18 March 2021

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee

Dear Mr Fitt

Thank you for the opportunity to provide a submission to the Senate Economic Legislation Committee on the

Treasury Laws Amendment (Your Future, Your Super) Bill 2021.

Preliminary

By way of introduction, I am Director of the Centre for Law, Markets and Regulation at UNSW Law. I research in the areas of trust law, superannuation, managed investments and the regulation of financial markets. I am also retained on a part-time basis as an External Consultant by Herbert Smith Freehills.

Prior to entering academia in 2010, I worked for ipac (1986-1994) and Frank Russell Company (now Russell Investment Group) (1994-2009, including five years as Director of Research and four as Director of Product Development). Much of that time was spent actively involved in advising superannuation funds and their stakeholders on governance matters and in investment manager research and selection.

The views expressed in this submission are informed by my experience and research, but they are my own and ought not be taken to reflect the views of UNSW or Herbert Smith Freehills, nor any of their clients, employees or associates. I make this submission in my personal capacity and not on anyone's behalf or at anyone's instruction. I should also like to acknowledge the valuable research assistance provided by Alistair Leung.

Submission

I wish to comment on all three Schedules to the Bill.

Schedule 1: Single default account

The proposal that participants in the superannuation system will have future contributions made to the fund in which they initially contributed, absent some election to the contrary, is a response to the valid concern about the inefficiencies arising from the proliferation of member accounts. I am aware that such an arrangement will have implications for industrial awards and enterprise agreements but leave that aspect of the proposal to others.

I am concerned about the implication of this for the structure of the industry. As the table below shows, the retail and hospitality industries have a disproportionate number of young workers.[1] This can be attributed to the propensity of young Australians to be employed in these industries, often on a part-time basis, while they complete secondary or tertiary education.

Employment by industry

	Employment			Employment Profile				Workforce Educational Profile			Projected Employment
	Employ't Nov 2018	5 year change to Nov 2018		Part-time	Female	Aged 15 to 24 years	Aged 55 years or older	Bachelor degree or higher	Cert III or higher VET qual	No post-school qual	5 year change to May 2023
Industry	'000	'000	%	%	%	%	%	%	%	%	%
Health Care and Social Assistance	1,685.1	297.5	21.4	45	79	9	23	48	32	16	14.9
Retail Trade	1,272.3	36.8	3.0	51	56	32	14	16	26	53	3.7
Construction	1,166.9	171.7	17.3	15	12	16	16	11	51	33	10.0
Professional, Scientific and Technical Services	1,082.1	175.7	19.4	23	44	10	17	63	19	16	10.2
Education and Training	1,035.4	141.3	15.8	39	72	9	22	65	19	13	11.2
Manufacturing	965.6	38.2	4.1	16	29	12	20	18	36	42	0.9
Accommodation and Food Services	900.1	127.0	16.4	60	55	45	10	15	25	55	9.1
Public Administration and Safety	838.5	85.3	11.3	17	49	5	22	39	31	24	5.0
Transport, Postal and Warehousing	648.7	63.8	10.9	21	21	8	25	17	32	46	4.3
Other Services	484.7	11.9	2.5	32	45	15	18	16	52	25	1.4
Financial and Insurance Services	448.8	32.7	7.9	17	49	7	14	50	24	23	3.2
Administrative and Support Services	407.4	19.2	5.0	42	53	12	21	23	28	43	6.6
Wholesale Trade	381.7	-17.8	-4.4	17	33	10	22	24	29	40	-2.7
Agriculture, Forestry and Fishing	327.3	16.1	5.2	28	30	10	41	13	30	49	-0.4
Mining	255.8	-11.9	-4.5	4	16	6	14	24	43	28	2.4
Arts and Recreation Services	244.5	36.8	17.7	48	48	27	15	31	27	38	8.7
Information Media and Telecommunications	227.1	32.2	16.5	22	41	12	14	45	25	27	4.7
Rental, Hiring and Real Estate Services	218.2	20.1	10.2	25	49	13	22	30	31	33	5.9
Electricity, Gas, Water and Waste Services	153.0	1.7	1.1	11	23	6	18	32	38	25	4.1
All Industries[1]	**12,694.8**	**1,242.5**	**10.8**	**32**	**47**	**15**	**19**	**32**	**31**	**32**	**7.1**

1. Some data are trend and, for these, totals do not add
Sources: ABS, Labour Force (trend and annual averages of original data); ABS, Education and Work; Department of Jobs and Small Business, Employment Projections

AUSTRALIAN JOBS 2019 | For more information see lmip.gov.au

[1] The table is directly sourced from the Commonwealth Department of Jobs and Small Business publication *Australian Jobs 2019*. https://docs.employment.gov.au/system/files/doc/other/australianjobs2019.pdf.

