CHAPTER 4
A SUPERANNUATION RELATIONSHIP FRAMEWORK

Introduction ............................................................................................................ 118
4.1 Trust: The Chosen One ........................................................................... 119
4.2 The Analysis of Regulation .................................................................. 121
  4.2.1 Regulatory Analysis: Stage One – Objectives of Regulation ............ 123
    4.2.1.1 SC Scheme ...................................................................................... 124
    4.2.1.2 SIS Scheme ........................................................................................ 129
  4.2.2 Regulatory Analysis: Stages Two & Three – Alternatives & Selection .. 133
    4.2.2.1 Trust .................................................................................................. 134
    4.2.2.2 Contract ............................................................................................ 150
    4.2.2.3 Company ........................................................................................... 165
4.3 Industry Preference ................................................................................. 181
4.4 Superannuation Relationship Framework – Outline and Application ....... 186
Conclusion ............................................................................................................. 190
Introduction

The phrase *superannuation law* does not represent a single faceted law that governs superannuation. To the contrary, the phrase can be conceptualised as an umbrella that shades the intersection of various competing bodies of law that together govern the superannuation industry. The competing bodies of law, as identified in Chapters 2 and 3, are trust, contract and statute.

Inherent in any interactionary relationship is the presence of conflicts or tensions. This chapter proposes a mechanism for improving the structured interaction of the foregoing bodies of law, thereby providing a basis for the minimisation of conflict and tension in superannuation law. The mechanism proposed for the achievement of this objective is the “superannuation relationship framework”.

The proposed superannuation relationship framework (“SRF”) is premised upon a schema of priorities that orders the application of the various competing bodies of law. A concomitant effect is to prioritise and structure the underlying interests of the various stakeholders. The essential features of the SRF are outlined in the following table.

**Table 5.1 - The Superannuation Relationship Framework**

<table>
<thead>
<tr>
<th>The proposed superannuation relationship framework embodies two limbs.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>First</strong>, the principles of trust law and accompanying equitable principles must be used in priority to all other principles of law for the settlement of any issues arising in the context of a superannuation fund. The elevation of trust principles is premised upon the attributes of the trust being the preferred vehicle for the delivery of the social objectives of superannuation.</td>
</tr>
<tr>
<td>However, in recognition that the trust is the “preferred” vehicle as opposed to a “perfect” vehicle, and to mitigate against a rigid adherence to trust principles such that the social objectives of superannuation are denied, the <strong>second</strong> limb of the framework dictates that principles of trust law should be used in priority to all other principles except where:</td>
</tr>
<tr>
<td>(I) the use of trust principles denies the fulfilment of a main objective of superannuation; or</td>
</tr>
<tr>
<td>(II) the rationale underlying the relevant trust principle is redundant in the context of superannuation.</td>
</tr>
</tbody>
</table>
The SRF is characterised by two core features. The first is preference of trust principle. In the Australian superannuation environment this accordance of priority rests on three principal foundations. First, the legislature has chosen the trust as the vehicle through which superannuation benefits are delivered. Secondly, and more importantly, notwithstanding the choice of the legislature, application of a process of regulatory analysis dictates that the trust should not only be chosen but that the underlying law of trusts should, as a general rule, be accorded priority in the schema of legal principles that underlie superannuation. Finally, the expressed industry preference for the trust justifies the theoretical choice of the trust vehicle and evidences the practical utility of the preference.

The second core feature is structured flexibility. The trust is not the perfect vehicle but the preferred. It permits the application of other principles to resolve tension or conflict if this is justified. To this end, the SRF supplies two circumstances where relegation of trust principle is permitted.

This chapter is dedicated to a more detailed examination of these features. The justifications underlying the preference for the trust are first discussed. Thereafter, in outlining the application of the SRF, attention is focused on the exceptions constituting the second limb.

4.1 Trust: The Chosen One

That trust principles should be accorded priority in the superannuation environment could conceivably rest upon one argument; that the trust is the primary vehicle through which the legislature has chosen to regulate the industry. In not only Australia, but also the United Kingdom, Ontario, New Zealand and Hong Kong has the trust been chosen as the regulatory foundation. Thus, if the trust structure has been chosen by the legislature, a
priori the associated principles of law should be those given priority in the resolution of conflict and tension within the law.

This argument does not rest upon the perceived advantages or disadvantages of the trust as a structure for the delivery of superannuation benefits. It is premised purely on the notions of consistency, logic and certainty. Unless justified against a systematic framework of analysis, it is logically inconsistent to argue that although the trust has been chosen, other principles of law should be preferred. Moreover, it imports significant uncertainty into an area already fraught with complexity. If the trust vehicle is chosen, the principles governing trusts should in the first instance be accorded priority.

This view has received judicial support in the Supreme Court of Canada. Significantly in the context of this discussion, pension funds in Canada may be established as trust funds, but also by way of contract. In Schmidt v Air Products of Canada Ltd Cory J (with whom La Forest, L'Heureux-Dube, Gonthier and Iacobucci JJ concurred) stated that "[w]hen a trust is created, the funds which form the corpus are subjected to the requirements of trust law". Also, "[i]f no trust is created, then the administration and distribution of the pension fund...will be governed solely by the terms of the plan [ie the contract]". His Honour emphasised this point of view when, in considering the issue of whether or not a superannuation trust is a trust for a purpose, he cited with approval the following statement of the Pension Commission of Ontario in Arrowhead Metals Ltd v Royal Trust Co:

It is important to recognise that the characterization of pension trusts as purpose trusts results in the pension text, a contract, taking precedence over the trust agreement. That is, it makes common law principles of contract paramount to the equitable principles of trust law. It is trite law that where common law and equity conflict, equity is to prevail. In light of that rule, it seems inappropriate to do indirectly that which could not be done directly.

Two crucial points can be drawn from these comments. First, the structure upon which a superannuation scheme is premised dictates the principles to be applied in the resolution of any conflict. Consequently, if the funding structure is a trust, trust principles apply. Secondly, as a corollary of the first point, in circumstances where the trust has been selected as the funding vehicle, it is inappropriate to elevate common law principles above equitable principles so as to give precedence to contract principles. Rather, trust principles should be

---

accorded priority in the resolution of any conflict or tension within the law. Departure from, or modification to, general trust principles should be sanctioned only where that departure or modification is critically assessed against a framework for analysis.

4.2 The Analysis of Regulation

The conclusions drawn from the application of a system of regulatory analysis dictate that not only has the legislature chosen the optimum legal structure, but that the underlying principles of trust law are inherently those best suited for the delivery of superannuation objectives.

The Nature of Regulation

Regulation is a multifaceted concept of diverse meaning. Though a variety of definitions are in usage,\(^8\) for the purpose of this chapter the concept of regulation is categorised according to two main forms. At the narrowest level, governmental regulation is an authoritative set of rules compliance with which is monitored and enforced by a prescribed mechanism, usually a public agency.\(^9\) Regulation in this context is considered one of the instruments by which governments seek to implement public policy. Other means include taxation, the direct provision of services, disclosure requirements and public ownership.\(^10\) At a broader level, regulation refers to "all the efforts of state agencies to steer the economy",\(^11\) and therefore encompasses any legislation or governmental policy that seeks to modify the behaviour of persons and organisations in the private sector.\(^12\) This latter definition does not seek to compartmentalise the various instruments in the governmental arsenal. For instance, while implementation of taxation and disclosure requirements would be excluded from the classic and narrower definition of regulation, each is included in the broader form.

