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18 March 2021

Dear Sir/Madam,

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

The Association of Superannuation Funds of Australia (ASFA) is pleased to make the submission to your inquiry into the provisions of the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*.

**ABOUT ASFA**

ASFA is a nonprofit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$3 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 16 million Australians with superannuation.

**GENERAL COMMENTS**

ASFA supports the objective of ensuring good governance of super funds and addressing underperformance. It is important, however, that the performance of Australian superannuation funds is recognised and that any measures put into place are measured and appropriate.

**SPECIFIC COMMENTS**

Specific observations and issues with respect to *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* are outlined in the body of our submission.

We would be please to attend and give evidence at a hearing should we be requested to do so.

Should you have any queries or comments in relation to the content of our submission, please contact Fiona Galbraith on [REDACTED] or via [REDACTED]

Yours sincerely

[REDACTED]  
Martin Fahy  
Chief Executive Officer



# SUBMISSION

## Submission to the Senate Economics Committee — Inquiry into the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021*

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18 March 2021

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## Contents

<b>A. General comments</b>	2
1. Australian superannuation funds' investment performance	2
2. Need for draft regulations to be released to determine full effect of legislative change	2
3. Commencement date	2
<b>B. List of recommendations</b>	3
<b>C. Specific provisions</b>	4
<b>1. Addressing underperformance in superannuation</b>	4
1.1. Performance benchmark test – retrospective application	4
1.2. Performance benchmark test – in conflict with best interests & member outcomes	5
1.3. Performance benchmark test – effect on investment decisions	5
1.4. Performance benchmark test – recommend initial trial run period	7
1.5. Performance benchmark test – not a 'reviewable decision'	7
1.6. Performance benchmark test – need for a two stage review mechanism	8
1.7. Proposed regulations – costs deducted from returns & fees deducted from accounts	9
1.8. Proposed regulations – 'net' investment returns and fees/costs – risk of double-counting	9
<b>2. Best Interest Obligation – best financial interest duty</b>	10
2.1 Royal Commission – no recommendation re best interest obligation	10
2.2 Best interest obligation (para 52(2)(c)) – EM not reflective of legislative obligations	10
2.3 Best interest obligation and quantification of benefit – no materiality threshold	11
<b>3. Prohibition of prescribed payments and investments – sections 117A</b>	13
<b>4. Evidential burden of proof reversed – proposed new section 220A</b>	14
4.1 Reversal of evidential burden of proof	14
4.2 Applicability of reverse evidential burden of proof	15
<b>ANNEXURE</b>	16

## A. General comments

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

It is important, however, that the strong performance of Australian superannuation funds is recognised.

ASFA has concerns about the appropriateness of some of the provisions of the *Treasury Laws Amendment (Your Future, Your Super) Bill 2021* (the Bill) which are detailed below.

### 1. Australian superannuation funds' investment performance

Australian superannuation funds consistently have achieved strong investment performance.

By way of example, the OECD in its report *Pensions at a Glance, 2019 OECD and G20 indicators*, observed that over the last 15 years Australia has the second highest average annual return:

*Real investment rates of return (net of investment expenses) of funded and private pension plans were negative on average in 2018 in the OECD (-3.2%). Pension plans suffered investment losses in 26 out of 31 reporting OECD countries, with the largest losses recorded in Poland (-11.1%) and Turkey (-9.4%). However, looking over the longer term, the investment performance of pension plans over the last 15 years was positive in real terms in 15 out of 18 reporting countries, with Canada achieving the strongest average annual return (4.8%), followed by Australia (4.7%)<sup>1</sup> (emphasis added).*

The OECD has found that, over the last 15 years, Australia superannuation funds had the second highest average annual return after Canada.

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

Given that the detail of how the prohibition on specified payments and investments (proposed new section 117A) and the performance benchmarking methodology will be contained in regulations, it is difficult to assess the full effect of the amendments being proposed to be made through the exposure draft legislation.

Accordingly, we submit that the bill should not be passed through Parliament until draft regulations have been released, to enable the full effect of the changes to be evaluated.

#### **Recommendation 1**

The Bill should not be passed through Parliament until draft regulations have been released for evaluation.

### 3. Commencement date

The proposed commencement date is 1 July 2021. Given the complexities involved with respect to the Single Default Account measures in particular, and the potential impact on employers, this does not provide sufficient time to implement the measures.

#### **Recommendation 2**

The commencement date of the Bill should be 1 July 2022.

