

December 21, 2020

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# Treasury Laws Amendment (Measures for a later sitting) Bill 2020: Best Financial Interests Duty

## Submission by the Responsible Investment Association Australasia

The Responsible Investment Association Australasia (RIAA) welcomes the opportunity to make a submission to The Treasury on the clarification to Best Financial interests Duty for Responsible Superannuation Entities.

### 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 proposed disclosure bill

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 members 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 the Australian Sustainable Finance Initiative

In November 2020, the Australian Sustainable Finance Initiative ([ASFI](#)) released its [Roadmap](#) setting out a bold plan to align Australia's financial system to support a thriving Australian society, a healthy environment and a strong, resilient and prosperous economy. The Roadmap (developed through an 18 month process involving 140 people from over 80 organisations across financial services) makes 37 recommendations that, once implemented, will enable the financial services sector, together with regulators and governments, to strengthen Australia's financial system with the aim of recovering from the impacts of COVID-19 and delivering a transition to a net zero, resource-efficient and inclusive economy.

Chapter 7.2.7 'working with financial service regulators' includes a number of opportunities for the sector and regulators to engage, with APRA for example incorporating sustainability risks in the list of material risks in Prudential Standards 220 and SPS 220 (Risk Management).

As part of APRA's planned updates to Prudential Guidance SPG530 (Investment Governance)

- recognising that a registrable superannuation entity (RSE) licensee may incorporate into investment strategies members' views on environmental and social issues, and ethical, themed or impact investments;
- stating that it would be expected that material sustainability factors would be systematically and explicitly integrated into an RSE licensee's investment strategy, analysis and decision-making;
- recognising that the process and criteria for selecting an investment may continue to include the investment's impact, provided the investment is consistent with the fund's investment strategy where the investment is made for a retirement purpose;
- removing the reference in clause 35 to quantification of environment, social and governance (ESG) considerations and removing clause 36;
- referencing sustainability risk as a potential risk factor to be considered in the assessment of risk exposures for an investment when conducting due diligence; and
- referencing consideration of an investment manager's approach to identifying and managing sustainability risk factors as part of the due diligence assessment prior to selecting an investment manager.

And of direct relevance to this submission:

- continuing to recognise that 'incidental advantages' of investments remain permitted; and

- 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.

The ASFI is modelled on the work and progress internationally to align the finance sector with the goals of a resilient and sustainable economy, including the European Union’s High Level Expert Group on Sustainable Finance and the UK’s Green Finance Taskforce.

[Simon O’Connor](#), RIAA’s CEO, is co-chair of the ASFI.

RIAA recommends the Roadmap to The Treasury for the purpose of its roll out of the *Your Future, Your Super* package.

### **About responsible investing and policy settings for superannuation trustees**

Back 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 undertaking ‘leading investment managers’ come from public, industry and retail sectors and they are as large as AustralianSuper and Mercer and as small as boutiques such as Australian Ethical and Future Super (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 the previous 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
3. [norms] the expectations of superannuation savers and annuitants including for example being out of 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 proposed amendments contained in these draft exposure bills need 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 also 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.

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

- better connected
- 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 shall be necessary for any proposed amendments to codify how these benefits be communicated to the regulator such that they are not inconsistent with the intention of the proposed amendments. In short, it is critical that these amendments don't inadvertently prevent fiduciaries from achieving exactly what the amendments are aiming to do – that is deliver on the best financial interests of beneficiaries, consistent with the needs and desires of those beneficiaries.

### **Scope and basis of input provided**

The scope of this submission covers the:

1. bills' objectives to clarify fiduciary duty
2. treatment of certain payments and investments by trustees and directors of RSEs (117A and d117B)
3. burden of proof (220A) - bears an evidential burden in relation to the matter
4. application – offence for directors of corporate trustees and compliance with record keeping requirements (timing being 1 July 2021, but full holdings disclosure is delayed again)
5. regulations may prohibit certain payments or prohibit certain payments unless certain conditions are met (regardless of whether the payment is considered to be in the best financial interests of beneficiaries).

