

March 17, 2021

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

by email: economics.sen@aph.gov.au

Treasury Laws Amendment (Your Future, Your Super) Bill 2021 [Provisions]

Submission by the Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make a submission to the Senate Standing Committees on Economics – Economics Legislation Committee on the clarification to best interests duty for Responsible Superannuation Entities (RSEs). The scope of this submission covers aspects related to Schedule 3 of the abovenamed bill.

About RIAA and our members

RIAA champions responsible investing and a sustainable financial system in Australia and New Zealand and is dedicated to ensuring capital is aligned with achieving a healthy society, environment and economy. With over 350 members managing more than \$9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across Australia and New Zealand.

RIAA's membership includes super funds, fund managers, banks, consultants, researchers, brokers, impact investors, property managers, community trusts, foundations, faith-based groups, financial advisers, financial advisory groups and others involved in the finance industry, across the full value chain of institutional to retail investors.

RIAA achieves its mission through:

- Acting as a hub for our members, the broader industry and stakeholders to build capacity, knowledge and collective impact;
- Being a trusted source of information about responsible investment;
- Delivering tools for investors and consumers to better understand and navigate towards responsible investment products and advice, including running the world's first and longest running fund Certification Program, and the online consumer tool Responsible Returns; and
- Supporting continuous improvement in responsible investment practice among members and the broader industry through education, benchmarking and promotion of best practice and innovation.

RIAA's disclosure of interest in this draft law

RIAA is a mission-based organisation that derives approximately 60% of its revenue from membership. As of December 2020, RIAA has 23 RSE members providing 6% of its annual operating revenue. RIAA is committed to improving member capacity to deliver stronger outcomes for beneficiaries and the organisation's commitment to consumer protection and improving the accountability of the superannuation industry is evidenced specifically in:

1. Operating the world's longest running certification program covering responsible investment products (as being true-to-label)
2. Hosting the consumer site, [Responsible Returns](#) which assists retail investors with finding responsible investment information on superannuation and other investment products
3. Publishing the biennial [RI Super Study](#) which assesses the 50 largest APRA regulated superfunds against a framework of good governance (based on ISO9000 quality systems which includes a leaders' board that rewards funds in part for their formal investment decision making processes, record keeping and disclosures).

About responsible investing and policy settings for superannuation trustees

In February of 2017, APRA Executive Board member Geoff Summerhayes [clarified for the audience of the Insurance Council of Australia's annual conference](#) that 'Some climate risks are distinctly 'financial' in nature. Many of these risks are foreseeable, material and actionable now.'

Each year for the last 16 years, applying a broad lens through which to view upside and downside risk in portfolios, one that incorporates environmental, social and governance considerations, and using this to inform valuations and portfolio construction, has led to member investments (for those taking their first job at age 16 or those drawing an annuity at age 76) delivering stronger long-term financial performance over most asset classes and most investment horizons ([RIAA's Responsible Investment Benchmark Report 2020](#) Figure 35, p29). This fact is the reason that as of December 2019, a full \$1.1 trillion (37%) of professionally managed funds in Australia are invested consistent with responsible investing strategies, be they ESG integration, corporate engagement, normative, negative or positive screens, impact intention or a combination of some or all of these (Figure 18, p18). The superannuation funds marked as 'leading investment managers' come from public, industry and retail sectors and are both large (i.e.. AustralianSuper) and small (i.e. Australian Ethical (Figure 17, p17).

Investing to account for ESG considerations continues to be a growth area as Australians become more aware of the extra-financial issues that play out in the world around them, from climate change in the form of devastating bushfires over 2019/20 summer to global pandemics such as Covid19. [Research into consumer expectations of their investments](#) (including super) shows that Australians care that they retire into a world that is safe, clean and equitable.

- 53% of them say they would be motivated to invest and save more money if they knew their savings or investments made a positive difference in the world (p8); and
- 87% of Australians think Australia's financial services sector has a role to play in generating positive social, environmental and economic outcomes for the country (p7).

With consideration to the above, undertaking responsible investment strategies (which may not immediately appear to be directly financial in nature) is not inconsistent with

1. [risk] APRA's stated expectations of RSEs with respect to risk management
2. [returns] delivering consistently strong financial returns over most periods and especially the long term (the focus on superannuation)
3. [norms] the expectations of superannuation savers and annuitants (see [McVeigh vs Rest](#)), including for example screening for harmful investments such as tobacco producers and/or investing in solutions to climate change and energy security such as micro-grids for renewable energy systems.

Accordingly, the bill needs to be mindful of not creating unintended outcomes that impact RSEs to continue to deliver on the above three essential aspects of being effective fiduciaries.

