced the SIS Indemnification Amendments, prior to the amendments effected by the Bill, the SIS Act and the RSE licensing regime were primarily designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and deliver quality outcome for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

8. APRA respectfully submits that the process of decision-making should reflect the requirements of the statutory covenants, including most relevantly the requirement by reason of s 52(2)(c) of the SIS Act that the trustee act in the best financial interests of the members of the fund. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises issues for the Court's consideration concerning the broad scope of the remuneration power which would be conferred on the QSuper Board by the Proposed Amendment, and the manner in which the QSuper Board proposes to exercise that power (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act).

The effect of the amendments to sections 56 and 57 of the SIS Act

9. The effect of s 56 is that:

   a) by s 56(1), not only may the governing rules provide an indemnity to a trustee for liability incurred while acting as trustee, but, subject to particular restrictions, any governing rule that purports to preclude or limit the extent of the indemnity is void;

   b) by s 56(2), governing rules which have the effect of exempting or indemnifying the trustee against particular liabilities are void, the breadth of which is expanded by the SIS Indemnification Amendments;

10. The effect of s 57 is:

   a) subject to the preclusion referred to below, to authorise a provision in the governing rules which indemnifies a director of the trustee out of the assets of the entity in respect of a liability incurred while acting as a director of the trustee;

   b) to render void a provision in so far as it would have the effect of indemnifying a director against identified liabilities, the breadth of which is expanded by the SIS Indemnification Amendments.

11. The SIS Indemnification Amendments are set out in paragraph 83 of the Statement of Facts. The penalties and infringement notices to which the amended provisions will apply arise in a broad range of circumstances including where the trustee has not engaged in criminal conduct, has not acted dishonestly and has not been guilty of gross negligence. The amendments will take effect in the context of heightened exposure of trustees to penalties in the circumstances

described in paragraphs 67 to 82 of the Statement of Facts.

12. The QSuper Deed presently provides, by sections 15(f) and (h) that the QSuper Board is entitled to pay from the Fund all taxes and all the expenses for the establishment, amendment and operation of the Fund incurred from time to time. The QSuper Board also has the right to reimbursement from the assets of the Fund conferred by section 72 of the Trusts Act.

13. Once the SIS Indemnification Amendments take effect, the QSuper Board will no longer be able to rely on those rights to indemnify itself from the assets of the Fund in the event that it incurs a pecuniary penalty under Commonwealth legislation or becomes liable to pay an amount under an infringement notice given under Commonwealth legislation. The Proposed Amendment is sought as a means of providing the QSuper Board with sufficient capital with which to meet liabilities for which it will no longer enjoy any right of indemnity: paragraph 99D(a) of the Statement of Facts.

14. The first question for the Court is whether the SIS Indemnification Amendments prohibit the outcome sought to be achieved by the Proposed Amendment.

15. As the name of the Bill suggests, the SIS Indemnification Amendments which the Bill introduced formed part of the federal government's response to recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The apparent aim of the recommendations made by the Royal Commission, and the federal government's response in implementing those recommendations, was to improve compliance on the part of providers of financial services (relevantly here the trustees of superannuation funds) with the duties and obligations owed to consumers of those services (relevantly here the members of superannuation funds).

16. The SIS Indemnification Amendments were set out in Schedule 9 to the Bill which, according to the Explanatory Statement, implemented recommendations 3.8, 6.3, 6.4 and 6.5 of the Royal Commission. Those recommendations concerned adjustments to the roles of APRA and ASIC with respect to superannuation.

17. One aspect of the adjustment of these roles is the extension of the Australian financial services licensing regime to cover the provision of a superannuation trustee service: paragraph 81 of the Statement of Facts. A consequence of this change is that trustees of superannuation funds are now required to hold an Australian financial services licence (**AFSL**) and are subject to regulation under Chapter 7 of the *Corporations Act 2001*, including obligations imposed by civil penalty provisions (for example, s 912A).

18. This change followed recent amendments effected by:

    a) the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019* (Cth) which prohibit contravention of the statutory covenants in ss 52 and 52A of the SIS Act and make contraventions of those statutory covenants the subject of a civil penalty: paragraphs 69 to 73 of the Statement of Facts;

    b) the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) which broadened the scope, and

increased the severity, of penalties for contravention of provisions of Chapter 7 of the *Corporations Act 2001*, among other legislation: paragraphs 74 to 79 of the Statement of Facts.

19. All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers of financial services) with the duties and obligations owed to members (among other consumers of financial services).

20. It was in the context of the extension of the AFSL regime that the SIS Indemnification Amendments extended the existing indemnification prohibitions.

21. To that extent, the SIS Indemnification Amendments disclose a clear legislative intention that trustees of superannuation funds bear in their personal capacity the immediate financial cost of the expanded range of liabilities to which they are to become subject, including liabilities arising by reason of the extension of the AFSL regime.

22. There is a real question as to whether that legislative intention would be defeated if trustees of superannuation funds are permitted to charge additional fees to members, or take from the assets of the fund itself, in order to build a capital reserve sufficient to pay liabilities for which they will no longer be permitted to be indemnified. That is, what legislative purpose is served by increasing the scope and severity of penalties to which superannuation trustees are subject, and remove the entitlement of such trustees to be indemnified for such penalties, only to permit trustees to avoid the consequences of the amendments by shifting the cost to members by another means, namely the imposition of additional fees?

23. The critical question is whether the legislative intention in enacting the SIS Indemnification Amendments, in the context of the other changes discussed above, extends to rendering unlawful any means by which a trustee may, over time, augment its own capital so as to be able to discharge such a liability, so long as the means by which it does so do not otherwise contravene basic principles governing the conduct of trustees.

24. Ascertaining whether the intention of the legislature extends that far requires consideration of the object of the SIS Act and the ambit of the preclusions imposed by the SIS Indemnification Amendments.

25. The main object of the SIS Act is to make provision for the prudent management of certain superannuation funds and for their supervision: s 3(1). This object raises a number of different matters for consideration.

26. As already noted, the focus of the SIS Act has been, and remains, upon governance and other prudential requirements that ensure trustees operate in a manner consistent with their best financial interests obligations and deliver quality outcomes for members. A central outcome in this regard is the prudent and diligent management of superannuation funds by trustees for the purpose of providing for the retirement benefits of members. Increases in fees charged to members or to the assets of the fund itself will have an adverse financial impact on those benefits over the long term.

27. Against the adverse financial impact on members' retirement benefits if a power

to charge remuneration is introduced, it is necessary to weigh the fact that a trustee with insufficient personal assets to meet a liability which might previously have been the subject of an indemnity, but can no longer upon the SIS Indemnification Amendments taking effect, will likely need to arrange access to funds by some different means or it may face the risk of insolvency.

28. In this regard, it should be noted that various provisions of the SIS Act recognise that the promotion of stability in the Australian financial system, together with the maintenance of a sound financial position by licensees, is desirable. Further, in providing that trustees may charge fees for their services, so long as the charging rules are complied with, and powers with respect to charging are exercised having regard to the various requirements discussed in more detail below, the SIS Act recognises that the earning of a fee by a superannuation trustee is permissible.

29. Although sections 56 and 57 of the SIS Act, both prior to and upon the commencement of the SIS Indemnification Amendments, preclude the governing rules affording the trustee a blanket right of indemnity or exemption in respect of particular liabilities, there can be and is no preclusion on a trustee meeting those liabilities from its own capital derived from the charging of a fee to members where the power to charge a fee exists. In that general sense, members of a fund where a fee-charging power exists may already bear an economic cost of liabilities that cannot be the subject of an indemnity.

30. Turning to the specific language of the statutory preclusion, section 56(2) of the SIS Act is directed to provisions in the governing rules of a superannuation entity that would have the effect of **exempting** a trustee from, or **indemnifying** the trustee against, identified liabilities.

31. Two points should be noted in this regard.

32. *First*, the concern of the provision, like the concern of s 199A of the *Corporations Act* which contains similar language, would appear to be with blanket exemption and indemnification.[1]

33. *Secondly*, the legislation has targeted concepts with a relatively technical legal meaning, namely, exemption from and indemnification against, liability.

34. To exempt from a liability is to free from an obligation or liability, and, at least prima facie, this presupposes a liability has arisen in the first place.[2]

35. In broad terms, the concept of an indemnity involves a promise or obligation to hold another party harmless against a particular loss or liability. The basic concept is the provision of a suite of rights or remedies which can be availed of to reduce the personal exposure of the promisee in respect of identified losses and liabilities. Although in certain cases a promisee might obtain incidental relief which requires a promisor to set aside a fund to facilitate the indemnification,[3] the nature and extent of the right is ultimately a function of, and reflective of, the nature and extent of the ultimate loss or liability suffered or incurred by the promisee.

36. The question then is whether the levying of a fee which is motivated by the need

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1 *Miller v Miller* (1995) 16 ACSR 73 at 87-88
2 *Miller v Miller* (1995) 16 ACSR 73 at 88
3 *Rankin v Palmer* (1912) 16 CLR 285 at 289-290

to build up a financial resource that may be deployed by the trustee in the event that it becomes subject to a liability against which it cannot be indemnified would involve, in effect, the giving of an exemption or the granting of an indemnity.

37. Although a difficult question subject to contention, and whilst it may not sit comfortably with the apparent aim of the SIS Indemnification Amendments, on the basis of the matters set out in the Statement of Facts, on balance APRA considers that the better view is that the Proposed Amendment would not have that effect. A fee charged from the assets of the Fund might prove insufficient, or it might prove excessive, from the perspective of covering some future liability, but the rights conferred by the right to charge a fee would not be tied to the extent of the future liability. Nor would the earning of a fee involve a release from the obligations associated with the future liability, so as to amount to an exemption in form or in substance. To recognise this is not to render sections 56 and 57 of the SIS Act pointless.

38. First, there is an evident danger in a trustee enjoying a blanket indemnity in respect of a broad range of liabilities that may be incurred, including where it has merely been careless. The danger is that the trustee is disincentivised from performing its duty carefully and diligently in the sense that it is freed from any personal consequence in the event of breach of duty, in the knowledge that it is the members that will suffer the financial consequence.

39. Secondly, the charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier, when the membership of the fund differed substantially.

40. For these reasons, having regard to the matters set out in the Statement of Facts, on balance APRA does not contend that the Proposed Amendment to introduce a power to charge a fee in order to accumulate resources with which to meet liabilities covered by the preclusion in s 56(2) of the SIS Act, engages that preclusion itself.

41. This is arguably an uncomfortable conclusion, having regard to the apparent aim of the SIS Indemnification Amendments, and not one which APRA arrives at lightly. Moreover, it leaves for further consideration the following further questions:

    a) whether there is some principle of equity that would preclude adoption of the Proposed Amendment as an attempt to do indirectly that which section 56(2) of the SIS Act forbids doing directly;

    b) whether the adoption of the Proposed Amendment would constitute a proper exercise of the power to amend the QSuper Deed;

    c) whether the adoption of the Proposed Amendment would contravene other duties or obligations at general law or under the SIS Act applying to trustees of superannuation funds.

Operation of equitable remedies or principles

42. In the present context, the means by which equity might conceivably control the exercise of powers so as to avoid incoherence with statutory law is by treating an apparently plenary power – here the power to amend the QSuper Deed – as being subject to a limitation that it not be deployed for a purpose which is contrary to statute.

43. In considering the application of such principle, it is important to identify what it is the statute is designed to prevent.

44. This, again, raises a difficult question requiring the consideration of different member outcomes. The adverse financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the potential disadvantages to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes insolvent.

45. For the reasons already discussed above in considering the direct application of the SIS Indemnification Amendments, APRA submits that, on balance, the better view is that the legislative intention of the preclusion in sections 56 and 57 of the SIS Act is not so broad as to necessarily render improper, extraneous or foreign, the exercise of a power otherwise available to a trustee for the purpose of achieving financial resilience. That is, the amendment of the QSuper Deed to confer a power to charge remuneration which would, in turn, enable a degree of financial resilience to be built up does not necessarily amount to doing indirectly what the law prohibits being done directly, however uncomfortably that conclusion may sit with the apparent aim of the SIS Indemnification Amendments.

46. As already discussed, APRA submits that the better view is likely that the nature of the statutory prohibition in this context is more specific. The statute does not prohibit a trustee using resources that may have come from members in discharging a personal liability. The statute prohibits the trustee being insulated from personal liability by reason of an indemnity.

Exercise of the power to amend the QSuper Deed

47. The power to vary or amend the terms of a trust deed cannot be exercised for a foreign purpose. The focus of that inquiry is upon the trust deed itself, expressing as it does the purposes for which the trust exists. Further, a power to vary a trust deed may be held not to extend to a variation which would alter the substratum of the trust.[4]

48. APRA does not contend that the making of the Proposed Amendment to grant a fee charging power would, in and of itself, alter the substratum of the Fund or otherwise be so foreign to the purpose for which the Fund exists as to render improper an exercise of the power to amend the Fund. The more relevant inquiry is whether, having regard to the purpose and nature of the Proposed Amendment, the exercise of the power of amendment would comply with the various duties and obligations of the QSuper Board in its position as trustee of

4 *Cachia v Westpac Financial Services Ltd* (2000) 170 ALR 65 at [68]-[75]

the Fund.

Compliance with duties as trustee

49. The QSuper Board owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the application ought be granted.

50. As to the general law, the relevant duties are:

    a) the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b) the duty to exercise reasonable care;

    c) the duty to preserve trust property;

    d) the duty to act impartially between the beneficiaries;

    e) the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f) the duty to avoid coming into a position of conflict of interest.

51. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards.

Statutory covenants in s 52(2)

52. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

    a) acting honestly in matters concerning the fund: s 52(2)(a);

    b) the degree of care, skill and diligence to be exercised in matters concerning the fund: s 52(2)(b);

    c) acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

    d) in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d);

    e) acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

53. For present purposes it is sufficient to focus upon s 52(2)(c) and s 52(2)(d).

Performing duties and exercising powers in the best financial interests of beneficiaries

54. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries.

55. The duty as it was previously framed was considered at some length in *APRA v*

Kelaher,[5] where Jagot J adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of Jagot J's reasoning are at [61] to [65].

56. Those observations suggest a relatively broad and practical approach will be taken to s 52(2)(c). It remains to be considered, however, whether the narrowing in focus that will be brought about by the recent amendments substantially transforms the duty. In particular, proposition (3) in paragraph [65] of Jagot J's reasons may require revisiting under a best financial interests test. The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[6]

57. The statute permits regard to be had not only to the immediate financial impact upon existing beneficiaries, but to the financial interests of future beneficiaries as well. If that is so, then even though a decision may impose an ongoing cost on present and future beneficiaries, if the cost is to ensure what with reasonable justification is able to be regarded as a correspondingly greater financial benefit to beneficiaries in the future, it is still capable of being regarded as having been exercised in the best financial interests of beneficiaries.

58. A relatively broad and practical approach to s 52(2)(c) is also evident in the decision in *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd*.[7]

59. In that case, Byrne J considered the intersection between s 52(2)(c) (as it was then worded) and a power of amendment. In resolving whether the exercise of the power to consent to an amendment (which would permit the distribution of a surplus to both employers and members) was in the best interests of "beneficiaries", within the meaning of s 52(2)(c), Byrne J proceeded on the basis (assumed but not decided) that this meant the past and present and potential future members, but not the employers (see at [109]).

60. His Honour then went on to consider the application of the obligation in terms that are important to the present application (see at [110] to [120]).

61. Although those observations are important, some equally important qualifications should be noted. First, the application in that case concerned a surplus of assets over and above vested benefits. Secondly, the application did not involve any direct benefit to the trustee (as distinct from the employer). Thirdly, insofar as one may have been an associate of the other, this was prior to the introduction of 2012 reforms concerning conflicts. Fourthly, the proposal was, in effect, "a package deal", which saw the release of benefits not only to

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5 (2019) 138 ACSR 459

6 *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50]. In the context of an application under s 59C of the *Trustee Act 1936* (SA), Blue J held that the requirement in s 59C(3)(b) that the variation be in the interests of the beneficiaries of the trust focused on the interests of beneficiaries as a whole, including not only financial interests but non-financial interests such as the freedom to choose their own investment options and the like. He considered the assessment process was holistic, requiring a weighing together of financial and non-financial interests: *Retail Employees Superannuation Pty Ltd v Pain* (2016) 115 ACSR 1 at [171].

7 (2006) 15 VR 87

the employer but to members.[8]

62. Speaking of the decision in *Invensys v Austrac*, Justice Sackville has observed, extrajudicially, that:[9]

> *Invensys v Austrac demonstrates the fundamental difficulty with the proposition that the statutory covenants implied by the SIS Act essentially restate equitable principles and that, accordingly, they should be construed by reference primarily, if not exclusively, to the antecedent law. The reasoning in the case essentially reflects an orthodox process of statutory construction that requires the content of the best interests covenant to be informed by s 117 of the SIS Act. In taking this approach, Byrne J recognised that the statutory covenants must be understood as part of a comprehensive regulatory scheme governing participants in the superannuation industry.*

63. The decisions in *Invensys* and *Kelaher* both support a fairly broad and practical approach to a consideration of what can be reasonably justified as being in the best interests of beneficiaries. The following propositions can be made:

    a) the interests of beneficiaries are broadly conceived of, and are informed not only by the purposes of the trust, but by the existing rights of the trustee under the trust deed;

    b) the interests of beneficiaries include both present and future beneficiaries;

    c) in considering whether something is in the best interests of beneficiaries, if it forms part of a course of action, a holistic view can be taken (rather than by isolating each step in the course of action in isolation);

    d) in considering whether something is in the best interests of beneficiaries, one can have regard to the position that the beneficiaries will find themselves in the future if the course of action is not pursued;

    e) in considering whether something is in the best interests of beneficiaries, one can also have regard to the commercial and practical realities of the superannuation industry generally.

64. What that means in the present context is that a trustee fee proposal ought not be assessed by:

    a) solely focusing only on the immediate cost to members, or the immediate gain to a trustee (as important as these considerations are);

    b) ignoring that the conduct of the business of trusteeship of a superannuation fund is permissibly undertaken for reward.

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8 That is consistent with what was said by Ungoed-Thomas J in *Re Van Gruisen's Will Trusts; Bagger v Dean* [1964] 1 All ER 843, in respect of a United Kingdom variation provision: "The court is concerned whether the arrangement as a whole, in all the circumstances, is such that it is proper to approve it. The court's concern involves, inter alia, a practical and businesslike consideration of the arrangement, including the total amounts of the advantages which the various parties obtain, and their bargaining strength".

9 Sackville, "Duties of superannuation trustees: From equity to statute" (2013) 37 Australian Bar Rev 1 at 7

Conflicts rules

65. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to avoid conflicts of interest.

66. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; and (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

67. Where s 52(2)(d) is engaged, Justice Sackville makes the point that the legislation may not necessarily be interpreted in an onerous fashion, in that:[10]

> *The SIS Act must be construed in its legislative context and particular provisions will be interpreted consistently with the language and purpose of the legislation as a whole. The legislative context includes an explicit statutory recognition that a corporate trustee of a superannuation fund ordinarily conducts a business for reward.*[11] *As such, the trustee will be entitled to payment for its services and will have to exercise business judgment in determining how it is to discharge its responsibilities to the beneficiaries of the fund.*
>
> *In determining whether a relevant 'conflict' of interests or duties exists for the purposes of s 52(2)(d), a court is likely to pay close attention to the provisions of the trust deed that govern the trustee's entitlements. For example, the mere fact that the trustee proposes, in conformity with the trust deed, to increase the fees it is entitled to charge beneficiaries will not necessarily create a conflict of interests in the relevant sense such that the trustee is required to forego the increase.*[12] *Similarly, in determining the content of the duty under s 52(2)(d) to accord 'priority' to the interests of the beneficiaries over those of the trustee in a situation of conflict, the terms of the trust deed may be important.*
>
> *For example, the deed ordinarily will deal with such matters as the trustee's entitlement to remuneration and the means by which it may carry out its responsibilities and manage its business. The deed may permit the trustee to engage related parties to deliver the services the trustee has undertaken to provide or which are necessary for the proper conduct of the affairs of the fund. If the terms of the deed are in accordance with recognised industry or prudential standards and are otherwise not detrimental to the interests of contributors (when*

10 Sackville, "Duties of superannuation trustees: From equity to statute" (2013) 37 Australian Bar Rev 1 at 14

11 See the definition of 'superannuation trustee' in s 52(3) of the SIS Act

12 Cf *National Nominees Ltd v Agora Asset Management Pty Ltd* [2011] VSCA 327; where the trustee of a managed investment scheme was held entitled to increase the exit fee charged to investors, the trustee having followed the procedure contemplated by the constituent documents. No breach of fiduciary duty was involved: see *National Nominees Ltd v Agora Asset Management Pty Ltd (No 2)* [2011] VSC 425 at [29]- [30] per Davies J.

compared with alternatives), there are reasonable grounds to expect that the trustee will not be in breach of the duty to give priority to the interests of beneficiaries. As always, each case will depend on its circumstances.

68. Although the case cited by Justice Sackville (*National Nominees v Agora Asset Management*) was not a superannuation case involving the statutory covenants, the point about the approach of equity to conflicts that are contemplated or authorised by the constituting document which governs the relationship are important and highlight a distinction between a case in which a constituting document already provides for or contemplates the exercise of the power (which may involve a degree of self-interest on the part of the trustee), and a case where there is no such power, save inasmuch as one might be introduced by the exercise of a power of amendment.

69. A broader point made by Justice Sackville is that, from the perspective of the SIS Act, which provides relevant context in which the trust deed, and the statutory covenants, are to be construed, the conduct of the business of a superannuation trustee will often be, and can permissibly be, for reward. The charging of a fee is not, in and of itself, the preferring of the trustee's interests over that of the beneficiaries.

70. A further point made by Justice Sackville is that where a deed contemplates such a possibility, it will be relevant to consider whether the manner of the proposed exercise of the relevant power or discretion is in accordance with recognised industry or prudential standards and is not otherwise detrimental to the interests of contributors when compared with alternatives. In other words, when considering a decision to confer a power to levy a fee when one has not previously been levied, it is too simplistic to look at the question of benefit or detriment by a simple before and after analysis. Rather, the relevant comparison may invite attention to a counter factual. That is to say, if QSuper does not adopt the Proposed Amendment, what might be the consequences for the members.

Further statutory covenants

71. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members, and, in doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

72. Sections 52(12) and (13) impose obligations to pursue the best financial interests of MySuper and choice product members.

73. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

74. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in s 55.

Further statutory provisions of significance

75. Part 2C (MySuper) makes various provisions for the offering of MySuper products and, in the case of fees, Division 5 sets out various fees that can be charged and charging rules. The fees that can be charged under s 29V(1) include, relevantly for present purposes, an "administration fee", which is defined in s 29V(2) to be "a fee that relates to the administration or operation of a superannuation entity and includes costs incurred by the trustee, or trustees, or the entity that (a) relate to the administration or operation of the trust; and (b) are not otherwise charged as [one of the other categories of defined fees]". Section 29VA then regulates the manner of charging of MySuper fees. In the case of administration fees, only certain types of fee structures are acceptable, including, principally, flat fees, fees that reflect a percentage of the member's account balance to the relevant MySuper fund, or a combination of both.

Consideration of general law duties in assessing the Proposed Amendment

76. The duty to exercise the requisite degree of skill and care does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

77. First, what might be a reasonable fee may be informed by a consideration of fees generally charged by superannuation fund trustees who provide similar services and products. The QSuper Board has not identified the amount of the fee which it proposes to charge as remuneration, or whether it will cease to charge remuneration once a sufficient capital reserve has been established. It has, however, indicated that it can be expected to exercise the remuneration power having regard to, inter alia, market analysis on the level of fees charged for trustee services: paragraph 99AA(j) of the Statement of Facts.

78. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

79. APRA is concerned that a trustee might not satisfy the prudence and best financial interests covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.

80. [redacted]

81. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The Proposed Amendment itself contains no such review mechanism. The QSuper Board has indicated that, if the Proposed Amendment is made, management can be expected to recommend to the QSuper Board that it adapt its Financial Capital Management Policy and Reserve Policy so as to be applicable to its own operations: paragraph 41B of the Statement of Facts. The material concerning these policies does not indicate how, if at all, the QSuper Board would monitor and review the Trustee Reserve to ascertain that the reserve remains appropriate to the QSuper Board's circumstances, and that controls and procedures implemented by the QSuper Board ensure that the Trustee Reserve is used only for the intended purpose of meeting liabilities for which it is no longer able to be indemnified.

82. Neither APRA nor, it appears, the Court has been provided with a copy of any proposed Trustee Capital Adequacy Policy or any other document governing the future exercise of the remuneration power that the QSuper Board proposes to adopt in the event the Proposed Amendment is made. All that the material discloses about the manner in which the QSuper Board proposes to exercise the remuneration power (if introduced) are assertions that the QSuper Board can be expected to exercise the power in compliance with its obligations: for example, paragraphs 41B and 99AA(n) of the Statement of Facts. APRA respectfully submits that this limited material concerning the manner in which the QSuper Board proposes to exercise the remuneration power (if introduced) makes it difficult for the Court to assess whether the exercise of the power of amendment to introduce a remuneration power would comply with QSuper's obligations as trustee.

83. Finally, in order to discharge the duty of diligence, APRA respectfully submits that a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members. That is to say, a trustee should explore:

    a) whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by investing in compliance or governance systems or upskilling. The QSuper Board has described enhancements it has made to its internal risk management systems and processes with a view to mitigating its possible future liabilities: paragraphs 96E to 96J of the Statement of Facts;

    b) insurance. The QSuper Board has described its insurance arrangements: paragraphs 46 to 48C of the Statement of Facts. The QSuper Board has also considered a Board paper which addressed this issue: paragraph 99A(b) of the Statement of Facts;

c) contributions from shareholders or associated entities. The QSuper Board has indicated that, in concluding that it was justified in consenting to the Proposed Amendment, it had regard to, inter alia, the fact that its capacity to generate its own resources is restricted by it having no share capital, no right to issue share capital and no right or power to call on a guarantee or indemnity from the State: paragraph 99(h) of the Statement of Facts. The Board paper considered by the QSuper Board also addressed this issue: paragraph 99A(d) of the Statement of Facts.

Consideration of the best financial interests covenant in assessing the Proposed Amendment

84. As *Kelaher* holds, the question for the Court is not whether the decision of the QSuper Board to consent to the Proposed Amendment is in the best financial interests of members, but whether it is reasonably justifiable on that basis. This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

85. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' interests, as a matter of reality, the Court might expect to see evidence that the QSuper Board has not pursued the Proposed Amendment without considering the alternatives described in paragraph 83 above. The parts of the material which address those matters have already been identified above.

86. The fact that, in this case, the QSuper Board has previously acted gratuitously and is seeking to change its governing rules to give effect to the Proposed Amendment has contextual relevance to the best financial interests duty. This situation reflects the position that the Fund is one in which profit is for members and is not to be operated for reward. APRA acknowledges that this need not be fatal to the Application if the Court is satisfied the material demonstrates an assessment on the part of the QSuper Board that the Fund cannot, with any reasonable expectation of stability, continue to be operated in that way without the introduction of a fee-charging power in the manner sought by the Proposed Amendment.

87. Nevertheless, APRA is concerned that the form of the Proposed Amendment, and the broad scope of the remuneration power it would introduce into the terms of the QSuper Deed, might not be reasonably justifiable as being in the best financial interests of members.

88. The literal effect of the Proposed Amendment would be to authorise the QSuper Board to operate the Fund on a for-profit basis, although APRA recognises that this may not be the intention of the QSuper Board.

89. APRA also accepts that the introduction of the power to charge remuneration does not mean that, when the QSuper Board later decides to impose a fee or to continue a fee in operation, its decision-making is entirely unconstrained. The same duties and obligations discussed above, including the statutory covenants, would apply to the subsequent exercise of the power.

90. However, as is clear from the authorities, the terms of the QSuper Deed (as amended to include a general fee-charging power) may inform the constraints upon any subsequent exercise of the power.

91. In those circumstances, APRA is concerned that, on the material available to it, there seem to be no arrangements proposed to be put in place by the QSuper Board that would provide comfort to the Court that the fee-charging power could not, or at least would not, be exercised in the future in a manner and for a purpose disconnected with the reasons presently advanced as the basis for its introduction: see paragraph 99D(a) of the Statement of Facts.

92. There is no clear statement, however, that any policy or other proposed arrangement would limit the exercise of the remuneration power to raising funds to be paid into the Trustee Reserve.

93. APRA raised its concern about the scope of the remuneration power which would be introduced by the Proposed Amendment in its letter to the solicitors for the QSuper Board dated 24 August 2021.[13] Although the QSuper Board responded to that letter and filed further material APRA remains concerned.

94. On that basis, APRA respectfully raises the broad scope of the proposed remuneration power and the apparent absence of any arrangements to limit the future exercise of that power to the purpose for which its introduction has been sought, as issues relevant to the Court's consideration whether consenting to the Proposed Amendment is reasonably justifiable as being in the best financial interests of members of the Fund.

Consideration of the conflicts covenant in assessing the Proposed Amendment

95. As noted above, s 52(2)(d)(i) requires that the QSuper Board give priority to the duties and interests of the members over the duties and interests of any other person.

96. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

97. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

98. For the reasons set out above, APRA is concerned that may not be the case for the Proposed Amendment given the broad scope of the remuneration power and the apparent absence of any arrangements to limit the future exercise of that power to the purpose for which its introduction has been sought.

13 See pages 54 to 56 of exhibit ESC-1 to the affidavit of Ms Costello

Consideration of the duty of impartiality in assessing the Proposed Amendment

99. The relevant duties in ss 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

100. Difficult questions of impartiality or fairness as between classes of beneficiaries and within classes of beneficiaries arise when a fee is proposed to be levied so as to build up a fund.

101. On the one hand, where it is only by reason of the SIS Indemnification Amendments to be introduced from 1 January 2022 that a trustee forms the view that it could not properly expose itself or the members of the fund to the risks attendant on it being unable to meet a particular liability, the Court might think it appropriate that the financial cost be borne only on and from that date and not by a transfer of a reserve built up during previous periods by contributions from members.

102. Of course, this might lead to the conclusion that, unless significant fees are charged from the outset, the whole purpose of levying the fund may prove insufficient to achieve the purpose of ensuring sufficient resilience to avoid adverse consequences for the fund in the event of the trustee incurring a significant liability. Much will turn on an assessment of the likely quantum of a relevant liability being incurred, and the likelihood of it being incurred.

103. The Court might consider that the trustee should consciously turn its mind not only to the likelihood and likely quantum of any relevant liabilities in respect of which a sound capital base is sought to be accumulated, but to the classes of product holders and the fair spreading of costs over time.

104. The QSuper Board has indicated that, in the event the Proposed Amendment is made, it can be expected to exercise the fee-charging power with reference to, inter alia, fairness between classes of beneficiaries and intergenerational equity: paragraph 99AA(j) of the Statement of Facts. Beyond this statement, the material filed by the QSuper Board does not address how this would be achieved.

105. The material indicates that the QSuper Board proposes to adapt and adopt compliant reserving policies, pursuant to which it anticipates it could smooth the initial impact on current and future members by deducting its remuneration, at least in part, from the Fund's General Reserve rather than immediately increasing the administration fee charged to member accounts: paragraph 99(o) of the Statement of Facts. The prospect of remuneration being deducted from the Fund's General Reserve, which has been established using fees paid by past and current members of the Fund, might unduly favour future members at the expense of past and current members.

106. Beyond noting the issue, it is difficult to say more about this issue in the absence of any real detail about the proposed structure of the fees to be charged as remuneration. APRA respectfully submits that this is a further example of

the Court's task being made more difficult by the lack of detail in the material about the manner in which the QSuper Board proposes to exercise the remuneration power (if introduced).

Consideration of MySuper charging rules in assessing the Proposed Amendment

107. In response to APRA's query concerning the application of the MySuper charging rules to the proposed exercise of the remuneration power (if introduced), the material simply states that the QSuper Board can be expected to charge its remuneration as an administration fee (which is a permitted fee under the MySuper charging rules) and having regard to obligations under the MySuper charging rules: paragraph 99AB of the Statement of Facts. No detail of how it is proposed that would be achieved has been provided. In particular, it remains unclear to APRA how the proposal to deduct remuneration from the Fund's General Reserve would meet the requirements of the charging rules that apply for MySuper members.

108. Again, it is difficult to do more than note the issue given the lack of detail in the material about the manner in which the QSuper Board proposes to exercise the remuneration power (if introduced).

