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23 December 2020

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Dear Sir/Madam

Your Future, Your Super package

Thank you for the opportunity to provide a submission to the Treasury on the Federal Government's proposed "*Your Future, Your Super*" package of legislation (**Your Super package**).

Jones Day

Jones Day is a global law firm with more than 2,500 lawyers in 42 offices across five continents.

In Australia, Jones Day's lawyers have over 25 years' experience advising superannuation trustees on a range of regulatory and operational matters, including trustee and director obligations, interpretation and implementation of regulatory changes, product design, member communications and disclosure obligations, administration, insurance and investment, and fund mergers and wind ups.

Our lawyers also regularly act for financial sector corporations and individual directors and officers in relation to regulatory investigations and enforcement actions, class actions, and Government inquiries and Royal Commissions.

We make this submission as interested members of the Australian legal profession. The submission is not made on behalf of any clients of Jones Day. The submission is not intended to be and does not constitute legal advice.

Proposed new best financial interests obligation

1. Jones Day acknowledges the importance of the superannuation system to the Australian economy and supports reforms that maximise the retirement savings of members of superannuation funds.

2. Jones Day notes the proposal in the Your Super package that the general covenants in the *Superannuation Industry Supervision Act 1993* (Cth) (the **SIS Act**) be amended so that the current obligation of corporate trustees of registrable superannuation entities (**RSEs**) and their directors to perform their duties and exercise their powers in the best interests of beneficiaries (SIS Act, ss 52(2)(c) and 52A(2)(c)) be clarified as an obligation to perform their duties and exercise their powers in the best *financial* interests of beneficiaries (the **BFI obligation**).

3. Jones Day is concerned by the proposal to reverse the evidential burden of proof so that corporate trustees and their directors are presumed to have breached the BFI obligation in the absence of evidence to the contrary. Proposed SIS Act, s 220A states:

> ***220A Burden of proof—civil proceedings relating to duty to act in best financial interests of beneficiaries***
>
> *(1) In civil proceedings for a contravention of subsection 54B(1) in relation to a covenant set out in paragraph 52(2)(c), it is presumed that a trustee did not perform the trustee's duties and exercise the trustee's powers in the best financial interests of beneficiaries, unless the trustee adduces evidence to the contrary.*
>
> *(2) In civil proceedings for a contravention of subsection 54B(2) in relation to a covenant set out in paragraph 52A(2)(c), it is presumed that a director of a corporate trustee of a registrable superannuation entity did not perform the director's duties and exercise the director's powers as director of the corporate trustee in the best financial interests of beneficiaries, unless the director of the corporate trustee adduces evidence to the contrary.*
>
> *(3) If, in such proceedings:*
>
> *(a) a trustee or director of a corporate trustee wishes to adduce evidence to the contrary—the trustee or director of the corporate trustee bears an evidential burden in relation to the matter; and*
>
> *(b) in the case that evidence to the contrary is so adduced—the Regulator must prove, on the balance of probabilities, that:*
>
> *(i) the trustee did not perform the trustee's duties and exercise the trustee's powers in the best financial interests of beneficiaries; or*
>
> *(ii) the director did not perform the director's duties and exercise the director's powers as director of the corporate trustee in the best financial interests of beneficiaries.*

4. The proposal to reverse the evidential burden of proof is particularly concerning in circumstances where the BFI obligation in the Your Super package does not have any materiality threshold, and the Explanatory Materials confirm that no such threshold applies. The Your Super package also clarifies that the BFI obligation applies to payments to third parties (proposed SIS Act, ss 52(2A), 52A(2A)).

5. The Explanatory Materials to the Your Super package states that the reversal of the onus of proof is:

> *"… proportional, necessary, reasonable and in pursuit of a legitimate objective. Given that the facts of whether a trustee has acted in the best financial interests of beneficiaries is peculiarly within the knowledge of the trustee; proof of this could be readily provided by the trustee; and the reverse onus is confined to situations where the consequences of a breach are civil penalties sought by the regulator, and will not be applied to situations where a criminal penalty is pursued."*[1]

6. With respect, while trustees and their directors may be in a position to adduce evidence that the BFI obligation has not been breached, we do not believe that imposing a reverse evidentiary burden on trustees or directors in civil penalty proceedings is a proportionate, necessary or reasonable burden.

7. For the reasons set out in this submission, we submit that the Government should reconsider the proposal to impose a reverse evidentiary burden.

[1] Exposure Draft Explanatory Materials, *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: (Best Financial Interests Obligation)*, [1.53].

Reverse evidential burden of proof in relation to directors

8. While it is appropriate that the reverse onus does not apply to criminal prosecutions against directors for breach of the BFI obligation, this does not justify its application to civil penalty proceedings.