---

\(^8\) See Baldwin, Scott and Hood (eds), *A Reader in Regulation* (OUP, 1998), p 2; Fels, "The Political Economy of Regulation" (1982) 5 UNSWLJ 29 at 31.


\(^12\) Fels, "The Political Economy of Regulation" (1982) 5 UNSWLJ 29 at 31.
Regulation may, at either the broad or narrow level, be classified by nature: economic, redistributive or social. Governmental regulation is usually couched in economic terms, the general justification for regulatory intervention being alleged economic market imperfections or failures. This concept of market imperfection and failure can likewise justify intervention on distributive and social grounds. Regulation for the purpose of redistribution seeks, as its title suggests, to redistribute income or wealth to certain groups in society. Conversely, the concept of social regulation, in a very general sense, refers to the broad social objectives underlying and embodied within the regulation. In these cases, the justification for legislative intervention is premised upon the notion that the unregulated market has imperfectly provided, or failed to provide, for an important policy objective.

In respect of the Australian superannuation regulatory scheme, the broader definition of regulation better represents Parliament's approach to regulation. The package of legislation constituting both the Superannuation Guarantee Scheme ("SG Scheme") and the Superannuation Industry Supervision Scheme ("SIS Scheme") prescribes rules that stakeholders in the superannuation industry must, at the risk of penalties, comply with. As one of the main penalties for non-compliance is the loss of taxation concessions, according to the narrower conception of regulation the legislature is arguably utilising the instrument of taxation as opposed to the instrument of regulation. Yet these definitional distinctions are circumvented if Parliament's actions are viewed in the context of the broader notion of regulation. Although the use of taxation measures can be viewed as an alternative to the instrument of regulation, to the extent that taxation is a measure implemented for the purpose of modifying the behaviour of stakeholders in the superannuation industry, the SG and SIS Schemes fall clearly within the bounds of the broader conception of regulation.

**Application of Regulatory Analysis Principles**

Regulatory analysis had its genesis in the notion that an unregulated marketplace is the norm. As such, governmental regulation must be justified by demonstrating that it is needed to secure an important policy objective that an unregulated marketplace cannot

---

13 The traditional market failure or imperfection justifications are catalogued as the control of: (a) monopoly power; (b) destructive competition; (c) externalities or spillovers; (d) inadequate provision of information; and (e) improper utilisation of natural resources: Economic Council of Canada, Responsible Regulation: An Interim Report, 1979, pp 45-49; Breyer, Regulation and Its Reform (Harvard University Press, 1982).

14 Economic Council of Canada, Responsible Regulation: An Interim Report, 1979, p 44.
achieve. Consequently, regulatory analysis yields an appreciation of the policy justifications and techniques utilised by governments to intervene in private markets.

The methodology of regulatory analysis dictates that the axiom for the creation, assessment or implementation of a program of regulation is first, to determine the objectives of regulation, secondly, to examine the alternative methods for achieving those objectives, and finally to select the optimum method for achieving the identified objectives.

Regulatory analysis is mainly utilised in the context of the narrow conception of regulation to assess the suitability of various instruments that the government may or does use to achieve a policy objective; for example, assessing the effectiveness of the tool of regulation as opposed to the tool of taxation. However, the principles of this analysis may also be applied to the broader concept of regulation. It can be applied to assess the substance of the regulation and whether the measures implemented best achieve the legislature’s policy objectives. So, in the context of the superannuation regulatory regime, the principles of regulatory analysis are used below to determine if the trust, with its underlying principles of law, is the optimum vehicle for the achievement of the legislature’s objectives.

4.2.1 REGULATORY ANALYSIS: STAGE ONE – OBJECTIVES OF REGULATION

The first stage of regulatory analysis assesses the objectives and justifications for regulating the superannuation industry. If it is assumed that the non-regulated market is the norm, the issue is whether or not the marketplace produces a result that is inconsistent with the economic, distributive or social policy objectives of parliament. In other words, does the market achieve what parliament views as important policy objectives?

The Australian regulatory regime is characterised by two limbs. The first is the SG Scheme, introduced in 1992 with the enactment of the Superannuation Guarantee Charge Act 1992 (Cth) and the Superannuation Guarantee (Administration) Act 1992 (Cth). The SG Scheme

requires all employers to provide a prescribed minimum level of superannuation support for each employee.9 The second limb is the SIS Scheme, introduced in 1993 for the purpose of effecting the prudential regulation of superannuation entities. Of the package of legislation introduced, the *Superannuation Industry (Supervision) Act* 1993 (Cth) ("SIS Act"), *Superannuation Industry (Supervision) Regulations 1994* (Cth) ("SIS Regulations") and the *Superannuation (Resolution of Complaints) Act* 1993 (Cth) are the most significant in terms of governance of superannuation entities.

It is not proposed to undertake a detailed regulatory analysis of the first limb. The object of this thesis is to derive a greater appreciation of the tripartite relationship of trust, contract and statute, with emphasis upon the combined impact of legislative intervention and contract law on the general principles of trust law. More specifically, the purpose of this chapter is to examine the regulatory justifications for using the trust. In that the SIS Scheme, as opposed to the SG Scheme, dictates the use of a trust, it is the second limb of regulation that is of primary interest. Even so, a preliminary regulatory analysis of the SG Scheme is necessary for the purpose of contextual integrity, as the SG Scheme was the springboard from which the SIS Scheme arose.

### 4.2.1.1 SG Scheme

The SG Scheme came into effect on 1 July 1992. The long titles to the relevant Acts do not set out in any detail the objectives of the legislation. The long title to the *Superannuation Guarantee Charge Act* 1992 (Cth) states merely that it is "[a]n Act to impose a charge on any shortfall in the amount contributed by employers to superannuation funds for the benefits of employees." In even simpler terms the long title to the *Superannuation Guarantee (Administration) Act* 1992 (Cth) refers to the Act as "relating to the establishment of the Superannuation Guarantee Scheme, and for related purposes." The objectives must therefore be drawn from the Scheme's historical background and any relevant publicly available information at the time of the Scheme's introduction.

In the decade prior to the introduction of the SG Scheme, the Australian Labor Party ("ALP"), which was then in power, entered into an Accord with the Australian Council of Trade Unions ("ACTU") for the purpose of developing a workable prices and

---

9 See 2.2.4.1.
incomes policy for Australia.\textsuperscript{20} To this end, the ALP and the ACTU agreed that an objective of their social security policy was to "redress anomalies in the availability of occupational welfare such as superannuation benefits."\textsuperscript{21} This, in conjunction with the outcome of the 1986 and 1987 \textit{National Wage Case} decisions,\textsuperscript{22} laid the foundation for award superannuation. The effect of these decisions was to require employers to contribute a minimum of 3 per cent superannuation on behalf of employees.\textsuperscript{23} As a result, superannuation coverage for employees rose sharply; between 1984 and 1989 the percentage of the Australian workforce covered by superannuation increased from 39.5 per cent to 47 per cent.\textsuperscript{24} Yet not surprisingly, the coverage favoured union members—"[i]n 1988, 60 per cent of unionists were the beneficiaries of superannuation schemes compared with only 28 per cent of non-unionists."\textsuperscript{25}

In the \textit{National Wage Case 1991}\textsuperscript{26} the ACTU, with the support of the Commonwealth Government, sought a further increase in award superannuation. This attempt was unsuccessful and led the Commonwealth Government to introduce the compulsory SG scheme.