Confidential material

109. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis, including a confidential opinion of counsel. The QSuper Board seeks relief that would maintain the confidentiality of this material.

110. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises.

111. As French CJ observed in *Hogan v Hinch*[14] (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself. Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*

112. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the QSuper Board or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[15]

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14 (2011) 243 CLR 506 at [20]

15 *Hogan v Hinch* (2011) 243 CLR 506 at [21]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69]

Sean Cooper QC
Counsel for APRA
29 September 2021

SUPREME COURT OF QUEENSLAND

REGISTRY: Brisbane
NUMBER: 8365/21

Applicant: **QSUPER BOARD ABN 32 125 059 006**

SUPPLEMENTARY SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

1. At the hearing of the Application on 1 October 2021, the Court gave leave to APRA to provide any further submissions it considered appropriate on matters arising from the written reply submissions delivered by the QSuper Board.

2. In these supplementary submissions, APRA does not seek to repeat the submissions it has already made in its outline dated 29 September 2021. Its intention is to clarify its position on a small number of matters.

3. *First*, in paragraph 20 of the reply submissions, the QSuper Board states that APRA's submission on this Application (extracted in paragraph 15 of the reply submissions) is an apparent departure from APRA's submissions, and the outcome, in the earlier decision in *APRA v Kelaher*.[1] It is not immediately clear to APRA from the discussion of *Kelaher* which follows in paragraph 20 of the reply submissions what the relevant departure is said to be, nor how it is said to be relevant to the court's determination of the Application. In any event, there would seem to be little point in engaging in debate on this issue given the concurrence expressed in paragraph 16 of the reply submissions with APRA's stated position on the non-engagement of s 56(2) of the SIS Act by the Proposed Amendment.

4. APRA did not intend, on this Application, to adopt a position different to that taken by it in *Kelaher*. However if, and to the extent, that the Court discerns some departure from APRA's submissions in *Kelaher* (and that difference in position is relevant to the Court's consideration and determination of the Application) the Court should proceed on the basis that APRA's position is as set out in the submissions made in this Application.

5. *Secondly*, in paragraph 54 of the reply submissions, the QSuper Board suggests that APRA is submitting that members' 'freedom to choose' their own superannuation fund is to be excluded from the s 52(2)(c) considerations. This suggestion rests on the QSuper Board's analysis of paragraph 56 of APRA's primary outline. That analysis commences at paragraph 48 and following of the reply submissions.

6. With respect, nothing set out in paragraph 56 of APRA's primary outline of submissions should be understood as advancing a submission of the type which

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1 [2019] FCA 1521; (2019) 138 ACSR 459

the QSuper Board seeks to attribute to APRA. The statements made in paragraph 56 of APRA's primary outline were intended to draw the court's attention to the fact that the language of the relevant statutory provision had changed, by reason of the recent amendment to insert the word "financial" into the description of "best interests", and that this change in the statutory language might require some reconsideration of principles identified in earlier authorities which were decided by reference to the pre-amendment form of the provision. The submission should not be understood as going further than that.

7. *Thirdly*, APRA does not accept the submission made in paragraph 5 of the reply submissions that it is common ground that the material tendered by the QSuper Board demonstrates there are good and sufficient reasons for the QSuper Board to consent to the Proposed Amendment so as to confer *a* power to charge remuneration (QSuper Board's emphasis). Nor does APRA accept the submission made in paragraph 8 of the reply submissions that the concerns it has raised in connection with the Proposed Amendment relate to the future exercise of the remuneration power.

8. The Application seeks judicial advice to the effect that the QSuper Board would be justified in consenting to the Proposed Amendment being made to the QSuper Deed. APRA's submissions are directed to the question whether, if the QSuper Board were to consent to the Proposed Amendment being made, it would be acting in accordance with the various obligations it owes as trustee of the QSuper Fund.

9. APRA has raised, as an issue for the court's consideration, the question whether consenting to the proposal to introduce a general remuneration power can, on the basis of the material tendered in support of the Application, be reasonably justified as being in the best financial interests of members and would otherwise be consistent with the QSuper Board's obligations as trustee (even accepting that the QSuper Board could be expected to endeavor to comply with its obligations in the subsequent exercise of any remuneration power that might be conferred on it).

10. APRA maintains its submission that the introduction of a general power to charge remuneration is not the only means which a trustee in the position of the QSuper Board might use to address the problem raised by the SIS Indemnification Amendments and the consequent need to build up a capital reserve outside the fund in order to meet liabilities against which the trustee can no longer be indemnified. One alternative would be the conferral of a more limited power to charge a fee or levy which could only be used to build the capital reserve to meet liabilities for which the trustee can no longer be indemnified from the assets of the fund, as distinct from a power to charge remuneration which the trustee would be free to deploy as it saw fit. Another alternative would be to introduce a more limited remuneration power which includes direct constraints upon the use to which fees charged as remuneration could be put.

11. As stated in APRA's letter to the solicitors for the QSuper Board dated 24 August 2021 (referred to in paragraph 93 of its primary outline of submissions), APRA does not consider it to be a part of its role to be prescriptive in suggesting to the QSuper Board (or any other industry participant) how a trustee should seek to address the problem created by the SIS Indemnification

Amendments, or how to frame or substantiate an application for judicial advice in respect of such a proposal. Nevertheless, APRA does regard the broad scope of the remuneration power proposed by the QSuper Board, and the availability of more limited alternatives, as important matters for the court to take into account in considering whether consenting to the making of the Proposed Amendment can be reasonably justified as being in the best interests of members and otherwise consistent with the QSuper Board's obligations as trustee of the Fund.

12. *Fourthly*, paragraph 13 of the reply submissions states that it is not clear to what extent APRA's primary submissions were informed by the letter from the solicitors for the QSuper Board dated 22 September 2021. Later, paragraph 94 of the reply submissions, the QSuper Board refers to additional detail provided in the 22 September letter.

13. For the avoidance of doubt, APRA confirms that its primary submissions were made having regard to all of the material tendered in support of the Application, including the 22 September letter. APRA remains of the view that the absence of detail about the proposed structure of the fees to be charged when the remuneration power is exercised makes it difficult for the Court to assess whether the exercise of the power to amend the QSuper Deed to introduce a remuneration power in the form set out in the Proposed Amendment can be reasonably justified as being in the best interests of members and otherwise consistent with the QSuper Board's obligations as trustee of the Fund.

Sean Cooper QC
Counsel for APRA
8 October 2021

SUPREME COURT OF NEW SOUTH WALES

REGISTRY: Sydney
NUMBER: 2021/286583

Plaintiff: **MOTOR TRADES ASSOCIATION OF AUSTRALIA SUPERANNUATION FUND PTY LIMITED (ACN 008 650 628) AS TRUSTEE FOR SPIRIT SUPER (ABN 74 559 365 913)**

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. On 11 October 2021, the plaintiff (the **Trustee**) served the Australian Prudential Regulation Authority (**APRA**) with its Summons dated 8 October 2021 (**Application**).

2. The Application, brought pursuant to subsection 63(1) of the *Trustee Act 1925* (NSW) (**Trustee Act**), seeks the Court's opinion, advice and direction that the Trustee is justified in amending the trust deed of Spirit Super, originally dated 31 May 1989 (**Trust Deed**), in a manner that would enable the Trustee to charge a fee from the assets of the Spirit Super fund (**Fund**) in relation to services it provides as trustee of the Fund (**Proposed Amendment**).

3. The Application is supported by a Statement of Facts (**Statement of Facts**).

4. The Proposed Amendment, set out in a draft deed of amendment annexed to the Statement of Facts, would provide the Trustee with a broad power to charge, deduct from the assets of the Fund, and retain for its own benefit, remuneration calculated as a percentage of the net assets of the Fund. The remuneration may not be paid to the Trustee if it would result in the net tangible assets of the Trustee exceeding a specified cap calculated as a percentage of the net assets of the Fund. The amount of the fee, and the cap on the Trustee's net tangible assets at which point the fee is not payable, may be adjusted by the Trustee as it determines to be fair and reasonable following each period of three years.

5. As is apparent from the Statement of Facts, the justification provided by the Trustee for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) that limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund.[1] Those changes are the latest instance of increasing regulation of superannuation trustees and their directors under Commonwealth law since the establishment of the fund in 1989. The Statement of Facts relies upon the concomitant greater exposure of the Trustee and the directors to Commonwealth penalties.[2] The amendments to section 56 and 57 prohibit a trustee from indemnifying itself out of the assets of a fund for a

[1] [12]-[15].
[2] [8]-[9].

criminal, civil or administrative penalty or for the payment of any amount payable under an infringement notice imposed or issued under any Commonwealth legislation and not, as previously, only under the SIS Act itself (**SIS Indemnification Amendments**).

APRA's position on the Application

6. In making the following submissions, APRA's intention is to assist the Court by identifying the legal principles and the discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[3]

7. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**), which introduced the SIS Indemnification Amendments, prior to the amendments effected by the Bill, the SIS Act and the RSE licensing regime were primarily designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

8. APRA respectfully submits that the process of decision-making should reflect the requirements of the statutory covenants, including most relevantly the requirement by reason of s 52(2)(c) of the SIS Act that the trustee act in the best financial interests of the members of the fund. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises issues for the Court's consideration concerning the broad scope of the remuneration power which would be conferred on the Trustee by the Proposed Amendment, and the manner in which the Trustee proposes to exercise that power (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act).

The effect of the amendments to sections 56 and 57 of the SIS Act

9. The effect of section 56 is that:

   a) by section 56(1), not only may the governing rules provide an indemnity to a trustee for liability incurred while acting as trustee, but, subject to particular restrictions, any governing rule that purports to preclude or limit the extent of the indemnity is void; and

   b) by section 56(2), governing rules which have the effect of exempting or indemnifying the trustee against particular liabilities are void, the breadth of which is expanded by the SIS Indemnification Amendments;

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[3] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).

10. The effect of section 57 is:

    a) subject to the preclusion referred to below, to authorise a provision in the governing rules which indemnifies a director of the trustee out of the assets of the entity in respect of a liability incurred while acting as a director of the trustee; and

    b) to render void a provision in so far as it would have the effect of indemnifying a director against identified liabilities, the breadth of which is expanded by the SIS Indemnification Amendments.

11. The SIS Indemnification Amendments are described in the background paper of Professor Pamela Hanrahan, "Superannuation Trustees' and their Directors' Changing Exposure to Commonwealth Penalties".[4] The penalties and infringement notices to which the amended provisions will apply arise in a broad range of circumstances including where the trustee has not engaged in criminal conduct, has not acted dishonestly and has not been guilty of gross negligence. The amendments will take effect in the context of heightened exposure of trustees to penalties in the circumstances described in the background paper.

12. The Trust Deed presently provides, by clause 11.3, that the Trustee is entitled to be paid from the Fund its costs and expenses properly incurred in carrying out its duties and obligations under the Trust Deed. The Trustee also has the right to reimbursement from the assets of the Fund conferred by section 59(4) of the Trustee Act.

13. Under the Trust Deed, the Trustee and the directors of the Trustee will be indemnified against all liabilities incurred by them in the execution of their duties and have a lien on the Fund for such indemnity.[5] The indemnity only applies to the extent permitted by law and does not apply where: the Trustee or a director fails to act honestly in a matter concerning the Fund; intentionally or recklessly fails to exercise, in relation to a matter affecting the Fund, the degree of care and diligence that the Trustee or director is required to exercise; or the liability is for a monetary penalty under a civil penalty order under the SIS Act.[6] This wording corresponds to sections 56 and 57 in the form they were originally enacted in the SIS Act of 1993.

14. Once the SIS Indemnification Amendments take effect, the Trustee and the directors will no longer be able to rely on those rights to indemnify themselves from the assets of the Fund in the event that they incur a penalty under Commonwealth legislation or become liable to pay an amount under an infringement notice given under Commonwealth legislation. The Proposed Amendment is sought as a means of providing the Trustee with sufficient capital with which to meet liabilities for which it will no longer enjoy any right of indemnity: paragraph 12 of the Statement of Facts.

15. The first question for the Court is whether the SIS Indemnification Amendments prohibit the outcome sought to be achieved by the Proposed Amendment.

16. As the name of the Bill suggests, the SIS Indemnification Amendments which the Bill introduced formed part of the federal government's response to

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[4] [92]-[102], CB 846-849.
[5] cl. 8.5.1, Trust Deed, CB 361.
[6] cl. 8.5.1, 8.5.3, Trust Deed, CB 361.

recommendations made by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. The apparent aim of the recommendations made by the Royal Commission, and the federal government's response in implementing those recommendations, was to improve compliance on the part of providers of financial services (relevantly here the trustees of superannuation funds) with the duties and obligations owed to consumers of those services (relevantly here the members of superannuation funds).

17. The SIS Indemnification Amendments were set out in Schedule 9 to the Bill which, according to the Explanatory Statement, implemented recommendations 3.8, 6.3, 6.4 and 6.5 of the Royal Commission. Those recommendations concerned adjustments to the roles of APRA and ASIC with respect to superannuation.

18. One aspect of the adjustment of these roles is the extension of the Australian financial services licensing regime to cover the provision of a superannuation trustee service. A consequence of this change is that trustees of superannuation funds are now required to hold an Australian financial services licence (**AFSL**) and are subject to regulation under Chapter 7 of the *Corporations Act 2001*, including obligations imposed by civil penalty provisions (for example, s 912A).

19. This change followed recent amendments effected by:

    a) the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019* (Cth) which prohibit contravention of the statutory covenants in ss 52 and 52A of the SIS Act and make contraventions of those statutory covenants the subject of a civil penalty;

    b) the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019* (Cth) which broadened the scope, and increased the maximum amount, of penalties for contravention of provisions of Chapter 7 of the *Corporations Act 2001*, among other legislation.

20. All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers of financial services) with the duties and obligations owed to members (among other consumers of financial services).

21. It was in the context of the extension of the AFSL regime that the SIS Indemnification Amendments extended the existing indemnification prohibitions.

22. To that extent, the SIS Indemnification Amendments disclose a clear legislative intention that trustees of superannuation funds bear in their personal capacity the immediate financial cost of the expanded range of liabilities to which they are to become subject, including liabilities arising by reason of the extension of the AFSL regime.

23. There is a real question as to whether that legislative intention would be defeated if trustees of superannuation funds are permitted to charge additional fees to members, or take from the assets of the fund itself, in order to build a capital reserve sufficient to pay liabilities for which they will no longer be permitted to be indemnified. That is, what legislative purpose is served by increasing the scope and severity of penalties to which superannuation trustees and directors are

subject, and removing the entitlement of such trustees and directors to be indemnified for such penalties, only to permit trustees and directors to avoid the consequences of the amendments by shifting the cost to members by another means?

24. The critical question is whether the legislative intention in enacting the SIS Indemnification Amendments, in the context of the other changes discussed above, extends to rendering unlawful any means by which a trustee may, over time, augment its own capital so as to be able to discharge such a liability, so long as the means by which it does so do not otherwise contravene basic principles governing the conduct of trustees.

25. Ascertaining whether the intention of the legislature extends that far requires consideration of the object of the SIS Act and the ambit of the preclusions imposed by the SIS Indemnification Amendments.

26. The main object of the SIS Act is to make provision for the prudent management of certain superannuation funds and for their supervision: s 3(1). This object raises a number of different matters for consideration.

27. As already noted, the focus of the SIS Act has been, and remains, upon governance and other prudential requirements that ensure trustees operate in a manner consistent with their best financial interests obligations and deliver outcomes for members. A central outcome in this regard is the prudent and diligent management of superannuation funds by trustees for the purpose of providing for the retirement benefits of members. Increases in fees charged to members or to the assets of the fund itself will have an adverse financial impact on those benefits over the long term.

28. Against the adverse financial impact on members' retirement benefits, if a power to charge remuneration is introduced, it is necessary to weigh the fact that a trustee with insufficient personal assets to meet a liability which might previously have been the subject of an indemnity, but can no longer upon the SIS Indemnification Amendments taking effect, will likely need to arrange access to funds by some different means or it may face the risk of insolvency.[7]

29. In this regard, it should be noted that various provisions of the SIS Act recognise that the promotion of stability in the Australian financial system, together with the maintenance of a sound financial position by licensees, is desirable. APRA has been given the power to set prudential standards relating to, in the words of section 34C of the SIS Act:

> "(c) the conduct by an RSE licensee of a registrable superannuation entity of the affairs of the licensee in such a way as:
> (i) to keep itself in a sound financial position; or
> (ii) not to cause or promote instability in the Australian financial system;"

30. Further, in providing that trustees may charge fees for their services, so long as the charging rules are complied with, and powers with respect to charging are exercised having regard to the various requirements discussed in more detail below, the SIS Act recognises that the earning of a fee by a superannuation trustee

[7] [14], Statement of Facts, CB 5.

is permissible.[8]

31. Although sections 56 and 57 of the SIS Act, both prior to and upon the commencement of the SIS Indemnification Amendments, preclude the governing rules affording the trustee a blanket right of indemnity or exemption in respect of particular liabilities, there can be and is no preclusion on a trustee meeting those liabilities from its own capital derived from the charging of a fee to members where the power to charge a fee exists and the power is exercised lawfully. In that general sense, members of a fund where a fee-charging power exists may already bear an economic cost of liabilities that cannot be the subject of an indemnity. The fact that, in the case of a profit-for-members structure, a trustee has previously been willing to act gratuitously but now seeks, by amendment to the trust deed, a power to charge a fee is plainly a relevant consideration, but not of itself decisive.

32. Turning to the specific language of the statutory preclusion, section 56(2) of the SIS Act is directed to provisions in the governing rules of a superannuation entity that would have the effect of **exempting** a trustee from, or **indemnifying** the trustee against, identified liabilities.

33. Two points should be noted in this regard.

34. *First*, the concern of the provision, like the concern of s 199A of the *Corporations Act* which contains similar language, would appear to be with blanket exemption and indemnification.[9]

35. *Secondly*, the legislation has targeted concepts with a relatively technical legal meaning, namely, exemption from and indemnification against, liability.

36. To exempt from a liability is to free from an obligation or liability, and, at least prima facie, this presupposes a liability has arisen in the first place.[10]

37. In broad terms, the concept of an indemnity involves a promise or obligation to hold another party harmless against a particular loss or liability. The basic concept is the provision of a suite of rights or remedies which can be availed of to reduce the personal exposure of the promisee in respect of identified losses and liabilities. Although in certain cases a promisee might obtain incidental relief which requires a promisor to set aside a fund to facilitate the indemnification,[11] the nature and extent of the right is ultimately a function of, and reflective of, the nature and extent of the ultimate loss or liability suffered or incurred by the promisee.

38. The question then is whether the levying of a fee which is motivated by the need to build up a financial resource that may be deployed by the trustee in the event that it becomes subject to a liability against which it cannot be indemnified would involve, in effect, the giving of an exemption or the granting of an indemnity.

39. Although a difficult question subject to contention, and whilst it may not sit comfortably with the apparent aim of the SIS Indemnification Amendments, on the basis of the matters set out in the Statement of Facts, on balance APRA considers that the better view is that the Proposed Amendment would not have

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[8] eg s 29V(2) SIS Act.
[9] *Miller v Miller* (1995) 16 ACSR 73 at 87-88
[10] *Miller v Miller* (1995) 16 ACSR 73 at 88
[11] *Rankin v Palmer* (1912) 16 CLR 285 at 289-290

that effect. A fee charged from the assets of the Fund might prove insufficient, or it might prove excessive, from the perspective of covering some future liability, but the rights conferred by the right to charge a fee would not be tied to the extent of the future liability. Nor would the earning of a fee involve a release from the obligations associated with the future liability, so as to amount to an exemption in form or in substance. To recognise this is not to render sections 56 and 57 of the SIS Act pointless.

40. First, there is an evident danger in a trustee enjoying a blanket indemnity in respect of a broad range of liabilities that may be incurred, including where it has merely been careless. The danger is that the trustee is disincentivised from performing its duty carefully and diligently in the sense that it is freed from any personal consequence in the event of breach of duty, in the knowledge that it is the members that will suffer the financial consequence.

41. Secondly, the charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee (which is relevant to a consideration whether the proposed exercise of the amendment power would be consistent with a trustee's duties or obligations at general law and under the SIS Act), spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

42. Thirdly, any use of trustee capital by the Trustee to indemnify directors against liability for Commonwealth penalties must be considered by the directors in light of their general law and statutory duties to act in good faith in the best interests of the Trustee[12] and the limits in section 199A of the Corporations Act on the scope of indemnities given by companies for liabilities incurred by a person as an officer of the company.

43. For these reasons, having regard to the matters set out in the Statement of Facts, on balance APRA does not contend that the Proposed Amendment to introduce a power to charge a fee in order to accumulate resources with which to meet liabilities covered by the preclusion in s 56(2) of the SIS Act, engages that preclusion itself.

44. This is arguably an uncomfortable conclusion, having regard to the apparent aim of the SIS Indemnification Amendments, and not one which APRA arrives at lightly. Moreover, it leaves for further consideration the following further questions:

    a) whether there is some principle of equity that would preclude adoption of the Proposed Amendment as an attempt to do indirectly that which section 56(2) of the SIS Act forbids doing directly;

    b) whether the adoption of the Proposed Amendment would constitute a proper exercise of the power to amend the Trust Deed; and

    c) whether the adoption of the Proposed Amendment would contravene other duties or obligations at general law or under the SIS Act applying to trustees

[12] s 181(1)(a) and (b) Corporations Act

of superannuation funds.

Operation of equitable remedies or principles

45. In the present context, the means by which equity might conceivably control the exercise of powers so as to avoid incoherence with statutory law is by treating an apparently plenary power – here the power to amend the Trust Deed – as being subject to a limitation that it not be deployed for a purpose which is contrary to statute.

46. In considering the application of such principle, it is important to identify what it is the statute is designed to prevent.

47. This, again, raises a difficult question requiring the consideration of different member outcomes. The financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the potential disadvantages to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes insolvent.[13]

48. For the reasons already discussed above in considering the direct application of the SIS Indemnification Amendments, APRA submits that, on balance, the better view is that the legislative intention of the preclusion in sections 56 and 57 of the SIS Act is not so broad as to necessarily render improper, extraneous or foreign, the exercise of a power otherwise available to a trustee for the purpose of achieving financial resilience. That is, the amendment of the Trust Deed to confer a power to charge remuneration which would, in turn, enable a degree of financial resilience to be built up does not necessarily amount to doing indirectly what the law prohibits being done directly, however uncomfortably that conclusion may sit with the apparent aim of the SIS Indemnification Amendments.

49. As already discussed, APRA submits that the better view is likely that the nature of the statutory prohibition in this context is more specific. The statute does not prohibit a trustee using resources that may have come from members in discharging a personal liability. The statute prohibits the trustee being insulated from personal liability by reason of an indemnity.

Exercise of the power to amend the Trust Deed

50. The power to vary or amend the terms of a trust deed cannot be exercised for a foreign purpose. The focus of that inquiry is upon the trust deed itself, expressing as it does the purposes for which the trust exists. Further, a power to vary a trust deed may be held not to extend to a variation which would alter the substratum of the trust.[14]

51. APRA does not contend that the making of the Proposed Amendment to grant a fee charging power would, in and of itself, alter the substratum of the Fund or otherwise be so foreign to the purpose for which the Fund exists as to render improper an exercise of the power to amend the Fund. The more relevant inquiry is whether, having regard to the purpose and nature of the Proposed Amendment, the exercise of the power of amendment would comply with the various duties

[13] [16]-[17], Statement of Facts, CB 6.
[14] *Cachia v Westpac Financial Services Ltd* (2000) 170 ALR 65 at [68]-[75]

and obligations of the Trustee in its position as trustee of the Fund.

Compliance with duties as trustee

52. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the application ought to be granted.

53. As to the general law, the relevant duties are:

    a) the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b) the duty to exercise reasonable care;

    c) the duty to preserve trust property;

    d) the duty to act impartially between the beneficiaries;

    e) the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f) the duty to avoid coming into a position of conflict of interest.

54. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards.

Statutory covenants in s 52(2)

55. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

    a) acting honestly in matters concerning the fund: s 52(2)(a);

    b) exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: s 52(2)(b);

    c) acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

    d) in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d); and

    e) acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

56. For present purposes it is sufficient to focus upon s 52(2)(c) and s 52(2)(d).

Performing duties and exercising powers in the best financial interests of beneficiaries

57. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries.

58. The duty as it was previously framed was considered at some length in *APRA v*

Kelaher,[15] where Jagot J adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of Jagot J's reasoning are at [61] to [65].

59. Those observations suggest a relatively broad and practical approach will be taken to s 52(2)(c). The courts have not yet had to consider whether a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Jagot J's reasons, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established, may require revisiting under a best financial interests test. The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[16]

60. The statute permits regard to be had not only to the immediate financial impact upon existing beneficiaries, but to the financial interests of future beneficiaries as well. If that is so, then even though a decision may impose an ongoing cost on present and future beneficiaries, if the cost is to ensure what with reasonable justification is able to be regarded as a correspondingly greater financial benefit to beneficiaries in the future, it is still capable of being regarded as having been exercised in the best financial interests of beneficiaries.

61. A relatively broad and practical approach to s 52(2)(c) is also evident in the decision in *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd*.[17]

62. In that case, Byrne J considered the intersection between s 52(2)(c) (as it was then worded) and a power of amendment. In resolving whether the exercise of the power to consent to an amendment (which would permit the distribution of a surplus to both employers and members) was in the best interests of "beneficiaries", within the meaning of s 52(2)(c), Byrne J proceeded on the basis (assumed but not decided) that this meant the past and present and potential future members, but not the employers (see at [109]).

63. His Honour then went on to consider the application of the obligation in terms that are important to the present application (see at [110] to [120]).

64. Although those observations are important, some equally important qualifications should be noted. First, the application in that case concerned a surplus of assets over and above vested benefits. Secondly, the application did not involve any direct benefit to the trustee (as distinct from the employer). Thirdly, insofar as one may have been an associate of the other, this was prior to the introduction of

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[15] (2019) 138 ACSR 459

[16] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50]. In the context of an application under s 59C of the *Trustee Act 1936* (SA), Blue J held that the requirement in s 59C(3)(b) that the variation be in the interests of the beneficiaries of the trust focused on the interests of beneficiaries as a whole, including not only financial interests but non-financial interests such as the freedom to choose their own investment options and the like. He considered the assessment process was holistic, requiring a weighing together of financial and non-financial interests: *Retail Employees Superannuation Pty Ltd v Pain* (2016) 115 ACSR 1 at [171].

[17] (2006) 15 VR 87

2012 reforms concerning conflicts. Fourthly, the proposal was, in effect, "a package deal", which saw the release of benefits not only to the employer but to members.[18]

65. Speaking of the decision in *Invensys v Austrac*, Justice Sackville has observed, extrajudicially, that:[19]

> *Invensys v Austrac demonstrates the fundamental difficulty with the proposition that the statutory covenants implied by the SIS Act essentially restate equitable principles and that, accordingly, they should be construed by reference primarily, if not exclusively, to the antecedent law. The reasoning in the case essentially reflects an orthodox process of statutory construction that requires the content of the best interests covenant to be informed by s 117 of the SIS Act. In taking this approach, Byrne J recognised that the statutory covenants must be understood as part of a comprehensive regulatory scheme governing participants in the superannuation industry.*

66. The decisions in *Invensys* and *Kelaher* both support a fairly broad and practical approach to a consideration of what can be reasonably justified as being in the best interests of beneficiaries. The following propositions can be made:

    a) the interests of beneficiaries are broadly conceived of, and are informed not only by the purposes of the trust, but by the existing rights of the trustee under the trust deed;

    b) the interests of beneficiaries include both present and future beneficiaries;

    c) in considering whether something is in the best interests of beneficiaries, if it forms part of a course of action, a holistic view can be taken (rather than by isolating each step in the course of action in isolation);

    d) in considering whether something is in the best interests of beneficiaries, one can have regard to the position that the beneficiaries will find themselves in the future if the course of action is not pursued; and

    e) in considering whether something is in the best interests of beneficiaries, one can also have regard to the commercial and practical realities of the superannuation industry generally.

67. What that means in the present context is that a trustee fee proposal ought not be assessed by:

    a) solely focusing only on the immediate cost to members, or the immediate gain to a trustee (as important as these considerations are); or

    b) ignoring that the conduct of the business of trusteeship of a superannuation fund is permissibly undertaken for reward.

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[18] That is consistent with what was said by Ungoed-Thomas J in *Re Van Gruisen's Will Trusts; Bagger v Dean* [1964] 1 All ER 843, in respect of a United Kingdom variation provision: "The court is concerned whether the arrangement as a whole, in all the circumstances, is such that it is proper to approve it. The court's concern involves, inter alia, a practical and businesslike consideration of the arrangement, including the total amounts of the advantages which the various parties obtain, and their bargaining strength".

[19] Sackville, "Duties of superannuation trustees: From equity to statute" (2013) 37 Australian Bar Rev 1 at 7

68. The best financial interests duty must also be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[20] The Report addressed the essential duties of responsible entities. It characterised the best interests duty as, "a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."[21] Trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[22]

Conflicts rules

69. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to avoid conflicts of interest.

70. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; and (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

71. Where s 52(2)(d) is engaged, Justice Sackville makes the point that the legislation may not necessarily be interpreted in an onerous fashion, in that:[23]

> *The SIS Act must be construed in its legislative context and particular provisions will be interpreted consistently with the language and purpose of the legislation as a whole. The legislative context includes an explicit statutory recognition that a corporate trustee of a superannuation fund ordinarily conducts a business for reward.*[24] *As such, the trustee will be entitled to payment for its services and will have to exercise business judgment in determining how it is to discharge its responsibilities to the beneficiaries of the fund.*
>
> *In determining whether a relevant 'conflict' of interests or duties exists for the purposes of s 52(2)(d), a court is likely to pay close attention to the provisions of the trust deed that govern the trustee's entitlements. For example, the mere fact that the trustee proposes, in conformity with the trust deed, to increase the fees it is entitled to charge beneficiaries will not necessarily create a conflict of interests in the relevant sense such that the trustee is required to forego the increase.*[25] *Similarly, in*

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[20] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).

[21] cited by Justice Mark Moshinsky, 'The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework', 9 March 2018, p 9.

[22] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

[23] Sackville, "Duties of superannuation trustees: From equity to statute" (2013) 37 Australian Bar Rev 1 at 14

[24] See the definition of 'superannuation trustee' in s 52(3) of the SIS Act

[25] Cf *National Nominees Ltd v Agora Asset Management Pty Ltd* [2011] VSCA 327; where the trustee of a managed investment scheme was held entitled to increase the exit fee charged to investors, the trustee having followed the procedure contemplated by the constituent documents. No breach of

determining the content of the duty under s 52(2)(d) to accord 'priority' to the interests of the beneficiaries over those of the trustee in a situation of conflict, the terms of the trust deed may be important.

For example, the deed ordinarily will deal with such matters as the trustee's entitlement to remuneration and the means by which it may carry out its responsibilities and manage its business. The deed may permit the trustee to engage related parties to deliver the services the trustee has undertaken to provide or which are necessary for the proper conduct of the affairs of the fund. If the terms of the deed are in accordance with recognised industry or prudential standards and are otherwise not detrimental to the interests of contributors (when compared with alternatives), there are reasonable grounds to expect that the trustee will not be in breach of the duty to give priority to the interests of beneficiaries. As always, each case will depend on its circumstances.

72. Although the case cited by Justice Sackville (*National Nominees v Agora Asset Management*) was not a superannuation case involving the statutory covenants, the point about the approach of equity to conflicts that are contemplated or authorised by the constituting document which governs the relationship are important and highlight a distinction between a case in which a constituting document already provides for or contemplates the exercise of the power (which may involve a degree of self-interest on the part of the trustee), and a case where there is no such power, save inasmuch as one might be introduced by the exercise of a power of amendment.

73. A broader point made by Justice Sackville is that the SIS Act, which provides relevant context in which the trust deed, including the statutory covenants imported into that trust deed by ss 52(1) and 52A(1), are to be construed, contemplates and permits the business of a superannuation trustee being conducted for reward. The charging of a fee is not, in and of itself, the preferring of the trustee's interests over that of the beneficiaries.

74. A further point made by Justice Sackville is that where a deed contemplates such a possibility, it will be relevant to consider whether the manner of the proposed exercise of the relevant power or discretion is in accordance with recognised industry or prudential standards and is not otherwise detrimental to the interests of contributors when compared with alternatives. In other words, when considering a decision to confer a power to levy a fee when one has not previously been levied, it is too simplistic to look at the question of benefit or detriment by a simple before and after analysis. Rather, the relevant comparison may invite attention to a counter factual. That is to say, if the Trustee does not adopt the Proposed Amendment, what might be the consequences for the members.