9. In December 2014, the Parliamentary Joint Committee on Human Rights published *Guidance Note 2: Offence provisions, civil penalties and human rights* (**Guidance Note 2**) which outlines that civil penalty provisions may engage due process rights contained in Art 14 and 15 of the International Covenant on Civil and Political Rights (**ICCPR**) where the penalty can be regarded as "criminal" for the purpose of international human rights law.

10. Guidance Note 2 provides that when considering whether a penalty is criminal legislative proponents will adopt a three-step process:

- ***Step one****: Is the penalty classified as criminal under Australian Law?*

  If so, the penalty will be considered 'criminal' for the purpose of human rights law. If not, proceed to step two.

- ***Step two****: What is the nature and purpose of the penalty?*

  The penalty is likely to be considered criminal for the purposes of human rights law if:

  a) the purpose of the penalty is to punish or deter; and

  b) the penalty applies to the public in general (rather than being restricted to people in a specific regulatory or disciplinary context.)

  If the penalty does not satisfy this test, proceed to step three.

- ***Step three****: What is the severity of the penalty?*

  The penalty is likely to be considered criminal for the purposes of human rights law if the penalty carries a penalty of imprisonment or a substantial pecuniary sanction.

  Note*: even if a penalty is not considered 'criminal' separately under steps two or three, it may still be considered 'criminal' where the nature and severity of the penalty are cumulatively considered.* [emphasis added][2]

11. Having regard to Guidance Note 2, we consider that a civil penalty for breach of the BFI obligation by a director should be considered to be 'criminal' for the purposes of the ICCPR. In that regard, we note the following:

(a) Governments increasingly regulate corporate behaviour through civil penalty provisions rather than the criminal law. According to the High Court in *Chief Executive Officer of Customs v Labrador Liquor Wholesale Pty Ltd,* civil penalty proceedings, including proceedings involving breaches of companies and trade practices legislation, increasingly have criminal and civil characteristics, and the purposes of those proceedings "*include purposes of deterrence, and the consequences can be large and punishing*".[3] A civil penalty proceeding against a

[2] Parliamentary Joint Committee on Human Rights, *Guidance Note 2: Offence provisions, civil penalties and human rights* (December 2014), 3.

[3] *Chief Executive Officer of Customs v Labrador Liquor Wholesale Pty Ltd* (2003) 216 CLR 161 at [114] (Hayne J with whom Gleeson CJ and McHugh J agreed).

director for breach of the BFI obligation is analogous to a proceeding for breach of directors' duties and has the purpose of punishment and deterrence.

(b) The sanction available to a court when making a civil penalty order against a director for breach of the BFI obligation is significant, and could include the court ordering a fine of up to 2,400 penalty units (SIS Act, s 196), which currently equates to $532,800.

(c) Civil penalty proceedings often have significant reputational impacts for persons found to have contravened the law (or even when there is an allegation they have contravened the law). The reputational impact for a director of a corporate trustee who is alleged to have breached the BFI obligation is likely to be severe and could permanently damage *their* reputations and the reputation of the trustee in circumstances where the regulator makes an assertion of wrongdoing which it is then up to the individual to prove otherwise.

(d) The SIS Act is currently administered by APRA. However, presuming that the *Financial Sector Reform (Hayne Royal Commission Response—Stronger Regulators (2020 Measures)) Bill 2020 ASIC regulation of superannuation* is passed by Parliament in its current form by 1 January 2020 as planned,[4] sections of the SIS Act, including ss 52(2)(c) and 52A(2)(c), will be co-regulated by ASIC and APRA, who will both have roles in enforcing regulatory compliance. Both regulators have wide coercive investigatory powers which they may use for the purposes of gathering evidence including the power to serve notices to produce (*ASIC Act 2001* (Cth), s 30; SIS Act, s 269), require company officers or employees to attend compulsory examinations (*ASIC Act*, s 19; SIS Act, s 270) and execute search warrants (*ASIC Act*, Pt 3, Div 3A; SIS Act, s 271). As such, directors are already in a position of significant disadvantage vis-à-vis both ASIC and APRA, and this disadvantage would be significantly heightened by a reversal of the evidentiary burden of proof.

12. Having regard to these matters, we consider that the application of civil liability to directors who breach the BFI obligation should be considered to be 'criminal' within the meaning of the ICCR.

13. Guidance Note 2 notes the following in relation to the circumstances where a reverse burden for a criminal offence (including a civil penalty provision that should be considered 'criminal') is justified and consistent with the ICCR:

> *"Reverse burden offences will be likely to be compatible with the presumption of innocence where they are shown by legislation proponents to be reasonable, necessary and proportionate in pursuit of a legitimate objective. Claims of greater convenience or ease for the prosecution in proving a case will be insufficient, in and of themselves, to justify a limitation on the defendant's right to be presumed innocent."*[5]

14. With respect, the justification in the Explanatory Materials for the reversal of the evidentiary onus appears to be solely based on convenience as it argues that:

[4] The Honourable Josh Frydenberg MP, "Update on the implementation of the Banking, Superannuation and Financial Services Royal Commission" (8 May 2020).