Prior to the Accord agreement, subsequent \textit{National Wage Case} decisions, and the introduction of the SG Scheme, Commonwealth Governments viewed the provision of superannuation as a voluntary, private sector, market-orientated activity.\textsuperscript{27} It is against

\begin{footnotesize}
\begin{enumerate}
\item \textit{National Wage Case June 1986} (1986) 14 IR 187; \textit{National Wage Case March 1987} (1987) 17 IR 65. In the 1986 \textit{National Wage Case} the Australian Conciliation and Arbitration Commission, in light of the agreement by the ACTU and ALP for the implementation of a three per cent productivity increase in the form of superannuation, agreed to monitor and regulate any agreements entered into for new superannuation schemes, or improvements to existing schemes: (1986) 14 IR 187 at 217. In the 1987 \textit{National Wage Case} the Commission extended its jurisdiction to the arbitration of superannuation and made an award that payments should be made by employers of up to three percent of ordinary time weekly earnings: (1987) 17 IR 65 at 86-89.
\item See 1.2.3.
\item (1991) 36 IR 120.
\item Taylor and Little, "Compulsory Occupational Superannuation: Forsaking Individual Protection for the National Interest" in Knox (ed), \textit{Superannuation: Contemporary Issues} (Longman Professional, 1994), p 148. See also Knox, "Occupational Superannuation in Australia: Present
this background of incremental governmental intervention in the superannuation market that the policy justifications for the SG Scheme must be identified.

Then Treasurer Dawkins revealed the purpose of the SG package in his second reading speech\(^{18}\) supporting the Bills and in a statement\(^ {19}\) released at the time the package came into force. He identified the function of the SG Scheme as being a central plank in the government's policy framework that is designed to interact with the established tiers of the retirement incomes policy, the old age pension and voluntary superannuation arrangements.\(^ {30}\) In this function, the SG Scheme was designed to counter and control the following challenges in the retirement incomes framework:

- **Aging Population**: Australia has an ageing population, slow population growth and increasing life expectancy, generating significant budgetary consequences for the Commonwealth Government in terms of both funding for old age pensions and high health care costs.\(^ {31}\)

- **Coverage of Superannuation**: Coupled with the first challenge was the second policy challenge of extending the coverage of superannuation saving. Treasurer Dawkins stated that "experience has shown that tax incentives, used alone...failed to call forth an adequate spread, level or rate of growth of superannuation saving".\(^ {32}\) Despite the reform of superannuation through the award system, there remained an ongoing need to ensure that "as many Australians as possible have access to superannuation".\(^ {33}\)

- **Sufficiency of Saving**: An effective system for the provision of adequate retirement income must not only be designed cover as many persons as possible, but must

---


\(^ {31}\) Commonwealth of Australia, Department of Treasury, *Security in Retirement: Planning for Tomorrow Today*, Statement by the Honourable John Dawkins MP, Treasurer of the Commonwealth of Australia, 1992 at 14-15. In 1992 there were 1.9 million persons over the age of 65 in Australia (11% of the population). This figure is projected to rise to 5.2 million (20%) by 2031. In respect of governmental outlay for pensions expenditure, in 1992 pensions cost 2.3% of gross domestic product. By 2025 this percentage is expected to increase to 4.5% of gross domestic product: Commonwealth of Australia, *Parliamentary Debates*, Senate 18 June 1992, at 3909 (Senator Nick Sherry).


meet the challenge of ensuring that individual superannuation savings provide an adequate level of income in retirement.

- **Improving Retirement Conditions**: Increased compulsory provision of superannuation contributions was also designed to assist the Commonwealth Government in the challenge of improving "the retirement conditions for those Australians who were unable to fund adequately their own retirement incomes".  

- **Strengthening National Saving**: The final challenge identified by Treasurer Dawkins was that of strengthening the national saving performance. Increased self-dependence and therefore greater domestic saving would lessen national dependence on foreign saving and assist to avoid incurring an unsustainable foreign debt.

In terms of regulatory analysis, these policy challenges reflect an underlying market failure: a significant group of persons did not choose to save for the future notwithstanding capacity to do so. In this respect Treasurer Dawkins, on the eve of the introduction of the SG Scheme, stated that:

...Australians generally undervalue savings for their own future retirement. Private voluntary savings cannot be relied upon to provide an adequate retirement security for most Australians.

The failure to independently save for the future and fund retirement living increases reliance upon governmental assistance and places a heavy strain upon governmental resources, especially in view of an ageing population. Although this market failure has economic consequences, the government’s decision to intervene was not premised entirely upon the traditional economic justifications for regulation. Justification also flowed from social underpinnings – a concern to lay a foundation for income security and higher standards of living in retirement for future generations of retirees.

---


36 Commonwealth of Australia, *Parliamentary Debates*, Senate Select Committee on Superannuation, 6 May 1992, at SSU 4 (Mr Anthony Cole, Secretary, Department of Treasury, Canberra, ACT).


Moreover, in that the system requires employers to make contributions on behalf of employees, redistributive themes are also evident.

In light of the challenges arising from the identified "market failure", two main governmental objectives underlie the SG Scheme: to increase the coverage of superannuation, and to increase the amount of individual superannuation savings.

Whether these were the "real" policy objectives and justifications for the introduction of the SG Scheme has been the subject of conjecture. In debating the SG Scheme set of Bills, the Opposition argued that evidence presented by the Department of Treasury indicated that there were "no economic, financial or social justifications for the Government's proposals." Moreover, it was further argued that the SG Scheme was not a bona fide retirement incomes proposal. It is, in effect, an attempt to use retirement income to solve what is nothing more nor less than an industrial relations problem relating to the ACTU and the implementation of the accord.

Further criticism alleged that introduction of the compulsory SG Scheme was based upon self-interest as opposed to public interest, with the government seeking to alleviate increasing demands on budgetary resources. However, for the purpose of this thesis the normative approach of regulatory analysis as propounded by Breyer negates the relevance of these criticisms. The normative approach assumes that the legislature seeks in good faith to attain the publicly stated goals of regulation, regardless of the existence of other possible motives in fact. In this respect Breyer has opined that:


40 Commonwealth of Australia, Parliamentary Debates, House of Representatives 2 April 1992, at 1763-1764 (Mr John Dawkins, Treasurer). Achievement of these objectives in turn allows scope for the government to fulfil other retirement income policy objectives, such as improving the retirement conditions of those who are unable to adequately fund their own retirement incomes and to strengthen national saving: at 1764.

41 Commonwealth of Australia, Parliamentary Debates, House of Representatives 5 May 1992, at 2393 (Mr David Connolly). Mr Connolly further stated that "[a]t a hearing of the Senate Select Committee on Superannuation, senior Treasury officials poured water on the alleged justification for compulsory superannuation by admitting that they were not in possession of any information which would support the usual arguments for such a system": at 2394-2395.

42 Commonwealth of Australia, Parliamentary Debates, House of Representatives 5 May 1992, at 2393 (Mr David Connolly).


45 Breyer further explains that the objective of regulatory analysis as propounded in his book is not to "provide a general causal theory or explanation of regulation. Instead, it asks what
Chapter 4: A Superannuation Relationship Framework

Even if the creation (or administration) of existing programs is best explained by the political power of special groups seeking selfish ends – which at least in some cases is doubtful – those who seek to justify those programs must appeal to the public interest. Legislators, administrators, judges, critics, and the public at large wish to know whether regulatory programs are justified. All of them seek standards against which to judge the success of a program and the merits of specific regulatory actions taken within a program's broad authority. Moreover, the view that regulators or politicians are motivated only by politics or self interest is far too narrow. Many surely seek the public good and are swayed by arguments on the merits.