Further statutory covenants

75. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and

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fiduciary duty was involved: see *National Nominees Ltd v Agora Asset Management Pty Ltd (No 2)* [2011] VSC 425 at [29]- [30] per Davies J.

choice products offered are being conducted in such a way as to promote the best financial interests of members, and, in doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

76. Sections 52(12) and (13) impose obligations to pursue the best financial interests of MySuper and choice product members.

77. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

78. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in section 55.

Further statutory provisions of significance

79. Part 2C (MySuper) makes various provisions for the offering of MySuper products and, in the case of fees, Division 5 sets out various fees that can be charged and charging rules. The fees that can be charged under s 29V(1) include, relevantly for present purposes, an "administration fee", which is defined in s 29V(2) to be "a fee that relates to the administration or operation of a superannuation entity and includes costs incurred by the trustee, or trustees, or the entity that (a) relate to the administration or operation of the trust; and (b) are not otherwise charged as [one of the other categories of defined fees]". Section 29VA then regulates the manner of charging of MySuper fees. In the case of administration fees, only certain types of fee structures are acceptable, including, principally, flat fees, fees that reflect a percentage of the member's account balance to the relevant MySuper fund, or a combination of both.

Consideration of the covenant to exercise care, skill and diligence, in assessing the Proposed Amendment

80. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

81. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it proposes to charge as remuneration, and that it will cease to charge remuneration once a sufficient capital reserve has been established. It has had regard to, inter alia, industry benchmarking on fees proposed to be charged by trustees of similar sized superannuation funds.[26]

82. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee

[26] [114], Affidavit of Leeanne Cherise Turner dated 7 October 2021, CB 208.

itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

83. APRA is concerned that a trustee might not satisfy the prudence and best financial interests covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.

84. Here, the process which the Trustee has followed to quantify the target amount for the Trustee Reserve is set out in the Report on Trustee Capital and Fee dated 21 September 2021[27] and the PricewaterhouseCoopers independent evaluation[28]. That process appears to involve setting the target amount by reference to all possible penalties to which the Trustee might become subject, but weighting these by an assessment of likelihood based on the Trustee's risk framework, controls and advice of the Trustee's risk managers.[29]

85. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The Proposed Amendment itself contains such a review mechanism. A review that results in an adjustment to the current fee or cap on trustee capital must have regard to the advice of an appropriately qualified independent consultant and may have regard to amounts that the Trustee *reasonably* considers necessary to appropriately compensate the Trustee for acting as trustee of the Fund and/or to appropriately compensate it for the personal financial risk it might incur.[30]

86. Finally, in order to discharge the duty of diligence, APRA respectfully submits that a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members. That is to say, a trustee should explore:

    a) whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by investing in compliance or governance systems or upskilling. The Trustee has described its robust approach to risk management;[31]

    b) insurance. The Trustee has described its insurance arrangements in the

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[27] CB 1025.
[28] CB 1065.
[29] [4.2.3], CB 1028.
[30] cl 11.6.5, proposed Deed of Amendment, CB 14.
[31] [97], Affidavit of Leeanne Cherise Turner dated 7 October 2021, CB 204.

affidavit of Sean Andrew Lindsay dated 29 September 2021; and

c) contributions from shareholders or associated entities. The Trustee has indicated that, in concluding that it was justified in consenting to the Proposed Amendment, it had regard to, inter alia, the fact that its capacity to generate its own resources is restricted by the Trustee holding only nominal personal capital and not receiving financial support from its shareholders due to the profit-to-member shareholding structure.[32]

Consideration of the best financial interests covenant in assessing the Proposed Amendment

87. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed Amendment is reasonably justifiable on that basis. This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

88. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives described in paragraph 86 above. The parts of the material which address those matters have already been identified above.

89. The fact that, in this case, the Trustee has previously accepted the responsibility to act as trustee of the Fund gratuitously[33] and is seeking to change its governing rules to give effect to the Proposed Amendment, has contextual relevance to the best financial interests duty. This situation reflects the position that the Fund is one in which profit is for members and is not to be operated for reward. APRA acknowledges that this need not be fatal to the Application if the Court is satisfied the material demonstrates an assessment on the part of the Trustee that the Fund cannot, with any reasonable expectation of stability, continue to be operated in that way without the introduction of a fee-charging power in the manner sought by the Proposed Amendment.

90. A material feature of this application is that the Trustee is itself a profit-for-members entity. The Trustee is an Australian proprietary company limited by shares. The sole purpose for which the Trustee is constituted is to be the trustee of the Fund and do all things that the directors consider necessary or desirable for that purpose.[34] All income and property of the Trustee must be applied solely towards the promotion of the Trustee being the trustee of the Fund. No portion of the income or property of the Trustee may be paid or transferred directly or indirectly by way of dividend, bonus or otherwise by way of profit or return of capital to shareholders.[35]

91. No person is entitled to hold a share in the Trustee unless the person is a director and consents to hold the share on behalf of the members of the Fund.[36] If, on the merger, winding up or dissolution of the Trustee, after the satisfaction of all its

[32] [85], Affidavit of Leeanne Cherise Turner dated 7 October 2021, CB 202
[33] Trust Deed, cl 2.3.
[34] cl 2, Trustee Constitution, CB 501.
[35] cl 19.1(a), Trustee Constitution, CB 520.
[36] cl 3.2, Trustee Constitution, CB 502.

debts and liabilities, any property of the Trustee remains, the surplus must be paid or applied to the Fund or its successor fund, a company that replaces the Trustee as trustee of the Fund, or a trustee of the Fund's successor fund, as the shareholders or the liquidator determine.[37]

92. An amendment to introduce a power for a Trustee whose shares are held on trust for the members of the Fund to charge a fee to the Fund is a different proposition from a new fee being payable to a company that is beneficially owned by persons other than the members of the Fund where that company had previously agreed to serve as trustee gratuitously.

93. The same duties and obligations discussed above, including the statutory covenants, would apply to the subsequent exercise of the power.

Consideration of the conflicts covenant in assessing the Proposed Amendment

94. As noted above, s 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

95. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

96. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Consideration of the duty of impartiality in assessing the Proposed Amendment

97. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

98. Difficult questions of impartiality or fairness as between classes of beneficiaries and within classes of beneficiaries arise when a fee is proposed to be levied so as to build up a fund.

99. On the one hand, where it is only by reason of the SIS Indemnification

[37] cl 19.3, Trustee Constitution, CB 520.

Amendments to be introduced from 1 January 2022 that a trustee forms the view that it could not properly expose itself or the members of the fund to the risks attendant on it being unable to meet a particular liability, the Court might think it appropriate that the financial cost be borne only on and from that date and not by a transfer of a reserve built up during previous periods by contributions from members.

100. Of course, this might lead to the conclusion that, unless significant fees are charged from the outset, the whole purpose of levying the fund may prove insufficient to achieve the purpose of ensuring sufficient resilience to avoid adverse consequences for the fund in the event of the trustee incurring a significant liability. Much will turn on an assessment of the likely quantum of a relevant liability being incurred, and the likelihood of it being incurred.

101. The Court might consider that the trustee should consciously turn its mind not only to the likelihood and likely quantum of any relevant liabilities in respect of which a sound capital base is sought to be accumulated, but to the classes of product holders and the fair spreading of costs over time.

102. The Trustee has indicated that it has considered that the proposed trustee fee is fair as between different groups of members.[38]

103. The material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting its remuneration from the Fund's General Reserve rather than immediately increasing the administration fee charged to member accounts.[39]

Consideration of MySuper charging rules in assessing the Proposed Amendment

104. It is unclear to APRA how the proposal to deduct remuneration from the Fund's General Reserve would meet the requirements of the charging rules that apply for MySuper members.

Process for setting the remuneration of directors

105. Clause 11.3 of the Trust Deed currently refers to remuneration of the Trustee's directors being able to be indemnified from the Fund only to the extent that the remuneration is determined by the Trustee to be reasonable, having regard to the advice of an independent remuneration consultant.[40] The Proposed Amendment would remove this limitation.

106. APRA wrote to the Trustee on 21 October 2021 asking to be directed to the materials relevant to the Trustee's proposed decision to amend clause 11.3. The Trustee indicated that the Trustee is contemplating that, if the Court approves the proposed amendments to the Trust Deed, remuneration of the Trustee's directors would be paid from the trustee capital generated by the trustee fee (rather than the Fund).[41]

107. APRA is concerned that, even if the limitation on the indemnification of directors' fees out of the Fund may become redundant, the amendment of the

[38] [110(d)], Affidavit of Leeanne Cherise Turner dated 7 October 2021, CB 207
[39] [110(c)], Affidavit of Leeanne Cherise Turner dated 7 October 2021, CB 207
[40] CB 366
[41] As contemplated by the calculation of the proposed annual trustee fee in the Report on Trustee Capital and Fee dated 21 September 2021, sections 2 and 4.4.

covenant in the Trust Deed may have the effect of removing an existing protection for beneficiaries in the event directors' remuneration ceases to be paid out of trustee capital. APRA is concerned that the materials do not disclose a reasonably justifiable basis for the Trustee to consider that the amendment to clause 11.3 is in the best financial interests of members.[42]

Confidential material

108. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. The Trustee seeks relief that would maintain the confidentiality of this material.

109. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises.

110. As French CJ observed in *Hogan v Hinch*[43] (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself. Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*

111. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[44]

Sean Cooper QC David Allen

Counsel for APRA
22 October 2021

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[42] cf. *H.E.S.T. Australia Ltd v Inkley* [2018] SASC 127 at [97] (Blue J)
[43] (2011) 243 CLR 506 at [20]
[44] *Hogan v Hinch* (2011) 243 CLR 506 at [21]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69]

SUPREME COURT OF NEW SOUTH WALES

REGISTRY: Sydney
NUMBER: 2021/301971

Plaintiff: **UNITED SUPER PTY LTD (ABN 46 006 261 623) AS TRUSTEE FOR CONSTRUCTION AND BUILDING UNIONS SUPERANNUATION FUND (ABN 75 493 363 262)**

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. On 25 October 2021, the plaintiff (the **Trustee**) served the Australian Prudential Regulation Authority (**APRA**) with its Summons dated 22 October 2021 (**Application**).

2. The Application, brought pursuant to subsection 63(1) of the *Trustee Act 1925* (NSW) (**Trustee Act**), seeks the Court's opinion, advice and direction that the Trustee would be justified in amending[1] the trust deed of Construction and Building Unions Superannuation Fund (the **Fund**), originally dated 29 May 1984 (**Trust Deed**), to replace an existing clause for the remuneration of the Trustee[2] with a clause that specifically allows a fee to be payable to the Trustee for an amount which the Trustee reasonably considers to appropriately compensate the Trustee for the personal financial risk it might incur in connection with its role as trustee of the Fund, in addition to an amount which the Trustee reasonably considers necessary to appropriately compensate the Trustee for acting as trustee of the Fund[3] (**Proposed Amendment**). The Application is supported by a Statement of Facts (**Statement of Facts**).

3. The Proposed Amendment, set out in a draft deed of amendment annexed to the Statement of Facts, would provide the Trustee with a broad power to charge, deduct from the assets of the Fund, and retain for its own benefit, a fee calculated as a percentage of the net assets of the Fund for each successive period of two years from 1 July 2021. The fee may not be paid to the Trustee if it would result in the net tangible assets of the Trustee exceeding a specified cap, calculated as a percentage of the net assets of the Fund. The amount of the fee, and the cap on the Trustee's net tangible assets at which point the fee is not payable, may be adjusted by the Trustee, to any higher or lower amounts as it determines to be fair and reasonable following each period of four years.

4. As is apparent from the Statement of Facts, the immediate catalyst for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) that limit the ability of a superannuation trustee to indemnify itself and its directors out of

[1] pursuant to a power of amendment in cl 6.7(a) of the Trust Deed.
[2] cl 1.1(g), Trust Deed
[3] proposed cl 1.7(d), Deed of Amendment.

the assets of a fund.[4] Those changes are the latest instance of increasing regulation of superannuation trustees and their directors under Commonwealth law since the Trustee first became trustee of the Fund on its establishment.[5]

5. The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019* (Cth) amended the SIS Act to make contraventions of the statutory covenants in ss 52 and 52A of the SIS Act the subject of a civil penalty. Following the passage of the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020*, trustees of superannuation funds are now required to hold an Australian financial services licence and are subject to regulation under Chapter 7 of the Corporations Act, including obligations imposed by civil penalty provisions (for example, the general obligations of financial services licensees in s 912A).

6. The Statement of Facts relies upon the concomitant escalating exposure of the Trustee and the directors to Commonwealth penalties over this time.[6] The amendments to section 56 and 57 prohibit a trustee from indemnifying itself out of the assets of a fund for a criminal, civil or administrative penalty or for the payment of any amount payable under an infringement notice imposed or issued under any Commonwealth legislation and not, as previously, only under the SIS Act itself (**SIS Indemnification Amendments**).

7. All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers of financial services) with the duties and obligations owed to members (among other consumers of financial services).

8. The possible effect on members of the imposition of penalties on a superannuation trustee was mitigated to some extent by simultaneous amendments made by the Hayne Royal Commission Response Act that require a court, in determining a pecuniary penalty under the *Australian Securities and Investments Commission Act 2001* or the Corporations Act, to take into account the impact that the penalty under consideration would have on the members of the fund.[7]

9. Even so, on the Trustee's evidence, lacking significant personal capital as it does, and without insurance as a complete solution or any indemnity out of Fund assets for a Commonwealth penalty, if the Trustee does not resolve to levy a fee to accumulate personal capital the Trustee would be at some risk of insolvency, even with robust compliance and risk management controls.[8]

APRA's position on the Application

10. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and the discretionary considerations which, in APRA's view, bear upon the decision whether to grant

[4] [14]-[16], Statement of Facts.
[5] Original Trust Deed, Exhibit JRA-1, p 9; Current and Historical Extract for the Trustee formerly known as B.U.S. Pty. Ltd., Exhibit JRA-1, p 207.
[6] [11]-[12], Statement of Facts.
[7] s 12GBB, *Australian Securities and Investments Commission Act 2001*; s 1317G(6), Corporations Act.
[8] [16], [17], [21], Statement of Facts.

the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[9]

11. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**), which introduced the SIS Indemnification Amendments, the SIS Act and the RSE licensing regime are primarily designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

12. APRA respectfully submits that the process of decision-making should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of s 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Fund and s 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises issues for the Court's consideration concerning the manner in which the Trustee proposes to amend and refine its remuneration power, being a power that has not to date been exercised by paying a fee to the Trustee[10] (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act).

The amendments to sections 56 and 57 of the SIS Act do not preclude payment of a trustee fee

13. The SIS Indemnification Amendments do not prohibit the outcome sought to be achieved by the Proposed Amendment. Sections 56(2) and 57(2) are directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee or a director of a trustee from or indemnifying a trustee or director against certain liabilities. The levying of a fee which is meant to build up over time into an asset that may be deployed by the Trustee in the event that it or a director becomes subject to a liability against which it or the director cannot be indemnified, does not have the substantive effect of conferring an exemption from or indemnifying against that liability.[11]

14. To recognise this is not to render sections 56 and 57 of the SIS Act pointless. The fee charged may prove to be insufficient to cover the extent of the Trustee's potential liability. The Proposed Amendment does not have the effect of excusing or extinguishing the liability of the trustee for any amount for which it cannot be indemnified out of the Fund. The Trustee would be able to accrue capital but would not enjoy a blanket indemnity that may disincentivise it from performing

[9] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).
[10] [6]-[8], Statement of Facts.
[11] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [32].

its duties carefully and diligently, in the sense that it is not freed from any personal consequence in the event of breach of duty.

15. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Fund must be considered by the board in light of their general law and statutory duties to act in good faith in the best interests of the Trustee[12]. The limits in sections 199A and 199B of the Corporations Act on the scope of indemnities given by companies and insurance paid for by companies in respect of liabilities incurred by a person as an officer of the company would apply.

16. This leaves for consideration whether the adoption of the Proposed Amendment would contravene other duties or obligations under the general law or the SIS Act applying to trustees of superannuation funds.

Compliance with duties as trustee

17. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the application ought to be granted. The Trust Deed provides that the board of directors of the Trustee in making decisions in relation to the Fund must comply with the provisions of the SIS Act relating to decisions by trustees[13] and the SIS Act covenants apply despite any provision in the governing rules of an entity[14].

18. As to the general law, the relevant duties are:

    a) the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b) the duty to exercise reasonable care;

    c) the duty to preserve trust property;

    d) the duty to act impartially between the beneficiaries;

    e) the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f) the duty to avoid coming into a position of conflict of interest.

19. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards.

<u>Statutory covenants in s 52(2)</u>

20. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

    a) acting honestly in matters concerning the fund: s 52(2)(a);

    b) exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: s 52(2)(b);

[12] s 181(1)(a) and (b) Corporations Act
[13] cl 1.1(b)(i); 'Relevant Law', cl 7.2.
[14] s 7, SIS Act.

c) acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

d) in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d); and

e) acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

21. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries. According to the explanatory memorandum, the purpose of the amendment was:

> *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations … The identification of a 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 evidence to support their expenditures.*[15]

22. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[16] where Jagot J adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of Jagot J's reasoning are at [61] to [65].

23. Those observations suggest a relatively broad and practical approach that focuses on financial interests will be taken to s 52(2)(c). The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Jagot J's reasons, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established, may require revisiting under a best financial interests test. The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[17]

24. The best financial interests duty must also be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[18] The Report addressed the essential duties of responsible entities. It

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[15] [3.32]-[3.33], Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*.
[16] (2019) 138 ACSR 459
[17] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[18] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR

characterised the best interests duty as, "a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."[19] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[20]

Conflicts rules

25. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to avoid conflicts of interest.

26. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; and (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

27. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members, and, in doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

28. Sections 52(12) and (13) impose obligations to pursue the best financial interests of MySuper and choice product members.

29. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

30. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

31. The Your Future, Your Super amendment to the covenant in section 52(2)(c) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of members in their decision-making processes. In the material put before the Court, the Trustee has evidenced the consideration it has given to how the financial interests of members may be affected if the Proposed Amendment is not made and the Trustee becomes insolvent or faces a real risk of

167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).

[19] cited by Justice Mark Moshinsky, 'The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework', 9 March 2018, p 9.

[20] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

insolvency.[21]

32. Increases in fees charged to members or to the assets of the Fund itself will have an adverse financial impact on the retirement benefits of members over the long term. The financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes or may become insolvent.

33. The chief executive officer of the Trustee has given evidence that one of three broad scenarios is likely to eventuate in the event the Trustee becomes insolvent and is thereby disqualified from acting as trustee[22]: (a) a replacement trustee is appointed; (b) the Fund is merged with another superannuation fund by way of successor fund transfer; or (c) a replacement trustee is appointed for an interim period before the Fund is merged with another fund by way of successor fund transfer.[23]

34. The transition costs to members to effect a successor fund transfer comprise direct investment-related costs, indirect investment-related costs and non-investment-related transition costs. Direct investment-related costs include broker commissions, taxes and fees expected to be incurred. Indirect investment-related transition costs reflect the forecast potential market impact of buying and selling assets, as well as the impact of market movement during the transition period. Non-investment-related transition costs are the anticipated costs of the transition of contracts, employment arrangements and administrative platforms and processes between the Trustee or Fund and a replacement trustee or fund, including associated legal costs.[24]

35. The chief executive officer has given evidence of his opinion that it is unlikely that a qualified replacement trustee would be willing to be appointed without the Proposed Amendment having been made or a similar power having been exercised, as the replacement trustee would then face the same risks that the Trustee faces.[25]

36. The Trustee has estimated these costs and received professional advice as to the reasonableness of the estimates.[26] There are further financial costs that are more difficult to quantify that would result from perceived or actual insolvency. These too have been identified and taken into consideration by the Trustee. They include the costs of obtaining short-term liquidity, by realising Fund assets at under-value, to satisfy early withdrawals and transfer and rollover requests (where members apply to transfer their benefits into other funds and this is exacerbated by reduced member inflows through lower member contributions, and the loss of employer nominations to the Fund and the loss of future merger partners). It is said there would also be the significant disruption to the business of administering the Fund, with resources dedicated to improving member outcomes being redirected to attend to the repercussions from Trustee insolvency

[21] [82]-[96], Affidavit of Justin Rowland Arter 20 October 2021, pp 17-20.
[22] s 120 SIS Act; it is an offence to be a trustee once disqualified (s 126K, SIS Act).
[23] [83], Aff. JRA 20 Oct 21, p 17.
[24] [84], Aff. JRA 20 Oct 21, pp 17-18.
[25] [88]-[90], Aff. JRA 20 Oct 21, pp 18-19.
[26] [87], Aff. JRA 20 Oct 21, p 18.

(such as liquidity, stakeholder and counterparty issues), and loss of the Trustee's significant expertise and reputation built up over many years, from which members have benefited to date.[27]

37. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed Amendment is reasonably justifiable on that basis. This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

38. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives. The parts of the material which address these matters are identified in paragraph 49 below in the context of the covenant to exercise care, skill and diligence.

39. One of the circumstances relevant to the payment of a new fee, is that the Trustee itself is restricted in its use of funds to some degree. The Trustee is an Australian proprietary company limited by shares. The purpose for which the Trustee is constituted is to act as trustee of the Fund.[28] The shares of the Trustee carry no right to a dividend.[29] The board must not at any time declare or determine a dividend, or apply any portion of the income or capital of the Trustee, to be paid or transferred directly or indirectly in any way to a shareholder of the Trustee.[30] These provisions in the Trustee's constitution do not prescribe for what uses the proceeds of the fee may be deployed, but they form part of the background to the Application.

Covenant to exercise care, skill and diligence

40. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

41. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it proposes to charge as remuneration, and that it will cease to charge remuneration once a sufficient capital reserve has been established. The Trustee commissioned an external consultant to benchmark its existing and proposed future fees to provide comfort that the fees charged to members of the Fund would still remain competitive even if the full amount of the fee were passed onto members.[31]

42. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose

[27] [92]-[93], Aff. JRA 20 Oct 21, p 19.
[28] cl 5, Articles of Association, Exhibit JRA-1, p 274.
[29] cl 6.4(b), Articles of Association, Exhibit JRA-1, p 275.
[30] cl 6.4A, Articles of Association, Exhibit JRA-1, p 275.
[31] [126], Aff. JRA 20 Oct 21, p 25; Exhibit JRA-1, pp 841-856.

a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

43. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.[32]

44. Here, the process which the Trustee has followed to quantify the target amount for trustee capital is set out in the Risk and Finance Methodology Report[33] and an opinion from an accounting firm[34]. The accounting firm has confirmed that in their view the methodology adopted for calculating the fee amount and the trustee capital cap is fair and reasonable, and consistent with the accounting firm's industry experience.

45. The Trustee conducted an analysis of the number and extent of the penalties or infringement notices under certain Commonwealth laws to which it or its directors could be subject, modified by an analysis of the likelihood that the Trustee will incur such penalties, having regard to the risk controls which the Trustee maintains to avoid contravening the law.[35] The chief executive officer has given evidence that he is not aware of any current or threatened enforcement activity that would result in a penalty being imposed on the Trustee or any directors.[36]

46. The aggregate cap on the Trustee's capital at which point the fee is not payable has been set at a higher amount which provides "an additional confidence level for the exposure range by forecasting a significant breakdown of the Fund's control environment".[37] However, there is no evidence that the Trustee's purpose is to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls or to exclude any residual risk to the Trustee.

47. The Trustee fee that is payable for each period of two years has been set at a lower amount which reflects a conservative, risk-adjusted, residual level of financial risk exposure to the Trustee and other relevant expenses proposed to be borne by

[32] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [47].
[33] Exhibit JRA-1, pp 828-840.
[34] Exhibit JRA-1, pp 781-789.
[35] [110(a)], Aff. JRA 20 Oct 21, p 22.
[36] [94], Aff. JRA 20 Oct 21, p 20.
[37] Risk and Finance Methodology Report, Exhibit JRA-1, p 829.

way of the Trustee fee net of tax.[38]

48. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The recognition of the application of the Trustee's legal obligations to the future exercise of the remuneration power is consistent with a trustee's duty of care, skill and diligence and duty to act in the best financial interest of members.[39] The Proposed Amendment itself contains such a review mechanism. The fee is subject to review every four years to ensure it remains fair and reasonable. A review that results in an adjustment to the current fee or cap on trustee capital may have regard to amounts that the Trustee *reasonably* considers necessary to appropriately compensate the Trustee for acting as trustee of the Fund and/or to appropriately compensate it for the personal financial risk it might incur.[40]

49. Finally, in order to discharge the duty of diligence, a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members.[41] That is to say, a trustee should explore:

    a) whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by investing in compliance or governance systems or upskilling. The Trustee has said it has invested significant resources in mitigating the likelihood of any Commonwealth penalties materialising, including through a robust risk management framework overseen by the Board. It has referred to its best efforts towards mitigation;[42]

    b) insurance. The Trustee has considered the availability, effectiveness and cost of insurance[43];

    c) contributions from shareholders or associated entities. The Trustee has indicated that it has contributed share capital of $15 and retained earnings of $33,695. Each shareholder has confirmed they are not in a position to commit to providing further shareholder capital.[44]; and

    d) the availability of indemnities from service providers to the Trustee.[45] The Trustee has provided details of its outsourcing arrangements and has said the position is that the Trustee remains primarily responsible for the provision of the services which the Trustee has outsourced.[46]

<u>Consideration of the conflicts covenant in assessing the Proposed Amendment</u>

50. As noted above, s 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

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[38] Risk and Finance Methodology Report, Exhibit JRA-1, p 830.
[39] *Re QSuper Board* at [44].
[40] proposed cl 1.7(d), Deed of Amendment; cf. *Re QSuper Board* at [43].
[41] *Re QSuper Board* at [48].
[42] [81], Aff. JRA 20 Oct 21, p17..
[43] [76]-[80], Aff. JRA 20 Oct 21, p 15; Affidavit of Geraldine Nora Joyce 15 October 2021.
[44] [74], Aff. JRA 20 Oct 21, p 15.
[45] cf. *Re QSuper Board* at [40(h)].
[46] [49], Aff. JRA 20 Oct 21, pp 9-10.

51. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

52. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

53. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

54. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

55. The material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting the trustee fee from the Fund's General Reserve, which has accumulated over time, rather than by increasing immediately the administration fee charged to member accounts.[47]

Confidential material

56. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. The Trustee seeks relief that would maintain the confidentiality of this material.

57. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises.

[47] [121]-[124], Aff. JRA 20 Oct 21, pp 24-25.

58. As French CJ observed in *Hogan v Hinch*[48] (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself. Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*

59. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[49]

Sean Cooper QC David Allen

Counsel for APRA
8 November 2021

[48] (2011) 243 CLR 506 at [20]
[49] *Hogan v Hinch* (2011) 243 CLR 506 at [21]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69]

IN THE SUPREME COURT OF VICTORIA
AT MELBOURNE
COMMERCIAL COURT

S ECI 2021 03668

IN THE MATTER of an application by **H.E.S.T. Australia Ltd** (ACN 006 818 695)
Plaintiff

And

IN THE MATTER of the **Health Employees Superannuation Trust Australia**

And

IN THE MATTER of **rule 54.02 of the *Supreme Court (General Civil Procedure) Rules 2015***

And

IN THE MATTER of **sections 63 and 63A of the *Trustee Act 1958***

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. By an Originating Motion dated 5 October 2021 (**Application**), the plaintiff (the **Trustee**) asks the Court to answer a question and to make orders. The question is whether the Trustee, as trustee of the Health Employees Superannuation Trust Australia (the **Plan**), is authorised to amend the trust deed dated 30 July 1987 and subsequently amended (**Trust Deed**)[1] in a specified manner. The orders sought include an order pursuant to section 63 or 63A of the *Trustee Act* 1958 (Vic) authorising the Trustee to amend the Trust Deed in the specified manner.

2. The specified amendments proposed by the Trustee are set out in a draft Deed of Amendment (the **Proposed Amendment**).[2] At the present time clause 7.1 of the Trust Deed authorises the Trustee to determine the amount of its entitlement to fees from the Plan that are reasonably necessary to recover costs and expenses, and clause 8.1 authorises the Trustee to deduct, pay or make provision from the assets of the Plan all costs and expenses that the Trustee incurs as trustee of the Plan that are not recovered through fees charged under clause 7.1. Clause 8.1 contains a list of expenses which include fees incurred in employing service providers and remuneration of the directors. The Proposed Amendment will add to the existing power of the Trustee in clause 7.1, by authorising the Trustee to determine that a trustee fee is payable to the Trustee from the Plan, provided that the Trustee's capital reserve of net tangible assets maintained in its personal

[1] The Trust Deed is in Exhibit DB-1 to the Affidavit of Deborah Jane Blakey 1 October 2021 (**DB-1**), p. 84.
[2] Confidential Exhibit DB-1, p. 484ff.

capacity, and the aggregate value of trustee fees, do not exceed specified percentages of the net assets of the Plan (proposed clause 7.3).

3. On 15 October 2021 your Honour granted leave to the Australian Prudential Regulation Authority (**APRA**) to appear as amicus curiae in the proceeding, and directed APRA to provide any outline of submissions on 12 November 2021. These are APRA's submissions.

Recent statutory and regulatory changes

4. The Trustee's evidence shows that the Proposed Amendment seeks to respond to various recent statutory and regulatory[3] changes which expose trustees of superannuation entities, and their directors, to increased risks of civil and criminal liability. Some recent statutory amendments which are of particular significance to superannuation trustees and their directors are usefully summarised in the judgment of Kelly J in *Re QSuper Board* [2021] QSC 276.[4] The risk of pecuniary liability has been raised, in particular, by three significant legislative changes.

5. First, the consequences of a breach of the statutory covenants in sections 52 and 52A of the *Superannuation Industry (Supervision) Act* 1993 (Cth) (**SIS Act**) have been changed. Section 52 sets out the covenants that are taken to be included in the governing rules for a registrable superannuation entity, including covenants by each trustee of the entity relating to honesty, due care and acting in the best financial[5] interests of beneficiaries. Section 52A sets out broadly similar covenants for directors of a corporate trustee of a registrable superannuation entity.

6. As Kelly J observed in *QSuper* (at [22]), historically a breach of the trustee covenants did not create a risk of imposition of a pecuniary penalty, but that situation changed upon the enactment of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Act* 2019 (Cth) (the **Improving Accountability Act**). That Act inserted sections 54B and 54C into the SIS Act. Section 54B(1) and (2) create statutory obligations not to contravene the covenants in sections 52 and 52A. Section 54B(3) provides that subsections (1) and (2) are civil penalty provisions for the purposes of Part 21 of the SIS Act. Consequently, a contravention of a statutory covenant creates an exposure to civil penalty orders including a monetary penalty under Part 21 Division 2 of the SIS Act or a compensation order under Division 5, or in the case of dishonest contravention, a criminal offence under Division 3. Further, any person who is involved in contravention of a statutory covenant may be taken to have contravened that covenant (section 194).

7. Second, section 766A of the *Corporations Act* defines the concept of providing a financial service. A person who provides a financial service as defined is required

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[3] See *Re QSuper Board* [2021] QSC 276 at [19]-[21], explaining how the statutory requirements to hold an RSE Licence and an AFS Licence have the effect of making the activities of a trustee of a registrable superannuation entity subject to regulation by both APRA and ASIC.

[4] The *QSuper* judgment also summarises other statutory changes which affect trustees of registrable superannuation entities and their directors: see judgment at [23] (new test for "dishonesty"), [26] (condition that an RSE licensee must not have a duty to act in the interests of another person).

[5] As discussed below, the statutory covenants for trustees and directors of a registrable superannuation entity to act in the best interests of beneficiaries were amended by the *Treasury Laws Amendment (Your Super, Your Future) Act 2021* (Cth) to become duties to act in the best *financial* interests of the beneficiaries.

by Part 7.6 of the *Corporations Act* to hold an Australian financial services licence. An Australian financial services licensee is subject to the obligations set out in Part 7.6 Division 3, including the broad obligation to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly (section 912A(1)(a)). If a person contravenes section 912A(1)(a) (or certain other obligations), they contravene section 912A(5A), which is a civil penalty provision (section 1317E). Contravention of a civil penalty provision may have the civil consequences set out in Part 9.4B of the *Corporations Act*, which include civil penalty orders and compensation orders. Further, a person who is involved in a contravention of a civil penalty provision is taken to have contravened the provision (section 1317E(4)).