### **Specific feedback and recommendations**

#### *Bill's objectives to clarify fiduciary duty*

Based on the evidence provided in the section above titled About responsible investing and policy settings for superannuation trustees, RIAA doesn't believe it's necessary to add the term word "financial" to clarify the sole purpose test. Trustees that take a broader view of risk and incorporate environmental, social and governance factors into investment decision making, have

demonstrated year on year (for the last 17) that as currently worded they are improving the risk, performance and better delivering to the expectations of members (through for example avoiding harm with their investments). However, the 'intent' to provide clarification is welcomed. Accordingly, RIAA suggests that The Treasury consider 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*

1.28 The identification of a quantifiable 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 quantitative and qualitative evidence to support their expenditures.

Before providing support for this, it will be necessary to provide the industry with the tools, or at least examples of what is meant by quantitative and qualitative evidence to support expenditures.

1.29 As a part of their decision making process, trustees will need to consider the appropriateness of making various kinds of expenditure, including a kind that can be considered core or essential to the operation of a superannuation entity. For example, such expenditure may be made towards investments in systems, risk management, governance and the engagement of sufficient resources to operate the trustee's business operations.

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.

1.31 There are other kinds of expenditure that might be considered discretionary or non-essential to the ongoing operation of the superannuation entity. Some of these expenditures could be strategic in nature (for example offering member services, including financial advice, or additional investment products for members). A business case, supported by technical analysis (including cost benefit analysis, articulation of risks associated with achieving the outcome and any mitigation strategy) and quantifiable metrics to reflect expected financial outcomes would be expected to support trustee decision making on strategic expenditure.

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 very diverse and evolving preferences of members. This would become especially important if the proposed law were to effectively curb expenditure on brand building and/or advertising.

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 17 years, has 194 certified RI products of which 38 products are issued by 10 RSEs.

1.32 Other strategic discretionary expenditure, such as expenditure relating to building a brand, promoting awareness of the fund or supporting external activities, which 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 interest obligation.

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*

1.44 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.

Despite example 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*

1.46 The evidential burden of proof for the best financial interests duty is reversed so that the onus is on the trustee and each director of a corporate trustee of a registrable superannuation entity to adduce evidence to support the contention that the trustee or director performed their duties and exercised their powers in the best financial interests of the beneficiaries. **[Schedule #, item 13, section 220A of the SIS Act]**

Whilst RIAA does not possess a body of knowledge to provide a sound 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.

1.49 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.

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 of the law (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*

1.57 – 1.62; and 1.57 Schedule # amends the SIS Act to allow regulations to be made to specify that certain payments or investments made by trustees of registrable superannuation entities, and trustees of SMSFs, are prohibited, or prohibited unless certain conditions are met. For the avoidance of doubt, this prohibition would apply to payments where the trustees have used a third party intermediary to procure the prohibited expenditure or investment on their behalf. **[Schedule #, item 12, subsections 117A(1) and 117C(1) of the SIS Act]**

1.58 The amendments allow regulations to be made to specify that directors of the corporate trustee are prohibited from causing the corporate trustee to make a payment or investment. This reflects the fact that directors do not make payments and investments themselves. **[Schedule #, item 12, subsection 117B(1) and paragraph 117C(1)(b) of the SIS Act]**

Due to the proposed reversal of the burden of evidential proof, it is inappropriate that the Act be amended 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. The adoption of this proposed amendment would result in unworkable uncertainty for trustees when attempting to exercise their fiduciary duties over other people's money.

#### *Application and transitional provisions*

1.71 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. **[Schedule #, item 15]**

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 will need time to view, assess, consider and comment on the proposed regulations (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 for over eight year (e.g. [Class Order \[14/443\] Deferral of choice product dashboard and portfolio holdings disclosure regimes](#) which was published only on December 8).

#### **Additional measures to consider**

Whilst The Treasury is in the process of clarifying 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 at the where this is inconsistent with delivering best financial interest of members), then it would be less unclear about the remit of superannuation funds to play in nation building investments that contribute to better beta and indirectly to better performance of a majority of assets that result in superior alpha.

Furthermore, some of the intent of this proposed legislation can be achieved through additional transparency measures, requiring the RSE 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 proposed Amendment, that the portfolio holdings disclosure regime is also brought in to force.

## Summary

Overall, RIAA commends the intent of these bills, which is to deliver stronger outcomes from superannuation members. However, as currently drafted, the proposed bill contributes to uncertainty of decision making by trustees which will likely have the reverse effect (removing trustee accountability).

Accordingly, the proposed amendments contained in these draft exposure bills need to be mindful of not creating unintended outcomes that impact RSEs to continue to deliver better risk, returns and in line with norms, which are 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,



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