This industry demographic is replicated in the demographics of the funds that serve these sectors. Funds such as REST and Hostplus today serve a membership profile that is younger than the industry average, as can be seen in the table below.[2]

Proportion of members by age										
Superfund	**<25**	**25 to 34**	**35 to 44**	**45 to 49**	**50 to 54**	**55 to 59**	**60 to 64**	**65 to 69**	**70 to 74**	**75 to 84**
HOSTPLUS	22%	36%	21%	7%	5%	4%	3%	1%	0%	0%
REST	35%	29%	16%	6%	5%	4%	3%	1%	1%	0%
AVERAGE	**17%**	**25%**	**22%**	**10%**	**8%**	**7%**	**5%**	**3%**	**1%**	**1%**

However, most workers don't stay in the retail and hospitality industries; most establish long term careers in other industries. Moreover, we know that active engagement in superannuation is low amongst young members,[3] so the likelihood of those members electing to switch funds as their employment arrangements change is low. Paradoxically the fact that they don't receive mailouts from multiple trustees (which overall will be a good thing) may exacerbate this interia, removing one of the catalysts that anecdotal reports suggest is responsible for younger participants engaging with their super. There is also considerable inertia in the election of default funds by employers, who have little or no incentive to monitor continuously which funds offer the most appropriate products for their employees' default arrangements and to adjust their contributions accordingly. **I am therefore concerned that the proposal for a single default account will provide an anti-competitive boost to funds currently positioned to serve industries that attract younger workers.** That favouritism is serendipitous and not based on deliberate and rational criteria. It is also likely to result in the homogenisation of the funds involved as their membership is increasingly comprised of workers who have moved to other industries, and less tailoring to the specific needs of their historic membership bases. Taking a whole of system view, the benefits of scale economies in these funds have then to be weighed against the disutility for the traditional members of such funds arising from the homogenisation of those offerings.

Overall, then, I believe the effects of this initiative will be to create several new industry behemoths, that alongside Australian Super, SunSuper and Aware Super will dominate the industry and Australian capital markets. Without meaning to cast any aspersions on the individual merit of any of those organisations, it does not seem to me that Australia's experience of oligopolistic markets over recent decades has been a happy one.

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2 Australian Prudential Regulation Authority, 'Annual MySuper Statistics: June 2020' (16 December 2020) Table 7.

3 Hazel Bateman, Jeanette Deetlefs, Loretti Dobrescu, Ben Newell, Andreas Ortmann and Susan Thorp, 'Just Interested or Getting Involved? An Analysis of Superannuation Attitudes and Actions' (2014) 90 (289) *Economic Record* 160. But cf Peng et al, which finds some evidence for switching away from poor performing funds towards heavily-marketed funds within the retail sector (only); Xiaowen Peng, Karen Alpert, Grace Chia-Man Hsu, 'Switching between superannuation funds: Does performance and marketing matter?' (2020) 63 *Pacific-Basin Finance Journal* 101431.

Schedule 2: Addressing underperformance in superannuation

The underperformance test has attracted considerable controversy in the Press and in earlier consultation rounds. As with most commentators, I respect the policy objective of the test. It is appropriate that only those trustees who can demonstrate that they are fit, proper, suitably skilful and committed to the task of actively pursuing member outcomes ought to be authorised to provide default products in a compulsory system. However, **the test proposed by the government to identify 'underperformance' contains a number of serious conceptual and practical flaws**:

1. An eight-year window of review might be expected to reduce the impact of random noise on performance outcomes if the process generating those returns was stationary (ie unchanging). However, the process by which a superannuation fund makes investment decisions is not stationary. Individuals and investment strategies change continuously, especially in the face of underperformance. So what is actually being measured over the period is a succession of people and an evolving process. The choice of eight years is therefore not a matter of econometric sensibility but rather is based on pragmatism (eight years being more than 5 and less than 10). Notably ASIC's MySuper product dashboard mandates a 10-year period for the product's target return and for presentation of historical performance.
2. There is no ability to 'reset the timer.' A trustee that takes steps to address shortcomings in its investment process, as a result of which an expert would expect it to earn acceptable returns in the future, will carry the underperformance in its performance history into the future even though there is no basis for expecting the underperformance to continue. A fund in that position would have a positive incentive to expose the portfolio to considerably more risk in an attempt to recoup the underperformance in the earlier period. That increase in risk taking is clearly not in members' best interests.
3. The test focuses on product performance and does not consider the impact of non-investment costs, many of which are experienced unevenly by members of different types and account sizes. This is inconsistent with the 'member outcomes' objective of the initiative.
4. The test assesses the investment performance of the product within each asset class, but it is the asset allocation decision that is the main determinant of the return and volatility of a portfolio.[4] The asset allocation decision is not assessed either in absolute terms nor in terms of its appropriateness for the needs of the members in the product. Again, this is inconsistent with a true 'member outcomes' perspective.
5. The test is not able to address the different experiences of members of different cohorts in a life-cycle product. The potential for underperformance and tracking error is uneven across asset classes. Hence underperformance in one sector will be felt differentially across cohorts with different asset allocations; it is quite likely that some may pass the test (eg those cohorts closer to retirement in low growth portfolios) and some not. It is unclear whether it would even be lawful to close access to a product only to members of a certain age bracket while leaving others open, so the product as a whole would need to be closed despite the 'underperformance' potentially only affecting some members.

[4] Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, 'Determinants of Portfolio Performance' (1986) 42(4) *Financial Analysts Journal* 39.

6. Using benchmarks derived from publicly listed markets makes investment in unlisted assets such as property, infrastructure and private equity very risky from the point of view of the trustee.[5] Those assets may have very attractive long-term return prospects, and relatively lower levels of short-term volatility. However, their lack of correlation with listed markets (which ought to be a virtue because it enhances diversification) makes them unduly risky for a trustee whose ongoing role is predicated on investment performance benchmarked wholly against listed benchmarks. One consequence of this feature of the test is that such assets will become markedly less attractive for trustees of MySuper products. I therefore concur with the consensus of other submissions that identify this as an entirely foreseeable and undesirable consequence of application of the test. At the very least, the cost of capital for such ventures will rise, and some projects will be forced to be structured for listing, with the layers of cost and complexity that listing necessarily entails.
7. The direct use in a regulatory regime of market benchmarks maintained by private actors poses issues about the governance of those benchmarks.[6] Decisions about the timing and terms of inclusion of potentially large, listed infrastructure assets in relevant indices would, for instance, be particularly sensitive.
8. Within listed assets, the risk of underperformance is greatest in asset classes, especially domestic and international equities, where the cross-sectional variation in returns is greatest (ie the most potential for tracking error). I therefore concur with the consensus of submissions by other parties that the test will discourage active risk-taking and encourage indexation in these markets. This will reduce market liquidity and the demand for securities research, suppressing the price discovery mechanism for these securities. Given the size of the superannuation system, this can be expected to reduce financial market efficiency.

These shortcomings of the test are significant and important. The first two points reinforce a key message in the disclosure regime applied to financial products in Australia – past performance is no guide to future performance. Points 3, 4 and 5 remind us that what ultimately matters are member outcomes. That the proposed test should ignore those two fundamental tenets of the regulatory regime designed to protect investors and members is remarkable. Points 6, 7 and 8 recognise that changes to the superannuation system are likely to have broader economic implications.

The mechanism by which the test is given practical application also contains a range of conceptual and practical flaws:

1. The performance of an investment portfolio is the product of changes in the value of the underlying assets as well as the costs and fees that are borne by the portfolio. Only the costs and fees are directly under the control of the trustee. This has several consequences:
    - The one year timeframe may be sufficient to re-organise the operation of the fund to reduce its fees and costs (assuming that has not already been done in the lead-up to the failed test) but it is not enough time to be confident that changes to the

5 For analysis demonstrating the dangers of assessing investment management skill using inappropriate benchmarks, see David R Gallagher, 'Attribution of investment performance: an analysis of Australian pooled superannuation funds' (2001) 41(1) *Accounting and Finance* 41.