8. The *Financial Sector Reform (Hayne Royal Commission Response) Act* 2020 (Cth) (the **Hayne Royal Commission Act**) amended the definition of providing a financial service by adding section 766A(1)(ec), which states that a person provides a financial service if they provide a superannuation trustee service. "Superannuation trustee service" is defined in section 766H, which states that a person provides a superannuation trustee service if the person operates a registrable superannuation entity as trustee of the entity. Hence the Hayne Royal Commission Act has exposed trustees of registrable superannuation entities, such as the Trustee, to the risk of civil penalties including pecuniary penalties and compensation orders if they contravene any of their statutory obligations as Australian financial services licensees. Directors and officers of such a trustee are exposed to those risks if they are involved in a contravention of the trustee's duties as licensee.

9. These risks were exacerbated by the enlargement of the scope of the civil penalties regime, and the increase in severity of penalties for criminal offences, enacted in the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act* 2019 (Cth).

10. Third, Sections 56 and 57 of the SIS Act currently limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund. According to section 56(2), a provision in the governing rules of a superannuation entity is void in so far as it would have the effect of exempting a trustee of the entity from, or indemnifying a trustee of the entity against, liability for breach of trust if the trustee fails to act honestly or intentionally or recklessly fails to exercise due care and diligence, or liability for a monetary penalty under a civil penalty order or for a payment under an infringement notice (section 56(2)). Section 57(2) states that a provision of the governing rules of a superannuation entity is void in so far as it has the effect of indemnifying a director of the trustee against such liabilities. According to Kelly J in the *QSuper* case (at [29]), sections 56 and 57 in their current form have been understood to allow superannuation fund trustees and their directors to indemnify themselves from all liabilities they incur by acting as a trustee or director, even if those liabilities are incurred in breach of trust, except for liabilities which are attributable to dishonest, intentional or reckless conduct or a liability with respect to a statutory penalty.

11. The Hayne Royal Commission Act has amended sections 56(2) and 57(2) (the **SIS Indemnification Amendments**) with effect from 1 January 2022, applying

in relation to liabilities imposed on or after that date.[6] The amendment to section 56(2) will extend the application of that provision so that it will apply to invalidate governing rules which purport to exempt or indemnify a trustee with respect to liability for "an amount of a criminal, civil or administrative penalty incurred by the trustee of the entity in relation to a contravention of a law of the Commonwealth". The amendment will also specify that the reference to an infringement notice is to an infringement notice "(however described) given under a law of the Commonwealth". Section 57(2), dealing with indemnifying a director of the trustee, is amended in the same fashion. Thus, bearing in mind legislative amendments exposing superannuation trustees and their directors to civil penalties under the Corporations Act (the second change discussed above), the amendments to sections 56 and 57 will prevent trustees and directors from using trust assets to pay a criminal, civil or administrative penalty incurred in relation to contravention of any Commonwealth law.[7] The Explanatory Memorandum to the Hayne Royal Commission Bill states that a contravention of a state or territory law may amount to a breach of trust for the purposes of sections 56 and 57 as amended.[8]

12. According to the chief executive officer's evidence, the Trustee lacks personal capital, and cannot rely on insurance as a complete solution to the problems posed by the recent legislative changes.[9] She gives evidence that if the Trustee does not amend the Trust Deed to let it charge a fee and hence to accumulate personal capital, there is a very real risk that the Trustee could be rendered insolvent at some point in the foreseeable future[10], even with robust compliance and risk management controls.

APRA's position on the Application

13. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and the discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[11]

14. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the Hayne Royal Commission Bill, which introduced the SIS Indemnification Amendments, the SIS Act and the RSE licensing regime are primarily designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the enactment of the Bill. For that reason, APRA submits that member outcomes are

[6] Explanatory Memorandum to the *Financial Sector Reform (Hayne Royal Commission Response) Bill* 2020, at [9.167].
[7] Op. cit., at [9.165].
[8] Op. cit., at [9.168].
[9] Aff. DJB, [61(b)], p. 18.
[10] Aff. DJB, [53], p.14.
[11] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).

a critical consideration in the determination of the Application.

15. APRA submits that the process of Trustee decision-making should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of section 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Plan and section 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises issues for the Court's consideration concerning the manner in which the Trustee proposes to amend and expand its remuneration power, and to exercise that power (including issues of intergenerational equity and the trustee's duties of impartiality under subparagraphs 52(2)(e) and (f) of the SIS Act).

The amendments to sections 56 and 57 of the SIS Act do not preclude payment of a trustee fee

16. APRA submits that the SIS Indemnification Amendments do not prohibit the outcome sought to be achieved by the Proposed Amendment. Sections 56(2) and 57(2) are directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee from, or indemnifying a trustee or director against, certain liabilities. The Proposed Amendment does not have the effect of exempting the Trustee or indemnifying the Trustee or its directors. The levying of a fee which is meant to build up over time into an asset that may be deployed by the Trustee in the event that it or a director becomes subject to a liability against which it or the director cannot be indemnified out of the Plan, does not have the substantive effect of conferring an exemption from or indemnifying against that liability.[12]

17. To recognise this is not to render sections 56 and 57 of the SIS Act pointless. The fee charged may prove to be insufficient to cover the extent of the Trustee's potential liability. The Proposed Amendment does not have the effect of excusing or extinguishing the liability of the Trustee for any amount for which it cannot be indemnified out of the Plan. The Trustee would be able to accrue capital but would not enjoy a blanket indemnity that may disincentivise it from performing its duties carefully and diligently. The Proposed Amendment would not free the Trustee or the directors from any personal non-monetary consequences in the event of breach of a statutory or general law duty or a statutory or regulatory requirement.

18. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Plan must be considered by the board in light of the directors' general law and statutory duties to act in good faith in the best interests of the Trustee[13], as well as the overriding statutory covenants of superannuation trustees and their directors under the SIS Act.

19. Sections 199A and 199B of the Corporations Act, which also apply to indemnities given by companies such as the Trustee, and insurance purchased by such

[12] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [32].
[13] Corporations Act, s 181(1)(a) and (b).

companies in respect of liabilities incurred by a person as an officer of the company, provide a useful comparison regarding the legislative policy basis for sections 56(2) and 57(2) of the SIS Act. According to the Explanatory Memorandum to the Corporate Law Reform Bill 1993 at [439], which introduced the current versions of these sections, the effect of these provisions is that a company is able, for example, to indemnify a director in a situation where the director was negligent and caused loss to a third party in his or her capacity as a director; but if the director acted without good faith, or the liability arose from conduct which was dishonest or otherwise illegal, an agreement to indemnify the indemnity would not be effective.[14]

20. Sections 56 and 57 must be understood as part of a comprehensive regulatory scheme governing participants in the superannuation industry. As noted by Kelly J, the provisions appear in a statute which has, as one of its main objects, the prudent management of superannuation funds.[15] The promotion of stability in the Australian financial system, together with the maintenance of a sound financial position by licensees, is specifically referred to. APRA has been given a broad power to set prudential standards relating to, in the words of section 34C of the SIS Act:

> "(c) the conduct by an RSE licensee of a registrable superannuation entity of the affairs of the licensee in such a way as:
> (i) to keep itself in a sound financial position; or
> (ii) not to cause or promote instability in the Australian financial system;"

21. Fairness between members is a legislative purpose that is reflected in numerous sections of the SIS Act and regulations.[16] The charging of a fee imposes an economic cost on members. However, a well-prepared fee may be designed so as to spread that cost equitably between members of the fund over time rather than imposing the entirety of the liability or loss on the cohort of members at the moment that the liability or loss crystallises. It is noteworthy that the latter situation will occur if an indemnity is granted at a particular time, and that outcome may be particularly unfair if the circumstances giving rise to the liability or loss have occurred at some significantly earlier time when the membership of the fund was substantially different. Consideration of the design of the fee is relevant to determining whether a proposed exercise of an amendment power would be consistent with a trustee's duties or obligations at general law and under the SIS Act.

22. A fee charged to members is subject to regulatory and fund member scrutiny in a way that an indemnity is not. APRA is required to undertake an annual assessment of certain superannuation fund products, including a MySuper product, under the 'Your future, Your super' reform.[17] This assessment considers the investment returns of the product net of fees and/or tax[18] and compares those returns against benchmark returns. It takes into account the actual administration

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[14] The history of sections 199A in 199B is described in *Austin & Black's Annotations to the Corporations Act* (Lexis-Nexis, looseleaf) at [2D.199A].
[15] At [32], citing SIS Act, s 3(1).
[16] For example, the covenants to act fairly in dealing with classes of beneficiaries within an entity and to act fairly in dealing with beneficiaries within a class in sections 52(2)(e) and (f).
[17] *Treasury Laws Amendment (Your Future, Your Super) Act* 2021 (Cth).
[18] SIS Act, section 60D(3).

fees and expenses charged in relation to the product being assessed. A trustee fee charged in relation to a MySuper product is likely to be characterised as an administration fee[19] and in that way taken into account. If the product fails the assessment, the trustee must notify each beneficiary that holds the product that the product has performed poorly. Separately, the fees associated with a superannuation product must be disclosed and updated in the product disclosure statement and any significant event notice (under section 1017B) required to be provided to a member in accordance with Part 7.9 of the Corporations Act.[20]

23. This leaves for consideration whether the adoption of the Proposed Amendment would contravene other duties or obligations under the general law or the SIS Act applying to trustees of superannuation funds.

Compliance with duties as trustee

24. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the Application ought to be granted. The Trustee covenants to comply with the covenants in section 52 of the SIS Act[21], and the SIS Act covenants apply despite any provision in the governing rules of an entity[22].

25. As to the general law, the relevant duties are:

    a) the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b) the duty to exercise reasonable care;

    c) the duty to preserve trust property;

    d) the duty to act impartially between the beneficiaries;

    e) the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f) the duty to avoid coming into a position of conflict of interest.

26. Trustees may come under statutory duties by a number of means under the SIS Act, including by reason of the statutory covenants expressed in s 52, covenants made under regulation (section 54A), or by reason of operating standards or prudential standards.

<u>Statutory covenants in s 52(2)</u>

27. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

    a) acting honestly in matters concerning the fund: section 52(2)(a);

    b) exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: section 52(2)(b);

    c) acting in the best financial interests of the beneficiaries when performing

[19] SIS Act, section 29V.
[20] A superannuation interest within the meaning of the SIS Act is a financial product for the purposes of Chapter 7 of the Corporations Act: section 764(1)(g).
[21] Trust Deed, cl. 3.2(a), DB-1, p. 96.
[22] SIS Act, section 7.

duties and exercising powers: section 52(2)(c);

d) in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: section 52(2)(d); and

e) acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: subparagraphs 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

28. As noted above, the *Treasury Laws Amendment (Your Future, Your Super) Act* 2021 (Cth) replaced the references to "best interest" of beneficiaries in section 52(2)(c) were replaced with references to "best financial interests" of beneficiaries, as from 1 July 2021. According to the Explanatory Memorandum, the purpose of the amendment was:

> *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations … The identification of a 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 evidence to support their expenditures.*[23]

29. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[24] where Jagot J adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of Jagot J's reasoning are at [61] to [65].

30. Those observations suggest a relatively broad and practical approach to s 52(2)(c) that focuses on financial interests. The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Jagot J's reasons, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established, may require revisiting under a best financial interests test. The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members that the trust be duly administered.[25]

31. The best financial interests duty must be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[26] The Report addressed the essential duties of responsible entities. It

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[23] Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*, [3.32]-[3.33].
[24] (2019) 138 ACSR 459.
[25] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[26] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR

characterised the best interests duty as "a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."[27] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[28]

Conflicts rules

32. Section 52(2)(d) differs from the general law duty of fiduciaries to avoid placing themselves in a position in which there is a conflict, or a real sensible possibility of a conflict, between their duty to the beneficiaries, on the one hand, and their interest or a duty to a third party, on the other hand.[29]

33. One difference between the general law and section 52(2)(d) is that the statutory provision is expressed to operate only if there is a conflict between the duties of the trustee to the beneficiaries or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee. Another difference is that in those circumstances, section 52(2)(d) imposes for specific obligations upon the trustee in response to that conflict: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; and (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

34. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members, and, in doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in subsections 52(10)-(10A).

35. Sections 52(12) and (13) impose obligations to pursue the best financial interests of MySuper and choice product members.

36. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

37. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: section 54B(3). Remedies are contained in

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167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).

[27] Cited by Justice Mark Moshinsky, 'The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework' (Conference Paper, 2018 Superannuation Conference: Order in the House, 9 March 2018), p 9.

[28] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

[29] As to the extension of the general law duty to cases of a "real sensible possibility of conflict" see *Boardman v Phipps* [1967] 2 AC 46 at 124 per Lord Upjohn, in a passage which is said to reflect the practical approach taken by Australian courts: *Ford, Austin & Ramsay's Principles of Corporations Law* (LexisNexis, looseleaf) at [9.070].

section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

38. The Your Future, Your Super amendment to the covenant in section 52(2)(c) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of members in their decision-making processes. In the material put before the Court, the Trustee has evidenced the consideration it has given to how the financial interests of members may be affected if the Proposed Amendment is not made and the Trustee becomes insolvent or faces a real risk of insolvency.[30]

39. Increases in fees charged to members or to the assets of the Plan itself will have an adverse financial impact on the retirement benefits of members over the long term. This may arise directly if the trustee fee is charged to members' accounts or indirectly, even if the fee is funded from the proceeds of existing administration fees[31], as those proceeds will no longer be available for other purposes, such as reducing administration fees in the future. The financial impact on members' retirement benefits caused by the trustee charging a new fee must be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes or may become insolvent.

40. The chief executive officer of the Trustee has given evidence of the assessment of the Trustee's executive team of a couple of scenarios that may eventuate in the event the Trustee becomes insolvent and is thereby disqualified from acting as trustee[32]: (a) an interim replacement trustee is appointed; or (b) the Plan is merged with another superannuation fund by way of successor fund transfer. The costs involved are substantial. In the case of the appointment of an interim replacement trustee, the costs estimated[33] are around half the aggregate trustee fee for the first three-year period[34]. But even then it is said to be unlikely that a new trustee will be found without some form of trustee fee at that point in any case.[35]

41. The estimated costs associated with a successor fund transfer[36] substantially exceed the aggregate trustee fee for the first three-year period. It is also deposed that a successor fund trustee is unlikely to agree to complete such a transfer if that trustee is unable to build up capital in its personal capacity from an analogous trustee fee.[37] It does not appear that the Trustee has sought professional advice as to the reasonableness of these estimates.

42. There are further financial costs that are more difficult to quantify that would result from perceived or actual insolvency. It is said that trustee insolvency also has the potential to greatly undermine the confidence of members in the Plan, leading to liquidity difficulties for the Plan and risk to counterparty

[30] Aff. DJB, [53]-[58], pp. 14-17; Estimated business costs, DB-1, pp. 375-377.
[31] as is contemplated by the Trustee: Aff. DJB, [80], p. 25.
[32] SIS Act, section 120; it is an offence to be a trustee once disqualified (SIS Act, section 126K).
[33] Aff. DJB, [55(d)], p.15.
[34] Trustee Indemnity Risk Assessment, DB-1, p. 407
[35] Aff DJB, [55(d)], p. 15.
[36] Aff. DJB, [55(e)], p. 16.
[37] Aff. DJB, [55(e)], p. 16.

arrangements.[38]

43. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed Amendment is reasonably justifiable on that basis. This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

44. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best financial interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives. The parts of the material which address these matters are identified in paragraph 58 below in the context of the covenant to exercise care, skill and diligence.

45. One of the circumstances relevant to the payment of a new fee is that the Trustee itself is restricted in its use of funds to some degree. The Trustee is an Australian company limited by guarantee.[39] The principal object of the Trustee is to act solely as the trustee for a registrable superannuation entity.[40] It will apply its profits (if any) or other income in promoting its objects and will not carry on its activities for the purpose of profit or gain to its guarantors.[41]

46. The Proposed Amendment requires that the Trustee must disclose to members of the Plan on an annual basis any payments out of what will be termed the Trustee Capital Reserve in the previous financial year.[42] The board of the Trustee resolved on 22 September 2021 to adopt a capital reserve governance framework in respect of the proceeds of the trustee fee.[43] Any payments from the trustee capital reserve must be authorised by the board.[44] The reserve can be applied to pay any amount the Trustee reasonably considers is necessary or desirable to pay in discharging liabilities or managing any personal financial risk of the Trustee in connection with its role as trustee of the Plan, and any director or officer of the Trustee in connection with their role as director or officer of the Trustee, to the extent that the Trustee can indemnify the director under the Corporations Act.[45]

<u>Covenant to exercise care, skill and diligence</u>

47. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's submission, it should be taken into account when considering the form and content of any such proposal, in at least the following ways.

48. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it

[38] Aff. DJB, [56], p. 16.
[39] Trustee Constitution, cl. 1.2(a), DB-1, p. 176.
[40] Trustee Constitution, cl. 1.4, DB-1, p. 176.
[41] Trustee Constitution, cl. 1.2(c)-(d), DB-1, p. 176. The "guarantors" are the members of the company (as opposed to the members of the Plan).
[42] Deed of Amendment, proposed cl. 7.3(b)(iv), DB-1, p. 489.
[43] Aff. DJB, [64], p. 20.
[44] Trustee Capital Reserve Governance Framework, DB-1, p. 514.
[45] Trustee Capital Reserve Governance Framework, DB-1, p. 514.

proposes to charge as remuneration, and that it will cease to charge a fee once a sufficient capital reserve has been established. The Trustee has obtained a benchmark report that shows that the Plan's level of operating expenses, relative to the size of its membership base and assets, is positioned below industry medians.[46] Given that payment of the proposed fee is to be made out of existing Plan reserves, the Plan's board and executive are satisfied that the introduction of the proposed fee will not detract from members' value-for-money.[47]

49. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities that are not able to be indemnified, and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

50. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.[48]

51. Here, the process which the Trustee has followed to quantify the cap amount for the trustee fee is set out in the Trustee Indemnity Risk Assessment[49] and a review from an accounting firm[50]. The accounting firm has confirmed that in their view the methodology adopted for calculating the fee amount and the trustee capital cap is fair and reasonable, and consistent with industry practice.[51]

52. The quantified exposure range in the Trustee Indemnity Risk Assessment does not take into account personal financial risks associated with general trust law and existing limitations on the Trustee's right of indemnity out of Trust assets under the SIS Act and the Trust Deed. It is acknowledged that this (along with other limits in the modelling approach taken – eg, the assumption that there will be a single penalty per incident) will almost certainly lead to a calculation of the exposure range which is materially lower than the personal financial risk which the Trustee faces in reality.[52]

53. The cap amount for the trustee fee was also sized based on what is described as

[46] Aff. DJB, [81], p. 26.
[47] Aff. DJB, [81], p. 26.
[48] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [47].
[49] DB-1, pp. 388 to 462.
[50] Review of Trustee Capital Estimates, DB-1, pp. 501-505.
[51] Review of Trustee Capital Estimates, DB-1, p. 504.
[52] Trustee Indemnity Risk Assessment, DB-1, p. 403.

the accounting firms' 'medium 95th percentile scenario' produced by stochastic modelling.[53] This is an amount sufficient to cover 95% of possible events in a medium scenario where risk of breach of Acts and imposition of fines or penalties is still relatively low and the Trustee's risk management, compliance and other frameworks remain in place. However, the approach shows that factors like, for example, business complexity, substantial workforce growth or breakdown in operational processes could lead to an incident which triggers a breach and fine/penalty event.[54]

54. The chief executive officer has given evidence that the Trustee has received no quantitatively significant fine or penalty, nor been involved in any major incident it considers could give rise to the material risk of enforcement action.[55]

55. There is no evidence that the Trustee's purpose is to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls[56] or to exclude any residual risk to the Trustee.

56. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The Proposed Amendment limits the amount that can be charged by way of trustee fee by reference to the amount of the fee in each three-year period and to a cap on the Trustee's capital reserve. Those caps have been justified by reference to the material put before the Court in connection with the Application. Otherwise, it is left to the Trustee to determine the amount of the fee payable to the Trustee from time to time.[57]

57. The Court may consider that it is appropriate and important for the purpose of the Court providing the advice sought by the Application to recognise that the Trustee's legal obligations under the SIS Act and at general law are applicable to the future exercise of the fee charging power[58]. Notwithstanding the inclusion of the caps, the requirement that the Trustee make a determination in accordance with its covenants at each point in time that it determines to charge a fee is an important review mechanism inherent in the Proposed Amendment. If in the coming years the observed incidence of penalties imposed on superannuation trustees is less frequent or for lower amounts than expected, or if the availability and responsiveness of insurance for penalties becomes broader than expected, other things being equal, a prudent trustee acting in the best financial interests of members would charge a lower trustee fee.

58. Finally, in order to discharge the duty of diligence, a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members.[59] That is to say, a trustee should explore:

    a) whether the risks of liabilities of the kind which are thought likely to arise

[53] Trustee Indemnity Risk Assessment, DB-1, p. 407.
[54] Trustee Indemnity Risk Assessment, DB-1, p. 399.
[55] Aff. DJB, [43], p. 11.
[56] The Trustee's investment in risk management is described at Aff. DJB, [44]-[46], pp. 11-12.
[57] Deed of Amendment, proposed cl. 7.3(a), DB-1, p. 489.
[58] cf *Re QSuper Board* [2021] QSC 276 (Kelly J) at [44].
[59] *Re QSuper Board* at [48].

could be mitigated or reduced by investing in compliance or governance systems or upskilling. The chief executive officer has given evidence about the Trustee's robust risk management and compliance framework and the Trustee's devotion of substantial resources towards risk management and compliance[60];

b) insurance: the Trustee has considered the availability, effectiveness and cost of insurance[61] and has obtained legal advice on that topic[62];

c) contributions from members of the company or associated entities: it is said that the Trustee's guarantors are unions and employer representative organisations that are subject to constitutional limitations on the use of their own members' funds. Without a return on any capital provided to the Trustee, it is not feasible for the guarantors to contribute capital towards a reserve[63]; and

d) the availability of indemnities from service providers to the Trustee:[64] the Trustee has said that it employs other service providers[65] but it has not put before the Court any material to enable the Court to assess to what extent indemnities from service providers may mitigate the risk of the Trustee's insolvency due to the imposition of a Commonwealth penalty.

Consideration of the conflicts covenant in assessing the Proposed Amendment

59. As noted above, section 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

60. APRA does not contend that this aspect of the covenant is breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. The covenant needs to be given a sensible operation. Section 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. The language of the covenant presupposes that a conflict exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person.

61. Where a trustee has a personal interest in a matter, complying with the duty in section 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with section 52(2)(d)(i), and also with subparagraphs 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

62. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of

[60] Aff. DJB, [44]-[46], pp. 11-12
[61] Aff. DJB [61(b)], p. 18; Affidavit of Sean Lindsay 30 September 2021.
[62] Aff. DJB, [49(d)], p. 13.
[63] Aff. DJB [61(d)], p. 18.
[64] cf. *Re QSuper Board* at [40(h)].
[65] Aff. DJB [30], p. 7.

a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

63. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

64. The material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting the trustee fee from the Plan's reserve, which has accumulated over time from historical administration fees, rather than by increasing immediately the administration fee charged to member accounts. It is said that this provides the best means of achieving intergenerational fairness between members of the Plan.[66]

Confidential material

65. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. The Trustee seeks relief that would maintain the confidentiality of this material.

66. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises.

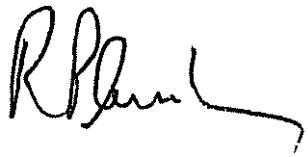
67. As French CJ observed in *Hogan v Hinch*[67] (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself. Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*

68. It is submitted that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Plan against the normal requirement that evidence deployed in legal proceedings is deployed openly.[68] Where the subject matter of an application may be of wide community

[66] Aff. DJB, [80(c)], p. 26.
[67] (2011) 243 CLR 506 at [20]
[68] *Hogan v Hinch* (2011) 243 CLR 506 at [21]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69]

concern, the interests of justice may require that all material aspects of the factual basis of the Court's decision are openly set out in the Court's reasons for judgment.



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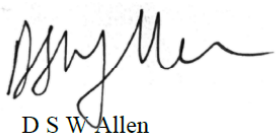

D S W Allen

Counsel for APRA
12 November 2021

IN THE SUPREME COURT OF VICTORIA

AT MELBOURNE

COMMERCIAL COURT

S ECI 2021 03963

IN THE MATTER of an application by **CARE SUPER PTY LTD (ABN 91 006 670 060) (IN ITS CAPACITY AS TRUSTEE OF CARE SUPER (ABN 98 172 275 725))** for judicial advice and directions under **rule 54.02 of the *Supreme Court (General Civil Procedure) Rules 2015***

Plaintiff

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. By an Originating Motion filed 26 October 2021 (**Application**), the plaintiff (the **Trustee**) asks the Court for the determination of certain questions pursuant to rule 54.02 of the Supreme Court (General Civil Procedure) Rules 2015. The questions include whether the Trustee, as trustee of Care Super (the **Fund**), is justified in proceeding on the basis that it is fair and reasonable to determine the amount payable to the Trustee in respect of its provision of services as Trustee of the Fund having regard to, among other relevant considerations, a risk that, from 1 January 2022, the Trustee might incur a liability for an amount of a criminal, civil, or administrative penalty in relation to a contravention of a law of the Commonwealth, or an amount payable under an infringement notice given under a law of the Commonwealth, being a liability against which, by reason of s 56(2) of the *Superannuation Industry (Supervision) Act* 1993 (Cth) (as amended) (**SIS Act**), the Trustee cannot be indemnified from the assets of the Fund (the **Proposed Fee Determination**).

2. The question arises in the execution of the trust provided for under a consolidated **Trust Deed**.[1] On the existing terms of the Fund, the Trustee may be remunerated for the bona fide provision of services to the Fund on such basis as the Trustee determines to be fair and reasonable.[2] The Trustee has the specific power to pay and advance out of the Fund the professional fees (if any) in respect of the

[1] The terms of the trust are set out in a deed of consolidation dated February 2019 read together with a deed of amendment dated 24 March 2020: First Affidavit of Julie Hermine Lander affirmed 25 October 2021 (**JHL-1**), p 3, [13], Exhibit JHL-1, pp 33-93.
[2] cl. 2.8(d), Exhibit JHL-1, p 50.

provision of its services as Trustee of the Fund.[3]

3. The specific manner in which the Trustee proposes to exercise its fee charging power is set out in a written resolution of the directors of the Trustee approved on 10 November 2021.[4] Subject to the outcome of this Application, the directors resolved that there would be a fair and reasonable basis for the Trustee to charge a fee for the current financial year in an amount calculated as a specified percentage of fund assets as at 30 September 2021.[5] The amount of the fee has been calculated so as to capitalise a 'Trustee's Resilience Reserve' up to a target amount based on modelling of the aggregate amount of Commonwealth penalties that could with some degree of probability be imposed on the Trustee, among other factors.[6] Any fee is to be paid out of the General Reserve of the Fund.[7]

4. On 4 November 2021 Riordan J directed APRA to file and serve any written outline of submissions in response to the Application. These are APRA's submissions. APRA will seek further leave to appear as *amicus curiae* at the hearing of the proceeding.

Recent statutory and regulatory changes

5. The Trustee's evidence shows that the Proposed Amendment seeks to respond to various recent statutory and regulatory[8] changes which expose trustees of superannuation entities, and their directors, to increased risks of civil and criminal liability. Some recent statutory amendments which are of particular significance to superannuation trustees and their directors are usefully summarised in the judgment of Kelly J in *Re QSuper Board* [2021] QSC 276.[9] The risk of pecuniary liability has been raised, in particular, by three significant legislative changes.

6. First, the consequences of a breach of the statutory covenants in sections 52 and 52A of the SIS Act have been changed.[10] Section 52 sets out the covenants that are taken to be included in the governing rules for a registrable superannuation entity, including covenants by each trustee of the entity relating to honesty, due

[3] cl. 2.8(a)(xvi), Exhibit JHL-1, p 50.
[4] Fourth Affidavit of Mark Albert Bland affirmed 10 November 2021 (**MAB-4**), p 9, [31]. In APRA's submission, the Trustee should put a copy of the directors' resolution into evidence.
[5] Confidential Exhibit MAB-3 to the Fourth Affidavit of Mark Albert Bland affirmed 10 November 2021 (**Confidential Exhibit MAB-3**), p 70, resolution (g).
[6] Confidential Exhibit MAB-3, pp 69-70, resolution (b) and (d).
[7] *ibid.*, resolution (h).
[8] See *Re QSuper Board* [2021] QSC 276 at [19]-[21], explaining how the statutory requirements to hold an RSE Licence and an AFS Licence have the effect of making the activities of a trustee of a registrable superannuation entity subject to regulation by both APRA and ASIC.
[9] The *QSuper* judgment also summarises other statutory changes which affect trustees of registrable superannuation entities and their directors: see judgment at [23] (new test for "dishonesty"), [26] (condition that an RSE licensee must not have a duty to act in the interests of another person).
[10] cf. First Affidavit of Mark Albert Bland affirmed 25 October 2021 (**MAB-1**), p 8, [33].

care and acting in the best financial[11] interests of beneficiaries. Section 52A sets out broadly similar covenants for directors of a corporate trustee of a registrable superannuation entity.

7. As Kelly J observed in *QSuper* (at [22]), historically a breach of the trustee covenants did not create a risk of imposition of a pecuniary penalty, but that situation changed upon the enactment of the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No 1) Act* 2019 (Cth) (the **Improving Accountability Act**). That Act inserted sections 54B and 54C into the SIS Act. Section 54B(1) and (2) create statutory obligations not to contravene the covenants in sections 52 and 52A. Section 54B(3) provides that subsections (1) and (2) are civil penalty provisions for the purposes of Part 21 of the SIS Act. Consequently, a contravention of a statutory covenant creates an exposure to civil penalty orders including a monetary penalty under Part 21 Division 2 of the SIS Act or a compensation order under Division 5, or in the case of dishonest contravention, a criminal offence under Division 3. Further, any person who is involved in contravention of a statutory covenant may be taken to have contravened that covenant (section 194).

8. Second, section 766A of the *Corporations Act* defines the concept of providing a financial service.[12] A person who provides a financial service as defined is required by Part 7.6 of the *Corporations Act* to hold an Australian financial services licence. An Australian financial services licensee is subject to the obligations set out in Part 7.6 Division 3, including the broad obligation to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly (section 912A(1)(a)). If a person contravenes section 912A(1)(a) (or certain other obligations), they contravene section 912A(5A), which is a civil penalty provision (section 1317E). Contravention of a civil penalty provision may have the civil consequences set out in Part 9.4B of the *Corporations Act*, which include civil penalty orders and compensation orders. Further, a person who is involved in a contravention of a civil penalty provision is taken to have contravened the provision (section 1317E(4)).

9. The *Financial Sector Reform (Hayne Royal Commission Response) Act* 2020 (Cth) (the **Hayne Royal Commission Act**) amended the definition of providing a financial service by adding section 766A(1)(ec), which states that a person provides a financial service if they provide a superannuation trustee service.

[11] As discussed below, the statutory covenants for trustees and directors of a registrable superannuation entity to act in the best interests of beneficiaries were amended by the *Treasury Laws Amendment (Your Super, Your Future) Act 2021* (Cth) to become duties to act in the best *financial* interests of the beneficiaries.
[12] cf. MAB-1, p 4, [17].

"Superannuation trustee service" is defined in section 766H, which states that a person provides a superannuation trustee service if the person operates a registrable superannuation entity as trustee of the entity. Hence the Hayne Royal Commission Act has exposed trustees of registrable superannuation entities, such as the Trustee, to the risk of civil penalties including pecuniary penalties and compensation orders if they contravene any of their statutory obligations as Australian financial services licensees. Directors and officers of such a trustee are exposed to those risks if they are involved in a contravention of the trustee's duties as licensee.

10. These risks were exacerbated by the enlargement of the scope of the civil penalties regime, and the increase in severity of penalties for criminal offences, enacted in the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act* 2019 (Cth).[13]

11. Third, Sections 56 and 57 of the SIS Act currently limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund. According to section 56(2), a provision in the governing rules of a superannuation entity is void in so far as it would have the effect of exempting a trustee of the entity from, or indemnifying a trustee of the entity against, liability for breach of trust if the trustee fails to act honestly or intentionally or recklessly fails to exercise due care and diligence, or liability for a monetary penalty under a civil penalty order or for a payment under an infringement notice (section 56(2)). Section 57(2) states that a provision of the governing rules of a superannuation entity is void in so far as it has the effect of indemnifying a director of the trustee against such liabilities. According to Kelly J in the *QSuper* case (at [29]), sections 56 and 57 in their current form have been understood to allow superannuation fund trustees and their directors to indemnify themselves from all liabilities they incur by acting as a trustee or director, even if those liabilities are incurred in breach of trust, except for liabilities which are attributable to dishonest, intentional or reckless conduct or a liability with respect to a statutory penalty.