<sup>1</sup> OECD, *Pensions at a Glance 2019, OECD and G20 indicators*, Page 214

## B. List of recommendations

- Recommendation 1** The Bill should not be passed through Parliament until draft regulations have been released for evaluation
- Recommendation 2** The commencement date of the Bill should be 1 July 2022
- Recommendation 3** There should be a ‘trial run’ of the performance benchmark test for a two year period
- Recommendation 4** APRA’s determination of the results of the annual performance test must be a ‘reviewable decision’
- Recommendation 5** There should be a two stage approach to assessing performance  
Should a product not meet the legislative performance benchmark test, the second stage would be a ‘balanced scorecard’ assessment, whereby APRA would evaluate whether the product is delivering appropriate member outcomes and whether the investment ‘underperformance’ is likely to be rectified
- Recommendation 6** When the regulations are drafted
- requirements with respect to investment returns should be net of investment fees and charges; and
  - annual performance test should also take into account all fees charged directly against members’ accounts (other than activity fees), in particular administration fees
- Recommendation 7** There is no need to amend the best interest obligation (paragraph 52 (2)(c))
- Recommendation 8** Statements in the EM to the effect that
- how any action will yield financial benefits to beneficiaries must be the determinative consideration
  - the identification of a quantifiable financial benefit to members is a threshold consideration
  - expenditure not supported by benefits articulated in a business case are unlikely to satisfy the duty
- should be amended or removed, as they are not accurate statements of the law in this context and are misleading
- Recommendation 9** The EM is modified to make it clear that expectations about robust evidence to support expenditure, and articulating financial benefits in a business case, are expected only with respect to material expenditure
- Recommendation 10** Should regulations with respect to record-keeping be made, any obligations to record evidence to support expenditure and articulate financial benefits should be with respect to material expenditure
- Recommendation 11** Given the explicit finding by Commissioner Hayne, we recommend that section 17A – to allow regulations to be made that can specify that certain payments and investments are prohibited – should not be inserted into the SIS Act
- Recommendation 12** If section 117A were to be inserted into the SIS Act it should be confined to the making of regulations to proscribe specified expenditure and should not be extended to investments
- Recommendation 13** As there is not sufficient justification for the reversal of the evidential burden of proof the evidential burden of proof should remain with the regulator and section 220A should not be inserted into the SIS Act
- Recommendation 14** If section 220A were to be inserted into the SIS Act, its application should be confined to matters with respect to expenditure only
- Recommendation 15** ASFA submits that, for the avoidance of doubt, the Bill should amend the SIS Act to clarify that the reverse onus would not apply to actions to recover loss or damage under section 55 of the SIS Act but only to actions brought by a regulator

## C. Specific provisions

### 1. Addressing underperformance in superannuation

ASFA supports the objective of ensuring good governance of superannuation funds and addressing underperformance. It is important, however, that the strong performance of Australian superannuation funds is recognised.

#### 1.1. Performance benchmark test – retrospective application

The proposed performance benchmark test has retrospective application.

The legislation provides that, by 1 July 2021, MySuper products will be subject to an annual performance test. The details of the test are to be prescribed in the regulations but the 2020/2021 Budget Papers indicate that:

*Products that underperform their net investment return benchmark by 0.5 percentage points per year over an eight-year period will be classified as underperforming. For MySuper products that were in place from 1 July 2014, their first performance test will be based on seven years of performance data.<sup>2</sup>*

The consequences for a product that has been deemed to be underperforming are significant:

- in the first year the product will be
  - required to inform its members of its underperformance by 1 October and provide them with information about the YourSuper comparison tool
  - listed as underperforming on the YourSuper comparison tool
- if the product fails two consecutive tests – it will not be permitted to accept new members.

This means that products will be being measured and assessed against legislative criteria that were not in place during the period over which the product is being assessed.

As observed by the Scrutiny of Bills committee:

*The Committee further notes that the requirements for the annual performance test may specify that **an assessment must consider the performance of a regulated superannuation fund prior to the bill's commencement**. For example, Budget documents published by the Treasury state:*

*Products that underperform their net investment return benchmark by 0.5 percentage points per year over an eight-year period will be classified as underperforming. For MySuper products that were in place from 1 July 2014, their first performance test will be based on seven years of performance data.*

***In this regard, it may be said that the proposed scheme for annual performance assessments may have a retrospective application<sup>3</sup>*** (emphasis added).