6 Darrell Duffie and Jeremy C Stein 'Reforming LIBOR and Other Financial Market Benchmarks' (2015) 29(2) *Journal of Economic Perspectives* 191; H Chand and P Howard "Additions to and Deletions from an Open-Ended Market Index: Evidence from the Australian All Ordinaries" (2002) 27(1) *Australian Journal of Management* 45.

investment approach have been productive of better performance and that the improvement will persist over subsequent years.
    - In practice, however, because the 8-year performance window is moving forward continuously, there is a crucial path dependency built into the assessment. A fund that only underperformed 8 years ago will have that underperformance leave the performance window by the time of the next assessment, but a fund that underperformed 3 years ago will have that underperformance counted for five more years.
2. Notifying the membership of a product that its trustee has underperformed is likely to hasten redemptions from the product. This can reasonably be expected to have a number of consequences:
    - Engaged members will react more quickly than disengaged members, exposing dis-engaged members to the risk of realising illiquid assets under fire-sale conditions.
    - Financial advisers will specifically target the members of underperforming funds to provide switching advice. This practice has repeatedly seen scandals in jurisdictions around the world, most notably in the UK, where unscrupulous elements in the financial planning industry prey on the relative financial illiteracy of members.[7]
    - The introduction of this regime on July 1 2021 will see a non-trivial number of funds simultaneously designated as underperforming, raising issues of system stability (one of APRA's nominated objectives).
3. Trustees will have an incentive to engage in 'pheonixing' strategies whereby new products are introduced to replace products approaching the 8-year measurement point. Unless APRA tightens its MySuper authorisation process, product proliferation is a foreseeable outcome of this incentive. Other strategies, for instance involving fund mergers designed to game the test, are also likely to emerge.

There are also a number of conceptual and practical issues with the element of the proposal to extend to the underperformance test to 'trustee directed' portfolios:

1. This proposal is inconsistent with the choice architecture upon which the superannuation system is based,[8] and in particular the principle that individuals should bear the consequences of their (informed) decisions.
2. It will fuel pheonixing activity, unconstrained by the authorisation process present in the MySuper environment.
3. It will discourage investments in unlisted assets within multi-asset portfolios and encourage managed account-type structures in which individuals advised by financial advisers take responsibility for the design of the investment portfolio. The fees and costs of these latter structure are notoriously difficult to monitor and hence regulate.

It should also be noted that APRA's role in this regime is crucial. It is pleasing to see that this is recognised to a greater extent in the Bill as introduced into Parliament than was apparent in earlier iterations. **Positioning APRA so that it can intervene to mitigate the effects of the**

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7 See most recently J Cumbo "FCA urged to probe pension transfer advice" *Financial Times* 25 January 2020 www.ft.com/content/18494748-3ebc-11ea-b232-000f4477fbca. Earlier UK scandals are described in Julia Black and Richard Nobles 'Personal Pensions Misselling: The Causes and Lessons of Regulatory Failure" (1998) 61(6) *Modern Law Review* 789.

8 Jeremy Cooper, 'Super for Members: A New Paradigm for Australia's Retirement Income System' (2010) 3(2) *Rotman International Journal of Pension Management* 8.

underperformance test is astute regulatory design. It relieves APRA of the obligation to justify each application of the test but enables it to intervene when circumstances warrant intervention. Notwithstanding this, it will be important for APRA to exercise this discretion in a considered, transparent and accountable way as the coercive force of this mechanism is considerable.

Finally, there is the very real issue that the test involves a form of retrospectivity. Retrospectivity in the law is a very dangerous matter. At best it is unfair. Parties subject to regulation deserve to know the standards by which they will be judged so that they can govern their behaviour accordingly. However, retrospectivity can be used much more cynically. Because the conduct is past, the rear-view mirror can be used to fine-tune and target the rule to ensure its impact is felt by specific individuals or cohorts. The common law is right to be very leery of retrospectivity.[9]

In the case of the underperformance test, decisions taken by trustees in accordance with the rules applying to them over the past eight years now become subject to a test that aligns imperfectly with the rules applied over those years. It is entirely possible that a fund could achieve the objectives it set for itself over the years, including those articulated in both the fund Product Disclosure Statement and fund Dashboard, and yet fail the proposed test. The trustee may therefore not have breached its duties but may be deemed to have 'underperformed' when its performance is viewed through this new lens, and that underperformance will have legal consequences.