12. The Hayne Royal Commission Act has amended sections 56(2) and 57(2) (the **SIS Indemnification Amendments**) with effect from 1 January 2022, applying in relation to liabilities imposed on or after that date.[14] The amendment to section 56(2) will extend the application of that provision so that it will apply to invalidate governing rules which purport to exempt or indemnify a trustee with respect to liability for "an amount of a criminal, civil or administrative penalty incurred by the trustee of the entity in relation to a contravention of a law of the

[13] cf. MAB-1, p 16, [68].
[14]Explanatory Memorandum to the *Financial Sector Reform (Hayne Royal Commission Response) Bill* 2020, at [9.167].

Commonwealth".[15] The amendment will also specify that the reference to an infringement notice is to an infringement notice "(however described) given under a law of the Commonwealth". Section 57(2), dealing with indemnifying a director of the trustee, is amended in the same fashion. Thus, bearing in mind legislative amendments exposing superannuation trustees and their directors to civil penalties under the Corporations Act (the second change discussed above), the amendments to sections 56 and 57 will render void a provision of the governing rules of a superannuation entity in so far as it would have the effect of indemnifying trustees and directors against criminal, civil or administrative penalties incurred in relation to contravention of any Commonwealth law. The Explanatory Memorandum to the Hayne Royal Commission Bill states that a contravention of a state or territory law may amount to a breach of trust for the purposes of sections 56 and 57 as amended.[16]

13. According to the chief executive officer's evidence, the Trustee's policy historically has been to exercise its rights to charge fees for cost recovery but not to derive any income from fees.[17] The Trustee has liquid assets of $60. It is said that if the Trustee incurs a penalty or fine for a contravention of a Commonwealth law after 1 January 2022 there is a significant risk that the Trustee could become insolvent or unable to carry on its business in the ordinary course and in accordance with its duties as trustee of the Fund.[18] The Trustee has formed the view it would be in the best financial interests of members to determine the basis for charging a trustee fee by reference to the risks of non-indemnified liabilities.[19]

APRA's position on the Application

14. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and the discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[20]

15. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the Hayne Royal Commission Bill, which introduced the SIS Indemnification Amendments, the SIS Act and the RSE licensing regime are primarily designed with prudential supervision in mind. This means the focus

[15] cf. MAB-1 pp15-16, [65]-[67].
[16] Op. cit., at [9.168].
[17] JHL-1, p 11, [48].
[18] JHL-1, p 13, [59].
[19] JHL-1, p 15, [66].
[20] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).

of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the enactment of the Bill. For that reason, APRA submits that member outcomes are a critical consideration in the determination of the Application.

16. APRA submits that the process of Trustee decision-making should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of section 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Fund and section 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises issues for the Court's consideration concerning the manner in which the Trustee proposes to exercise its remuneration power (including issues of intergenerational equity and the trustee's duties of impartiality under subparagraphs 52(2)(e) and (f) of the SIS Act).

The effect of the amendments to sections 56 of the SIS Act

17. The natural and ordinary meaning of the words of section 56 is that:

    a) by section 56(1), not only may the governing rules of a superannuation entity indemnify a trustee for liability incurred while acting as trustee, but, subject to particular restrictions, any governing rule that purports to preclude or limit the extent of an indemnity is void; and

    b) by section 56(2), a provision in the governing rules is void **in so far as** it **[that provision in the governing rules]** would have the **effect** of exempting or indemnifying the trustee against particular liabilities is void, the breadth of which is expanded by the SIS Indemnification Amendments;

18. The relevant provisions of the governing rules in this Application are cl. 2.8(a)(xvi) and 2.8(d).

19. APRA submits that the SIS Indemnification Amendments would not result in clauses 2.8(a)(xvi) and 2.8(d) of the Trust Deed being void to the extent the Trustee relies upon them to make the Proposed Fee Determination. Section 56(2) is directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee from, or indemnifying a trustee or director against, certain liabilities. The levying of a fee which is meant to capitalise a reserve that may be deployed by the Trustee in the event that it becomes subject to a liability against which it cannot be indemnified out of the Fund, is conceptually distinct from a provision that has the effect of exemption

from or indemnifying against that liability.[21]

20. It is presumed that Parliament does not intend to enact legislation with consequences that can be described as inconvenient or improbable. If two constructions of a provision are open, the court will prefer that which avoids such consequences.[22] If the Trustee's *purpose* in making the Proposed Fee Determination could result in the *effect* of a fee-charging provision in the governing rules of a superannuation entity becoming void to some extent, it would have the inconvenient or improbable consequence that the exercise of any fee-charging power by a superannuation trustee could be held to be void (exposing the Trustee to claims for breach of trust) if the Trustee applies the proceeds of a fee towards payment of Commonwealth penalties. The Court may take notice of the fact that the charging of fees is a feature of the superannuation system, and many if not most trustees will be capitalised, at least in part, from retained earnings from the charging of fees.

21. There is already provision in the SIS Act for the charging of fees to be regulated directly, where that is the legislative intention. The fee rules for MySuper Products are contained in Part 2C Division 5 of the SIS Act. A trustee must consider fees when it makes its annual determination whether the financial interests of the beneficiary are being promoted by the trustee (section 52 (9), (10), (10A)); similarly, it must consider fees under its covenant to promote returns to beneficiaries after the deduction of fees, costs and taxes (section 52 (12)). The regulations may prescribe standards applicable to RSE Licensees relating to the charging of fees (section 31(2)(da)).

22. It is notable that section 56 is not expressed in terms as broad as the corresponding section of the *Corporations Act* that deals with limits on indemnification and exemption (section 199A). That section contains a prohibition on indemnification by the company and is not directed only to the provisions of a company's constitution like section 56. It also is expressed to apply to indemnification *whether directly or through an interposed entity*. The language chosen for section 56 is limited by comparison.

23. A construction of section 56 that treats that provision as only applying to governing rules that themselves have the effect of indemnifying a Trustee is consistent with the intention of the legislature. The critical question is whether the legislative intention in enacting the SIS Indemnification Amendments, in the context of the other changes discussed above, extends to rendering unlawful any

[21] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [32].
[22] *CIC Insurance Ltd v Bankstown Football Club Ltd* (1997) 187 CLR 384 at 408 (Brennan CJ, Dawson, Toohey and Gummow JJ), cited among other cases in Herzfeld and Prince *Interpretation*, 2nd edition (2020) at [9.30].

means by which a trustee may augment its own capital so as to be able to discharge a non-indemnifiable liability, in particular by charging a fee, so long as the means by which it does so do not otherwise contravene basic principles governing the conduct of trustees.

24. A fee charged to members is subject to regulatory and fund member scrutiny in a way that a provision for an indemnity in the governing rules of a superannuation entity is not. APRA is required to undertake an annual assessment of certain superannuation fund products, including a MySuper product, under the 'Your future, Your super' reforms.[23] This assessment considers the investment returns of the product net of fees and/or tax[24] and compares those returns against benchmark returns. It takes into account the actual administration fees and expenses charged in relation to the product being assessed. A trustee fee charged in relation to a MySuper product is likely to be characterised as an administration fee[25]. If the product fails the assessment, the trustee must notify each beneficiary that holds the product that the product has performed poorly.

25. There is a comprehensive body of regulation for the disclosure of fees that does not apply to indemnities. The fees associated with a superannuation product must be disclosed and updated in the product disclosure statement or any significant event notice (under section 1017B) required to be provided to a member in accordance with Part 7.9 of the Corporations Act.[26]

26. Fairness between members is a legislative purpose that is reflected in numerous sections of the SIS Act and regulations.[27] The charging of a fee imposes an economic cost on members. However, a fee may be designed so as to spread that cost equitably between members of the fund over time rather than imposing the entirety of the liability or loss on the cohort of members at the moment that the liability or loss crystallises. It is noteworthy that the latter situation will occur if a provision of the governing rules has the effect of indemnifying a trustee, and that outcome may be particularly unfair if the circumstances giving rise to the liability or loss have occurred at some significantly earlier time when the membership of the fund was substantially different.

27. Section 56 must be understood as part of a comprehensive regulatory scheme governing participants in the superannuation industry. As noted by Kelly J, the provisions appear in a statute which has, as one of its main objects, the prudent

[23] *Treasury Laws Amendment (Your Future, Your Super) Act* 2021 (Cth).
[24] SIS Act, section 60D(3).
[25] SIS Act, section 29V.
[26] A superannuation interest within the meaning of the SIS Act is a financial product for the purposes of Chapter 7 of the Corporations Act: section 764(1)(g).
[27] For example, the covenants to act fairly in dealing with classes of beneficiaries within an entity and to act fairly in dealing with beneficiaries within a class in sections 52(2)(e) and (f).

management of superannuation funds.[28] The promotion of stability in the Australian financial system, together with the maintenance of a sound financial position by licensees, is specifically referred to. APRA has been given a broad power to set prudential standards relating to, in the words of section 34C of the SIS Act:

> "(c) the conduct by an RSE licensee of a registrable superannuation entity of the affairs of the licensee in such a way as:
>
> (i) to keep itself in a sound financial position; or
>
> (ii) not to cause or promote instability in the Australian financial system;"

Compliance with duties as trustee

28. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the Application ought to be granted. The SIS Act covenants apply despite any provision in the governing rules of an entity[29] and the governing rules are taken to include the SIS Act covenants[30].

29. As to the general law, the relevant duties are:

    a) the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b) the duty to exercise reasonable care;

    c) the duty to preserve trust property;

    d) the duty to act impartially between the beneficiaries;

    e) the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f) the duty to avoid coming into a position of conflict of interest.

30. Trustees may come under statutory duties by a number of means under the SIS Act, including by reason of the statutory covenants expressed in s 52, covenants made under regulation (section 54A), or by reason of operating standards or prudential standards.

[28] At [32], citing SIS Act, s 3(1).
[29] SIS Act, section 7.
[30] SIS Act, section 52(1).

Statutory covenants in s 52(2)

31. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

    a) acting honestly in matters concerning the fund: section 52(2)(a);

    b) exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: section 52(2)(b);

    c) acting in the best financial interests of the beneficiaries when performing duties and exercising powers: section 52(2)(c);

    d) in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: section 52(2)(d); and

    e) acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: subparagraphs 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

32. As noted above, the *Treasury Laws Amendment (Your Future, Your Super) Act* 2021 (Cth) replaced the references to "best interest" of beneficiaries in section 52(2)(c) were replaced with references to "best financial interests" of beneficiaries, as from 1 July 2021. According to the Explanatory Memorandum, the purpose of the amendment was:

    > *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations … The identification of a 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 evidence to support their expenditures.*[31]

33. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[32] where Jagot J adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is

[31] Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*, [3.32]-[3.33].
[32] (2019) 138 ACSR 459.

breached. The relevant parts of Jagot J's reasoning are at [61] to [65].

34. Those observations suggest a relatively broad and practical approach to s 52(2)(c) that focuses on financial interests. The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Jagot J's reasons, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established, may require revisiting under a best financial interests test. The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members that the trust be duly administered.[33]

35. The best financial interests duty must be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[34] The Report addressed the essential duties of responsible entities. It characterised the best interests duty as "a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."[35] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[36]

Conflicts rules

36. Section 52(2)(d) differs from the general law duty of fiduciaries to avoid placing themselves in a position in which there is a conflict, or a real sensible possibility of a conflict, between their duty to the beneficiaries, on the one hand, and their interest or a duty to a third party, on the other hand.[37]

37. One difference between the general law and section 52(2)(d) is that the statutory provision is expressed to operate only if there is a conflict between the duties of

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[33] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[34] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).
[35] Cited by Justice Mark Moshinsky, 'The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework' (Conference Paper, 2018 Superannuation Conference: Order in the House, 9 March 2018), p 9.
[36] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).
[37] As to the extension of the general law duty to cases of a "real sensible possibility of conflict" see *Boardman v Phipps* [1967] 2 AC 46 at 124 per Lord Upjohn, in a passage which is said to reflect the practical approach taken by Australian courts: *Ford, Austin & Ramsay's Principles of Corporations Law* (LexisNexis, loose-leaf) at [9.070].

the trustee to the beneficiaries or the interests of the beneficiaries, and the duties of the trustee to any other person or the interests of the trustee or an associate of the trustee. Another difference is that in those circumstances, section 52(2)(d) imposes four specific obligations upon the trustee in response to that conflict: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; and (ii) to ensure that the duties to the beneficiaries are met despite the conflict; and (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

38. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members, and, in doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in subsections 52(10)-(10A).

39. Sections 52(12) and (13) impose obligations to pursue the best financial interests of MySuper and choice product members.

40. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

41. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: section 54B(3). Remedies are contained in section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

42. The Your Future, Your Super amendment to the covenant in section 52(2)(c) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of fund members in their decision-making processes. In the material put before the Court, the Trustee has not evidenced the consideration it has given to how the financial interests of members may be affected if the Proposed Fee Determination is not made and as a result the Trustee faces a heightened risk of insolvency or becomes insolvent.

43. Increases in fees charged to fund members or to the assets of the Fund will have an adverse financial impact on the retirement benefits of members over the long

term. This may arise directly if the trustee fee is charged to members' accounts or indirectly, if the fee is funded from a reserve maintained by the Fund[38], as those proceeds will no longer be available for other purposes, such as reducing administration fees in the future[39]. The financial impact on members' retirement benefits caused by the trustee charging a new fee to capitalise a trustee reserve must be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, may become or becomes insolvent.

44. APRA is concerned that the Trustee appears to have assumed that accepting the Trustee's residual risk of insolvency at the level that will pertain after commencement of the SIS Indemnification Amendments, and after accounting for the mitigating effects of insurance[40] and the Trustee's risk management strategy,[41] will necessarily not be in the best financial interests of members, in comparison with the Trustee making the Proposed Fee Determination.

45. If a trustee becomes insolvent it is thereby disqualified from acting as trustee of a superannuation entity.[42] The office of trustee of the Fund automatically becomes vacant pursuant to the Trust Deed.[43] The Trustee can then be replaced[44] or it could result in the Fund being amalgamated with another fund pursuant to Part 18 of the SIS Act.

46. The disruption and transition costs associated with the insolvency of a superannuation trustee may, in many circumstances, significantly outweigh the costs to be borne by the fund members through the imposition of a fee of a similar order of magnitude to the Proposed Fee Determination. However, in APRA's submission, that outcome is not something that can be assumed by the Trustee (if that is what has occurred) without proper consideration by the Trustee and without advice or evidence from appropriately qualified experts or industry participants. That advice or evidence should quantify the likely financial impact on fund members that can reasonably be expected to arise out of or in connection with the replacement of the Trustee or the amalgamation of the Fund.

47. The Trustee has considered this factor at least insofar as the directors of the

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[38] as is contemplated by the Trustee: Confidential Exhibit MAB-3, pp 69-70, resolution (h).
[39] The trustee of a regulated superannuation fund may refund, to a member's benefits in the fund, costs charged against the member's benefits: Superannuation Industry (Supervision) Regulations 1994, regulation 5.02C.
[40] cf. JHL-1, p 14, [63(e)].
[41] Required to be maintained in accordance with SIS Act, section 52(8).
[42] SIS Act, section 120; it is an offence to be a trustee once disqualified (SIS Act, section 126K).
[43] Trust Deed, cl. 2.2(d), Exhibit JHL-1, p 46.
[44] The Fund may be administered by some other corporation which replaces the Trustees (complying with any rules as to equal representation of Members and Employers): Trust Deed, cl. 2.1, Exhibit JHL-1, p 46.

Trustee have adopted a Trustee Resilience Policy[45] that includes as a relevant circumstance for the determination of a trustee fee to capitalise the Trustee Resilience Reserve, "Whether the Trustee considers that it is in the best financial interests of members to undertake a successor fund transfer to another registrable superannuation entity"[46]. Another relevant circumstance specified in the Policy is, "Any financial interest of members of the Fund in the Trustee being required to be replaced …".[47]

48. As *Kelaher* holds, the question for a Court in scrutinising the performance of the covenant to act in the best financial interests of fund members is not what is in fact in the best financial interests of the fund members (if that could be determined), but whether the decision of the Trustee is reasonably justifiable on that basis. This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

49. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best financial interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Fee Determination without considering the alternatives. The parts of the material which do address these matters are identified in paragraph 65 below in the context of the covenant to exercise care, skill and diligence.

50. Another circumstance relevant to whether the Proposed Fee Determination is in the best financial interests of fund members is that the Trustee is restricted in its use of funds to some degree. The Trustee is an Australian proprietary company limited by shares.[48] The Trustee is prohibited from distributing the income or capital of the Trustee to the shareholders, including by way of payment of dividends.[49] Shares can only be transferred at a nominal price.[50] If the Trustee is wound up or dissolved, any surplus assets or property of the Trustee available for distribution after satisfaction of all debts and liabilities must be transferred to the Fund for the benefit of the beneficiaries of the Fund.[51]

51. The objects of the Trustee are not limited under the Trustee Constitution.[52] The Trustee Resilience Policy is a document adopted by the board of CARE Super Pty Ltd that is "wholly and solely for internal use" by CARE Super Pty Ltd.[53]

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[45] MAB-4, p 9, [31]; Resolution (a), Confidential Exhibit MAB-3, p 69.
[46] Confidential Exhibit MAB-3, p 83, cl. 1.13.
[47] Trustee Resilience Policy, cl. 7.2, Confidential Exhibit MAB-3, p 87.
[48] Trustee Constitution, cl. 2, Exhibit JHL-1, p 201.
[49] Trustee Constitution, cl. 4.6, Exhibit JHL-1, p 203.
[50] Trustee Constitution, cl. 10.6, Exhibit JHL-1, p 205.
[51] Trustee Constitution, cl. 34.2, Exhibit JHL-1, p 222.
[52] Trustee Constitution, Exhibit JHL-1, pp 194-222.
[53] Trustee Resilience Policy, Confidential Exhibit MAB-3, p 74.

The Reserve may be utilised to meet various financial commitments or for expenses of the Trustee or Fund.[54]

52. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Fund must be considered by the board in light of the directors' general law and statutory duties to act in good faith in the best interests of the Trustee[55]. The limits in sections 199A and 199B of the Corporations Act on the scope of indemnities given by companies and insurance paid for by companies in respect of liabilities incurred by a person as an officer of the company would apply.

Covenant to exercise care, skill and diligence

53. In APRA's submission, the duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the exercise of a fee-charging power to capitalise a trustee reserve but should be taken into account when considering the form and content of any such proposal, in at least the following ways.

54. *First*, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it proposes to charge as remuneration, and that it will cease to charge a fee once a sufficient capital reserve has been established.[56] The Trustee has reviewed its analysis of comparable superannuation trustee fee structures.[57] The Trustee Resilience Policy includes as a relevant consideration, "The level of administration costs and fees payable by members of other registrable entities over time, relative to that which would apply to the Trustee"[58]

55. *Secondly*, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities that are not able to be indemnified, and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against the potential costs of the alternative,

[54] Trustee Resilience Policy, Confidential Exhibit MAB-4, p 79.
[55] Corporations Act, s 181(1)(a) and (b).
[56] Trustee Board Paper, Confidential Exhibit MAB-3, p 69, resolution (d).
[57] JHL-1, p 14, [63(f)].
[58] Trustee Resilience Policy, cl. 1.15, Confidential Exhibit MAB-3, p 83.

and compared with industry benchmarks for fees, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

56. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.[59]

57. Here, the process which the Trustee has followed to quantify the target amount for the Trustee Resilience Reserve is set out in a report from an accounting firm[60]. The firm was engaged to undertake a targeted assessment of the Trustee's capital needs to determine a range of potential capital that would reasonably be required to manage the Trustee's risk of having to pay a fine or penalty which cannot be indemnified from the Fund (including having regard to the Trustee's compliance arrangements and risk management systems)[61].

58. The report has been prepared on the basis that it is prudent to anticipate that contraventions could occur despite best efforts to comply with applicable laws and regulations.[62] The report concludes it would not be possible for Trustees to hold enough capital to cover all potential losses from penalties and that there will need to be a balance maintained between protecting the Trustee by holding more capital and minimising the impact on members.[63]

59. The Trustee's solicitors have given evidence that Trustee management assessed the likelihood of a contravention of Commonwealth legislation on the basis of it operating within its current risk management and governance frameworks, and that any contravention by the Trustee would be inadvertent, or caused by an external service provider (such as the Fund's administrator), or an officer acting outside the scope of their authority.[64] The Trustee is currently not aware of any matter that would give rise to a fine or penalty that would be paid from the proposed Trustee Resilience Reserve.[65]

60. The Proposed Fee Determination is based on a target amount for the Trustee's

[59] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) at [47].
[60] Trustee Capital Framework, Final Report – Capital Options, September 2021, Confidential Exhibit MAB-3, pp 14-44.
[61] JHL-1, p 14, [63(d)].
[62] Trustee Capital Framework Report, Executive summary, Confidential Exhibit MAB-3, p 15.
[63] Trustee Capital Framework Report, Executive summary, Confidential Exhibit MAB-3, p 16.
[64] MAB-4, p 5, [17].
[65] MAB-4, p 5, [18]; Trustee Board Paper, Confidential Exhibit MAB-3, p 70.

Resilience Reserve at the amount calculated to cover a 75th percentile of capital adequacy based on stochastic modelling.[66] In other words, it is accepted that the Proposed Fee Determination would not create a reserve that would insulate the Trustee against the potential liability associated with 25 per cent of the scenarios modelled by the accounting firm. Management of the Trustee considers that this is appropriate based on the latest industry information, issues identified by APRA and members best financial interest considerations.[67]

61. There is no evidence that the Trustee's purpose is to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls[68] or to exclude any residual risk to the Trustee.

62. *Thirdly*, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The Proposed Fee Determination has been quantified. The Trustee Resilience Policy provides that in the event that the Reserve is or appears likely to be outside its target range, the Trustee's board will review whether the trustee fee is fair and reasonable by reference to the detailed factors that have been identified as relevant to that consideration and that are set out in an appendix to the policy.[69]

63. The Court may consider that it is appropriate and important for the purpose of the Court providing the advice sought by the Application to recognise that the Trustee's legal obligations under the SIS Act and at general law are applicable to the future exercise of the fee charging power.[70] The requirement that any fee determination, including the Proposed Fee Determination, be based on the factors listed in the appendix to the Trustee Resilience Policy is an inherent review mechanism that in APRA's submission is consistent with the Trustee's legal obligations.

64. If in coming years the observed incidence of penalties imposed on superannuation trustees is less frequent or for lower amounts than expected, or if the availability and responsiveness of insurance for penalties becomes broader than expected, other things being equal, a prudent trustee acting in the best financial interests of members would charge a lower trustee fee or maintain a trustee capital reserve at a lower level.

65. *Finally*, in order to discharge the duty of diligence, a trustee would be expected

[66] Resolution (e), Confidential Exhibit MAB-3, p 70
[67] Trustee Board Paper, Confidential Exhibit MAB-3, p 72.
[68] The Trustee's consideration of risk management controls is identified at paragraph 65.a) below.
[69] Trustee Resilience Policy, cl. 7, Confidential Exhibit MAB-3, p 79.
[70] cf *Re QSuper Board* [2021] QSC 276 (Kelly J) at [44].

to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members.[71] That is to say, a trustee should explore:

a) whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by investing in compliance or governance systems or upskilling. The chief executive officer has given evidence about the Trustee's risk management framework and rigorous processes for risk management[72];

b) insurance: the Trustee has considered the availability, effectiveness and cost of insurance to some extent.[73] APRA is concerned that the evidence before the Court does not demonstrate that the Trustee has considered or obtained advice on the effect of the exclusions or limitations contained in the Trustee's insurance policies as could reasonably be expected to apply to the Trustee's use of insurance to pay non-indemnifiable Commonwealth penalties;

c) contributions from members of the company or associated entities: there is evidence that all the shareholders of the company have confirmed that they do not agree to contribute any additional capital or provide an indemnity to the Trustee.[74] The Trustee has written to its Employer Organisations and Fund Member Organisations and is awaiting some responses[75]; and

d) the availability of indemnities from service providers to the Trustee:[76] there is evidence that the trustee employs a fund administrator[77] but the Trustee has not put before the Court any material to enable the Court to assess to what extent indemnities from service providers may mitigate the risk of the Trustee's insolvency due to the imposition of a Commonwealth penalty.

Consideration of the conflicts covenant in assessing the Proposed Amendment

66. As noted above, section 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

67. APRA does not contend that this aspect of the covenant is breached simply because a benefit of some kind enures to the trustee as a result of the conduct in

[71] *Re QSuper Board* at [48].
[72] JHL-1, p 7, [30]; p 12, [53];
[73] Second Affidavit of Julie Hermine Lander affirmed 25 October 2021 (**JHL-2**), pp 4-5, [17].
[74] JHL-1, p 9, [43].
[75] MAB-4, pp3-4, [10]-[13].
[76] cf. *Re QSuper Board* at [40(h)].
[77] Third Affidavit of Mark Albert Bland affirmed 3 November 2021, p 4, [18(b)].

question. The covenant needs to be given a sensible operation. Section 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. The language of the covenant presupposes that a conflict exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person.

68. Where a trustee has a personal interest in a matter, complying with the duty in section 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with section 52(2)(d)(i), and also with subparagraphs 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

69. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

70. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

71. The material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting the trustee fee from the Fund's reserve, rather than by increasing immediately the administration fee charged to member accounts. The Trustee Resilience Policy includes as a relevant consideration that the replenishment of the General Reserve can occur over time.[78]

Confidential material

72. The evidence served on APRA was redacted by the Trustee to exclude certain

[78] Trustee Resilience Policy, cl. 5.16, Confidential Exhibit MAB-3, p 86.

documents. Necessarily, these submissions are made without knowledge of the contents of those documents:

a) the memorandum of advice dated 10 May 2021 of the Trustee's senior counsel;[79]

b) the certificates of currency for the Trustee's insurance arrangements;[80]

c) the insurance renewal report of the Trustee's insurance broker dated 11 October 2021;[81]

d) a description of APRA's SRI model;[82]

e) the opinion of counsel on question 2(a) in the Originating Motion;[83]

f) the opinion of counsel on question 2(b) in the Originating Motion;[84] and

g) the opinion of counsel on question 2(c) in the Originating Motion[85].

73. A related question on the Application concerns the tender to the Court of relevant material on a confidential basis. The Trustee seeks relief that would maintain the confidentiality of this material.

74. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises.

75. As French CJ observed in *Hogan v Hinch*[86] (citations omitted):

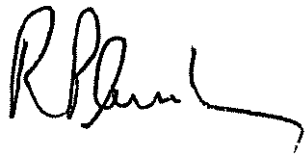
> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself. Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*

[79] Exhibit JHL-2, pp 65 to 83.
[80] Exhibit JHL-2, pp 84-86.
[81] Exhibit JHL-2, pp 87-116.
[82] Exhibit JHL-2, pp 10-33.
[83] Confidential Exhibit MAB-1 to the Second Affidavit of Mark Albert Bland affirmed 27 October 2021 (**Confidential Exhibit MAB-1**), pp 4 to 13
[84] Confidential Exhibit MAB-1, pp 14 to 18.
[85] Confidential Exhibit MAB-3, pp 45 to 68.
[86] (2011) 243 CLR 506 at [20]

76. It is submitted that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[87] An application for judicial advice is not, inherently or universally, exempt from the need for the business of the Court to be conducted, generally, in public.[88] Where the subject matter of an application may be of wide community concern, the interests of justice may require that all material aspects of the factual basis of the Court's decision are openly set out in the Court's reasons for judgment.

Other proceedings

77. The Court will be aware that the present proceeding is one of several which raise some similar or identical issues. Apart from *QSuper* where the decision has already been handed down, proceedings are underway in respect of HESTA (Supreme Court of Victoria), Cbus and Spirit (Motor Traders) (Supreme Court of New South Wales), and Australian Super and Hostplus (Supreme Court of South Australia). If judgment is handed down in any of those proceedings before the hearing in the present case, APRA may seek leave to file brief supplementary written submissions to respond to that judgment.



Dr R P Austin

D S W Allen

Counsel for APRA
22 November 2021

[87] *Hogan v Hinch* (2011) 243 CLR 506 at [21]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69]
[88] *Re Estate Late Chow Cho-Poon; Application for judicial advice* (2013) 10 ASTLR 251; [2013] NSWSC 844 (Lindsay J) at [38].

IN THE SUPREME COURT
OF NEW SOUTH WALES **2021/327135**
EQUITY DIVISION

MARITIME SUPER PTY LIMITED (ACN 058 013 773) AS TRUSTEE FOR MARITIME SUPER (ABN 77 455 663 441)

Plaintiff

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (AS AMICUS CURAE)

A. INTRODUCTION

1. On 17 November 2021, the plaintiff (the **Trustee**) served the Australian Prudential Regulation Authority (**APRA**) with its Summons dated 17 November 2021 (**Application**).

2. The Application, brought pursuant to subsection 63(1) of the *Trustee Act 1925* (NSW) (**Trustee Act**), seeks the Court's opinion, advice and direction that the Trustee would be justified in amending[1] the trust deed of Maritime Super (the **Fund**), originally dated 6 October 1967 (**Trust Deed**), to insert a clause that, for the first time, allows a fee to be payable to the Trustee for an amount fixed by reference to the net assets of the Fund, subject to a discretionary power given to the Trustee to reduce, waive, suspend or postpone that fee and to, every three years, adjust the fee payable to an amount which the Trustee considers fair and reasonable (**Proposed Amendment**).[2] The Application is supported by a Statement of Facts (**Statement of Facts**).

3. The Proposed Amendment, set out in a draft deed of amendment annexed to the Statement of Facts, would provide the Trustee with a broad power to charge, deduct from the assets of the Fund, and retain for its own benefit, a fee calculated as a percentage of the net assets of the Fund for each successive period of three years from 1 July 2021.[3] The fee may not be paid to the Trustee if it would result in the net tangible assets of the Trustee exceeding a specified cap, calculated as a percentage of the net

[1] Pursuant to a power of amendment in Fund Rule 16.1of the Trust Deed – Exhibit PVR-1 p 296; Affidavit Peter Robertson affirmed 12 November 2021 at [105]-[114].
[2] Proposed Fund Rule 11.7, Deed of Amendment.
[3] See "Reference Period" in Fund Rule 11.7(f)(i) (and 11.7(a)), Deed of Amendment.

assets of the Fund.[4] The amount of the fee, and the cap on the Trustee's net tangible assets at which point the fee is not payable, may be adjusted by the Trustee, to any higher or lower amounts as it determines to be fair and reasonable, having regard to the advice of an appropriately qualified independent consultant, following each period of three years.[5]

4. As is apparent from the Statement of Facts, the immediate catalyst for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) that limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund.[6] Those changes are the latest instance of increasing regulation of superannuation trustees and their directors under Commonwealth law since the Trustee first became trustee of the Fund in November 1992.[7]

5. The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Act 2019* (Cth) amended the SIS Act to make contraventions of the statutory covenants in ss 52 and 52A of the SIS Act the subject of a civil penalty. Following the passage of the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) (**Hayne Royal Commission Response Act**), trustees of superannuation funds are now required to hold an Australian Financial Services Licence and are subject to regulation under Chapter 7 of the *Corporations Act 2001* (Cth) (**Corporations Act**), including obligations imposed by civil penalty provisions (for example, the general obligations of financial services licensees in s 912A of the Corporations Act).

6. The Statement of Facts relies upon the concomitant escalating exposure of the Trustee and the directors to Commonwealth penalties over this time.[8] The amendments to sections 56 and 57 prohibit a trustee from indemnifying itself out of the assets of a fund for a criminal, civil or administrative penalty or for the payment of any amount payable under an infringement notice imposed or issued under any Commonwealth legislation

[4] See "Trustee Capital" in Fund Rule 11.7(f)(iv) (and 11.7(c)(i)), Deed of Amendment.
[5] Fund Rule 11.7(d)-(e), Deed of Amendment.
[6] Statement of Facts [14]-[20].
[7] ASIC Records Exhibit PVR-1 p 5-6; Expert Opinion Associate Professor Brand at Exhibit PVR-1 p 707-786; Affidavit Peter Robertson affirmed 12 November 2021 at [60]-[69]; Affidavit Lynelle Briggs affirmed 16 November 2021 at [39]-[40].
[8] Statement of Facts [14]-[16].

and not, as previously, only under the SIS Act itself (**SIS Indemnification Amendments**). All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers of financial services) with the duties and obligations owed to members (among other consumers of financial services).