Consequently, though legislative schemes may in fact be introduced other than for publicly stated justifications and objectives, any regulatory reform should nevertheless be assessed against its publicly declared rationales and objectives. To this end, the objectives identified from public statements of the government at the time of the introduction of the scheme are relied upon as the genuine objectives of the scheme.

4.2.1.2 SIS Scheme

Having compulsorily exacted a pool of money to be preserved until retirement, the Commonwealth Government then had a strong interest in examining the security of the investment of that pool and, if necessary, intervene in the retirement incomes market to buttress the existing security measures.47

As early as 1915 the Commonwealth Government intervened in the market by introducing taxation incentives for participation in superannuation. However, it was not until the 1960s that the Commonwealth Government took an interest in the security of funds preserved. In 1961, following findings of the Commonwealth Ligertwood Committee of Taxation of widespread abuse of the taxation concessions offered to superannuation funds,48 the Income Tax Assessment Act 1936 (Cth) was amended so that funds were required to satisfy a number of tests before concessional taxation status would be granted.49

reasonable human goals a program might sensibly have, regardless of its historical origins. It assumes that regulators seek in good faith to attain such goals, regardless of the existence of other possible motives in fact". Breyer, Regulation and Its Reform (Harvard University Press, 1982), p 10.

49 The taxation concession granted was that the income of the superannuation fund was exempt from taxation. A selection of the tests a fund was required to satisfy included the following:

- the fund must be a superannuation fund that is indefinitely continuing;
- the fund must be established and administered solely to provide superannuation benefits for employees on their retirement or for dependants of employees in the event of the death of employees, not for the benefit of the employer sponsoring the fund;
Chapter 4: A Superannuation Relationship Framework

Notwithstanding these requirements, it was not until 1987 with the enactment of the *Occupational Superannuation Standards Act 1987* (Cth), the *Occupational Superannuation Standards Regulations 1987* (Cth) (collectively the "OSSA Scheme") and the *Insurance and Superannuation Commissioner Act 1987* (Cth) ("ISC Act"), that the Commonwealth Government gave detailed consideration to the prudential regulation of the superannuation industry. Tied to the introduction of award superannuation, the OSSA Scheme set out various operating standards that superannuation funds and approved deposit funds were required to meet in order to qualify for concessional taxation treatment. The purpose of the OSSA Scheme, as stated by the then Minister for Science, Mr Barry Jones, was to ensure that superannuation arrangements were directed at meeting genuine retirement needs and that members' entitlements were protected.  

In addition to the OSSA standards, the ISC Act created the position of the Insurance and Superannuation Commissioner. Instituted as regulator of the OSSA standards, the Commissioner was conferred various powers for the purpose of checking compliance with the standards.  

Following the introduction of the SG Scheme, the Government had cause again to consider the adequacy of the prudential regulation of the superannuation market. Indeed, given the compulsory nature of the SG Scheme, as stated by Senator John Watson, "employees are entitled to expect measures to exist which protect those funds that are set aside for their benefit". As the Commonwealth Government considered that it was obliged "to provide an appropriate prudential framework", a review of the superannuation industry was instituted through referral to both the Australian Law Reform Commission and the Senate Select Committee on

---

- the rights of members and beneficiaries must be fully defined by the terms of the fund and the right to receive benefits must be fully secured; and
- income from a non-arm's length investment must not exceed that which would be derived from an arm's length investment.


52 Senator John Watson was at that time a Liberal member of the Select Senate Committee on Superannuation.
Superannuation. The ensuing reports recommended various changes to the regulation of the superannuation industry to effect greater prudential security. These recommendations culminated in the introduction of a package of legislation collectively termed the SIS Scheme.

The regulatory objectives of the SIS Scheme were clearly enumerated by the Commonwealth Government at the time the package of Bills constituting the scheme was introduced. The then Treasurer, Mr John Dawkins, outlining the policy of the government in a statement entitled “Strengthening Superannuation Security: The New Prudential Arrangements for Superannuation”, stated that:

An appropriate supervisory framework is a central component of superannuation policy. Notwithstanding the sound record of superannuation funds in this country, the growth of superannuation has necessitated a full review of the supervisory arrangements. The Government has undertaken to establish a comprehensive and effective prudential framework to give added protection to superannuation savings and to promote a more efficient superannuation industry...

That prudential security is the objective of the SIS Scheme was further emphasised by the comments of Mr Gary Johns (then Parliamentary Secretary to the Treasurer) in his second reading speech in support of the SIS Bill. He foreshadowed that it, as part of the entire legislative package, would “substantially increase the level of prudential protection provided to the superannuation industry, and represent a substantial strengthening of the security of superannuation savings and of the protection of the rights of superannuation fund members”. Finally, and perhaps most persuasively, the objective of prudential security was also included in the SIS Act. The relevant section, SIS Act s 3, as originally enacted, read:

---


56 In 1993 the following seven Acts were introduced as the “SIS Scheme”: Superannuation (Financial Assistance Funding) Levy Act 1993 (Cth); Superannuation (Resolution of Complaints) Act 1993 (Cth); Superannuation (Rolled-Over Benefits) Levy Act 1993 (Cth); Superannuation Industry (Supervision) Act 1993 (Cth); Superannuation Industry (Supervision) Consequential Amendments Act 1993 (Cth); Superannuation Supervisory Levy Amendment Act 1993 (Cth); Occupational Superannuation Standards Amendment Act 1993 (Cth).


59 Emphasis supplied. The section has been subsequently amended to reflect changes in the Regulator of the superannuation industry. The SIS Act s 3 was amended in 1998 (Financial Sector Reform (Amendments and Transitional Provisions) Act 1998 (Cth) s 3, Sch 16) and 1999 (Superannuation Legislation Amendment Act (No 3) 1999 (Cth) s 3, Sch 1). It now reads:
The object of this Act is to make provision for the prudent management of certain superannuation funds, approved deposit funds and pooled superannuation trusts and for their supervision by the Insurance and Superannuation Commissioner.\(^6^0\)

On first reading it appears that the objective is twofold: prudent management and supervision by a Regulator. In reality the second stated objective is a subset of the first. The supervision of the industry by a Regulator is a means of enforcing the prudential standards set out by the legislation, thereby facilitating the prudential security of superannuation savings.\(^6^1\)

In summary, prudential security of superannuation savings is the justification for governmental intervention in the superannuation industry. The impetus for this intervention stemmed in part from the compulsory nature of the SG Scheme. The secure operation of the retirement income market was, and is, necessary to ensure the effective implementation of the SG Scheme.\(^6^2\) If contributions are compulsorily collected and invested in superannuation trusts, the social and fiscal justifications for directing such collection cannot be achieved unless the system instituted for this purpose is secure.\(^6^3\)

---

\(^6^0\) The Senate Select Committee on Superannuation also confirmed that prudential security is the objective of the SIS Act in its review of the Bills constituting the SIS Scheme. Specifically in respect of the SIS Act it was stated that:

This Bill is the most important of these seven SIS Bills and is designed to:

* Increase the level of prudential protection provided to the superannuation industry;
* Increase the security of superannuation savings; and
* Increase the protection and rights of superannuation fund members.

Commonwealth of Australia, Senate Select Committee on Superannuation, Super Supervision Bills, Ninth Report, 1993, at §2.5.