This led to the Scrutiny of Bills Committee to request detailed advice as to:

*whether the proposed scheme for annual performance assessments may have a retrospective application and, if so, whether any persons are likely to be adversely affected and the extent to which their interests are likely to be affected<sup>4</sup>*

<sup>2</sup> Treasury, Budget 2020-21: Your Future, Your Super reforms to make your super work harder for you, October 2020, p. 24. Available at <https://treasury.gov.au/publication/p2020-super>

<sup>3</sup> The Senate Standing Committee for the Scrutiny of Bills, Scrutiny Digest 4 of 2021, Paras 1.35 and 1.36

<sup>4</sup> Ibid, para 1.38

### 1.2. Performance benchmark test – in conflict with best interests & member outcomes

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

Consideration of ‘member outcomes’, as per APRA *Superannuation Prudential Guide 515 Strategic and Business Planning* (SPG 515), generally aligns with the trustee’s duty to act in the best interests of members – especially when it comes to making investment decisions over a medium to long-term time horizon.

In managing MySuper products the super industry has complied with guidance from APRA, including looking to maximise member outcomes, and had regard to the two years of MySuper heatmaps, and set ‘CPI plus’ investment targets.

Eight years after the commencement of MySuper products their outcomes are now to be evaluated solely on investment performance, which will be assessed retrospectively against a new set of benchmarks to be prescribed in the regulations.

### 1.3. Performance benchmark test – effect on investment decisions

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

Given the seriousness of the consequences of the ‘underperformance’ test, the proposed test will drive trustees to make investment decisions effectively to ‘hug the index’. This is in conflict with the objective of delivering good member outcomes over the medium to long term.

ASFA wrote to the Treasurer on 24 November 2020 about the industry’s concerns about the benchmarking methodology and that the underperformance test would have unintended consequences for the way in which superannuation savings are invested, contrary to the objective of delivering good member outcomes. The letter included an offer to meet with the Treasurer to share the industry’s insights and experience and was signed by the Chief Investment Officers of eight major superannuation funds and five large investment managers. A copy of the letter can be found in the Annexure to this submission.

Recent research performed by the Conexus Institute into the opportunity cost of the performance test proposed under the Bill has revealed that, should funds invest to prioritise passing the performance test, consumers will incur an opportunity cost of \$3.3b per annum. As pointed out in the research paper, this far exceeds the benefit of the performance test, which the 2020/2021 Budget forecast to be \$10.7b over ten years and in fact is larger than the forecast benefits of the entire reform package of \$17.9b over ten years.<sup>5</sup>

The paper identifies that the performance benchmark test will cost consumers because it will constrain super funds from constructing portfolios which are in the members’ best interests. This difference in asset allocation generates opportunity cost in terms of less effective risk management and less investment in opportunities that could reasonably be expected to generate outperformance over time. The paper points out that it only assesses the return opportunity cost and has not considered the risk impacts and, accordingly, in this respect it could be challenged that its analysis understates the full impact of the performance test on consumers<sup>6</sup>.

The opportunity cost to consumers of the performance test can be expected to be \$3.3b per annum – far in excess of the benefit which is forecast to be \$10.7b over ten years.

<sup>5</sup> *Your Future Your Super Performance Test, Estimating the Opportunity Cost to Consumers, 10 March 2021, Author: David Bell, Page 3*

<sup>6</sup> *Ibid*

In particular, the proposed benchmark test approach is likely to alter trustees' investment behaviour with respect to investment in unlisted assets such as infrastructure, property, private equity and venture capital. Typically, due to its relatively stable and predictable cash-flows over a long time horizon, infrastructure is an attractive asset class for super funds.

Australian super funds are big investors in infrastructure by international comparisons, with 5 per cent of their funds under management invested in unlisted infrastructure assets, compared with around 1.3 per cent for pension funds globally<sup>7</sup>, the majority of which is located in Australia. Typical unlisted assets held by super funds include airports, seaports, toll-roads and railways, as well as energy infrastructure assets such as electricity generation facilities (including renewables).

The proposed benchmarking test is likely to alter the investment behaviour of super funds, with respect to the composition of their portfolio, as it would incentivise trustees to attempt to replicate, as much as possible, the asset class indexes, to minimise the risk that an adverse investment outcome would result in the product under-performing.

The investment performance of a super product with a portfolio of infrastructure assets will reflect the performance of the underlying assets, however, the portfolio will have a smaller number of assets, and be less diversified, than those of an infrastructure index constructed across different asset types and geographic locations. Unlisted infrastructure assets, such as airports and toll-roads, are subject to a variety of idiosyncratic risks that can negatively affect the investment outcomes for that asset.

This is problematic, as a single infrastructure asset is likely to have a disproportionate effect on the investment performance of a super product's unlisted infrastructure assets when compared with the index. Accordingly, there is a risk that funds will eschew unlisted infrastructure assets and end up with a smaller portfolio of unlisted infrastructure assets. Similar issues arise with respect to other types of unlisted assets, such as unlisted property, and investments in private equity and venture capital.