7. The possible effect on members of the imposition of penalties on a superannuation trustee was mitigated to some extent by simultaneous amendments made by the Hayne Royal Commission Response Act that require a court, in determining a pecuniary penalty under the *Australian Securities and Investments Commission Act 2001* (Cth) or the Corporations Act, to take into account the impact that the penalty under consideration would have on the members of the fund.[9]

8. Even so, on the Trustee's evidence, lacking any significant fund of personal capital (as it currently does), and without insurance as a complete solution or any indemnity out of Fund assets for a Commonwealth penalty, if the Trustee does not resolve to levy a fee to accumulate personal capital the Trustee would be at some risk of insolvency, even with robust compliance and risk management controls.[10]

B. APRA's position on the Application

9. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[11]

10. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**), which introduced the SIS Indemnification Amendments, the SIS Act and the Registrable Superannuation Entity licensing regime are primarily

[9] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GBB; Corporations Act s 1317G(6).
[10] Affidavit Peter Robertson affirmed 12 November 2021 at [70]-[74]; Affidavit Lynelle Briggs affirmed 16 November 2021 at [41]-[42], [44].
[11] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).

designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and they deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

11. APRA further respectfully submits that the process of decision-making by a superannuation trustee in these circumstances should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of s 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Fund and s 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises various issues for the Court's consideration (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act) relevant to the manner in which the Trustee proposes to introduce a fee-charging power that has not previously been granted to the Trustee[12].

The amendments to sections 56 and 57 of the SIS Act do not preclude payment of a trustee fee

12. The SIS Indemnification Amendments do not prohibit the outcome sought to be achieved by the Proposed Amendment. Sections 56(2) and 57(2) are directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee or a director of a trustee from, or indemnifying a trustee or director against, certain liabilities. The levying of a fee which is meant to build up over time into an asset that may be deployed by the trustee in the event that it or a director becomes subject to a liability against which it or the director cannot be indemnified does not have the substantive effect of conferring an exemption from or indemnifying against that liability.[13]

13. To recognise this is not to render sections 56 and 57 of the SIS Act pointless. The fee charged may prove to be insufficient to cover the extent of the Trustee's potential

[12] Affidavit Peter Robertson affirmed 12 November 2021 at [48]-[51].
[13] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) (**Re QSuper Board**) at [32].

liability. Further, the Proposed Amendment does not have the effect of excusing or extinguishing the liability of the Trustee for any amount for which it cannot be indemnified out of the Fund. The Trustee would be able to accrue capital but would not enjoy a blanket indemnity that may dis-incentivise it from performing its duties carefully and diligently, in the sense that it is not freed from any personal consequence in the event of breach of duty.

14. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Fund must be considered by the board in light of their general law and statutory duties to act in good faith in the best interests of the Trustee.[14] The limits in sections 199A and 199B of the Corporations Act on the scope of indemnities given by companies, and insurance paid for by companies, in respect of liabilities incurred by a person as an officer of the company would apply.

15. This leaves for consideration whether the adoption of the Proposed Amendment would contravene other duties or obligations under the general law or the SIS Act applying to trustees of superannuation funds.

Compliance with duties as trustee

16. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the Application ought to be granted. The Trust Deed provides that the Trustee, in making decisions in relation to the Fund may do anything that is required by the SIS Act.[15] The SIS Act covenants in any event apply despite any provision in the governing rules of an entity.[16]

17. As to the general law, the relevant duties are:

    a. the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b. the duty to exercise reasonable care;

    c. the duty to preserve trust property;

    d. the duty to act impartially between the beneficiaries;

[14] Corporations Act s 181(1)(a) and (b).
[15] Fund Rule 19 of the Trust Deed – Exhibit PVR-1 p 299.
[16] SIS Act s 7.

e. the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

f. the duty to avoid coming into a position of conflict of interest.

18. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards (Parts 3 and 3A).

Statutory covenants in s 52(2) SIS Act

19. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

a. acting honestly in matters concerning the fund: s 52(2)(a);

b. exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: s 52(2)(b);

c. acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

d. in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d); and

e. acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

20. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) (**Your Future, Your Super**), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries. According to the explanatory memorandum, the purpose of the amendment was:

> *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations … The identification of a 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 evidence to support their expenditures.[17]

21. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[18] where her Honour Justice Jagot adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of her Honour's decision are at [61] to [65].

22. Those observations suggest a relatively broad and practical approach will be taken to s 52(2)(c), with a focus on financial interests. The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Justice Jagot's reasons – namely, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established – may require revisiting under a "best financial interests test". The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[19]

23. The best financial interests duty must also be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[20] The Report addressed the essential duties of responsible entities. It characterised the best interests duty as, *"a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."*[21] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely

[17] Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* at [3.32]-[3.33].
[18] (2019) 138 ACSR 459; see also Re QSuper Board at [36] and [42].
[19] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[20] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).
[21] Cited by Justice Moshinsky, "The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework", 9 March 2018, p 9.

avoid harming them.[22]

Conflicts Rule

24. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to avoid conflicts of interest. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; (ii) to ensure that the duties to the beneficiaries are met despite the conflict; (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

25. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members. In doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

26. Section 52(12) imposes on trustees an obligation to promote the best financial interests of MySuper and choice product members, by reference in particular to the returns to those beneficiaries (after the deduction of fees, costs and taxes).

27. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

28. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

29. The Your Future, Your Super amendment to the covenant in section 52(2)(c) (as noted at paragraphs 20-23 above) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of members in their decision-making processes. In the material put before the Court, the Trustee has evidenced the consideration it has given to how the financial interests of members may be affected if the Proposed Amendment is

[22] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

not made and the Trustee becomes insolvent or faces a real risk of insolvency.[23]

30. The Trustee does not currently have the power to charge or be paid a fee for the services that it performs for the Fund, although it does have several general powers to recover any loss or expenditure incurred in relation to the administration of the Trustee and to have repaid from the Fund all expenses in connection with the Fund or administration of the Trustee.[24] The chief executive officer of the Trustee has given evidence as to the nature of the current fees and costs charged to members and to the Fund, which are substantial.[25]

31. The introduction of a fee to be charged to members or to the assets of the Fund itself will have an adverse financial impact on the retirement benefits of members over the long term. Relevantly however, the material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting the proposed trustee fee from the Fund's Operating Reserve, which has accumulated over time, rather than by increasing immediately the administration fee charged to member accounts. [26]

32. Furthermore, the financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes or may become insolvent. The chief executive officer of the Trustee has given evidence that one of three broad scenarios is likely to eventuate in the event the Trustee becomes insolvent and is thereby disqualified from acting as trustee:[27] (a) a replacement trustee is appointed; (b) the Fund is merged with another superannuation fund by way of successor fund transfer; or (c) a replacement trustee is appointed for an interim period before the Fund is merged with another fund by way of successor fund transfer.[28]

33. The chief executive officer has further given evidence that, in his opinion, it would be difficult to locate a suitably qualified replacement trustee that would be willing to be appointed without the Proposed Amendment having been made or a similar power having been granted under the Trust Deed, as the replacement trustee would then face the same risks that the Trustee faces.[29] On that basis, the chief executive office has given

[23] Affidavit Peter Robertson affirmed 12 November 2021 at [70]-[102].
[24] Fund Rule 11.2, 11.5; Affidavit Peter Robertson affirmed 12 November 2021 at [48]-[51].
[25] Affidavit Peter Robertson affirmed 12 November 2021 at [52]-[59].
[26] Affidavit Peter Robertson affirmed 12 November 2021 at [130]-[131]; Exhibit PVR-1 p 1036.
[27] SIS Act s 120; it is an offence to be a trustee once disqualified (SIS Act s 126K).
[28] Affidavit Peter Robertson affirmed 12 November 2021 at [76].
[29] Affidavit Peter Robertson affirmed 12 November 2021 at [78], [80].

evidence that the more likely outcome would be a successor fund transfer.[30]

34. The transition costs to members to effect a successor fund transfer comprise direct investment-related costs, indirect investment-related costs and non-investment-related transition costs. Direct investment-related costs include broker commissions, taxes and fees expected to be incurred. Indirect investment-related transition costs reflect the forecast potential market impact of buying and selling assets, as well as the impact of market movement during the transition period. Non-investment-related transition costs are the anticipated costs of the transition of contracts, employment arrangements and administrative platforms and processes between the Trustee or Fund and a replacement trustee or fund, including associated legal costs.[31] The Trustee has prepared estimates of these costs.[32]

35. The Trustee has further identified and taken into consideration other financial costs that are said to be more difficult to quantify that would result from perceived or actual insolvency.[33] They include the costs of obtaining short-term liquidity, by realising Fund assets at under-value to satisfy early withdrawals and transfer and rollover requests (where members apply to transfer their benefits into other funds and this is exacerbated by reduced member inflows through lower member contributions, and the loss of employer nominations to the Fund and the loss of future merger partners). It is said there would also be significant disruption to the business of administering the Fund, with resources dedicated to improving member outcomes being redirected to attend to the repercussions from Trustee insolvency.[34]

36. The chief executive officer has further given evidence that, in his opinion, the fact of there being a risk of insolvency (even if it did not eventuate) would have significant negative consequences for the Fund's members, including the possibility of causing a more risk averse approach to be taken by the Trustee and difficulties in recruiting and retaining suitably qualified directors.[35] This evidence as to the detrimental impact on the willingness of skilled and qualified directors to continue or accept appointment as a director of the Trustee is supported by that of the incoming chair of the Trustee.[36]

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[30] Affidavit Peter Robertson affirmed 12 November 2021 at [81].
[31] Affidavit Peter Robertson affirmed 12 November 2021 at [77]-[79].
[32] Affidavit Peter Robertson affirmed 12 November 2021 at [77]-[79]; Exhibit PVR-1 p 1034-1036, 1069-1072.
[33] Affidavit Peter Robertson affirmed 12 November 2021 at [82].
[34] Affidavit Peter Robertson affirmed 12 November 2021 at [82].
[35] Affidavit Peter Robertson affirmed 12 November 2021 at [83].
[36] Affidavit Lynelle Briggs affirmed 16 November 2021 at [45]-[53].

37. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed Amendment is reasonably justifiable on that basis.[37] This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

38. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives. The Trustee has put on evidence in this regard,[38] which is outlined in paragraph 51 below in the context of the covenant to exercise care, skill and diligence.

39. One of the circumstances relevant to the payment of a new fee is that the Trustee itself is restricted in its use of funds to some degree. The Trustee has prepared and endorsed a draft Policy on use of Trustee Capital setting out permitted and prohibited uses of Trustee Capital.[39] In addition, the Trustee is an Australian proprietary company limited by shares. The purpose for which the Trustee is constituted is to act as trustee of the Fund.[40] The shares of the Trustee carry no right to a dividend.[41] The board must not at any time declare or determine a dividend, or apply any portion of the income or capital of the Trustee, to be paid or transferred directly or indirectly in any way to a shareholder of the Trustee.[42] These provisions in the Trustee's constitution do not prescribe for what uses the proceeds of the fee may be deployed, but they form part of the background to the Application.

40. In considering whether the Proposed Amendment is in the best financial interests of beneficiaries, there are matters particular to the circumstances of the Trustee – concerning aspects of the Trustee's evidence over which confidentiality is claimed – on which APRA's wishes to make submissions. In light of the confidentiality claim that has been made, those are set out in confidential Annexure A to these submissions.

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[37] (2019) 138 ACSR 459 at [64]; see also Re QSuper Board at [36].
[38] Affidavit Peter Robertson affirmed 12 November 2021 at [115]-[120].
[39] Affidavit Peter Robertson affirmed 12 November 2021 at [93]; Exhibit PVR-1 p 1077-1099, 1112, 1118.
[40] Affidavit Peter Robertson affirmed 12 November 2021 at [34], [44]-[45].
[41] Constitution cl 1.1; Exhibit PVR-1 p 567; Affidavit Peter Robertson affirmed 12 November 2021 at [34]-[35].
[42] Constitution cl 1.6; Exhibit PVR-1 p 568.

Covenant to exercise care, skill and diligence

41. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

42. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it proposes to charge as remuneration, and that it will cease to charge remuneration once a sufficient capital reserve has been established.[43] The Trustee commissioned an external consultant to undertake financial modelling for the proposed future fees to provide comfort that the fees have been quantified having regard to the effectiveness of governance, risk management framework, risk practices, resources and controls in place to minimize systemic and one off breaches, and to balance the purpose of reducing and managing the risk of insolvency against the members' best financial interests.[44]

43. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

44. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the

[43] Affidavit Peter Robertson affirmed 12 November 2021 at [90].
[44] Affidavit Peter Robertson affirmed 12 November 2021 at [91]-[92], [94(f)]; Exhibit PVR-1 p 1023-1076.

creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.[45]

45. Here, the process which the Trustee has followed to quantify the target amount for trustee capital is set out in a Report on Trustee Fee and Trustee Capital (**Report**)[46] and a Trustee Capital Framework Report prepared by Price Waterhouse Coopers (**PwC Report**).[47] PwC has in its report confirmed that in their view the amounts of the target capital, three-year fee cap, and aggregate cap on Trustee Capital in the Proposed Amendment are reasonable and consistent with its industry knowledge.[48]

46. The PwC Report sets out the modelling framework that has been applied to calculate the fee amount and capital cap, by reference to the number and extent of the penalties or infringement notices under certain Commonwealth laws to which the Trustee or its directors could be subject, modified by an analysis of the likelihood that the Trustee will incur such penalties, having regard to the risk controls which the Trustee maintains to avoid contravening the law and the likely penalty that would be imposed.[49] The Trustee's Report acknowledged that there were certain factors that had been excluded from the PwC Report, however concluded that on balance these factors did not warrant a departure from the modelling undertaken by PwC.[50]

47. Although the aggregate cap on the Trustee's capital (at which point the fee is not payable) has been set at an amount that the PwC Report indicates would be required to cover a very significant percentage of the expected penalties[51] the target amount for the Trustee's capital has been set at a lower level.[52] There is, subject to the matters noted in confidential Annexure A, no evidence that the Trustee's purpose is to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls or to exclude any residual risk to the Trustee.

48. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build

[45] cf Re QSuper Board at [47].
[46] Exhibit PVR-1 p 1024-1076.
[47] Exhibit PVR-1 p 1038-1068.
[48] Exhibit PVR-1 p 1073.
[49] Exhibit PVR-1 p 1027-1029.
[50] Exhibit PVR-1 p 1030-1032.
[51] Exhibit PVR-1 p 1029, 1032, 1040, 1074.
[52] Exhibit PVR-1 p 1074.

into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The recognition of the application of the Trustee's legal obligations to the future exercise of the remuneration power is consistent with a trustee's duty of care, skill and diligence and duty to act in the best financial interest of members.[53]

49. The Proposed Amendment itself contains such a review mechanism. The fee is subject to review every three years to ensure it remains fair and reasonable. A review that results in an adjustment to the current fee or cap on trustee capital may have regard to amounts that the Trustee *reasonably* considers necessary to appropriately compensate the Trustee for acting as trustee of the Fund and/or to appropriately compensate it for the personal financial risk it might incur.[54] The review mechanism further requires the Trustee to seek the advice of an appropriately qualified independent consultant.[55]

50. Finally, in order to discharge the duty of diligence, a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members.[56] That is to say, a trustee should explore whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by:

    a. investing in compliance or governance systems or upskilling;

    b. insurance;

    c. contributions from shareholders or associated entities; and/or

    d. the availability of indemnities from service providers to the Trustee.[57]

51. The Trustee has said in this regard, respectively, that:[58]

    a. it has invested significant resources in mitigating the likelihood of any Commonwealth penalties materialising, including through a robust risk management framework overseen by the Board;[59]

[53] Re QSuper Board at [44].
[54] Proposed Fund Rule 11.7(e)(ii), Deed of Amendment.
[55] Proposed Fund Rule 11.7(e)(i), Deed of Amendment.
[56] Re QSuper Board at [48].
[57] cf Re QSuper Board at [40(h)].
[58] Affidavit Peter Robertson affirmed 12 November 2021 at [75], [115]-[120]; Affidavit Lynelle Briggs affirmed 16 November 2021 at [43]-[44]; Exhibit PVR-1 p 1023-1076.
[59] Affidavit Peter Robertson affirmed 12 November 2021 at [70]-[71].

b. it has considered the availability, effectiveness and cost of insurance, and formed the view that this is not a complete solution as it will not respond fully in all scenarios and there may be practical obstacles even where insurance does respond;[60]

c. it is not considered reasonable for shareholders to contribute capital given shares are held by the directors and secretary of the Trustee, and it is in any event understood that shareholders are not in a position to contribute;[61]

d. it has provided details of its outsourcing arrangements and has said the position is that the Trustee remains primarily responsible for the provision of the services which the Trustee has outsourced;[62] and

e. additionally, it has given consideration as to the availability of a bank debt or shareholder loan, but concluded that it was not a feasible solution given the Trustee currently has no personal capital to repay such a debt.[63]

Consideration of the conflicts covenant in assessing the Proposed Amendment

52. As noted above, s 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

53. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

54. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may

[60] Affidavit Peter Robertson affirmed 12 November 2021 at [115]-[118]; Affidavit Sean Lindsay affirmed 26 October 2021 at [27]-[54]; Affidavit Lynelle Briggs affirmed 16 November 2021 at [44].
[61] Affidavit Peter Robertson affirmed 12 November 2021 at [119(a)].
[62] Affidavit Peter Robertson affirmed 12 November 2021 at [47].
[63] Affidavit Peter Robertson affirmed 12 November 2021 at [119(b)].

be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

55. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

56. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

57. As noted at paragraph 31 above, the Trustee has proposed to smooth the initial impact on current and future members by deducting the proposed trustee fee from the Fund's Operating Reserve, rather than by increasing immediately the administration fee charged to member accounts.[64]

C. CONFIDENTIAL MATERIAL

58. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. Although no confidentiality order has been formally sought in the Application, the evidence put forward by the Trustee appears to seek relief that would maintain the confidentiality of certain of that evidentiary material.[65]

59. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court

[64] Affidavit Peter Robertson affirmed 12 November 2021 at [130]-[131]; Exhibit PVR-1 p 1036.
[65] Affidavit Peter Robertson affirmed 12 November 2021 at [8]; Affidavit Lynelle Briggs affirmed 16 November 2021 at [7]; Affidavit Sean Lindsay affirmed 26 October 2021 at [3].

principle arises. As French CJ observed in *Hogan v Hinch* (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*[66]

60. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[67]

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[66] (2011) 243 CLR 506 at [20].
[67] *Hogan v Hinch* (2011) 243 CLR 506 at [20]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69].

CONFIDENTIAL ANNEXURE A TO APRA'S SUBMISSIONS

[redacted]

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30 November 2021

[redacted]

IN THE SUPREME COURT OF VICTORIA

AT MELBOURNE

COMMERCIAL COURT

S ECI 2021 03963

IN THE MATTER of an application by CARE SUPER PTY LTD (ABN 91 006 670 060) (IN ITS CAPACITY AS TRUSTEE OF CARE SUPER (ABN 98 172 275 725)) for judicial advice and directions under rule 54.02 of the *Supreme Court (General Civil Procedure) Rules 2015*

Plaintiff

SUPPLEMENTARY SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

Introduction

1. These supplementary submissions, filed pursuant to the Court's order in chambers on 26 November 2021, take into account the plaintiff's supplementary submissions dated 25 November 2021 regarding SIS Act indemnification amendments **(Plaintiff's SIS Indemnification Submissions)** and a further document dated 26 November 2021 entitled "Plaintiff's Response to APRA Submissions" **(Plaintiff's Response to APRA).**

2. On 26 November APRA also received an affidavit of Samuel Mark Horskins affirmed on 26 November 2021 and a copy of Exhibit SH-1, but not Confidential Exhibit SH-2. That evidence is taken into account in the present submissions. At the time of preparing these submissions, counsel has not received evidence foreshadowed by the plaintiff in response to the issues raised in an email dated 24 November 2021 from your Honour's chambers regarding the verification of the Trust Deed and proof of beneficial ownership of the shares in the Trustee.

3. The present submissions also have regard to the plaintiff's outline of submissions dated 28 October 2021 **(Plaintiff's Initial Submissions)**, the plaintiff's outline of submissions on confidentiality dated 10 November 2021 (**Plaintiff's Confidentiality Submissions**) and APRA's submissions dated 22 November 2021 **(APRA's Submissions)**. At the time of preparation of the present submissions, APRA has not received a copy of the submissions of Wendy Harris QC that has been redacted for matters over which the trustee seeks to maintain confidentiality. APRA anticipates that its counsel will seek leave at the hearing to address the submissions of Ms Harris orally.

4. APRA's purpose in providing these supplementary submissions is to assist the Court as amicus curiae by focusing on and responding where appropriate to key points raised in the Plaintiff's SIS Indemnification Submissions and the Plaintiff's Response to APRA. The present supplementary submissions employ the abbreviations defined in APRA's Submissions.

5. It appears from the plaintiff's submissions and the correspondence received from your Honour's chambers that there are three potentially contentious issues for the Court to consider in the present application:

   (a) whether the Court should make the determinations under rule 54.02 of the *Supreme Court (General Civil Procedure) Rules 2015* (Vic) sought in subparagraphs (2)(a) and (b) of the Originating Motion, relating respectively to identifying the current operative trust deed of the Fund and to determining whether the shareholders of the Trustee hold their shares beneficially and not as assets of the Fund;

   (b) whether the Court should make the determination under rule 54.02 sought in subparagraph (2)(c) which would support the plaintiff's proposal to establish a non-trust reserve by advancing an amount out of the Fund;

   (c) whether the Court should make order sought in paragraph (3) with respect to the confidentiality of some exhibits to be tendered by the plaintiff.

6. In these supplementary submissions APRA will make some brief points regarding items (a) and (c) above, followed by some more substantial submissions regarding item (b).

Originating Motion, subpara (2)(a) (identifying operative trust deed) and subpara (2)(b) (beneficial ownership of shares issued by Trustee)

7. At the time of preparing these supplementary submissions, APRA has not received any evidence of the plaintiff responding to the evidentiary gaps identified in the email from your Honour's chambers sent to the plaintiff and APRA on the afternoon of 24 November 2021. In these circumstances, APRA is not in a position to make submissions on the adequacy of the evidence tendered to support these two applications.

8. Where an application under rule 54.02 relates to a lost document, there must be clear and convincing proof of the existence and contents of the document; but this does not mean that the required standard of proof is other than proof on the balance of probabilities.[1] If no further evidence is adduced, it may be sufficient for the

[1] *Application by Barry McMahon Nominees Pty Ltd* [2021] VSC 351, at [12] per McMillan J.

plaintiff to tender a copy of the most recent consolidated trust deed as part of the records kept by the Care Super business[2], and to rely on the affidavit evidence of Ms Ray to establish the provenance of that document.

9. As regards beneficial ownership of the shares in the Trustee, it is relevant that the court is engaged in determining what ought to be done in the best interests of the trust estate and not in determining the rights of any adversarial parties.[3]

Originating Motion, subpara (3) (confidential exhibits)

10. The Plaintiff's Confidentiality Submissions foreshadow the extension of the confidentiality orders sought in subparagraph (3) to cover Confidential Exhibits MAB-1 and MAB-3. Presumably the plaintiff will seek to have the confidentiality orders cover Confidential Exhibit SH-2 as well.

11. APRA believes it is unnecessary to add to the substance of APRA's Submissions [72]-[76], except to note again the relevance of the open-court principle with respect to documents said to be commercially sensitive (as distinct from documents that provide privileged legal advice), and to observe that excluding evidence from APRA on the ground of confidentiality necessarily limits the extent to which APRA is in a position to assist the court as amicus curiae. The Court will weigh those considerations against the matters identified in the Plaintiff's Response to APRA at [21], to determine whether those considerations justify excluding the Court's amici curiae from access to evidence that may have particular importance.

Originating Motion, subpara (2)(c) (Proposed Fee Determination)

12. The general principles applying to the giving of judicial advice under rule 54.02 are adequately summarised in paragraphs [31]-[43] of the Plaintiff's Initial Submissions. APRA has submitted that in applying those principles to a case where judicial advice is sought by a superannuation trustee, the Court should consider some more particular issues of principle, relating to member outcomes and the requirements of the statutory covenants.[4]

13. The Plaintiff's Initial Submissions did not address why, having regard to the plaintiff's evidence, the Court should provide the judicial advice sought in subparagraph (2)(c). The plaintiff explained that it was awaiting access to the judgment in *Re QSuper Board* [2021] QSC 276 (*QSuper*). The two further submissions by the plaintiff are designed to fill this gap.[5]

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[2] *Evidence Act 2008* (Vic), section 48(1)(e).
[3] *Marley v Mutual Security Merchant Bank & Trust Co Ltd* [1991] 3 All ER198 at 201 (Privy Council).
[4] APRA's submissions, [15]-[16].
[5] The *QSuper* case is helpfully analysed in detail in the Plaintiff's SIS Indemnification Submissions, especially at [2], [9]-[10] and [16]-[21].

14. Having considered the additional sets of submissions provided by the plaintiff, APRA submits that two principal and contestable questions will need to be resolved by the Court:

    (a) whether the establishment and deployment of the proposed reserve will be ineffective because section 56(2) of the SIS Act renders void the provisions of the Trust Deed upon which the plaintiff will rely for imposing the Trustee fee on the Fund; and

    (b) whether, having regard to the plaintiff's evidence, the establishment of the proposed reserve is in the best interests of the beneficiaries (thereby optimising member outcomes).

Section 56(2) of the SIS Act

15. Paragraph (2)(c) of the Originating Motion indicates that the plaintiff will rely on clauses 2.8(a)(xvi), 2.8(d) and 7.10 of the Trust Deed (the **Three Clauses**) as powers which permit the Trustee to establish the Trustee Resilience Reserve and adopt the Trustee Resilience Policy. This raises the question whether the Three Clauses are rendered void, to the extent that they may be used for these purposes, by section 56(2) of the SIS Act.

16. Section 56(2) states that a provision in the governing rules of a superannuation entity is void insofar as it would have the effect of exempting a trustee of the entity from, or indemnifying a trustee of the entity against, four potential liabilities: liability for dishonest or intentionally or recklessly careless breach of trust; liability for a criminal, civil or administrative penalty incurred in relation to a contravention of any Commonwealth law; liability to pay an infringement notice under a Commonwealth law; or liability for the cost of a course of education and compliance with an education direction under the SIS Act. The plaintiff is concerned by the proposed expansion of the second category of liability to cover any Commonwealth law (including the Corporations Act), not only liabilities arising under Part 21 of the SIS Act.

17. APRA's Submissions contend that section 56(2), in its amended form commencing on 1 January 2022, will not result in these clauses of the Trust Deed being void to the extent that the Trustee relies upon them as its authority to make the Proposed Fee Determination.[6]

18. As a matter of construction of section 56(2), the Three Clauses are provisions in the governing rules of the Care Super superannuation entity but they do not have the effect of indemnifying the Trustee against any liabilities. In the Plaintiff's SIS

[6] APRA's Submissions [19].

Indemnification Submissions, the Trustee supports APRA's submissions in relation to the construction of section 56(2)[7], and provides a detailed analysis of the question of construction by reference to the legislative history of section 56[8] and its recent amendments, followed by detailed investigation of key words used in the statutory provision.[9] The Trustee submits that the words "in so far as it would have the effect of" refers to the extent an indemnity provided for under the governing rules, which historically would not have extended to unauthorised acts, is enlarged by the governing rules or section 56(1) in a way which would have the effect of indemnifying a trustee against one of the specified liabilities.[10]

19. APRA has identified the following considerations that support the contention that section 56(2) does not invalidate the Three Clauses of the Trust Deed[11]:

(a) a power to levy a fee which is meant to capitalise a reserve that may be deployed by the Trustee if it becomes subject to a liability from which it cannot be indemnified out of the Fund is conceptually distinct from a provision that has the effect of an exemption from or indemnifying against that liability[12];

(b) the Court would not construe section 56(2) as applying to the generally expressed Three Clauses simply because of the purpose for which the Trustee uses those powers;[13]

(c) other provisions in the SIS Act regulate the exercise of powers which authorise the charging of fees[14];

(d) the narrow scope of section 56(2), the language of which applies only to the provisions of governing rules, is obvious if it is compared with section 199A(2) of the Corporations Act[15];

[7] Plaintiff's SIS Indemnification Submissions, at [4].
[8] At [22]-[38].
[9] At [39]-[84].
[10] At [83].
[11] The Plaintiff's Response to APRA provides a summary of APRA's contentions at [2], but APRA prefers its own summary in paragraph [19] above.
[12] APRA's Submissions, [19]. See also Plaintiff's SIS Indemnification Submissions at [2], citing Kelly J in *QSuper* at [32].
[13] APRA's Submissions, [20]; further as to the purpose issue, see Plaintiff's SIS Indemnification Submissions at [85]-[88].
[14] APRA's Submissions, [21], [24] and [25]; and as to the requirement of fairness in exercising a power to impose a fee, see [26] citing sections 52(2)(e) and (f) of the SIS Act.
[15] APRA's Submissions, [22].

(e) the construction of section 56(2) which treats that provision as only applying to governing rules that make provisions having the effect of indemnifying a trustee is consistent with the intention of the legislature[16].

20. The above considerations would support the contention that section 56(2) does not apply to render void the Three Clauses either wholly or in part. Arguably, the fact that one or more of these broadly expressed powers is used for the purpose of authorising the imposition of a Trustee fee to establish a non-trust reserve that is to be used, among other things, to indemnify the trustee in respect of liabilities for contravention of Commonwealth laws, does not justify the conclusion that the clause or clauses of the Trust Deed upon which the Trustee relies in order to impose the Trustee fee has the effect of indemnifying the Trustee in respect of those liabilities.

21. <u>The best interests of the beneficiaries (member outcomes)</u>

22. The plaintiff has given consideration to APRA's Submissions concerning the best financial interests covenant and the covenant to exercise due care, skill and diligence, and has responded to some of APRA's observations by filing an affidavit by Samuel Mark Horskins affirmed on 26 November 2021, with proposed Exhibit SH-1 and Confidential Exhibit SH-2, and by drawing attention to relevant parts of that evidence in the Plaintiff's Response to APRA at [4]-[17].

23. The evidence now advanced is helpful for the Court's determination of whether the concerns about inadequate evidence expressed in APRA's Submissions at [42], [44] and [46] have been addressed. These concerns related to proving compliance with the best financial interests covenant regarding insolvency risk and financial impact. Additionally, in APRA's view the Trustee has advanced evidence in response to APRA's concerns expressed at [65] of APRA's submissions relating to proof of compliance with the care skill and diligence covenant. Mr Horskin's evidence assists in establishing that for the purposes of the care skill and diligence covenant, the Trustee has considered the availability, effectiveness and cost of insurance, the views of associated entities, and the availability of indemnities from service providers.

24. Additionally, the Plaintiff's SIS Indemnification Submissions explore in further detail the Trustee's concerns about insolvency risk.[17]

25. The determination sought in subparagraph (2)(c) of the Originating Motion is specific: it is whether the Trustee may pay and advance out of the Fund an amount

[16] APRA's Submissions, [23]; cf. Explanatory Memorandum to the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012, at [1.112].
[17] At [9]-[15].

in respect of its provision of services as Trustee of the Fund, on the basis that it is fair and reasonable to determine that amount having regard to the risk that from 1 January 2022 the Trustee might incur certain specified liabilities for contravention of a Commonwealth law against which it could not be indemnified by reason of section 56(2) of the SIS Act.