\(^6^1\) See Commonwealth of Australia, Parliamentary Debates, House of Representatives 27 May 1993, at 1103, where Mr Johns stated: “The Superannuation Industry (Supervision) Bill 1993 provides for effective supervisory arrangements involving direct enforcement powers for the Insurance and Superannuation Commission, enabling effective enforcement of the prudential requirements and obligations placed on funds and trustees”.

\(^6^2\) Commonwealth of Australia, Department of Treasury, Security in Retirement: Planning for Tomorrow Today, Statement by the Honourable John Dawkins MP, Treasurer of the Commonwealth of Australia, 1992 at 29. This link was highlighted by the then Treasurer, Mr John Dawkins, when he remarked that:

The Government is committed to the effective prudential supervision of the superannuation industry. This commitment recognises that official encouragement of superannuation saving brings with it an obligation to provide an appropriate prudential framework which will minimise prudential risk and ensure that superannuation fulfils its role in retirement incomes policy and the mobilisation and investment of savings.


\(^6^3\) This was emphasised by Mr Allan Rocher, during the debate on the second reading of the Bills constituting the SIS Scheme, who stated:
The perceived inadequacies of the OSSA standards gave further impetus for intervention in the form of the SIS Scheme. In 1992, the ALRC and the Senate Select Committee of Superannuation recommended that the current system of prudential regulation provided by the combination of general law and the OSSA standards required strengthening. Thus with the same regulatory objective as its forerunner, the SIS Scheme was borne.

4.2.2 REGULATORY ANALYSIS: STAGES TWO & THREE – ALTERNATIVES & SELECTION

The second and third stages of regulatory analysis require that the alternatives for achieving the stated regulatory objective be identified, and then assessed, so as to determine which alternative will best achieve the stated regulatory objective of prudential security.

The concept of prudential security carries with it notions of minimising risk. In this context the general overarching risk is that superannuation benefits will not pass to the ultimate designated beneficiaries. Thus, the issue is to identify the vehicle that will provide the most secure foundation for the delivery of superannuation benefits. Accordingly, the protective attributes inherent in each legal vehicle are central to this assessment.

The bills introduce far-reaching changes to the regulation and prudential supervision of superannuation funds, approved deposit funds and pooled superannuation trustees in Australia. Measure contained in the bills reflect the government's objective of ensuring that Australians increasingly provide for their own retirement, and also reflect a conviction on the part of the government that superannuation is the preferred savings vehicle by which such provision is to be made.


64 The failings of the combined OSSA standards and general law can be summarised as:
   - Uncertainty of the application of trust law and common law precedent;
   - The ability to draft or amend trust deeds such that: (a) the strict general law duties that are imposed on trustees could be abrogated or lessened; and (b) entities other than the trustee effectively controlled the operation of the trust (for example, employers);
   - The inability to impose direct penalties upon trustees and directors of trustees for breaches;
   - Insufficient protection for members in respect of fees;
   - The time and cost associated with challenging a trustee's position at general law as well as a general inability to review discretionary decisions of trustees.


66 As to the meaning of prudential security see 4.4.
The legal vehicles that can found the provision of superannuation benefits are trust, contract and company. As the SIS Act already mandates the use of the trust, the real question is whether or not it is the best choice given the stated regulatory objective. The following outlines the nature of each alternative vehicle and assesses the relevant features of each that add and detract from its ability to facilitate the security of superannuation contributions, investments and benefits.

4.2.2.1 TRUST

The relationship of the trust has been defined as "the obligation enforceable in equity which rests on a person (the trustee) as owner of some specific property (the trust property) to deal with that property for the benefit of another person (the beneficiary)". The relationship between trustee and beneficiary is equitable in nature and can be further characterised by the responsibilities attendant upon the trustee in respect of the property held. In Re Scott (deed) Mayo J defined the trust relationship in the context of responsibility, stating that:

[The trust] refers...to the duty or the aggregate accumulation of obligations that rest upon a person, described as a trustee. The responsibilities are in relation to property held by him, or under his control. That property he will be compelled by a court in its equitable jurisdiction to administer in a manner lawfully prescribed by the trust instrument, or where there be no specific provision written or oral, or to the extent that such provision is invalid or lacking, in accordance with equitable principles. As a consequence the administration will be in such a manner that the consequential benefits and advantages accrue, not to the trustee, but to the person called cestuis que trust or beneficiaries, if there be any, if not, for some purpose which the law will recognise and enforce.

The obligations that rest upon a trustee flow from both the trust instrument and, to the extent not modified by the trust instrument, the general law of trusts. General trust law principles can be formally categorised by the following trustee duties:

- to acquaint oneself with the terms of the trust instrument;
- to obey the terms of the trust instrument;
- to act in the best interests of the beneficiaries;
- not to place oneself in a position of conflict or profit from one's fiduciary position;
- to preserve and protect the trust property;
- to invest;
- to account to the beneficiaries;

---

69 For elaboration of the duties specified see 2.2.3.4.
The following example illustrates how the trust can be utilised for the provision of superannuation and related benefits.

**TRUST - EXAMPLE NO 1**

The employer pays a contribution (which may be added to by the employee) into a trust fund on behalf of an employee. The legal owner, namely the trustee, manages and invests the fund for the purpose of providing benefits to the beneficiaries upon retirement or for other ancillary purposes specified in the trust instrument. Other ancillary purposes may include the payment of a benefit to the employee if he or she becomes disabled, or to a person nominated by the employee upon the death of the employee. A benefit will not be paid to a beneficiary unless the requirements in the trust deed as to the payment of such benefits have been met (otherwise termed "conditions of release").

The trust scheme may have been established by the employer on behalf of his or her employees. Alternatively the scheme may have been be established by an institution or entity independent of the employer.

The relationships between the parties can be diagrammatically represented as follows:

![Diagram of Trust Relationships]

Even though the protective features underlying the trust arrangement arguably make it the optimum vehicle for the delivery of superannuation objectives, the trust, as the foundation of superannuation provision, has been the subject of criticism. The following details the protective features of the trust and assesses the criticisms against the regulatory objective of the prudential security.

**The Protective Features of the Trust**

The features of the trust arrangement that underlie its protective nature are: (i) duality of ownership and concomitant segregation of assets; (ii) access to an existing body of
law; (iii) protection of trust funds during bankruptcy and insolvency; (iv) access to the advice of the court; and (v) representative trusteeship.

(i) Duality of Ownership and Segregation of Assets

The foremost feature of the trust relationship is duality of ownership: the trustee, as legal owner holds trust property for the benefit of beneficiaries. In the superannuation context, a pool of funds consisting of superannuation contributions is held by the trustee to be invested and managed for the benefit of the beneficiaries. There are two principal advantages of this structure. First, it achieves a separation of the assets of the superannuation fund from those of the sponsoring employer. This segregation prevents the employer-sponsor from utilising fund assets for its own purposes and, upon insolvency of the employer-sponsor, protects the fund from distribution to the employer-sponsor's creditors.\(^7\)

Secondly, although legal ownership is vested in the trustee, upon its insolvency the assets of the trust are also protected from the creditors of the trustee. A sharp distinction is drawn between the assets of the superannuation fund and the personal assets of the trustee.\(^7\) It is a fundamental principle of insolvency law, established both by statute and the general law, that property held on trust lies outside the pool of property available to satisfy the claims of creditors.\(^7\) It must be recognised that creditors may have a limited claim on the trust fund via the doctrine of subrogation. Where a trustee has incurred debts on behalf of the trust, in the event of insolvency the creditors may have their claim subrogated to the trustee's right of indemnity.\(^7\) In essence, the creditors stand in the shoes of the trustee and are substituted as being entitled to the right of indemnity. However, the right of subrogation in favour of creditors does not lessen the security of the fund; it merely represents what is rightly owed to the trustee and is therefore limited to properly incurred expenses on behalf of the trust and by restrictions in the trust deed. Moreover, where the trustee has

---


72 Bankruptcy Act 1966 (Cth) s 116(2)(a); Re Australian Home Finance Ltd [1956] VLR 1; Barclays Bank Ltd v Quickscore Investments Ltd [1970] AC 567.