The current proposed benchmark index for infrastructure investments is the *FTSE Developed Core Infrastructure Index (hedged to AUD)*, which is dominated by US infrastructure assets – with a weighting of almost 70 per cent – the major components of which are railroads and electricity generation facilities. Australian infrastructure assets have a weighting of only 2.6 per cent in the index. Accordingly, it would be expected that the performance of the index largely would reflect US economic conditions, in particular the performance of US railroads and electricity generation facilities, and US government policies.

There is a considerable risk that, in order to align more closely with the proposed index, Australian super funds would tend to shift their investment in infrastructure to assets in North America, for which performance is expected to be highly correlated with the major constituents in the index, and reduce their holdings of Australian unlisted infrastructure assets.

Overall, it is likely that the introduction of the performance benchmark test will result in the value of fund investments in unlisted assets being less than otherwise would be the case, with a lower proportion in Australia assets and a concomitant increase in foreign ownership. Providers of infrastructure projects would then need to obtain funding from alternative sources, and possibly offer higher rates of return, which may mean that some projects do not go ahead.

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<sup>7</sup> OECD 2019, *Annual Survey of Large Pension Funds and Public Pension Reserve Funds*



#### 1.4. Performance benchmark test – recommend initial trial run period

Given the concerns about the potential effects of the proposed underperformance test, the significance of the consequences of failure, and the risk of unintended consequences in the outworking of the performance test, ASFA submits that consideration should be given to there being a ‘trial run’ for a two year period.

During the ‘trial-run’ period the benchmarking would still operate but the consequences for a product that did not meet the benchmark would not be deployed. Instead, a trustee would effectively be ‘put on notice’ as to the product’s performance, which would provide the opportunity for an orderly transition through a mechanism such as a successor fund transfer.

Facilitating an orderly transition would be in the interests of fund members – by way of contrast the mechanisms proposed in the exposure draft legislation are likely to have undesirable consequences for members’ benefits.

Furthermore, this would also allow the performance test and/or benchmark methodology to be refined if necessary, and will have the added benefit of allowing performance to be measured over a ten year period, as opposed to eight years.

The very fact that the performance benchmark test is to be prescribed in regulations, and is not contained in the Bill itself, speaks to a need for flexibility to refine the test over time.

#### **Recommendation 3**

There should be a ‘trial run’ of the performance benchmark test for a two year period.

#### 1.5. Performance benchmark test – not a ‘reviewable decision’

According to the Explanatory Memorandum to the Bill (EM):

*The requirements for the annual performance test will be set out in regulations. It is expected that the regulations will be made for this purpose that include, but are not limited to the following matters:*

- *specifying requirements in respect of investment returns (which may be net of fees and taxes); and*
- *specifying requirements that **depend on the exercise of a discretion** by APRA; and*
- *specifying matters that APRA **may or must take into account in exercising such a discretion**; and*
- *allowing APRA to **make specified assumptions in exercising such a discretion**.*

*APRA’s determination of the results of the annual performance test **will not be a ‘reviewable decision’** within the meaning of the SIS Act. This is because the test results are based on product performance compared to relevant benchmarks over the assessment period. **The methodology to calculate a product’s performance and benchmark will be clearly specified in regulations**<sup>8</sup>*

Given that APRA’s determination of the results of the annual performance test may involve the exercise of a discretion by APRA, that APRA may, or may not, have taken into account a matter specified in the regulations, and that APRA may have made a specified assumption in exercising such a discretion, it is manifestly inappropriate that APRA’s determination of the results of the annual performance test will not be a ‘reviewable decision’.

#### **Recommendation 4**

APRA’s determination of the results of the annual performance test must be a ‘reviewable decision’.

<sup>8</sup> Explanatory Memorandum to the Bill, Paragraphs 2.25 and 2.26

### 1.6. Performance benchmark test – need for a two stage review mechanism

APRA's *Superannuation Prudential Guidance SPG 515 – Strategic and Business Planning* (SPG 515) articulates its expectations with respect to 'member outcomes'.

A recurring theme is that, while achieving a certain level of risk adjusted net investment performance is a central consideration, it is not the only one and that in fact relying solely on net returns is not sufficient.

By way of example, this includes:

- APRA expects ... common outcomes **may include** achieving a certain level of investment performance ... APRA also expects that targeting achievement of certain retirement benefit levels would be a key consideration...in articulating member outcomes.<sup>9</sup>
- APRA expects that an RSE licensee would take a broad approach to articulating outcomes, **including, but not limited to** ... risk-adjusted investment returns net of investment fees<sup>10</sup>
- For many members, investment performance **will be central to the outcomes sought**. However, in APRA's view, **relying solely on net returns as a measure of outcomes**, whether on a relative or absolute basis, **would not be sufficient**. In addition, seeking to provide the lowest relative fees and costs may not necessarily provide better outcomes for members over the long-term. An RSE licensee may conclude, for example, that members would benefit from short-term increases in costs where this will support appropriate investment in systems and services that are expected to deliver enhanced outcomes over time. **Similarly, improved outcomes may result from investments that involve higher investment costs but are expected to provide higher (risk-adjusted) investment returns to offset these additional costs over time**<sup>11</sup> (emphasis added).