26. The plaintiff's evidence provides a more complete account of the Proposed Fee Determination. On 10 November 2021 the board of directors of the Trustee resolved to adopt a document entitled the "Trustee Resilience Policy" (the **Policy**) and to maintain the Trustee's Resilience Reserve (the **Reserve**) proposed in the Policy.[18] The board's resolution approved a target amount for the Reserve expressed as a percentile of capital adequacy and as a percentage of Fund Assets, and resolved to fund the Reserve with a Trustee Fee that the board considered to be fair and reasonable for the provision of services to the Fund by the Trustee.[19] The target amount was determined having regard to accounting advice and also information obtained by management regarding trustee fees proposed in similar legal proceedings by trustees of other superannuation funds.[20]

27. The board paper also referred to Kelly J's observations in the *QSuper* case with respect to a submission by APRA. In that case a superannuation trustee sought judicial advice with respect to a proposed amendment to its trust deed that would empower its board to charge reasonable remuneration that would be deducted from the assets of the superannuation fund, in circumstances where the board had no existing entitlement to remuneration. APRA had expressed a concern that the broad nature of the charging power in the absence of any documentation in relation to its future exercise might not satisfy the prudence and best financial interests covenants because it may countenance imposing a cost on members "with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct".[21]

28. The Trustee's board paper stated that there had been some difficulty for Care Super in applying APRA's expression of concern, noting that APRA had not responded to correspondence from its solicitors seeking a clarification and definition. In fact APRA responded to that correspondence by letter dated 16 November 2021, and published a discussion paper, *Strengthening Financial Resilience in Superannuation*, on 19 November 2021.[22]

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[18] Fourth affidavit of Mark Albert Bland affirmed on 10 November 2021, at [31]. The board paper for the directors' circular resolution is in Confidential Exhibit MAB-3 pages 69-73. The version of the draft Trustee Resilience Policy which was adopted by the board is at pages 74 to 89 of that Exhibit.
[19] Confidential Exhibit MAB-3 pages 69-70.
[20] Confidential Exhibit MAB-3 page 72.
[21] [2021] QSC 276 at [47].
[22] Affidavit of Samuel Mark Horskins affirmed on 26 November 2021 at [15]-[16] and Exhibit SH-1 pages 20-40.

29. As noted by Kelly J[23], APRA expressed its concern in terms that:

> "a trustee might not satisfy the prudence and best financial interests covenants if the trustee's scheme was to introduce a fee directed to the creation of the capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that the trustee may incur including where it has acted inappropriately".

30. Kelly J accepted evidence and submissions by the QSuper Board to the effect that when it became necessary to exercise the proposed remuneration power, the Board would be mindful of the implicit risk of regulatory action if there was any reasonable likelihood of liability for seriously delinquent conduct. His Honour concluded that when it came to exercise its proposed new remuneration power, the QSuper Board could be expected to be mindful of, and have due regard to, APRA's expressed concern that any change ought not impose a cost of members to cater for seriously delinquent conduct. These observations are generally applicable to the present case, and additionally in the present case no amendment to the Trust Deed is proposed and the Trustee's policy for the administration of the Reserve is before the Court.

31. In its submission in the *QSuper* case APRA did not define the expression "seriously delinquent conduct", but it was obviously an expression used to describe one end of the spectrum ranging from very poor contravening conduct through to inadvertent contraventions.[24] Legislation imposing limits on indemnities to a trustee and to company directors uses more widely recognised terms to define the borderline between permissible and impermissible indemnities. For example:

    (a) section 56(2) renders void a provision that (inter alia) would have the effect of indemnifying the trustee of a superannuation entity against liability for breach of trust if the trustee fails to act honestly or intentionally or recklessly fails to exercise care and diligence;

    (b) section 199A(2) of the Companies Act, which applies to a superannuation trustee company, prohibits a company or its related body corporate from indemnifying a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against (inter alia) a liability

[23] [2021] QSC 276 at [47].
[24] See APRA's Submissions [56], which explain that if the trustee were to introduce a fee directed to the creation of the capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all the non-indemnifiable liabilities the trustee may incur, including where it has acted inappropriately, the trustee might not satisfy the prudence, best financial interests and conflicts covenants.

owed to someone other than the company or a related body corporate that did not arise out of conduct in good faith;

(c) section 36(1) of the Trustee Act 1958 (Vic) expresses an implied indemnity of trustees which excludes loss that happens through the trustee's "own wilful default".

32. In addition to the statutory limitations on indemnifying a superannuation trustee, members of the CareSuper board will be subject to statutory and general law fiduciary duties not only in determining to establish the Reserve but also in administering the Reserve. This is because, while the Reserve will be personal property of the Trustee, it is a reserve established through a fee charged by the Trustee against the members' Fund and is established for the benefit of members, as explained in the Trustee Resilience Policy. Thus, as noted in APRA's Submissions, the board's statutory and general law duties as directors include the duty to act in the best interests of their company.[25] Other restrictions on any inappropriate payment of Reserve money to the Trustee are also noted in APRA's Submissions.[26]

33. The Trustee Resilience Policy which the CareSuper Board adopted on 10 November 2021 (the **Policy**) concerns how the Trustee will conduct its affairs. It is said the board's adoption of the Policy is central to keeping the Trustee in a sound financial position so as to protect the financial interests of members.[27] The Policy identifies uses for the Reserve which extend beyond what might be inferred from subparagraph (2)(c) of the Originating Motion, in two respects.

34. First, under the heading "Utilisation", the Policy states that "the Reserve is held by the Trustee beneficially to ensure funds are available for unforeseen contingencies that may require payments by the Trustee, including an amount required to meet a liability for which the Trustee is not permitted to be indemnified from the Fund".[28] This implies that the board may choose to deploy funds from the Reserve for purposes other than meeting liabilities for which the trustee is not permitted to be indemnified. Examples given in the Policy are to meet taxation liabilities of the Trustee that are not able to be met from the Fund and to maintain professional indemnity insurance by payment of premiums.[29] The Policy acknowledges that the Trustee's decisions to approve expenditure from the Reserve are governed by the

[25] APRA's Submissions, at [52].
[26] APRA's Submissions, at [50]-[51].
[27] See Policy page 4, first paragraph.
[28] Policy, pages 4, 6.
[29] Policy, page 6.

Trustee's obligation to balance the need for resilience with the objective of minimising cost to members and achieving appropriate member outcomes.[30]

35. Second, according to the Policy the Reserve will contain amounts "to provide for potential liabilities not permitted to be paid from the Fund". The Policy refers to payment of "penalties, infringement notices and other liabilities of the Trustee including under settlement of litigation and other claims". It also appears from the Policy and the board paper that the Reserve is to be used where primary liability is incurred by a director rather than by the Trustee. For example, in Appendix 1 to the Policy, one of the "Risks to the Trustee" is "the risk that failure to offer indemnities to directors of normal commercial terms or to have sufficient financial substance to enable the directors to be confident that they will be able to enforce their indemnity rights will endanger the ability of the Trustee to secure the appointment and retention of fit and proper directors …".[31] Similarly, the board paper says that while "profit to member ethos is central to our culture of putting members first", nevertheless "there is an inherent risk with this issue in that it affects directors personally as well as in their role as directors of the company that is the trustee of CareSuper", so that "without sufficient capital in the Trustee company, this presents a risk to the Trustee that it will not be able to retain fit and proper persons to act as directors of the company …".[32]

36. The Court may be concerned about whether there are sufficient constraints on a trustee in the position of the CareSuper Trustee making payments to directors to indemnify them from liability in respect of dishonest or reckless conduct. Article 33.1 of CareSuper's Constitution authorises the board to determine that the company indemnifies any officer for liability incurred in the capacity of officer of the company and for legal costs in defending an action for such liability; but the indemnity does not extend to an amount in respect of which the Corporations Act or any other statute prohibits the company from indemnifying. Given the terms of the board paper quoted above, it seems appropriate to infer that the directors have been granted the indemnity permitted by article 33.1.

37. The scope of any such indemnity is necessarily limited by any statutory restrictions on indemnities. Section 199A(2) of the Corporations Act prohibits any company from indemnifying a person (whether by agreement or by making a payment and whether directly or through an interposed entity) against liabilities including liabilities for pecuniary penalties or compensation orders made under specified Corporations Act provisions including relevant provisions of Part 9.4B, and also a liability owed to a third person which did not arise out of conduct in good faith.

[30] Policy, page 4; Appendix 1 at [2.1], page 11.
[31] Policy, Appendix 1 [3.5] page 11.
[32] Board paper, Confidential Exhibit MAB-3

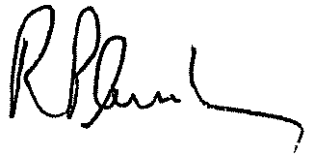
The Trustee would need to take this provision into account when considering any indemnity payment to a director.

38. Section 57 of the SIS Act applies to render void a provision of the governing rules of a superannuation entity insofar as it would have the effect of indemnifying a director of the trustee against certain liabilities, including a liability arising because the director fails to act honestly, or intentionally or recklessly fails to exercise the required degree of care and diligence, or a liability that is incurred for an amount of a criminal, civil or administrative penalty for contravention of a Commonwealth law. The permitted range of indemnities for directors is approximately reflected in clause 2.6(d) of the Trust Deed. But it appears likely that any payment from the Reserve indemnifying a director in respect of liability incurred in the course of his or her office would not be made under the governing rules of the CareSuper entity, but instead it would be made under contractual indemnity arrangements between Trustee and director.

39. Additional restrictions on potential misuse of the Reserve to benefit directors arise out of the terms of the Policy, as discussed above, and the statutory and general law duties of the members of the CareSuper board when considering whether to approve indemnity payments to directors.[33]

Costs

40. As amicus curiae, APRA is not a party to the proceeding and does not seek any order with respect to costs.



Dr R P Austin

D S W Allen

Counsel for APRA
29 November 2021

[33] APRA's Submissions, at [50]-[52].

IN THE SUPREME COURT
OF NEW SOUTH WALES
EQUITY DIVISION

2021/324994

NGS SUPER PTY LIMITED (ACN 46 003 491 487) AS TRUSTEE OF NGS SUPER (ABN 72 549 180 515)
Plaintiff

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (AS AMICUS CURIAE)

A. INTRODUCTION

1. On 11 November 2021, the plaintiff (the **Trustee**) served the Australian Prudential Regulation Authority (**APRA**) with its Summons dated 11 November 2021 (**Application**).

2. The Application, brought pursuant to subsection 63(1) of the *Trustee Act 1925* (NSW) (**Trustee Act**), seeks the Court's opinion, advice and direction that the Trustee would be justified in amending[1] the trust deed of NGS Super (the **Fund**), originally dated 10 June 1988 (**Trust Deed**),[2] to insert a clause that would allow a fee to be payable to the Trustee as remuneration in such amount as it determines to be "reasonable"[3] (**Proposed Amendment**) to replace an existing clause which made provision for the receipt of remuneration by the Trustee (but which has not previously been used by the Trustee to charge remuneration and which has been said to be unworkable).[4] The Application is supported by a Statement of Facts (**Statement of Facts**).

3. The Proposed Amendment, set out in the Statement of Facts, would provide the Trustee with a broad power to charge, deduct from the assets of the Fund, and retain for its own benefit, an amount which it determines to be *"reasonable remuneration"*.[5] The basis on which such fee is to be calculated is not otherwise provided for by the Proposed Amendment, although provision is made to permit the Trustee to charge a different fee or amount to any member or class of members based on *"such criteria as it determines*

[1] Pursuant to a power of amendment in clause 1.11.2 of the Trust Deed – Statement of Facts [44].
[2] Statement of Facts [30]; Affidavit Natalie Previtera affirmed 11 November 2021 at [2].
[3] Statement of Facts [6]; proposed clause 1.7.5.
[4] Statement of Facts [36], [50]; Affidavit Natalie Previtera affirmed 11 November 2021 at [10].
[5] Statement of Facts [6]; proposed clause 1.7.5(a).

is fair and reasonable".[6] The Proposed Amendment does not provide for any fixed time period by reference to which such remuneration is to be paid, any metric by which the quantum of the remuneration to be charged is to be fixed, any fixed cap on the trustee capital able to be accumulated by way of the exercise of that power, or for any review process in respect of the exercise of that power.

4. As is apparent from the Statement of Facts, the immediate catalyst for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) that limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund.[7] Those changes are the latest instance of increasing regulation of superannuation trustees and their directors under Commonwealth law.

5. The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Act 2019* (Cth) amended the SIS Act to make contraventions of the statutory covenants in ss 52 and 52A of the SIS Act the subject of a civil penalty. Following the passage of the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) (**Hayne Royal Commission Response Act**), trustees of superannuation funds are now required to hold an Australian Financial Services Licence and are subject to regulation under Chapter 7 of the *Corporations Act 2001* (Cth) (**Corporations Act**), including obligations imposed by civil penalty provisions (for example, the general obligations of financial services licensees in s 912A of the Corporations Act).

6. The Statement of Facts relies upon the concomitant escalating exposure of the Trustee and the directors to Commonwealth penalties over this time.[8] The amendments to sections 56 and 57 prohibit a trustee from indemnifying itself out of the assets of a fund for a criminal, civil or administrative penalty or for the payment of any amount payable under an infringement notice imposed or issued under any Commonwealth legislation and not, as previously, only under the SIS Act itself (**SIS Indemnification Amendments**). All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers

[6] Statement of Facts [6]; proposed clause 1.7.5(c).
[7] Statement of Facts [20], [64]-[111]; Affidavit Natalie Previtera affirmed 11 November 2021 at [7]-[9], [16].
[8] Statement of Facts [20], [64]-[111].

of financial services) with the duties and obligations owed to members (among other consumers of financial services).

7. The possible effect on members of the imposition of penalties on a superannuation trustee was mitigated to some extent by simultaneous amendments made by the Hayne Royal Commission Response Act that require a court, in determining a pecuniary penalty under the *Australian Securities and Investments Commission Act 2001* (Cth) or the Corporations Act, to take into account the impact that the penalty under consideration would have on the members of the fund.[9]

8. Even so, on the Trustee's Statement of Facts, lacking any significant fund of personal capital (as it currently does), and without insurance as a complete solution or any indemnity out of Fund assets for a Commonwealth penalty, if the Trustee does not resolve to levy a fee to accumulate personal capital the Trustee may not have the financial means to meet an un-indemnifiable liability and so would face some risk of insolvency, even with internal risk management systems and processes.[10]

B. APRA's position on the Application

9. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[11] APRA notes that these submissions are made without the benefit of having been provided by the Trustee with the documents underlying its Statement of Facts and evidence and the confidential Opinions.[12]

10. At the outset, it is important to note that, as recognised in paragraph 9.5 of the Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**), which introduced the SIS Indemnification Amendments, the SIS Act and the Registrable Superannuation Entity licensing regime are primarily

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[9] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GBB; Corporations Act s 1317G(6).
[10] Statement of Facts [51]-[52], [116]; Affidavit Natalie Previtera affirmed 11 November 2021 at [6], [13], [133](o).
[11] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).
[12] Plaintiff's submissions dated 11 November 2021 at [11]-[15].

designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and they deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

11. APRA further respectfully submits that the process of decision-making by a superannuation trustee in these circumstances should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of s 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Fund and s 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises various issues for the Court's consideration (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act) relevant to the manner in which the Trustee proposes to amend the existing fee-charging power, being a power that it has not previously exercised.[13]

Amendments to sections 56 and 57 of the SIS Act do not preclude payment of a trustee fee

12. The SIS Indemnification Amendments do not prohibit the outcome sought to be achieved by the Proposed Amendment. Sections 56(2) and 57(2) are directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee or a director of a trustee from, or indemnifying a trustee or director against, certain liabilities. The levying of a fee which is meant to build up over time into an asset that may be deployed by the trustee in the event that it or a director becomes subject to a liability against which it or the director cannot be indemnified does not have the substantive effect of conferring an exemption from or indemnifying against that liability.[14]

13. To recognise this is not to render sections 56 and 57 of the SIS Act pointless. The fee charged may prove to be insufficient to cover the extent of the Trustee's potential liability. Further, the Proposed Amendment does not have the effect of excusing or

[13] Statement of Facts [36], [50].
[14] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) (**Re QSuper Board**) at [32].

extinguishing the liability of the Trustee for any amount for which it cannot be indemnified out of the Fund. The Trustee would be able to accrue capital but would not enjoy a blanket indemnity that may dis-incentivise it from performing its duties carefully and diligently, in the sense that it is not freed from any personal consequence in the event of breach of duty.

14. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Fund must be considered by the board in light of their general law and statutory duties to act in good faith in the best interests of the Trustee.[15] The limits in sections 199A and 199B of the Corporations Act on the scope of indemnities given by companies, and insurance paid for by companies, in respect of liabilities incurred by a person as an officer of the company would apply.

15. This leaves for consideration whether the adoption of the Proposed Amendment would contravene other duties or obligations under the general law or the SIS Act applying to trustees of superannuation funds.

Compliance with duties as trustee

16. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the Application ought to be granted. The SIS Act covenants apply despite any provision in the governing rules of an entity.[16]

17. As to the general law, the relevant duties are:

    a. the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

    b. the duty to exercise reasonable care;

    c. the duty to preserve trust property;

    d. the duty to act impartially between the beneficiaries;

    e. the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

    f. the duty to avoid coming into a position of conflict of interest.

[15] Corporations Act s 181(1)(a) and (b).
[16] SIS Act s 7.

18. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards (Parts 3 and 3A).

Statutory covenants in s 52(2) SIS Act

19. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

a. acting honestly in matters concerning the fund: s 52(2)(a);

b. exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: s 52(2)(b);

c. acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

d. in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d); and

e. acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

20. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) (**Your Future, Your Super**), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries. According to the explanatory memorandum, the purpose of the amendment was:

> *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations ... The identification of a 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 evidence to support their expenditures.*[17]

[17] Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* at [3.32]-[3.33].

21. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[18] where her Honour Justice Jagot adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of her Honour's decision are at [61] to [65].

22. Those observations suggest a relatively broad and practical approach will be taken to s 52(2)(c), with a focus on financial interests. The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Justice Jagot's reasons – namely, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established – may require revisiting under a "best financial interests test". The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[19]

23. The best financial interests duty must also be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[20] The Report addressed the essential duties of responsible entities. It characterised the best interests duty as *"a general duty that complements the more specific obligations to act honestly and to exercise care, diligence and skill."*[21] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[22]

Conflicts Rule

24. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to

[18] (2019) 138 ACSR 459; see also Re QSuper Board at [36] and [42].
[19] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[20] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).
[21] Cited by Justice Moshinsky, "The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework", 9 March 2018, p 9.
[22] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

avoid conflicts of interest. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; (ii) to ensure that the duties to the beneficiaries are met despite the conflict; (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

25. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members. In doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

26. Section 52(12) imposes on trustees an obligation to promote the best financial interests of MySuper and choice product members, by reference in particular to the returns to those beneficiaries (after the deduction of fees, costs and taxes).

27. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

28. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

29. The Your Future, Your Super amendment to the covenant in section 52(2)(c) (as noted at paragraphs 20-23 above) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of members in their decision-making processes.

30. The Trustee currently has power to charge and be paid a fee by way of remuneration *"at an amount or rate agreed to by the Participant and the Trustee"*.[23] In addition, the Trustee has the power to charge a fee for the purposes of obtaining any necessary licences or approval, to recover any loss or expenditure incurred in connection with the Trust Deed, and to have repaid from the Fund all Fund expenses.[24] There is also currently a power for

[23] Statement of Facts [36]; cl 1.7.5(a) of existing Trust Deed; Affidavit Natalie Previtera affirmed 11 November 2021 at [10].
[24] Statement of Facts [36], [38]-[39], [48]-[49]; c;l 1.7.5(a), 1.3.9, 1.3.12 of existing Trust Deed.

any "Authorised Person" who performs work for the Fund to be paid *"all usual fees for work done by that person or any firm in which that person is a partner or an employee"*.[25]

31. The introduction of a fee to be charged to members or to the assets of the Fund itself will have an adverse financial impact on the retirement benefits of members over the long term. Relevantly however, the material indicates that the Trustee proposes to smooth the initial impact by deducting the proposed trustee fee from the Fund's Administration Reserve, which it is said would have the consequence that there will not be an increase in fees charged against a member's account.[26] The Statement of Facts also indicate an intention on the part of the Trustee to disclose movements in the Administration Reserve, and the steps that have already been taken to disclose the proposed introduction of the remuneration fee to its members.[27]

32. Furthermore, the financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes or may become insolvent. In contrast to other applications of a similar kind which have been (or are soon to be) heard by this Court (and courts in other states), the Trustee has not sought to put before this Court evidence of its assessment of the potential costs and other consequences in the event that the Trustee becomes insolvent and is thereby disqualified from acting as trustee.[28] It is left to this Court therefore to infer what such disruption and cost would be.[29]

33. In its Statement of Facts, the Trustee has however identified some of the circumstances it has considered relevant to, and which provide reasons for consenting to, the Proposed Amendment.[30] A number of these bear similarity to those circumstances which in Re QSuper Board were found by Justice Kelly to provide good and sufficient reasons for the proposed amendment in that case.[31]

34. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed

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[25] Statement of Facts [36]; cl 1.7.5(b) of existing Trust Deed.
[26] Statement of Facts [114], [133](s), [134](i)-(k).
[27] Statement of Facts [136]-[137].
[28] SIS Act s 120; it is an offence to be a trustee once disqualified (SIS Act s 126K).
[29] cf Statement of Facts [134](e)
[30] Statement of Facts [133]-[134].
[31] Re QSuper Board at [37] cf Statement of Facts [133]; Affidavit Natalie Previtera affirmed 11 November 2021 at [17].

Amendment is reasonably justifiable on that basis.[32] This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a given problem.

35. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives.[33] The Trustee has made statements in this regard,[34] which are outlined in paragraph 46 below in the context of the covenant to exercise care, skill and diligence.

36. One of the circumstances relevant to the payment of a new fee is that the Trustee itself is restricted in its use of funds to some degree. The Trustee has indicated that it has a draft Trustee Capital Management Policy to govern the raising, use and management of the proposed capital reserve.[35] The Trustee's shareholders have also recently approved amendments to its constitution which govern how the assets or property of the Trustee are to be dealt with should certain events occur, including if the Trustee ceases to be the trustee of the Fund or is wound up or dissolved.[36]

37. In addition, the Trustee is an Australian proprietary company limited by shares. The object for which the Trustee is constituted is to act as trustee of the Fund.[37] The Trustee's constitution provides that the income and property of the Trustee must be applied by it for the purpose of carrying out that object and must not be distributed to members of the Trustee.[38] The Trustee is prohibited from distributing any income or capital of the Trustee to its members, including by pay of payment of dividends,[39] and has stated that it has never paid and does not intend to pay any dividends.[40] These provisions in the Trustee's constitution do not prescribe for what uses the proceeds of the fee may be deployed, but they form part of the background to the Application.

38. Relevantly also, the chief risk and governance officer of the Trustee has given evidence that she is not aware of any matter that would give rise to a fine or penalty that would

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[32] (2019) 138 ACSR 459 at [64]; see also Re QSuper Board at [36].
[33] As for example referenced at Statement of Facts [128]-[129].
[34] Statement of Facts [112]-[113], [116].
[35] Statement of Facts [115], [133](r), [134](m)-(n).
[36] Statement of Facts [22](b); Constitution cll 15.2-15.3.
[37] Statement of Facts [22](a), Constitution cl 1.7(a).
[38] Statement of Facts [22](a), Constitution cl 1.7(c).
[39] Statement of Facts [22](b), Constitution cl 15.1.
[40] Statement of Facts [18].

need to be paid from any capital reserve created pursuant to the Proposed Amendment.[41] The Trustee has additionally in its Statement of Facts identified that the Board is not aware of any investigation or enforcement proceedings in respect of the Trustee or any of its directors or officers, and further is not aware of any allegations of breach of trust.[42]

Covenant to exercise care, skill and diligence

39. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

40. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. In contrast to other applications of a similar kind which have been (or are soon to be) heard by this Court (and courts in other states), the Trustee has not sought to put before this Court evidence as to the amount of the fee which it proposes to charge as remuneration, although it has indicated a proposed target level for the capital reserve.[43] Nor has the Trustee put on (in contrast to other applicants) a report from an external consultant demonstrating that it has undertaken financial modelling for the proposed future fees to provide comfort that the fees have been quantified having regard to the effectiveness of governance, risk management framework, risk practices, resources and controls in place to minimize systemic and one off breaches, and to balance the purpose of reducing and managing the risk of insolvency against the members' best financial interests. Nevertheless it is to be noted that in Re QSuper Board Justice Kelly was, in respect of a similarly broadly worded proposed remuneration power, satisfied that it was appropriate to give the advice sought notwithstanding such breadth.[44]

41. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally

[41] Affidavit Natalie Previtera affirmed 11 November 2021 at [21]; see also Statement of Facts [119].
[42] Statement of Facts [28], [118], [133](v)-(w).
[43] Statement of Facts [134](m).
[44] Re QSuper Board at [43]-[47].

diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

42. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may occur including where it has acted inappropriately.[45]

43. Here, as noted, no report has been put forward to explain the proposed fee or target level for the capital reserve. Nevertheless, as in Re QSuper Board, it is open also to this Court to assume that the Trustee, when exercising that broad remuneration power, will be mindful that any charge ought not to impose a cost on members to cater for seriously delinquent conduct.[46] Likewise it is open to this Court to infer that the Trustee will, in exercising the proposed power and setting the level of remuneration, have regard to its duties as a trustee which, inter alia, require the remuneration power to be exercised for a proper purpose having regard to the best financial interests of the members, and in accordance with its duty of care, skill and diligence.[47] The Trustee has notably stated that it proposes to exercise the remuneration power having regard to (amongst other matters) its responsibilities under the Corporations Act, the financial impact on members, industry benchmarking, and a medium risk appetite.[48] There is otherwise no evidence that the Trustee's purpose in seeking the Proposed Amendment is to enable it to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls or to exclude any residual risk to the Trustee.

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[45] cf Re QSuper Board at [47].
[46] Re QSuper Board at [47].
[47] Re QSuper Board at [41], [43]-[44].
[48] Statement of Facts [134].

44. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The recognition of the application of the Trustee's legal obligations to the future exercise of the remuneration power is consistent with a trustee's duty of care, skill and diligence and duty to act in the best financial interest of members.[49] The Proposed Amendment does not contain such a review mechanism. The Trustee has however made statements that it proposes to exercise the remuneration power taking into account (amongst other matters) the target level of capital reserve and extent of capital reserve held.[50]

45. Finally, in order to discharge the duty of diligence, a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon members.[51] That is to say, a trustee should explore whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by, for example, investing in compliance or governance systems or upskilling; insurance; contributions from shareholders or associated entities; and/or the availability of indemnities from service providers to the Trustee.[52]

46. The Trustee has made statements in this regard as to the enhancements made to its internal risk management systems and processes[53] and to the considerations it has given for alternative options to fund un-indemnifiable liabilities.[54] It has been said that such alternative options would not suffice to meet that risk.[55]

Consideration of the conflicts covenant in assessing the Proposed Amendment

47. As noted above, s 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

48. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind enures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant

[49] Re QSuper Board at [44].
[50] Statement of Facts [134](m)-(n).
[51] Re QSuper Board at [48].
[52] cf Re QSuper Board at [40(h)].
[53] Statement of Facts [116].
[54] Statement of Facts [51]-[53], [112].
[55] Statement of Facts [113].

presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

49. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

50. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

51. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

52. As noted at paragraph 31 above, the Trustee has proposed to smooth the initial impact on current and future members by deducting the proposed trustee fee from the Fund's Administrative Reserve, rather than by increasing the administration fee charged to member accounts.[56] The Proposed Amendment also permits the Trustee to charge a different fee or amount to any member or class of members based on such criteria as it

[56] Statement of Facts [114], [133](s), [134](i)-(k).

determines is fair and reasonable.[57]

C. CONFIDENTIAL MATERIAL

53. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. APRA understands that on 3 December 2021 this Court made interim suppression orders pursuant to section 10 of the *Court Suppression and Non-publication Orders Act 2010* (NSW) (**CSPO**) over certain of the material filed by the Trustee in support of the Application.[58] APRA further understands that the Trustee seeks final suppression orders pursuant to s 8 of the CSPO over that same material.

54. Part 2 of the CSPO relevantly empowers the Court to make a suppression order or non-publication order,[59] as follows:

> **6 Safeguarding public interest in open justice**
>
> In deciding whether to make a suppression order or non-publication order, a court must take into account that a primary objective of the administration of justice is to safeguard the public interest in open justice.
>
> **7 Power to make orders**
>
> A court may, by making a suppression order or non-publication order on grounds permitted by this Act, prohibit or restrict the publication or other disclosure of—
>
> (a) information tending to reveal the identity of or otherwise concerning any party to or witness in proceedings before the court or any person who is related to or otherwise associated with any party to or witness in proceedings before the court, or
>
> (b) information that comprises evidence, or information about evidence, given in proceedings before the court.
>
> **8 Grounds for making an order**
>
> (1) A court may make a suppression order or non-publication order on one or more of the following grounds—
>
> (a) the order is necessary to prevent prejudice to the proper administration of justice...

55. As explained by Bathurst CJ and McColl JA in *Rinehart v Welker* (2011) 93 NSWLR 311; [2011] NSWCA 403 at [27]:

> The operative condition for making a suppression order under s 8 of the CSPO Act is that it be "necessary" to do so, which "... is a strong word [which, in] collocation [with] necessity to prevent prejudice to the administration of justice ...'suggests Parliament was

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[57] Statement of Facts [6].

[58] See also: Statement of Facts [7]; Affidavit Natalie Previtera affirmed 11 November 2021 at [26]-[31].

[59] As noted by the High Court in *HT v The Queen* [2019] HCA 40; 93 ALJR 1307 a superior court also has inherent power to *"vary its procedures to meet the exigencies of a particular case"* including to maintain confidentiality (at [42], [46], [81]-[84]).

not dealing with trivialities'": *Hogan v Australian Crime Commission* [2010] HCA 21; (2010) 240 CLR 651 (at [30]). The observations in *Hogan v Australian Crime Commission* were made in relation to a legislative scheme which, while it required the jurisdiction of the Court to be exercised in open court (s 17, Federal Court of Australia Act) did not contain a provision in like terms to s 6 of the CSPO Act. That provision, in our view, reinforces the legislative intention that CSPO Act orders should only be made in exceptional circumstances, a position which prevailed at common law: *John Fairfax Publications Pty Ltd v District Court of NSW* (at [21]).

56. Further, as recently noted by Davies J in *State of New South Wales v Avakian (No 2)* [2021] NSWSC 677 at [16]-[17]:

> [16] When discussing the meaning of the word "necessary", Bathurst CJ said in *Fairfax Digital Australia & New Zealand Pty Ltd v Ibrahim* (2012) 83 NSWLR 52; [2012] NSWCCA 125 at [8] that it is not sufficient that orders are merely reasonable or sensible. Even if that were the appropriate test when considering s 8, regard would still need to be had to the mandatory requirement in s 6, that a primary objective of the administration of justice is to safeguard the public interest in open justice. That, as the Court of Appeal said in *Rinehart v Welker*, means that orders under the CSNO Act should only be made in exceptional circumstances.
>
> [17] In *State of New South Wales v Wilmot* [2019] NSWSC 1002 at [24], Lonergan J helpfully summarised the important principles for applications such as the present;
>
> > For present purposes, the following principles may be distilled from the authorities concerning the operation of the Suppression Act:
> >
> > 1) The starting point is consideration of the public interest in open justice which is the primary objective of the administration of justice.
> >
> > 2) In s 8(1) of the Suppression Act, "necessary" identifies a standard as to which the Court must be satisfied before making an order.
> >
> > 3) The applicant has to prove on the "balance of probabilities" that the order sought is necessary.
> >
> > 4) The test of necessity requires a high degree of certainty.
> >
> > 5) The question of necessity depends on the strength of the evidence called in support.
> >
> > 6) An order will not be "necessary" if it is simply convenient, reasonable or sensible or to serve some notion of the public interest. Mere belief that the order is necessary is not sufficient.
> >
> > 7) The order must have utility and must not be futile....

57. Relevantly, s 8(1)(a) of the CSPO is directed to the "multi-faceted concept" of "prejudice to the proper administration of justice"; its premise being *"that if the kind of order proposed is not made, the result will be — or at least will be assumed to be — that particular consequences will flow, that those consequences are unacceptable, and*

that therefore the power to make orders which will prevent them is to be implied as necessary to the proper function of the court."[60]

58. A further relevant consideration is the open-court principle. It is only in "exceptional circumstances" that the Court should depart from the primary objective of safeguarding the public interest in open justice (s 6 of the CSPO). Open justice requires that proceedings are *"fully exposed to public and professional scrutiny and criticism… to maintain confidence in the integrity and independence of the courts".*[61] Equally, open justice will at times be held to yield to the need to do justice.[62] As French CJ observed in *Hogan v Hinch* (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain that standard. However, it is not absolute.*[63]

59. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[64]

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[60] *Wilson v Basson* [2020] NSWSC 512 at [17]; *John Fairfax Group Pty Ltd v Local Court of New South Wales* (1991) 26 NSWLR 131 at 161.
[61] *Russell v Russell* (1976) 134 CLR 495 at 520; [1976] HCA 23; *Hogan v Hinch* [2011] HCA 4; 243 CLR 506; at [20]-[27].
[62] *HT v The Queen* [2019] HCA 40; 93 ALJR 1307 at [43]-[46].
[63] (2011) 243 CLR 506 at [20].
[64] *Hogan v Hinch* (2011) 243 CLR 506 at [20]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69].