Furthermore, the ability of fiduciaries to engage in, deliver and benefit from better risk management and alignment with consumer expectations is a function in part to the organisations and services that they connect into, including ours. We have disclosed our interest around why we wish to retain RSEs as RIAA members – it goes further than their financial contribution to our membership body, it goes to the role that they play in providing precompetitive insights to leadership, cultural and systemic-wide issues, essential for whole-of-investment network efficiencies and effectiveness, as well as (ultimately through investment decision-making) the resilience, performance, and competitiveness of the Australian economy essential for underpinning long-term performance of members' investments.

Findings flowing from the annual RIAA Member Survey show us that our members continue to derive strong or very strong value from participation in RIAA events, working groups, research and policy with them:

- being better connected
- being better informed
- sharing pre-competitive knowledge to drive sector-wide efficiencies and outcomes, such as requesting better company disclosures around risk
- collaborating on the development of building knowledge and tools, such as [reporting on modern slavery](#)
- benchmarking their performance against peers and against regional and international leading practice.

It is necessary to codify how these benefits be communicated to the regulator such that they are not inconsistent with the intention of the proposed amendments; it is essential that the amendments do not inadvertently prevent fiduciaries from achieving what the amendments intend – deliver on the best financial interests of beneficiaries, consistent with the needs and desires of those beneficiaries.

Specific feedback and recommendations

Clarification sought for the concept of fiduciary duty

Based on the evidence provided in the section above titled About responsible investing and policy settings for superannuation trustees, RIAA takes a view that adding the word “financial” shall not further clarify the sole purpose test for the trustee, the regulator, or other stakeholders; in fact, there is a risk that it may confuse.

However, the ‘intent’ to provide clarification is welcomed and the appropriate place for this to occur is in Superannuation Circular No.III.A.4 (Sole Purpose Test Guidance). RIAA suggests updating and broadening the list of incidental advantages in clause 35 of Superannuation Circular No.III.A.4 (Sole Purpose Test Guidance) to include investments that deliver positive environmental and/or social impacts (so long as they also deliver long term value to beneficiaries).

Obligation applies to trustees of registrable superannuation entities

As a part of their decision making process, trustees will need to consider the appropriateness of making various kinds of expenditure. (EM 3.34)

A schedule of the complying or non-complying activities should be codified in the legislation such that it is formal. This is especially important given the proposed provision to reverse the burden of evidential proof resting on trustees.

Where a fund undertakes expenditure that might be considered discretionary or non-essential to the ongoing operation of the superannuation entity they should expect to face greater scrutiny about the basis for that expenditure. (EM 3.36)

Member choice is key to retaining and attracting members, so it especially important that funds be able to offer a range of options that meet the diverse and evolving preferences of members. This becomes especially important if the proposed law were to effectively curb expenditure on brand building and/or promotional spend.

A strategy deployed by funds includes developing bespoke options to test the appetite of membership to these selected features; an example may include ethical or sustainable options. Should the fund discover that the financial performance and/or the inflows by members to these funds increases, the business case exists to wholesale update the mainstream funds with these features present in the option.

RIAA's RI Certification Program that has been in existence for 16 years, has 209 certified RI products of which 38 products are issued by 10 RSEs.

Clearly, expenditure on items that are not supported by an identifiable and quantifiable financial benefit to members, articulated in a clear business case, are unlikely to satisfy the requirements of the best financial interests duty. (EM 3.38)

Given many recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry are predicated on a very low level of financial literacy with members, it follows that funds should be able to invest in activities such as attracting and retaining members consistent with improving their beneficiaries' financial literacy as this increases engagement with the member and ultimately, enables members (in annuity phase) to prudently manage their retirement, irrespective of precisely the final figure in their account.

Clarification of the best financial interest duty – third party payments

Trustees cannot hide behind unjustifiable claims that they are ignorant of what they are purchasing. Trustees should reasonably know what they are purchasing, and such purchases should be in the best financial interests of beneficiaries. (EM 3.56)

Despite the example 3.4 provided in the Explanatory Memorandum, it would be helpful that a register/list of activities deemed to not be in the best financial interests of beneficiaries be codified in the law such that trustees have a clear and reliable basis on which to perform their revised expected duties.

Reversal of the evidential burden (SIS Act, Section 220A)

The evidential burden of proof for the best financial interests duty is reversed so that the onus is on the trustee of a registrable superannuation entity.

Whilst RIAA does not possess a body of evidence to inform a considered view on whether or not this proposal is reasonable, implementable and/or likely to be effective to achieve the intended goal, it may be noted ([as done by the Australian Law Reform Commission](#)), that other than the criminal code (relating to terrorism offences, drug offences, child-sex offences outside of Australia, plastic explosives), taxation (relating to false and misleading statement and incorrectly keeping records), copyright (subsistence and ownership) and a small sample of other laws, evidential burden of proof is seldom reversed, mainly because this undermines the Rule of Law. Depending on how this is viewed by the providers of professional (specifically directors' and officers' indemnity) insurance, it is a possible outcome that the implementation of this provision results in a proportion of currently effective and responsible trustees no longer willing to risk acting in these roles.