73 Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 at 367, 370-371 per Stephen, Aickin and Wilson JJ; Re Enhill Pty Ltd [1982] 1 VR 561 at 568 per Lush J; McLean v Burns Philip Trustee Co Pty Ltd (1985) 2 NSWLR 623 at 640 per Young J.
already exercised his or her right of indemnity, creditors lose any right of subrogation and must proceed directly against the trustee.

(ii) Existing Body of Law

The protection and security of superannuation assets are bolstered in the trust context by the body of general law principles and duties established over time to regulate the trust mechanism. Primary among such principles are the duties attendant upon the trustee as legal owner of the assets. At general law, a trustee, by reason of his or her position as trustee, holds a fiduciary position vis-à-vis the beneficiaries. To this end, trustees must not place themselves in a position of conflict with their duty as trustee, or make an unauthorised profit from their position as trustee. Added to this, general principles of trust law require that trustees act in the best interests of the beneficiaries. This dictates that trustees must act to the exclusion of all other interests, be they those of the employer-sponsor or their own. It is often stated that power follows property. However, in the case of a trustee, although legal title vests in trustee, the power that follows that property is limited for a specific purpose. In this context Professor Waters has stated that:

Trustees' powers of disposition and management over the property of which it has sole and absolute legal title are powers which vis-à-vis the beneficiary...are subordinate to the right of enjoyment. They serve the right of enjoyment. The office of trustee is nothing but dispositive "trusts" and, in furtherance of those "trusts", administrative and dispositive powers. It follows that there is literally no place whereby the trustee when acting (or omitting to act) within the scope of his trustee task can ever entertain any thought of advancing his own interests, even in the slightest degree.

In addition to these requirements, trustees are required to strictly obey the terms of the trust instrument, and beneficiaries, even those holding a mere expectancy, are granted standing at general law to enforce the terms of the trust.

The role of trustee is the most demanding known to equity. The equitable and trust law obligations that underlie the trust relationship embody “high-level

---

principles of commercial morality\textsuperscript{77} which at their very core require the trustee to act exclusively for the benefit of the beneficiaries.

(iii) Guidance

Stemming from the court's inherent jurisdiction to control trusts, a feature unique to equity is that trustees have a right to seek the opinion, advice or direction of the court on any question regarding the management or administration of the trust.\textsuperscript{78} Mirrored by statute in most Australian jurisdictions,\textsuperscript{79} this provides a support network for trustees in their protection and management functions. A trustee who acts in accordance with the advice or directions given is deemed to have discharged his or her duty, provided the facts disclosed to the court have remained substantially the same.\textsuperscript{80} So well established is this right that trustees who fail to seek the direction and advice or the court in difficult circumstances have been judicially criticised.\textsuperscript{81}

(iv) Representative Trusteeship

The flexibility of the trust mechanism permits collective representation. Members and beneficiaries may participate directly at the trustee level as elected representatives serving either as individual trustees or as directors of a corporate trustee. As a result, the persons for whom the assets are held have direct input into the management and direction of the trust. This adds an additional layer of supervision over the trust activities and ultimately increases the security of trust funds. In 1992, the Pension Law Review Committee in the United Kingdom was established to review the framework of law and regulation within which occupational pension schemes operated. In respect of the role of trustee, the Committee


\textsuperscript{78} Re Earl of Radnor’s Will Trusts (1890) 45 Ch D 402 at 423 per Lord Esher MR; Re Permanent Trustee Australia Ltd (1994) 33 NSWLR 547 at 548 per Young J.

\textsuperscript{79} Trustee Act 1925 (ACT) s 63; Trustee Act 1925 (NSW) s 63; Trusts Act 1973 (Qld) s 96; Trustee Act 1936 (SA) s 91; General Rules of Procedure in Civil Proceedings 1996 (Vic) rr 54.02, 54.03; Trustees Act 1962 (WA) s 92.

\textsuperscript{80} Trustee Act 1925 (ACT) s 63(2); Trustee Act 1925 (NSW) s 63(2); Trusts Act 1973 (Qld) s 97; Trustee Act 1936 (SA) s 91; Trustees Act 1962 (WA) s 95. At general law see Re Earl of Radnor’s Will Trusts (1890) 45 Ch D 402 at 423 per Lord Esher MR.

concluded that while an important function of the trust was the segregation of assets for the protection of beneficiaries, equally important was that it provided "a mechanism for the collective representation and protection of members of a group of people linked by a common interest". 83

(v) The Remedy of Tracing

A distinct strength of the trust concept is that it is a hybrid of obligation and property rights. 84 Not only are the obligations placed upon trustees of a personal nature, such that any derivation from duty can be remedied in a personal action against the trustee, proprietary rights also flow from the nature of the relationship. In that the beneficiaries of a trust, at least collectively in the case of a discretionary trust, 84 have a proprietary interest in the assets of the trust, the proprietary process of tracing is also available. When the requirements for tracing have been made out, the beneficial owners (ie the beneficiaries) may through that process follow trust property into the hands of anyone except a bona fide purchaser for value without notice. 85 Once assets are identified ("traced") as trust property, a proprietary remedy, such as a constructive trust or an equitable charge, may be awarded to secure either the property or the value of property back to the trust.

The process of tracing exhibits its greatest utility in the context of insolvency, as it permits recognition of a pre-existing equitable proprietary interest that may then pre-date the claims of third parties. Take the example of a trustee who, contrary to the duty not to place himself or herself in a position of conflict, places trust money in his or her bank account and then purchases shares in his or her own name from the money in that account. The process of tracing permits the identification of those shares as trust property. In circumstances where the trustee subsequently becomes bankrupt, rendering a personal action against the trustee for breach of duty is likely to be fruitless, the identification of the shares as trust property pre-dates any claim of the trustee in bankruptcy and therefore prevents distribution of the shares to

84 Sir Moses Montefiore Jewish Home v Howell & Co (No 2) Pty Ltd [1984] 2 NSWLR 406.
creditors of the trustee; the shares as trust property (or the value thereof) will be returned to the trust.

**Criticisms of the Trust**

Use of the trust structure as a foundation for securing superannuation and pension benefits has not been without its critics. In both Australia and the United Kingdom high profile collapses of superannuation and pension funds have led to increased scrutiny of the trust mechanism. In 1982 the Occupational Pension Board called for a review of trust law, concluding that the present structure of trust law did “not provide satisfactory safeguards for members’ rights and expectations in occupational pension schemes”. It recommended that a new type of legal structure similar to the limited liability company be developed.  

Although this recommendation failed to gain support, and in 1993 the Pension Law Review Committee confirmed the role of the trust as the foundation of pension schemes, the criticisms directed at the trust are still asserted by various commentators and must therefore be addressed.