APRA's SPG 515 re 'member outcomes' states that, while achieving a certain level of investment return is a central consideration, it is not the only one and it is not sufficient to rely solely on net performance.

Given this it is imperative that superannuation products are not assessed solely on the basis of net investment performance.

ASFA submits that there should be a two stage approach to assessing performance. Should a product not meet the legislative performance test, the second stage would be a 'balanced scorecard' assessment, whereby APRA would evaluate whether the product is delivering appropriate member outcomes, as communicated to members, and whether the product's 'underperformance' is likely to be rectified.

Potential examples of the criteria that could be incorporated into a 'balanced scorecard' could include:

- *recent short-term net investment performance* – a product may have had poor performance in the early part of the assessment period, which has dragged down its longer-term average, but recent performance could be strong
- *improvements in investment governance processes* – could have regard to the fact that the product has re-vamped its investment governance to turn around its investment performance and this is likely to continue to be reflected in improved investment performance
- *improvements in broader governance and risk or compliance management* – a trustee may have experienced governance, risk or compliance issues but has taken action, such as replacing directors and/or key risk or compliance personnel; implementing material improvements to its governance framework; or overhauling or enhancing its risk management and compliance framework
- *quality and value of insurance* – regard could be had to the quality and value of the product's insurance offering, including the payout to premium ratio

<sup>9</sup> *Superannuation Prudential Guidance SPG 515 (SPG 515) - Strategic and Business Planning – paragraph 9*

<sup>10</sup> *Ibid, paragraph 11*

<sup>11</sup> *Ibid, paragraph 12*

- *provision of, and investment in, member services, including advice* – this could help account for products that have higher fees but in return provide a higher level or quality of services and benefits, such as financial advice or IT applications, which are appropriate for their members, or where the trustee has invested additional expenditure on product or service innovation.

#### **Recommendation 5**

There should be a two stage approach to assessing performance.

Should a product not meet the legislative performance benchmark test, the second stage would be a ‘balanced scorecard’ assessment, whereby APRA would evaluate whether the product is delivering appropriate member outcomes and whether the investment ‘underperformance’ is likely to be rectified.

#### **1.7. Proposed regulations – costs deducted from returns & fees deducted from accounts**

The Explanatory Memorandum (EM) to the Bill states as follows:

*It is expected that the regulations will be made [for the purpose of stipulating the requirements for the annual performance test] that include, but are not limited to the following matters:*

- *specifying requirements in respect of investment returns (which **may be** net of fees and taxes); and*
- *specifying requirements that depend on the exercise of a discretion by APRA; and*
- *specifying matters that APRA may or must take into account in exercising such a discretion; and*
- *allowing APRA to make specified assumptions in exercising such a discretion<sup>12</sup> (emphasis added).*

Requirements with respect to investment returns should be net of investment fees and charges, as it is net investment returns that directly affect member outcomes, not gross investment returns. Two products could have identical gross investment returns but if one product has a higher cost of investment the net return to its members will be lower.

It is imperative that the annual performance test should also take into account **all fees charged directly against members’ accounts** (other than activity fees e.g. for a family law split), in particular administration fees. Like investment returns, the deduction of administration and other fees from a member’s account has a material effect on member outcomes and this effect should be reflected in any performance test.

#### **Recommendation 6**

When the regulations are drafted

- requirements with respect to investment returns should be net of investment fees and charges; and
- annual performance test should also take into account **all fees charged directly against members’ accounts** (other than activity fees), in particular administration fees.

#### **1.8. Proposed regulations – ‘net’ investment returns and fees/costs – risk of double-counting**

As a net investment return will have deducted investment fees and costs from the gross investment return to calculate the net return figure, this has had the effect of taking into account the costs of investment.

If the matters specified in the regulations – that will form the basis of the performance test and the ranking of super products – include any measures of ‘fees and costs’, care will need to be taken to avoid double-counting investment fees. If net investment returns are used any separate ‘fees and cost’ measure must explicitly exclude any investment fees and costs that have been deducted from investment returns.