It is true that the proposed underperformance regime does not specifically render those decisions unlawful and does not expose the trustee to legal liability. The trustee is simply required to disclose its underperformance to members, and, if subject to a putative second strike, to close its doors to new members until performance had approved – the proverbial 'naughty corner'. However, no prudent trustee would have failed to consider the implications of the new test as part of their decision process had it been in place when the decisions were being taken. The risk of a run of existing members, and the reduction in cashflow if new members couldn't be admitted, would have to be considered in the investment strategy formulated by the trustee. To have failed to do so would potentially constitute a breach of the covenant in section 52(6) of the *SIS Act* that requires the trustee to have regard inter alia for the circumstances of the fund. As noted above, investment in unlisted assets such as infrastructure, property and private equity would all be much less attractive, as would active management of share portfolios. Moreover, a failure by a trustee to consider properly the implications of underperformance arising from the proposed test would also have disappointed the strategic planning and member outcomes expectations of APRA, now formalised in *Prudential Standard SPS 515 Strategic Planning and Member Outcomes*. So **the test deems as unsatisfactory decisions that were made in accordance with the law at the time they were made, a form of retrospectivity that challenges fundamentally the legitimacy of the regulatory scheme**.

9 *Australian Education Union v Fair Work Australia* (2012) 246 CLR 117, 133 et seq (French CJ, Crennan and Kiefel JJ).

Schedule 3: Best financial interests duty

The duty expressed by the covenant in section 52(2)(c) of the *SIS Act* is a centrepiece of the regulatory scheme orienting superannuation fund trustees towards the interests of the members they serve. In Australia it serves alongside the covenant in section 52(2) of the *SIS Act* and the sole purpose test imposed in section 62 of the *SIS Act*. It has a close analogy in the regulatory scheme applied to managed investment schemes,[10] and more distant analogies in the regimes applied to financial advice,[11] mortgage broking[12] and corporate governance[13] more generally.

The section 52(2)(c) covenant resembles (and is said to derive from)[14] a duty recognised sporadically in the general law in Australia and the United Kingdom.[15] In recent times the courts have held that the substance of the covenant draws on that general law position.[16] This is particularly pertinent in the present context because the courts have consistently understood the reference to members' 'best interests' as connoting, in the context of superannuation and pension funds, members' 'best financial interests'.[17]

This may inspire the conclusion that the proposed amendment to the covenant is unnecessary. However, it is true that the express reference to 'financial' makes salient what hitherto has been implicit. It is worth recalling that one of the reasons for formalising trustee duties in the *SIS Act* in the first place was the 'declaratory' value of expressing them in statutory form[18] where they are visible to all and not just those with a specialist knowledge of trust law. The other main reason for formalising trustee duties in the *SIS Act* was the desire to entrench them in statute so that they were less vulnerable to erosion or circumscription by the trust instrument governing the administration of the fund.[19] In that respect, too, the amendment might be expected to have an effect at the margin,

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10 Section 601FC(1)(c), *Corporations Act 2001* (Cth).

11 Section 961B, *Corporations Act 2001* (Cth).

12 Section 158LA, *National Consumer Credit Protection Act 2009* (Cth).

13 Section 281, *Corporations Act 2001* (Cth).

14 *Invensys Australia Superannuation Fund Pty Ltd v Austrac Investments Ltd* (2006) 15 VR 87, [107] (Byrne J). For discussion of the provenance see Donald Duval, 'The Objectives of the Superannuation Supervisory Legislation' in M. Scott Donald and Lisa Butler Beatty eds, *The Evolving Role of Trust in Superannuation*, (Federation Press, 2017); Geraint Thomas, 'The duty of trustees to act in the "best interests" of their beneficiaries' (2008) *Journal of Equity* 3; M. Scott Donald, 'Best interests' (2008) 2 Journal of Equity 245; David Pollard, 'The Shortform "Best Interests Duty": Mad, Bad and Dangerous to Know' (2018) 32(2) *Trust Law International* 106 and 176.