The major criticisms of the utilisation of the concept of the trust are that:

1. **Archaic Vehicle**
   - the trust vehicle is archaic and its principles were developed principally in the context of transmission of intergenerational wealth;
   - the principles of trust law are not suited to pension schemes;
   - the flexibility of the trust reduces the security of the superannuation assets; and
   - the potential for imprecise drafting, and the difficulties of enforcement that can be experienced by beneficiaries, detract from the ability of the trust to provide a secure foundation for superannuation interests.

Taking each criticism in turn.

(i) **Archaic Vehicle**

The Social Security Committee of the House of Commons in its 1992 report on the “Operation of Pension Funds” (“Field report”), concerned to find a scapegoat for the Maxwell plundering of pensions trusts, could not appreciate how the government had permitted “medieval trust law” to found a system of private pension

---


88 As to the Maxwell fraud see 5.2 note 169.
The essence of the concern was that trust principles, developed centuries earlier for the purpose of facilitating family dispositions and inheritances, were antiquarian in nature and therefore constituted an unsuitable base for pension and superannuation schemes.90

This criticism is not only misplaced but inaccurate. Whilst the origins of the trust stem from the historical "use" developed in equity, the trust, in the words of the Pension Law Review Committee in the United Kingdom, "has shown a remarkable ability to adapt itself to modern commercial requirements".91 The advantage, not replicated in any other legal structure, of the separation of legal and equitable ownership combined with the considerable flexibility with which the terms of a trust deed can be drafted, underlies the trust's many variations of use. That the trust has developed well beyond its medieval origins was recognised by Issacs in 1929 when he catalogued the modern uses of the trust as "a readily available tool for everyday purposes of organization, financing, risk-shifting, credit operations, settling of disputes, and liquidation of business affairs".92

Added to this list are two particular forms of trust, the trading trust and the unit trust. In 1981 Professor Ford remarked on the prevalence of trading trusts, with the controllers of family businesses abandoning the proprietary company in favour of the trust.93 The unit trust is also a feature of modern institutions, permitting the pooling of assets for investment or general use as a business structure. In respect of the prevalence of commercial applications of the trust, Dal Pont and Chalmers comment:94

92 Issacs, "Trusteeship in Modern Business" (1929) 42 Harv L Rev 1048 at 1048. Flannigan catalogues the various modern commercial applications of the trust as: (i) holding property and facilitating transactions; (ii) regulating opportunism; (iii) facilitating joint control; (iv) an investment vehicle; (v) facilitating financing and security arrangements; (vi) credit proofing (asset protection); and (vii) permitting tax minimization: see Flannigan, "Business Applications of the Express Trust" (1998) 36 Alberta L Rev 630. Langbein similarly identifies the principal forms of the commercial trust in the United States as being: (i) pension trusts; (ii) investment trusts; (iii) corporate trusts; (iv) regulatory trusts; and (v) remedial trusts: see Langbein, "The Secret Life of the Trust: The Trust as an Instrument of Commerce" (1997) 107 Yale L J 165.
94 Dal Pont and Chalmers, Equity and Trusts in Australia and New Zealand (2nd ed, LBC Information Services, 2000), p 683.
One of the most salient aspects of any account of the modern-day trust has been its penetration into commercial life. The trust has become a popular vehicle for management and commerce. If the 19th-century use of trusts was principally for the retention and redistribution of wealth within the family, then the 20th-century expansion of the use of trusts has been predominantly in the commercial field.

Issacs alternatively depicts modern business as having become “honey-combed with trusteeship”. To suggest that the “medieval” origins of the trust limit its commercial application is out of accord with the reality that the trust is a much utilised form of business organisation with many different commercial applications. Thus in the words of Professor Hayton, “the trust can hardly be regarded as a dying medieval institution: it is a thriving modern institution dancing vivaciously along to the tune of ‘[a]nything you can do I can do better’.”

(ii) Inadequacy of Trusts for Superannuation and Pension Schemes

The criticism that trust law is inadequate for superannuation revolves around the significance of the employment relationship in the context of the provision of superannuation. It is a trite comment that superannuation trusts differ from the traditional trust and customarily any analysis of this issue is prefaced by the following comment of Browne-Wilkinson VC in *Imperial Group Pension Trust Ltd v Imperial Tobacco Ltd*:

Pension schemes are of quite a different nature to traditional trusts. The traditional trust is one under which the settlor, by way of bounty, transfers property to trustees to be administered for the beneficiaries as objects of his bounty. Normally, there is no legal relationship between the parties apart from the trust. The beneficiaries give no consideration for what they receive. The settlor, as donor, can impose such limits on his bounty as he chooses, including imposing a requirement that the consent of himself or some other person shall be required to the exercise of the powers...a pension scheme is quite different. Pension benefits are part of the consideration which an employee receives in return for the rendering of his services. In many cases...membership of the pension scheme is a requirement of employment...Beneficiaries of the scheme, the members, far from being volunteers have given valuable consideration.

The general issue that arises is whether these differences between the traditional trust and the superannuation trust are such that the trust is rendered ineffective to produce the desired superannuation outcomes. Two specific concerns that underlie...
this issue are that first, the nature of the interest of a beneficiary of superannuation trust is not representative of the “earned” nature of the employee’s interest, and secondly, trust law principles were developed in the context of family relationships and are therefore not suited for application in an employment context.

**Nature of interest not representative**

From an employee’s perspective, the trust structure is argued to be inadequate for the purposes of superannuation provision as the nature of the interest attributed to an employee member in the fund does not reflect the fact that an employee’s interest in the fund is “earned”. Superannuation benefits are an integral part of the remuneration package of employees, such that consideration for services rendered is argued to be deferred pay. The undercurrent of this argument essentially focuses on ownership: if superannuation provision is earned as result of the employment relationship the employees/members of the superannuation fund should “own” the superannuation fund. Implicit in this is the concern that the interest bestowed upon a member of a superannuation fund – a mere expectancy that does not convert to a equitable proprietary interest until a condition of release is satisfied – is inconsistent with the notion that a superannuation entitlement is “deferred pay”. Consequently, it is said the trust concept in its application to superannuation schemes is fundamentally flawed in that it does not reflect the “real nature” of the interest. Nobles described the problem from the perspective of the role of property ideology in pension trust doctrine when he stated that:

> Employees have been impeded from claiming that their labour has given them property rights in the pension fund, by their inability to point to the fund as a “thing” which they can be said, in any meaningful way, to “own”.

---


99 This argument is particularly prevalent in relation to a superannuation fund that is in surplus. If the employee members’ superannuation entitlements are deferred pay and the employee members therefore “own” the superannuation fund, they also own any surplus within the fund: Glover, “Lock v Westpac Banking Corporation and the Problem of Superannuation Fund Surpluses” (1992) 9 Aust Bar Rev 172 at 178-179; Gillese, “Pension Plans and the Law of Trusts” (1996) 75 Can Bar Rev 221 at 230-231. See further 6.2.1.