<sup>12</sup> Explanatory Memorandum to the Bill, Paragraph 2.26

## 2. Best Interest Obligation – best financial interest duty

### 2.1 Royal Commission – no recommendation re best interest obligation

The Final Report of the Royal Commission **made no recommendation** with respect to amending the ‘best interest’ obligations within superannuation – **in fact quite the opposite**.

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

*‘I consider that the existing rules, especially the best interests covenant and the sole purpose test, set the necessary standards. Those standards should be applied according to their terms and without more specific elaboration’<sup>13</sup> (emphasis in original).*

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

The Royal Commission **made no recommendation** regarding amending the ‘best interests’ obligation. Commissioner Hayne examined the best interests obligation and concluded:

- the existing rules set the necessary standards; and
- those standards should be applied according to their terms and without more specific elaboration.

#### **Recommendation 7**

There is no need to amend the best interest obligation (paragraph 52 (2)(c)).

### 2.2 Best interest obligation (para 52(2)(c)) – EM not reflective of legislative obligations

There is a great deal of confusion about the interaction of the

- amendment to the best interest duty, to insert the word ‘financial’ before the word ‘interest’;
- the reversal of the onus of proof with respect to the best interests duty; and
- the insertion of a power to make regulations with respect to record-keeping

that is reflected in statements in the Explanatory Memorandum (EM) about the need for trustees to identify and quantify benefits in order to discharge the best financial interests obligation.

Trustees have a range of powers, duties and discretions granted under the common law, trust instrument and legislation. There will be a number of instances where the nature of a power, duty and discretion exercised by the trustee does not produce a quantifiable financial benefit to members.

The EM states:

***Actions** taken by trustees differ in **quantum, complexity, regularity and duration**. The detail in supporting analysis would be expected to reflect these aspects of any **particular action**. **For example**, a trustee decision which represents a significant expenditure of members’ money, would be expected to be supported by a robust analysis with quantifiable metrics to reflect expected financial outcomes (including but not limited to cost benefit analysis, articulation of risks associated with achieving the outcome and any mitigation strategy)<sup>14</sup> (emphasis added).*

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

<sup>13</sup> The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), Final Report, page 234

<sup>14</sup> EM - paragraph 3.37

The EM states that:

*How **any action** will yield financial benefits to the beneficiaries of the superannuation entity **must be the determinative consideration** for any trustee.*

*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**.*

*Clearly, **expenditure** on items that are not supported by identifiable financial benefits to members **articulated in a clear business case**, are **unlikely to satisfy the requirements** of the best financial interests duty<sup>15</sup> (emphasis added).*

The best financial interests duty requires that the exercise of a particular power, duty or discretion must be in the best financial interests of members but the Bill (quite rightly) does not state that it must be the determinative consideration; nor does it impose an obligation to identify a quantifiable financial benefit as a 'threshold consideration' or to document a business case.

While these statements in the EM may be a reflection of the practical outworking of the best interests obligation, in combination with the reversal of the onus of proof (and potentially any regulations made with respect to record-keeping) we do not believe this to be an accurate statement of the legal effect of inserting the word 'financial' into paragraph 52(2)(c).

This is acknowledged later in the EM where it states:

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

#### **Recommendation 8**

Statements in the EM to the effect that

- how any action will yield financial benefits to beneficiaries must be the determinative consideration
- the identification of a quantifiable financial benefit to members is a threshold consideration
- expenditure not supported by benefits articulated in a business case are unlikely to satisfy the duty should be amended or removed, as they are not accurate statements of the law and in this context are misleading.

### **2.3 Best interest obligation and quantification of benefit – no materiality threshold**

We agree with the statement in the EM that the best financial interests duty is not subject to any materiality threshold – this is entirely consistent with trust law.

Unfortunately, however, the EM has conflated the best interest duty with the practical effect of the reversal of the onus of proof and potentially the new power to make record-keeping regulations. This has resulted in the EM making strong statements with respect to the need to identify, quantify and document benefits, including the following statements:

*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**.*

<sup>15</sup> EM – paragraphs 3.32, 3.33 and 3.38

<sup>16</sup> EM - paragraph 3.85

*Clearly, expenditure on items that are not supported by identifiable financial benefits to members articulated in a clear business case, are unlikely to satisfy the requirements of the best financial interests duty*<sup>17</sup> (emphasis added).

Notwithstanding that these obligations are not in the legislation itself, these statements in the EM have caused member funds to express considerable concern about the lack of materiality, especially with respect to small amounts of non-strategic, discretionary expenditure.

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

**Recommendation 9**

The EM is modified to make it clear that expectations about robust evidence to support expenditure, and articulating financial benefits in a business case, are expected only with respect to *material* expenditure.