15 See *Asea Brown Boveri Superannuation Fund v Asea Brown Boveri* [1999] 1 VR 144, 159-160 (Beach J) citing *Cowan v Scargill* (1985) 1 Ch 270, 287 (Megarry V-C).

16 *Manglicmot v Commonwealth Bank Officers Superannuation Corporation Pty Ltd* [2011] NSWCA 204, [118]. (Giles JA, with whom Young and Whealy JJA agreed); *Commonwealth Bank Officers Superannuation Corporation v Beck* (2016) 334 ALR 692, [136]–[140] (Bathurst CJ. with whom Macfarlan and Gleeson JJA relevantly agreed); *Australian Prudential Regulatory Authority v Kelaher* (2019) 138 ACSR 459, [49] (Jagot J).

17 *Cowan*, n 15, 287; *Invensys*, n 14 [108]; *Beck*, n 11 [140]; *Kelaher*, n 11, [45], [69].

18 Duval, n 14, 15. As Australian Government Actuary during the drafting and passage of the *SIS Act*, Donald Duval was intimately involved in the policy debates surrounding the structure and substance of the Act.

19 Ibid. Also *Manglicmot v Commonwealth Bank Officers Superannuation Corporation* (2011) 282 ALR 167, [110]–[114], [118].

buttressing the requirement in section 62 that the assets of the superannuation fund be employed solely in pursuit of the objectives outlined in that section, all of which are financial. Indeed, it is possible to see this reform initiative as being a response to concerns expressed in some quarters[20] that APRA has failed to apply the sole purpose test with sufficient vigour. If that is genuinely the underlying motivation behind this reform, then reforming the framing of the sole purpose test may be a more direct and appropriate response to the perceived problem.

It is possible that the introduction of section 117A is just such a direct approach. Although it seems likely that many of the transaction types that might reasonably be expected to appear on a list of prohibited transactions such as that anticipated by section 177A would already be inconsistent with the sole purpose test in section 62 of the *SIS Act* or beyond the power of superannuation trustees under the general law, that cannot be ascertained until such time as the list is formulated in the Regulations. Even assuming that that list is well-formulated when introduced into the Regulations, the danger with lists such as that anticipated in section 117A is that they come to represent the extent of the law in the area, and items of expenditure that can be distinguished from those identified on the list are taken thereby to be authorised.[21] This has the additional effect, implicitly, of transferring the regulatory risk from the trustee to parliament, in that a failure by parliament to include an unacceptable expenditure on the list can lead to its being believed to be acceptable through an ejusdem generis process. **It will be important therefore to ensure that the current constraints on trustee expenditure continue to apply and that the list will not be used to read down the content of the sole purpose test and the general law.** It is to be hoped that this perspective is maintained by APRA, in particular, because if it is not then this reform will have an unintended but seriously detrimental effect on the regulatory regime, encouraging superannuation fund trustees to use compliance with the list, rather than the more comprehensive and nuanced legal principles, as their guide.

I note also that there have been suggestions that the addition of 'financial' into the formulation in section 52(2)(c) will stymie consideration of broader environmental, social and governance factors by superannuation fund trustees.[22] Although such moves were controversially considered in the United States,[23] there is a strong trend in other jurisdictions towards recognising the role that capital markets (and pension fund trustees as under-appreciated forces within those markets) can play in

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20 See for instance, Michael Roddan, 'APRA fails on super sole purpose test: Liberal MP' (*Australian Financial Review*, 16 September 2020). Aleks Vickovich ' Super fund ban on ads and lobby fees' (*Australian Financial Review*, 26 November 2020).

21 Historical analyses of the development of trustee investment practices over much of the nineteenth and early twentieth centuries trace the much-criticised conservatism of trustee investment rules to the influence of the so-called Court Lists of the Chancery Court. A list such as that envisaged in section 177A could exercise an analogous ossifying effect on the law. See Chantal Stebbings, *The Private Trustee in Victorian England*, (Cambridge University Press, 2002); Joshua Getzler, 'Fiduciary investment in the shadow of financial crisis: Was Lord Eldon right?' (2009) 3 *Journal of Equity* 219.