Trustees should assess the costs and benefits of actions, including 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. (EM 3.62)

The intent of this is welcomed but to deliver this meaningfully, clear guidance is required such that all parties to these decisions can enable satisfaction of this requirement (in terms of evidence expected by regulator). RIAA recommends that these expectations be clearly articulated and codified in the Act itself.

Prohibition on certain payments and investments

Regulations may prohibit trustees of registrable superannuation entities from making certain payments, or prohibit certain payments being made unless certain conditions are met (regardless of whether the payment is considered to be in the best financial interests of the beneficiaries).

The adoption of this proposed addition would result in unworkable uncertainty for trustees when attempting to exercise their fiduciary duties to other people's money. Due to the proposed reversal of the burden of evidential proof, it is inappropriate that the bill be revised to allow for regulations to be made to specify that certain payments or investments made by trustees of RSEs are prohibited. This schedule of prohibited payments should be codified in the Act itself.

Application and transitional provisions and holdings disclosure

The amendments relating to the duty to act in the best financial interest of beneficiaries apply in relation to duties that are performed, or powers that are exercised on or after 1 July 2021.

Whilst RIAA welcomes strong and decisive action to improve the governance of the financial services sector where consumer best interests are pursued, the introduction of these proposed amendments for 1 July 2021 is too rushed. Stakeholders need time to view, assess, consider and comment on the bill (should these in fact be used to guide how the provisions of the act are ultimately implemented). The proposed timeline seems out of step with other relevant regulations seeking to protect consumer interest, that have failed to be enacted despite them having been drafted in part since 2012 (e.g. [Class Order \[14/443\] Deferral of choice product dashboard and portfolio holdings disclosure regimes](#)). The failure to enact transparency measures puts the Australian superannuation marketplace out of step with comparable markets. According to [Morningstar Global Fund Investor Experience Study: Disclosure](#), Australia is rated 'below average' for disclosure when compared with all other OECD countries. "There are some notable laggards, such as Australia, that have neither dealt with existing basic deficiencies in their markets' disclosure practices nor adapted to changing investor expectations around ESG and Stewardship disclosure," p6.

Additional measures to consider

Firstly, much of the intent of this bill can be achieved through additional transparency measures, requiring RSEs to publicly disclose expenditure, with, in the case of spending on third parties and intermediaries, a look through to the underlying activities that provide outcomes consistent with being in the members' best financial interests. In this same manner, we recommend that consistent with the spirit of this bill, that the portfolio holdings disclosure regime is also brought into force.

Secondly, whilst the Committee is in the process of considering the clarification of the interpretation of the sole purpose test to be applied by fiduciaries pursuant to the SIS Act, it would also be opportune to respond the [Australian Sustainable Finance Roadmap recommendations](#) to clarify fiduciary duty with respect to 'incidental advantages'. By updating and broadening the list of incidental advantages in clause 35 of Superannuation Circular No.III.A.4 (Sole Purpose Test Guidance) to include investments that deliver positive environmental and/or social impacts (but not where this is inconsistent with delivering best financial interest of members), then it would be less unclear about the remit of superannuation funds in nation building investments that contribute to better beta and indirectly to better performance of a majority of assets that result in superior alpha.

Summary of comments

Overall, RIAA commends the intent of this bill, which is to deliver stronger outcomes from superannuation members. However, as currently drafted, the bill contributes to decision making uncertainty for trustees. Accordingly, the proposed amendments contained in this bill need to be mindful of not creating unintended

outcomes that impact RSEs to continue to deliver strong performance based on sound risk management in line with evolving norms, characteristics of behaving as responsible fiduciaries.

Specifically, it is recommended that:

1. Description and examples of robust quantitative and qualitative evidence to support their expenditures (including for third-party payments and investments) be codified in the Act itself so that further uncertainty is not created
2. A schedule of complying and non-complying expenditures also be codified in the Act itself
3. The burden of evidential proof is not reversed; this measure undermines the Rule of Law
4. Provisions that limit consumer engagement and choice (such as through removing sustainable investing options) not be supported because of the role that these play in retaining and attracting members as well as providing learnings for funds in terms of overall portfolio improvements
5. Provisions that limit a fund's ability to improve financial literacy of members should also not be prohibited; higher levels of literacy are consistent with more prudent financial management throughout savings and annuity phases
6. Proposed provisions are not rushed through for 1 July 2021, but due consideration be applied to this suite of draft measures. Once more substantively drafted, stakeholders can provide better informed feedback on the impact of provisions.

We welcome the opportunity to provide further feedback or clarification on the points made herein.

Yours sincerely,



Nicolette Boele
Executive, Policy and Standards
Responsible Investment Association Australasia