**Recommendation 10**

Should regulations with respect to record-keeping be made, any obligations to record evidence to support expenditure and articulate financial benefits should be with respect to *material* expenditure.

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<sup>17</sup> EM – paragraphs 3.33 and 3.38

### 3. Prohibition of prescribed payments and investments – sections 117A

Of great concern is the proposal to amend the SIS Act to insert a new section 117A that will allow regulations to be made that can specify that certain payments are prohibited, or prohibited unless certain conditions are met.

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

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

*I do not favour the adoption of a rule of that kind. Even if a rule of that kind could be made (and I do not stay to examine how the implied freedom of political communication might apply) it is not a rule that I consider should be made*<sup>18</sup> (emphasis added).

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

Commissioner Hayne did not favour the adoption of a rule, for example, prohibiting funds from engaging in certain kinds of advertising – he stated explicitly that it was not a rule that he considered should be made.

#### **Recommendation 11**

Given the explicit finding by Commissioner Hayne, we recommend that section 117A – to allow regulations to be made that can specify that certain payments and investments are prohibited – should not be inserted into the SIS Act.

The ED EM states

*The power has been drafted to broadly cover any payments and investments from a superannuation entity, including payments relating to expenses associated with running the entity or investments made by the entity.*

*This ensures that regulations can be made to prohibit certain payments and investments **where they are considered to be unsuitable expenditure by trustees in any circumstance***<sup>19</sup> (emphasis added).

If it is decided that section 117A is to be inserted into the SIS Act, (notwithstanding that it is inconsistent with the views of Commissioner Hayne), it is important that trustees are not fettered in their ability to make any investment they consider to be suitable and appropriate. Accordingly, should a regulation-making power be inserted into the SIS Act, it should be confined to the making of regulations to proscribe specified *expenditure* and should not extend to the prohibition of *investments*.

#### **Recommendation 12**

If section 117A were to be inserted into the SIS Act it should be confined to the making of regulations to proscribe specified *expenditure* and should not be extended to *investments*.

<sup>18</sup> *Op cit*; page 234

<sup>19</sup> *EM* – paragraphs 3.73 and 3.74

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

### 4.1 Reversal of evidential burden of proof

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

As noted by the Standing Committee for the Scrutiny of Bills (Standing Committee) in Scrutiny Digest 18 of 2020, in a different context:

*At common law, it is ordinarily the duty of the prosecution to prove all elements of an offence. This is an important aspect of the right to be presumed innocent until proven guilty. Provisions that reverse the burden of proof and require a defendant to disprove, or raise evidence to disprove, one or more elements of an offence, interferes with this common law right.<sup>20</sup>*

The Standing Committee goes on to note that:

*[T]he Guide to Framing Commonwealth Offences provides that a matter should only be included in an offence-specific defence (as opposed to being specified as an element of the offence), where:*

- *it is peculiarly within the knowledge of the defendant; and*
- *it would be significantly more difficult and costly for the prosecution to disprove than for the defendant to establish the matter.<sup>21</sup>*

The Standing Committee went on to observe that:

*While ... the defendant bears an evidential burden (requiring the defendant to raise evidence about the matter), rather than a legal burden (requiring the defendant to positively prove the matter), the committee expects any such reversal of the evidential burden of proof to be justified.<sup>22</sup>*

In ASFA's view there is no justification for the reversal of the evidential burden of proof.

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

Accordingly, it is neither necessary nor reasonable to reverse the evidential burden of proof - it is manifestly inappropriate to presume, legally, that a trustee did not perform its duties or exercise its powers in accordance with the best interests duty.

#### **Recommendation 13**

As there is not sufficient justification for the reversal of the evidential burden of proof the evidential burden of proof should remain with the regulator and section 220A should not be inserted into the SIS Act.

<sup>20</sup> Standing Committee for the Scrutiny of Bills, Scrutiny Digest 18 of 2020, 9 December 2020 – paragraph 1.95

<sup>21</sup> Ibid – paragraph 1.96

<sup>22</sup> Ibid – paragraph 1.97



The EM states:

*The reversal of the evidential burden should emphasise to trustees that they need to have strong systems and processes in place to ensure they can **point to evidence, for example, quantifiable metrics**, that the performance of their duties and exercise of their powers were in the best financial interests of members. ... Trustees should assess the **costs and benefits of actions**, which will commonly include **quantifiable metrics to demonstrate what the anticipated financial outcome is** and the reasonable basis for that expectation. **Actions** taken by trustees differ in **quantum, complexity and duration**, and the detail in supporting analysis would be expected to reflect these aspects of a particular **action**<sup>23</sup> (emphasis added).*

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

Further evidence of the focus on expenditure is the example given in the EM is as follows:

*For example, in the **case of a payment to a third party for services**, the trustee could adduce records showing the due diligence undertaken in respect of the payment and the relevant third party and other factors demonstrating that the **payment was in the best financial interests of beneficiaries**<sup>24</sup> (emphasis added).*

#### **Recommendation 14**

If section 220A were to be inserted into the SIS Act, its application should be confined to matters with respect to *expenditure* only.