22 See for instance Josephine Cumbo, 'Australia's pensions minister clashes with fund managers and green lobby' (*Financial Times*, 27 October 2020); Ronald Mizen 'Super is for retirement income, not getting to net zero: Jane Hume' (*Australian Financial Review*, 13 November 2020).

23 https://www.dol.gov/newsroom/releases/ebsa/ebsa20201030. See Brian Croce, 'DOL walks back ESG language in final rule' (*Pensions and Investments*, 30 October 2020).

helping to address environmental, social and governance concerns.[24] I have also heard anecdotal reports of trustee boards across the country seeking clarification from their advisers on the implications of the proposed change to section 52(2)(c) on their current approach and plans in respect of ESG. On balance, however, it does not seem to me that the proposed amendment of section 52(2)(c) would of itself cause trustees to conduct themselves differently. Consistent with APRA's preliminary findings,[25] I believe most trustees have already considered their position and have in place strategies for addressing ESG risks and opportunities in both their investment portfolios and in their operations. Although many will no doubt re-evaluate their positions in light of the proposed amendment, that re-evaluation is unlikely to cause them to change their plans materially as their plans would have been formulated on the basis that section 52(2)(c) was already implicitly directed towards 'financial' interests.

Finally, (and another reason the amendment is likely to affect trustees' ESG plans) it is unclear what this amendment will mean for the covenant in section 52(12), introduced in 2019. That covenant already imposes on trustees a positive duty to promote the 'financial interests' of members, arguably a more active and muscular exhortation than that represented by the section 52(2)(c) covenant even in its amended form. The covenant in section 52(12) is moreover not limited on its terms to circumstances where the trustee is exercising its powers or performing its duties. On some readings, therefore, the covenant in section 52(12) eclipses the requirement in section 52(2)(c), rendering the latter otiose. The one respect in which the covenants are not co-extensive is that the section 52(2)(c) covenant applies to all beneficiaries, but the section 52(12) covenant only applies to beneficiaries who hold MySuper or choice products (leaving a small but important group of fund beneficiaries, namely those entitled to death benefits, out). Perhaps less consequentially, the section 52(12) covenant is expressed in terms of the financial interests of members but omits the reference to 'best.' Though seemingly pedantic, these variations in drafting are unnecessary and simply add to the complexity of an already overly-complex set of rules and requirements.

A more problematic aspect of the amendments contained in the Bill is the apparent reversal of the burden of proof in section 220A. Although this feature of the reform package appears to be motivated by a laudable objective (the desire to hold trustees accountable for their decisions) I believe such a reversal is undesirable. There has been considerable growth in APRA and ASIC's powers of enquiry and investigation over the past decade. There is therefore no reason to believe that the regulators face the same asymmetries of information that exist for a private citizen seeking to hold a superannuation fund trustee to account. The application of this rule will require the trustee's reasoning in respect of all its decisions, not matter how small the decision, to be documented in a way that would satisfy a court that the decision was taken in the best interests of members. To do otherwise would mean that a failure to produce such documentation at some point in the future would leave unrebutted the presumption that the decision was not taken in the best

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24 Specifically in relation to pension funds see Attracta Mooney and Patrick Temple-West 'Climate change: asset managers join forces with the eco-warriors' (*Financial Times*, 26 July 26 2020) and more recently Alistair Marsh, 'Pension Funds Seek ESG-Conscious Money Managers, Survey Shows' at https://www.bloomberg.com/news/articles/2021-02-08/pension-funds-seek-esg-conscious-money-managers-survey-shows.

25 APRA, 'Climate change: Awareness to action' 20 March 2019.

financial interests of members. Such an undocumented decision, however well-intentioned and however small, would then constitute contravention of a civil penalty provision. The administrative burden of this requirement will be substantial, a consideration apparently entirely bypassed given the absence of a formal Regulatory Impact Statement in respect of this aspect of the reforms.

Concluding Comments

The efficiency of the superannuation system is of crucial importance to Australia's future. Ensuring that measures put in place to pursue that objective are carefully evaluated before they are deployed is equally crucial. Maladjusted regulatory measures have the potential to distort the system and to corrode public confidence. I therefore appreciate the opportunity to participate in this consultation process.

Please do not hesitate to contact me if you have any questions or require any further information or elaboration.

Yours sincerely

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