[5] Parliamentary Joint Committee on Human Rights, *Guidance Note 2: Offence provisions, civil penalties and human rights* (December 2014), 2.

> "*the facts of whether a trustee has acted in the best financial interests of beneficiaries is peculiarly within the k nowledge of the trustee; proof of this could be readily provided by the trustee*";[6] and
>
> "*a trustee should be readily able to point to evidence that they considered the likely financial impact on beneficiaries of a decision to make a payment to a third party and how such payment was in the best financial interests of beneficiaries*."[7]

15. In addition, as the extracted quotes in the above paragraph underline, the justification for the reverse burden outlined in the Explanatory Materials continually refers to "trustee" and fails to provide a specific justification as to why this burden should apply to directors individually. This will apply to all superannuation trustees, and to all directors of superannuation trustees whether they are employee or employer representatives in industry funds, appointees of related parties in retail funds, or independent directors. The Explanatory Materials do not consider whether ICCR due process rights apply to directors, or provide reasons why they do not.

16. Lastly, from a practical perspective, imposing a reverse onus on a director has the potential to discourage appropriately qualified and experienced individuals from accepting positions as directors of trustees. This may be to the detriment of members, whose interests are ultimately served by trustees being able to attract and retain directors of sufficient experience and expertise and who can provide intelligent oversight of the internal and external managers of the fund.

Reverse evidential burden of proof in relation to trustees

17. Although corporate trustees prosecuted for breach of civil penalty provisions are not entitled to due process rights under the ICCR, many of the concerns with a reverse evidentiary onus outlined above are equally applicable to its application to corporate trustees, which seems to be justified for reasons of mere convenience rather than sound legal principle.

18. The Explanatory Materials states that the reverse onus will emphasise the need for trustees to have "*strong systems and processes in place to ensure all actions they take can be demonstrated to be in the best interests of beneficiaries*" and "*keep clear records of the decision-making process*".[8]

19. It is relevant to note that the current obligation to act in the best interests of beneficiaries is generally interpreted in accordance with long standing trust law, which views the best interests of beneficiaries as their best financial interests. [9] This is acknowledged in the Explanatory Materials which states that the BFI obligation "*is intended to clarify the existing best interests duty*."[10]

20. Leaving aside the question of whether the change from "best interests" to "best financial interests" does or does not assist in clarifying the law, it would be expected that concern

[6] Exposure Draft Explanatory Materials, *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: (Best Financial Interests Obligation)*, [1.53].

[7] Exposure Draft Explanatory Materials, *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: (Best Financial Interests Obligation)*, [1.54].

[8] Exposure Draft Explanatory Materials, *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: (Best Financial Interests Obligation)*, [1.48].

[9] *Cowan v Scargill* [1985] 1 Ch 270 at 286-287.

[10] Exposure Draft Explanatory Materials, *Treasury Laws Amendment (Measures for a later sitting) Bill 2020: (Best Financial Interests Obligation)*, [1.6].

about potential liability for a civil penalty provision under the existing law has already incentivised trustees to put in place strong systems and processes to ensure that all actions they take are in the best financial interests of beneficiaries. There is no evidence cited in the Explanatory Materials which suggests that trustees do not already have in place such systems and processes.

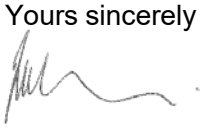
21. If the objective is to ensure that trustees have strong systems and processes and keep clear records of their decision making processes, this would be achieved by prescribing the systems and process requirements and the record keeping obligations that trustees must meet. The Explanatory Materials do not include any commentary explaining why the reverse onus is thought to be necessary to achieve this objective, and the commentary on "reasonableness" appears to be directed at convenience for the regulator.

22. Our concern is that the reverse onus is likely to lead to significantly increased compliance costs, incurred by overcautious directors fearful of potential liability, particularly given that the BFI obligation is not subject to any materiality threshold and that what will constitute "evidence" that the trustee has performed duties or exercised powers in the best financial interests of members will be unclear in many circumstances. A natural response would be for boards to consider every item of fund expenditure, no matter how trivial, to ensure each individual item can in some way be supported by "evidence" which could be adduced in civil penalty proceedings.[11] This has the potential to materially impede the ability of trustees and their directors to make decisions based on sound business judgements and to set up sensible delegations.

We hope our comments will be of assistance to you.

If you would like to discuss any aspect of our views, please contact the writers.

Yours sincerely



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[11] The example a paragraph 1.54 of the Explanatory Materials is: "*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*". This could be interpreted as a suggesting that, in order to ensure that the trustee and the directors are able to adduce evidence in the event of a civil penalty proceeding, the trustee is expected to conduct a due diligence process for every item of expenditure, no matter how trivial.