#### **4.2 Applicability of reverse evidential burden of proof**

The EM states

*The reverse onus would not apply to actions to recover loss or damage under section 55 of the SIS Act. This means that it will only apply to actions brought by a regulator for the contravention of the best financial interests duty where a civil penalty applies for the breach and not actions to recover loss or damages as a result of a contravention of the best financial interests duty. The reverse onus would not apply to class actions against trustees brought by beneficiaries or brought by the regulator on behalf of beneficiaries.<sup>25</sup>*

#### **Recommendation 15**

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

<sup>23</sup> EM - paragraph 3.62

<sup>24</sup> EM - paragraph 3.67

<sup>25</sup> EM - paragraph 3.65



24 November 2020

The Hon Josh Frydenberg MP  
Treasurer  
By e-mail

Copies to:  
Senator Jane Hume – Assistant Minister for Superannuation, Financial Services and Financial  
Technology  
Ms Helen Rowell - APRA Deputy Chair  
Dr Steven Kennedy - Treasury Secretary

Dear Treasurer

**Re: Your Future, Your Super – Investment Issues**

We are writing to you in relation to the Government's 'Your Future, Your Super' package announced in the Federal Budget.

We commend the objective of the package to maximise the retirement savings of all Australians, so that they can enjoy a higher standard of living in retirement. This objective also is at the heart of every investment decision we make on behalf of fund members and highlights our common purpose.

We are concerned that the benchmarking methodology and underperformance test will have unintended consequences for the way in which superannuation savings are invested that are contrary to delivering good member outcomes. The key issues are:

- a. The benchmarking framework is too simplistic to capture the diversity of strategic asset allocations that are fundamental to building long-term wealth for fund members.
- b. For unlisted assets, implementation of the proposed benchmark indices will lead to a lower level, and different mix, of investment than is optimal for long-term returns. This will also have broader implications for the Australian economy.
- c. In particular, implementation of the proposed benchmark indices may lead funds to shift their investments to the types of assets that are contained in the indices:
  - i. The infrastructure index is comprised mainly of North American infrastructure assets (80% of the total), with a concentration in railways and electricity generation. A shift towards this allocation is likely to lead to lower levels of domestic infrastructure investment by funds
  - ii. The property index is dominated by a small number of property developers, who have a fundamentally different risk profile than owners of property assets. Implementation of this index is likely to lead to lower investment in real commercial property assets.
- d. The benchmarks do not provide scope for funds to invest more defensively within asset classes, so strategies designed to reduce or manage market risks could be unintentionally compromised. Defensively orientated portfolios including those

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designed for retirees, will be required to increase risk or exit the market, increasing risk within the system.

- e. International best practice is that targeted risk-adjusted return objectives are a more appropriate way of measuring performance (for example CPI+), and the Government's Future Fund is a prime example of this. Superannuation funds are required to set and disclose CPI+ return targets for MySuper products to members.
- f. Implementation of new benchmarking methodology should recognise that investment strategies have been set to achieve Member Outcomes tests that prescribe a different approach to performance measurement.
- g. The proposed benchmarking is inconsistent with consumer disclosures that past performance is not an indicator of future performance.

We believe that our combined insights and experience can be of practical use to Government in developing these important reforms.

We would appreciate the opportunity to have an open and constructive dialogue with you on these matters, prior to the legislation being introduced into Parliament.

We look forward to meeting with you as soon as is practicable to discuss these critical issues.

Yours sincerely

John Pearce  
Chief Investment Officer  
UniSuper

Sonya Sawtell-Rickson  
Chief Investment Officer  
HESTA

Damian Graham  
Chief Investment Officer  
Aware Super

Sam Sicilia  
Chief Investment Officer  
Hostplus

Graeme Miller  
Chief Investment Officer  
Telstra Super

Kylie Willment  
Chief Investment Officer - Pacific  
Mercer

Andrew Lill  
Chief Investment Officer  
REST

Con Michalakis  
Chief Investment Officer  
Statewide Super

Dr Ross Barry  
Chief Investment Officer  
MTAA Superannuation Fund

Aisling Freiheit  
Head of Australia  
Wellington Management

Paul Hennessy  
Managing Director  
Capital Group

Brett Jollie  
Managing Director - Australia  
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