IN THE SUPREME COURT
OF NEW SOUTH WALES **2021/326965**
EQUITY DIVISION

LGSS PTY LIMITED (ACN 078 003 497) AS TRUSTEE FOR LOCAL GOVERNMENT SUPER (ABN 28 901 371 321)
Plaintiff

SUBMISSIONS OF THE AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY (AS AMICUS CURIAE)

A. INTRODUCTION

1. On 17 November 2021, the plaintiff (the **Trustee**) served the Australian Prudential Regulation Authority (**APRA**) with its Summons dated 16 November 2021 (**Application**).

2. The Application, brought pursuant to subsection 63(1) of the *Trustee Act 1925* (NSW) (**Trustee Act**), seeks the Court's opinion, advice and direction that the Trustee would be justified in amending[1] the trust deed of Local Government Super (operating under the name Active Super) (the **Fund**),[2] originally dated 30 June 1997 (**Trust Deed**),[3] to insert a clause that provides a general power under the Trust Deed that allows a fee to be payable to the Trustee for an amount fixed by reference to the net assets of the Fund, subject to a discretionary power given to the Trustee to reduce, waive, suspend or postpone that fee and to, every three years, adjust the fee payable to an amount which the Trustee considers fair and reasonable (**Proposed Amendment**).[4]

3. The Application is supported by a Statement of Facts (**Statement of Facts**) and bears a number of similarities to other recent judicial advice applications before this Court – as to both the form of the Proposed Amendment sought and the material and reasons advanced in support of the advice sought by the Application.

[1] Pursuant to a power of amendment in clauses 20.5 and 20.6 of the Trust Deed – Exhibit DMH-1 p 417; Affidavit Donna Heffernan affirmed 16 November 2021 at [71]-[81], [128].
[2] Affidavit Donna Heffernan affirmed 16 November 2021 at [5].
[3] Exhibit DMH-1 p 40-345.
[4] Proposed clause 4.6, Deed of Amendment; Affidavit Donna Heffernan affirmed 16 November 2021 at [63]-[70]. The Proposed Amendment additionally provides for an amendment to cl 9.2 of the Trust Deed to take into account the restrictions imposed by ss 56 and 57 of the SIS Act.

4. The Proposed Amendment, set out in a draft deed of amendment annexed to the Statement of Facts, would provide the Trustee with a broad power to charge, deduct from the assets of the Fund, and retain for its own benefit, a fee calculated as a percentage of the net assets of the Fund for each financial year.[5] The fee may not be paid to the Trustee if it would result in the net tangible assets of the Trustee exceeding a specified cap, calculated as a percentage of the net assets of the Fund.[6] The amount of the fee, and the cap on the Trustee's net tangible assets at which point the fee is not payable, may be adjusted by the Trustee, to any higher or lower amounts as it determines to be fair and reasonable, having regard to the advice of an appropriately qualified independent consultant, following each period of three years.[7]

5. As is apparent from the Statement of Facts, the immediate catalyst for the Proposed Amendment is the impact of recent amendments to sections 56 and 57 of the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) that limit the ability of a superannuation trustee to indemnify itself and its directors out of the assets of a fund.[8] Those changes are the latest instance of increasing regulation of superannuation trustees and their directors under Commonwealth law since the Trustee first became trustee of the Fund in 1997.[9]

6. The *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No.1) Act 2019* (Cth) amended the SIS Act to make contraventions of the statutory covenants in ss 52 and 52A of the SIS Act the subject of a civil penalty. Following the passage of the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020* (Cth) (**Hayne Royal Commission Response Act**), trustees of superannuation funds are now required to hold an Australian Financial Services Licence and are subject to regulation under Chapter 7 of the *Corporations Act 2001* (Cth) (**Corporations Act**), including obligations imposed by civil penalty provisions (for example, the general obligations of financial services licensees in s 912A of the Corporations Act).

7. The Statement of Facts relies upon the concomitant escalating exposure of the Trustee

[5] See clause 4.6(a), Deed of Amendment.
[6] See "Trustee Capital" in clause 4.6(f)(iii) (and cl 4.6(c)(i)), Deed of Amendment.
[7] Clause 4.6(d)-(e) (and see "Review Period" in cl 4.6(f)(i)), Deed of Amendment.
[8] Statement of Facts [8]-[17].
[9] Affidavit Donna Heffernan affirmed 16 November 2021 at [82]-[84], [96]-[98]; Exhibit DMH-1 p 1, 40.

and the directors to Commonwealth penalties over this time.[10] The amendments to sections 56 and 57 prohibit a trustee from indemnifying itself out of the assets of a fund for a criminal, civil or administrative penalty or for the payment of any amount payable under an infringement notice imposed or issued under any Commonwealth legislation and not, as previously, only under the SIS Act itself (**SIS Indemnification Amendments**). All of these changes are consistent with the legislative focus on improving compliance on the part of superannuation trustees (among other providers of financial services) with the duties and obligations owed to members (among other consumers of financial services).

8. The possible effect on members of the imposition of penalties on a superannuation trustee was mitigated to some extent by simultaneous amendments made by the Hayne Royal Commission Response Act that require a court, in determining a pecuniary penalty under the *Australian Securities and Investments Commission Act 2001* (Cth) or the Corporations Act, to take into account the impact that the penalty under consideration would have on the members of the fund.[11]

9. Even so, on the Trustee's evidence, lacking any significant fund of personal capital (as it currently does), and without insurance as a complete solution or any indemnity out of Fund assets for a Commonwealth penalty, if the Trustee does not resolve to levy a fee to accumulate personal capital the Trustee would be at some risk of insolvency.[12]

B. APRA's position on the Application

10. In making the following submissions, APRA's intention is to assist the Court as an *amicus curiae* by identifying the legal principles and discretionary considerations which, in APRA's view, bear upon the decision whether to grant the relief sought in the Application. Litigation involving statutes of wide public importance often calls for the participation of the regulator, who will often perceive the application of the statute distinctly.[13]

11. At the outset, it is important to note that, as recognised in paragraph 9.5 of the

[10] Statement of Facts [8]-[17].
[11] *Australian Securities and Investments Commission Act 2001* (Cth) s 12GBB; Corporations Act s 1317G(6).
[12] Affidavit Donna Heffernan affirmed 16 November 2021 at [85], [87].
[13] *Tonto Home Loans Australia Pty Ltd v Tavares; FirstMac Ltd v Di Benedetto; FirstMac Ltd v O'Donnell (No 2)* [2012] NSWCA 129 at [7] (Allsop P, Bathurst CJ and Campbell JA agreeing).

Explanatory Statement to the *Financial Sector Reform (Hayne Royal Commission Response) Bill 2020* (**Bill**), which introduced the SIS Indemnification Amendments, the SIS Act and the Registrable Superannuation Entity licensing regime are primarily designed with prudential supervision in mind. This means the focus of obligations is on governance and other prudential requirements that ensure trustees operate in a manner consistent with their best interest obligations and they deliver quality outcomes for members, including financial outcomes for members. That focus was not altered by the amendments effected by the Bill. For that reason, APRA respectfully submits that member outcomes are a critical consideration in the determination of the Application.

12. APRA further respectfully submits that the process of decision-making by a superannuation trustee in these circumstances should reflect the requirements of the statutory covenants, including most relevantly the requirements by reason of s 52(2)(c) of the SIS Act that the Trustee act in the best financial interests of the members of the Fund and s 52(2)(b) that the Trustee exercise the same degree of care, skill and diligence as a prudent superannuation trustee. A central issue in that decision-making process ought to be whether the proposed solution is proportionate and appropriately tailored to the problem. This raises various issues for the Court's consideration (including issues of intergenerational equity and the trustee's duties of impartiality under s 52(2)(e) and (f) of the SIS Act) relevant to the manner in which the Trustee proposes to introduce a fee-charging power, being a power that has not previously been granted to the Trustee.[14]

The amendments to sections 56 and 57 of the SIS Act do not preclude payment of a trustee fee

13. The SIS Indemnification Amendments do not prohibit the outcome sought to be achieved by the Proposed Amendment. Sections 56(2) and 57(2) are directed to provisions of the governing rules of a superannuation entity which would have the effect of exempting a trustee or a director of a trustee from, or indemnifying a trustee or director against, certain liabilities. The levying of a fee which is meant to build up over time into an asset that may be deployed by the trustee in the event that it or a director becomes subject to a liability against which it or the director cannot be indemnified does not have the substantive effect of conferring an exemption from or

[14] Affidavit Donna Heffernan affirmed 16 November 2021 at [63]-[70].

indemnifying against that liability.[15]

14. To recognise this is not to render sections 56 and 57 of the SIS Act pointless. The fee charged may prove to be insufficient to cover the extent of the Trustee's potential liability. Further, the Proposed Amendment does not have the effect of excusing or extinguishing the liability of the Trustee for any amount for which it cannot be indemnified out of the Fund. The Trustee would be able to accrue capital but would not enjoy a blanket indemnity that may dis-incentivise it from performing its duties carefully and diligently, in the sense that it is not freed from any personal consequence in the event of breach of duty.

15. Any use of trustee capital by the board of the Trustee to indemnify or insure directors against liabilities for which the directors cannot be indemnified out of the Fund must be considered by the board in light of their general law and statutory duties to act in good faith in the best interests of the Trustee.[16] The limits in sections 199A and 199B of the Corporations Act on the scope of indemnities given by companies, and insurance paid for by companies, in respect of liabilities incurred by a person as an officer of the company would apply.

16. This leaves for consideration whether the adoption of the Proposed Amendment would contravene other duties or obligations under the general law or the SIS Act applying to trustees of superannuation funds.

Compliance with duties as trustee

17. The Trustee owes duties as a trustee, both at general law and under the SIS Act, which bear upon the question whether the relief sought in the Application ought to be granted. The Trust Deed provides that the Trustee, in making decisions in relation to the Fund must comply with the requirements of the SIS Act.[17] The SIS Act covenants in any event apply despite any provision in the governing rules of an entity.[18]

18. As to the general law, the relevant duties are:

    a. the duty to exercise powers fairly and honestly and for the purposes for which such powers were given;

[15] cf. *Re QSuper Board* [2021] QSC 276 (Kelly J) (**Re QSuper Board**) at [32].
[16] Corporations Act s 181(1)(a) and (b).
[17] Clause 3.16 and 6.1-6.2, 6.8 of the Trust Deed – Exhibit DMH-1 p 376, 380-383, 385.
[18] SIS Act s 7.

b. the duty to exercise reasonable care;

c. the duty to preserve trust property;

d. the duty to act impartially between the beneficiaries;

e. the duty not to deal with trust property for personal benefit, or otherwise to profit from the trust; and

f. the duty to avoid coming into a position of conflict of interest.

19. Trustees may come under statutory duties by a number of means under the SIS Act including by reason of the statutory covenants expressed in s 52 (and s 52A), covenants made under regulation (s 54A), or by reason of operating standards or prudential standards (Parts 3 and 3A).

Statutory covenants in s 52(2) SIS Act

20. Section 52(2) of the SIS Act sets out numerous covenants which bind superannuation trustees, including:

a. acting honestly in matters concerning the fund: s 52(2)(a);

b. exercising the same degree of care, skill and diligence as a prudent superannuation trustee in matters concerning the fund: s 52(2)(b);

c. acting in the best financial interests of the beneficiaries when performing duties and exercising powers: s 52(2)(c);

d. in circumstances where a conflict exists, giving priority to the duties owed to, and interests of, beneficiaries and ensuring that the duties to beneficiaries are met and the interests of beneficiaries are not adversely affected by the conflict: s 52(2)(d); and

e. acting fairly in dealing with classes of beneficiaries within the fund and when dealing with beneficiaries within a class: s 52(2)(e) and (f).

Performing duties and exercising powers in the best financial interests of beneficiaries

21. By reason of the *Treasury Laws Amendment (Your Future, Your Super) Act 2021* (Cth) (**Your Future, Your Super**), from 1 July 2021, the references to "best interest" of beneficiaries in s 52(2)(c) were replaced with references to "best financial interests" of beneficiaries. According to the explanatory memorandum, the purpose of the

amendment was:

> *to clarify that the financial interests (and not non-financial interests) of beneficiaries must be the determinative factor for trustees to comply with their obligations … The identification of a 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 evidence to support their expenditures.*[19]

22. The duty as it was previously framed was considered at some length in *APRA v Kelaher*,[20] where her Honour Justice Jagot adopted an approach to the duty that directs attention to an objective assessment of the interests of beneficiaries at the time of the relevant decision, subject to the qualification that if the trustee is proved to have had a purpose or object contrary to the best interests of the beneficiaries, the duty is breached. The relevant parts of her Honour's decision are at [61] to [65].

23. Those observations suggest a relatively broad and practical approach will be taken to s 52(2)(c), with a focus on financial interests. The courts have not yet had to consider the extent to which a narrowing in focus brought about by the recent amendments alters the duty. In particular, proposition (3) in paragraph [65] of Justice Jagot's reasons – namely, that acting in the best interest of the beneficiaries is in effect synonymous with a trustee's obligation to promote and act consistently with the purpose for which the trust was established – may require revisiting under a "best financial interests test". The expression "interests of the beneficiaries" has been held to have a broad general meaning which includes the concern of the members with the due administration of the trust.[21]

24. The best financial interests duty must also be considered within the setting of the trustee's covenant to exercise the care, skill and diligence of a prudent superannuation trustee. The origin of section 52 of the SIS Act can be traced to the joint Report of the Australian Law Reform Commission and the Companies and Securities Advisory Committee, *Collective Investments: Superannuation* (1992).[22] The Report addressed the essential duties of responsible entities. It characterised the best interests duty as, *"a general duty that complements the more specific obligations to act honestly and to*

[19] Explanatory Memorandum, *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* at [3.32]-[3.33].
[20] (2019) 138 ACSR 459; see also Re QSuper Board at [36] and [42].
[21] *Australian Securities and Investments Commission v Lewski* (2018) 266 CLR 173 at [50].
[22] *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* (2011) 282 ALR 167 at [110]-[115] (Giles JA, Young and Whealy JJA agreeing).

exercise care, diligence and skill."[23] The notion of a proactive best interests duty was the basis upon which *Cowan v Scargill* [1985] Ch 270 was decided, in which Megarry V-C said that trustees must do the best they can for their beneficiaries, and not merely avoid harming them.[24]

Conflicts Rule

25. Section 52(2)(d) differs from the conventional formulation of the duty of a fiduciary to avoid conflicts of interest. The provision operates where there is a relevant conflict. In those circumstances, s 52(2)(d) requires the trustee: (i) to give priority to the duties to and interests of the beneficiaries over the duties to and interests of the other persons; (ii) to ensure that the duties to the beneficiaries are met despite the conflict; (iii) to ensure that the interests of the beneficiaries are not adversely affected by the conflict; and (iv) to comply with the prudential standards in relation to conflicts.

Further statutory covenants

26. Section 52(9) imposes on trustees by way of covenant an obligation to undertake an annual outcomes assessment which focuses on whether the MySuper and choice products offered are being conducted in such a way as to promote the best financial interests of members. In doing so, the trustee is required to make relevant comparisons with other superannuation funds by reference to benchmarks set out in ss 52(10)-(10A).

27. Section 52(12) imposes on trustees an obligation to promote the best financial interests of MySuper and choice product members, by reference in particular to the returns to those beneficiaries (after the deduction of fees, costs and taxes).

28. Section 54A provides that regulations may prescribe further covenants so long as they are capable of operating concurrently with the statutorily enshrined covenants.

29. Section 54B requires that a trustee not contravene the relevant covenants. These are civil penalty provisions: s 54B(3). Remedies are contained in section 55.

Consideration of duties as trustee in assessing the Proposed Amendment

Best financial interests covenant

30. The Your Future, Your Super amendment to the covenant in section 52(2)(c) (as noted at

[23] Cited by Justice Moshinsky, "The continuing evolution of the 'best interests' duty for superannuation trustees from *Cowan v Scargill* to the current regulatory framework", 9 March 2018, p 9.
[24] *Cowan v Scargill* [1985] Ch 270 at 295 (Megarry V-C).

paragraphs 21-24 above) demonstrates a legislative purpose of ensuring that trustees give primacy to the financial interests of members in their decision-making processes. In the material put before the Court, the Trustee has evidenced the consideration it has given to how the financial interests of members may be affected if the Proposed Amendment is not made and the Trustee becomes insolvent or faces a real risk of insolvency.[25]

31. The Trustee does not currently have a general power to charge or be paid a fee for the services that it performs for the Fund, although there are in respect of certain divisions of the Fund limited powers granting the Trustee an entitlement to fees.[26] The deputy chief executive officer of the Trustee has given evidence that such entitlements are not, in her opinion, suitable to address the risks to which the Proposed Amendment is directed.

32. The Trustee also has several general powers to be reimbursed from the Fund for all reasonable expenses incurred in carrying out its duties (including for remuneration paid to directors of the Trustee); to have repaid all expenses in connection with the management and administration of the Fund; and to realise and make deductions from Fund assets (as required) to meet anticipated expenses or obligations.[27] The deputy chief executive officer of the Trustee has given evidence as to the nature of the current fees and costs charged to members and to the Fund, which are substantial.[28]

33. The introduction of a fee to be charged to members or to the assets of the Fund itself will have an adverse financial impact on the retirement benefits of members over the long term. Relevantly however, the material indicates that the Trustee proposes to smooth the initial impact on current and future members by deducting at least part of the proposed trustee fee from the Fund's Administration Reserve, which has accumulated over time, rather than by increasing immediately the administration fee charged to member accounts.[29]

34. Furthermore, the financial impact on members' retirement benefits caused by the trustee charging remuneration has to be weighed against the financial impact to members if the trustee, having been precluded from relying on indemnities and otherwise having insufficient capital to meet its liabilities, becomes or may become insolvent. The deputy chief executive officer of the Trustee has given evidence that one

[25] Affidavit Donna Heffernan affirmed 16 November 2021 at [94]-[131].
[26] Affidavit Donna Heffernan affirmed 16 November 2021 at [68]-[70], [95].
[27] Affidavit Donna Heffernan affirmed 16 November 2021 at [34], [63]-[67]; Trust Deed cl 4.5, 6.7, 9.2, 16.5.
[28] Affidavit Donna Heffernan affirmed 16 November 2021 at [34]-[44], [67].
[29] Affidavit Donna Heffernan affirmed 16 November 2021 at [111]; Exhibit DMH-2 p 24-27.

of three broad scenarios is likely to eventuate in the event the Trustee becomes insolvent and is thereby disqualified from acting as trustee:[30] (a) a replacement trustee is appointed; (b) the Fund is merged with another superannuation fund by way of successor fund transfer; or (c) a replacement trustee is appointed for an interim period before the Fund is merged with another fund by way of successor fund transfer.[31]

35. The transition costs to members to effect a successor fund transfer comprise direct investment-related costs, indirect investment-related costs and non-investment-related transition costs. Direct investment-related costs include broker commissions, taxes and fees expected to be incurred. Indirect investment-related transition costs reflect the forecast potential market impact of buying and selling assets, as well as the impact of market movement during the transition period. Non-investment-related transition costs are the anticipated costs of the transition of contracts, employment arrangements and administrative platforms and processes between the Trustee or Fund and a replacement trustee or fund, including associated legal costs.[32] The Trustee has prepared estimates of costs of this kind.[33] The Trustee has further identified and taken into consideration other financial costs that are said to be more difficult to quantify, including the reputational and member sentiment risks associated with insolvency[34] and the increased difficulties in attracting and retaining appropriately skilled directors.[35]

36. Additionally, the deputy chief executive officer of the Trustee has identified certain additional complexities particular to this Fund – namely, the vesting of power to appoint a new trustee in the Treasurer and the impact of a successor fund transfer on participating employer's contribution obligations – which in her view are matters relevant to the potential harm to members were an insolvency situation to result.[36]

37. As *Kelaher* holds, the question for the Court is not what is in the best financial interests of members, but whether the decision of the Trustee to consent to the Proposed Amendment is reasonably justifiable on that basis.[37] This distinction recognises that the test does not presuppose that only one course of action is permissible in response to a

[30] SIS Act s 120; it is an offence to be a trustee once disqualified (SIS Act s 126K).
[31] Affidavit Donna Heffernan affirmed 16 November 2021 at [98].
[32] Affidavit Donna Heffernan affirmed 16 November 2021 at [99].
[33] Affidavit Donna Heffernan affirmed 16 November 2021 at [99]; Exhibit DMH-2 p 2-11, 25-27.
[34] Affidavit Donna Heffernan affirmed 16 November 2021 at [101].
[35] Affidavit Donna Heffernan affirmed 16 November 2021 at [105], [113].
[36] Affidavit Donna Heffernan affirmed 16 November 2021 at [102]-[104].
[37] (2019) 138 ACSR 459 at [64]; see also Re QSuper Board at [36].

given problem.

38. Notwithstanding the apparently objective assessment required of whether a course of conduct is 'reasonably justifiable' as being in the beneficiaries' best interests, as a matter of reality, the Court might expect to see evidence that the Trustee has not pursued the Proposed Amendment without considering the alternatives. In contrast to other applications of a similar kind which have been (or are soon to be) heard by this Court (and courts in other states), the Trustee has not put before this Court substantial evidence of the extent to which it has considered alternatives.[38]

39. One of the circumstances relevant to the payment of a new fee is that the Trustee itself is restricted in its use of funds to some degree. The Trustee is an Australian proprietary company limited by shares.[39] The purpose for which the Trustee is constituted is to act as trustee of the Fund.[40] The constitution of the Trustee provides that its income and property is to be applied solely towards the object of the Trustee and no portion may be paid, transferred, or distributed to the shareholders.[41] The Trustee has recently made amendments to its constitution with a view to further constraining the purposes for which the proposed Trustee fee may be used in the event that the Trustee is wound up.[42] These provisions in the Trustee's constitution do not prescribe for what uses the proceeds of the fee may be deployed, but they form part of the background to the Application.

Covenant to exercise care, skill and diligence

40. The duty to exercise the same care, skill and diligence as a prudent superannuation trustee does not absolutely preclude the introduction of a power to charge remuneration, but, in APRA's respectful submission, it should be taken account of when considering the form and content of any such proposal, in at least the following ways.

41. First, what might be a reasonable fee may be informed by a consideration of fees proposed to be charged by superannuation fund trustees who provide similar services and products. The Trustee has identified the amount of the fee which it proposes to charge as remuneration, and that it will cease to charge remuneration once a sufficient capital reserve has been established.[43] The Trustee has further commissioned an external

[38] cf Affidavit Donna Heffernan affirmed 16 November 2021 at [85].
[39] Affidavit Donna Heffernan affirmed 16 November 2021 at [58]; Exhibit DMH-1 p 796; Constitution cl 1.1.
[40] Affidavit Donna Heffernan affirmed 16 November 2021 at [88], [129]-[131]; Exhibit DMH-1 p 796; Constitution cl 1.2.
[41] Exhibit DMH-1 p 826; Constitution cl 21.1.
[42] Exhibit DMH-1 p 998; Affidavit Donna Heffernan affirmed 16 November 2021 at [129]-[131].
[43] Affidavit Donna Heffernan affirmed 16 November 2021 at [117]-[124].

consultant to undertake financial modelling for the proposed future fees.[44]

42. Secondly, if a fee were constructed for the purpose of providing the trustee with the capacity to absorb future liabilities of a wide kind, there would come a point where, by implicitly catering for the real possibility of liabilities that presuppose a failure to exercise reasonable standards of diligence, the adoption of the fee itself would bespeak a lack of the relevant diligence. That is to say, it is one thing to recognise that a generally diligent trustee charged with the administration of a complex or large superannuation fund may from time to time incur liabilities (that are not able to be indemnified), and that prudence dictates that financial resources sufficient to absorb such liabilities be built up, especially if that can be done by levying a fee which, when weighed against other fees and costs, and compared with industry benchmarks, does not involve an unreasonable imposition on members. It is quite another to impose a more significant cost on members with a view to catering for the reasonable likelihood of liability for seriously delinquent conduct.

43. APRA is concerned that a trustee might not satisfy the prudence, best financial interests and conflicts covenants if the trustee's scheme was to introduce a fee directed to the creation of a capital reserve sufficient to cater not only for regulatory liabilities and infringements of an inadvertent and honest kind, but to cater for any and all non-indemnifiable liabilities that a trustee may incur including where it has acted inappropriately.[45]

44. Here, the process which the Trustee has followed to quantify the target amount for trustee capital is set out in a Report on Trustee Fee and Trustee Capital (**Report**)[46] and a Trustee Capital Framework Report prepared by Price Waterhouse Coopers (**PwC Report**).[47] The PwC Report sets out the modelling framework that has been applied to calculate the fee amount and capital cap, by reference to the number and extent of the penalties or infringement notices under certain Commonwealth laws to which the Trustee or its directors could be subject, modified by an analysis of the likelihood that the Trustee will incur such penalties, having regard to the risk controls which the Trustee maintains to avoid contravening the law and the likely penalty that would be

[44] Affidavit Donna Heffernan affirmed 16 November 2021 at [119]; Exhibit DMH-2 p 29-59.
[45] cf Re QSuper Board at [47].
[46] Affidavit Donna Heffernan affirmed 16 November 2021 at [111]; Exhibit DMH-2 p 14-28.
[47] Affidavit Donna Heffernan affirmed 16 November 2021 at [111]; Exhibit DMH-2 p 29-59.

imposed.[48] The Trustee's Report acknowledged that there were certain factors that had been excluded from the PwC Report, however concluded that on balance these factors did not warrant a departure from the modelling undertaken by PwC.[49]

45. The aggregate cap on the Trustee's capital (at which point the fee is not payable), the target capital amount, and the annual fee cap have each been set at an amount that the PwC Report indicates is consistent with (or lower than) comparable industry funds.[50] PwC has further confirmed that in their view the amounts of the target capital, three-year fee cap, and aggregate cap on Trustee Capital in the Proposed Amendment are reasonable and consistent with its industry knowledge.[51] There is no evidence that the Trustee's purpose is to substitute setting a high fee to accumulate a larger than necessary reserve in place of proper diligence in implementing risk management controls or to exclude any residual risk to the Trustee.

46. Thirdly, the Court might consider that a diligent and prudent trustee would seek to build into a trustee fee proposal review mechanisms to ensure that, over time, the total amount levied, or levied from time to time, remains appropriate. The recognition of the application of the Trustee's legal obligations to the future exercise of the remuneration power is consistent with a trustee's duty of care, skill and diligence and duty to act in the best financial interest of members.[52]

47. The Proposed Amendment itself contains such a review mechanism. The fee is subject to review every three years to ensure it remains fair and reasonable. A review that results in an adjustment to the current fee or cap on trustee capital may have regard to amounts that the Trustee *reasonably* considers necessary to appropriately compensate the Trustee for acting as trustee of the Fund and/or to appropriately compensate it for the personal financial risk it might incur.[53] The review mechanism further requires the Trustee to seek the advice of an appropriately qualified independent consultant.[54]

48. Finally, in order to discharge the duty of diligence, a trustee would be expected to have explored all reasonably available alternative means of establishing sufficient financial resilience, or otherwise mitigating the relevant risks, before imposing a fee upon

[48] Exhibit DMH-2 p 29-59.
[49] Exhibit DMH-2 p 20-24.
[50] Exhibit DMH-2 p 61.
[51] Exhibit DMH-2 p 60; Affidavit Donna Heffernan affirmed 16 November 2021 at [119]-[124].
[52] Re QSuper Board at [44].
[53] Proposed cl 4.6(e)(ii), Deed of Amendment.
[54] Proposed cl 4.6(e)(i), Deed of Amendment.

members.[55] That is to say, a trustee should explore whether the risks of liabilities of the kind which are thought likely to arise could be mitigated or reduced by, for example: investing in compliance or governance systems or upskilling; insurance; contributions from shareholders or associated entities; and/or the availability of indemnities from service providers to the Trustee.[56]

49. The Trustee has said in this regard that its insurance coverage has several limitations with the consequence that it would not necessarily respond fully or in a timely manner, and that it does not receive any financial support from its shareholders.[57]

Consideration of the conflicts covenant in assessing the Proposed Amendment

50. As noted above, s 52(2)(d)(i) requires that the Trustee give priority to the duties and interests of the members over the duties and interests of any other person.

51. APRA does not contend that this aspect of the covenant is necessarily breached simply because a benefit of some kind ensures to the trustee as a result of the conduct in question. In other words, s 52(2)(d) is not a rule against acting at all where a personal interest exists, resulting in a conflict. Rather, in APRA's submission, the covenant presupposes that a conflict (or at least the substantial potential for conflict) exists. What the trustee must then do is give priority to the duties and interests of the beneficiaries over the duties to and interests of the other person. However, the covenant needs to be given a sensible operation.

52. Where a trustee has a personal interest in a matter, complying with the duty in s 52(2)(d) does not necessarily mean that the trustee must act contrary to the trustee's interests. Rather, the trustee must give priority to the duties and interests of the beneficiaries over the interests of the trustee if and to the extent that they point in different directions. Accordingly, compliance with s 52(2)(d)(i), and also with s 52(2)(d)(ii) and (iii), may be established if the introduction of the remuneration power is demonstrably in the best financial interests of beneficiaries.

Covenant to act fairly between members and classes of members

53. The relevant duties in sections 52(2)(e) and (f), which largely reflect the duty of a trustee at general law, are to be applied practically, recognising that it may not be

[55] Re QSuper Board at [48].
[56] cf Re QSuper Board at [40(h)].
[57] Affidavit Donna Heffernan affirmed 16 November 2021 at [85], [91]-[93].

possible to know, in prospect, whether an allocation of cost, as between different cohorts (whether they be defined temporally, or by reference to product class) will prove to be fair and appropriate. The critical requirement is that due and proper consideration be given to the various dimensions that may distinguish groups of members.

54. The charging of a fee, whilst it does impose an economic cost on members, may, subject to the design of the fee, spread that cost more equitably between members of the fund over time, rather than imposing the entirety of the liability or loss on the cohort of members at the moment the liability or loss crystallises, as would be the case if an indemnity were available. The latter situation may be particularly unfair if the circumstances giving rise to the liability or loss occurred some significant time earlier when the membership of the fund differed substantially.

55. As noted at paragraph 33 above, the Trustee has proposed to smooth the initial impact on current and future members by deducting the proposed trustee fee from the Fund's Administration Reserve, rather than by increasing immediately the administration fee charged to member accounts.[58]

C. CONFIDENTIAL MATERIAL

56. A separate question on the Application concerns the tender to the Court of relevant material on a confidential basis. Although no confidentiality order has been formally sought in the Application, the evidence put forward by the Trustee appears to seek relief that would maintain the confidentiality of certain of that evidentiary material.[59]

57. To the extent that relief is sought in respect of matters of fact said to be commercially sensitive (as distinct from privileged legal advice) then consideration of the open-court principle arises. As French CJ observed in *Hogan v Hinch* (citations omitted):

> *An essential characteristic of courts is that they sit in public. That principle is a means to an end, and not an end in itself Its rationale is the benefit that flows from subjecting court proceedings to public and professional scrutiny. It is also critical to the maintenance of public confidence in the courts. Under the Constitution courts capable of exercising the judicial power of the Commonwealth must at all times be and appear to be independent and impartial tribunals. The open-court principle serves to maintain*

[58] Affidavit Donna Heffernan affirmed 16 November 2021 at [111]; Exhibit DMH-2 p 24-27.
[59] Affidavit Donna Heffernan affirmed 16 November 2021 at [3]; Affidavit Donna Heffernan affirmed 23 November 2021.

that standard. However, it is not absolute.[60]

58. There is no doubt that the Court has jurisdiction to make orders which would maintain the confidentiality of the material. Whether that jurisdiction is exercised would ordinarily involve weighing the nature of the confidential factual material and the impact its disclosure might have on the Trustee or the Fund against the normal requirement that evidence deployed in legal proceedings is deployed openly.[61]

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[60] (2011) 243 CLR 506 at [20].
[61] *Hogan v Hinch* (2011) 243 CLR 506 at [20]; *Tribal Health Pty Ltd v Flush Fitness Pty Ltd* [2016] QSC 103 at [69].