There is some judicial support for the notion that superannuation is an earned right, and as a consequence of being an integral part of the remuneration package is considered conceptually as “deferred pay”. However, without commenting on the validity or otherwise of this notion, this conclusion by itself does not determine what the legal consequence of that description should be. The foregoing argument equates the nature of deferred pay with that of an immediate right to pay such as salary or wages for services performed. However, the terminological use of the word “deferred” immediately communicates that the right to pay is not current but to occur at some time in the future. The Shorter Oxford English Dictionary defines the word “defer” to mean “to put off to some later time; to delay or postpone”. The phrase deferred pay therefore refers to a type of pay that is delayed or put off to some later time. In this context, superannuation entitlements are of quite a different nature to the traditional conception of pay; the pay and the benefits of pay, namely the rights of alienation, management and enjoyment, do not accrue until a later point in time. That later point in time is when a condition of release (as specified in the trust instrument or by statute) has been satisfied (such as, for example, that the relevant member has reached the specified age of retirement). This view of deferred pay is entirely consistent with nature of the interest held by beneficiaries of a superannuation fund. Superannuation contributions are held, preserved and protected until a later point in time. Beneficiaries can “expect” to receive a benefit upon fulfilment of the required conditions. Upon fulfilment of the relevant conditions, “ownership” is transferred from the trustee to the beneficiary in line with the terms of the trust deed and the object of the superannuation trust. The crucial issue is not the nature of the interest held but the security of that interest until the later point in time. Importantly, the trustee as legal owner is subject to arguably the most onerous duties imposed by the general law in order to facilitate his or her guardianship role as a protector of the “deferred interest”.

Principles were developed in the context of family settlements

The second concern is that the content of the various principles of trust law were developed in the context of family settlements and is therefore generally inadequate.
to provide a system of principles for the governance of the relationships developed in the employment context. Hand describes the concern as follows:\textsuperscript{102}

Existing trust law, to state the issue simply, fails adequately to deal with many major pensions issues, either because they are peculiar to pension law, so general trust law has never had to find a solution, or because they result from recent developments in the law which were simply never envisaged.

Examples of areas in which trust law is argued to operate inadequately relate to distribution of surpluses, the allowance of contribution holidays, conflicts inherent in trusteeship, and the exercise of the discretion by trustees and employers.\textsuperscript{103}

It is not proposed in this chapter to address the criticisms relating to each specific area; a further assessment of these issues is made in Chapter 6. However, at a general level, the criticism that trust principles are inadequate can nonetheless be rejected for three reasons.

\begin{itemize}
  \item It is inaccurate to view the general principles of trust law as static principles undeveloped over time. While general principles of trust law were conceived and initially developed in the context of the familial relationship, the equitable jurisdiction from which these principles flowed is flexible and progressive in nature. In this respect Sir Anthony Mason has commented that "[e]quitable doctrines and relief have extended beyond old boundaries into new territory where no Lord Chancellor’s foot has previously left its imprint".\textsuperscript{104} Sir Leonard Hoffman has similarly encapsulated this point by reference to a comment of Lord Justice Harman that “equity is not presumed to be beyond the age of child bearing".\textsuperscript{105} Just one example of the child bearing capacity of equity is the constructive trust. This doctrine has shown itself to be infinitely adaptable, allocating interests of property on a broad
\end{itemize}

\textsuperscript{102} Hand, “A New Legal Basis for Occupational Pension Schemes” (1993) 3 ICCLR 101 at 102.


\textsuperscript{104} Mason, “The Place of Equity and Equitable Doctrines in the Contemporary Common Law World” (1994) 110 LQR 238 at 238.

unconscionability ground independent of fiduciary relations in a manner that was not foreseeable prior to the 1970s and 1980s.\textsuperscript{106} Moreover, it has shown similar versatility in "handling problems created by the modern multi-company director who gains commercial knowledge by virtue of an appointment with one company but exploits it for another and/or herself or himself".\textsuperscript{107}

- To criticise a body of law for failing to have on hand solutions and principles developed for application to new circumstances and relationships arguably expects too much of that body of law. As a feature of both common law and equity is their development on a case by case basis, this criticism is one that could be made of any body of law. Though the criticism may be apposite to the issue of the ability of the common law or equity to supply timely reform and response to legal issues, it cannot be relied upon as a means to distinguish the suitability of trust from any other mechanism.

- The criticism at hand goes to the operational efficiency of the trust rather than to its structural ability to achieve the desired outcome. Addressing criticisms of the trust mechanism raised by submissions to the Goode Committee in its review of the United Kingdom's private pension system, Waters argued that:\textsuperscript{108}

  None of these issues challenge the appropriateness to pensions plans of the trust concept. But they all affect the quality of trust operation.

It is likewise argued in this context that the criticisms raised in respect of the suitability of trust principles, if indeed they can be sustained, do not go to the fundamental issue of suitability of the trust structure. Instead, they relate to the operation of those principles in the superannuation context. This is not to say that identified inadequacies in the operation of the trust principles are matters of no importance. Rather, in this context, the criticisms are not

\textsuperscript{106} See generally Cope, \textit{Constructive Trusts} (Law Book Co, 1992), Chs 1, 2, 21-24.

\textsuperscript{107} Dal Pont and Chalmers, \textit{Equity and Trusts in Australia and New Zealand} (2nd ed, LBC Information Services, 2000), p 410.

fundamental to the suitability of the trust to provide a secure foundation for superannuation provision. Waters makes the further point that:109

In the interests of efficiency it is trust operation that the courts are constantly re-weighing. And that concern seems unlikely to change. In my opinion it should remain so.

It is in the context of review by the judiciary and by Parliament that criticisms of the efficiency of trust operation are currently addressed, and should continue to be so addressed. Their relevance is one step removed from that of assessing the structural ability of the trust mechanism to achieve identified outcomes.

(iii) Flexibility

The flexibility of the trust and its resultant versatility is a much commended feature of the modern commercial trust in that it permits the vehicle to be shaped to cater for new circumstances and relationships.110 Professor Maitland's appreciation of this feature is apparent from his depiction of the trust as "an 'institute' of great elasticity and generality; as elastic, as general as a contract".111 Yet whether or not this flexibility is to be applauded depends upon the purpose of the trust and degree to which strong protection is sought for the beneficiaries.112 In the context of superannuation law, the trust's inherent flexibility can be seen as a drawback that has the potential to go to the heart of the ability of the trust to facilitate the security of superannuation contributions and benefits.

The flexibility of the trust flows from the ability of the settlor to frame the terms of a trust instrument so as to modify the general principles of trust law that govern the trust relationship. Except for the irreducible core of obligations fundamental to the concept of a trust,113 fiduciary and general law duties of trustees can be excluded, diluted or supplemented. For example, the trust deed may permit the trustee to


111 Maitland, Maitland's Equity (Brunyate ed, Cambridge University Press, 1936), p 23.


113 Armitage v Nurse [1997] 3 WLR 1046 at 1056 per Millett LJ. His Lordship viewed the "irreducible core" obligation of the trust as the "duty of the trustees to perform the trust honestly and in good faith for the benefit of the beneficiaries": at 1056.
profit from his or her role, or may include a wide exoneration clause exempting a
trustee from liability from imprudent or negligent breaches of trust thereby
obstructing the beneficiaries' ability to secure the proper administration of the
trust."\(^{14}\) The trust instrument can also be drafted so as to tailor mechanisms for
governance and confer powers of management and administration on other parties,
such as the settlor.

From an employer's perspective this feature is of great advantage. The employer,
most often as settlor, can draft the trust deed to include provisions that confer upon
itself the power to appoint and remove trustees, amend or consent to any
amendment of the trust instrument, determine the amount of contributions,
determine the destination of surplus, and/or revoke and wind up the trust. This
ability to vest significant control in the employer, has been the subject of criticism.\(^{15}\)
The balance of power has been seen to lie so much with the employer that one
commentator has suggested that a new form of trust, the pension trust, has evolved
with the management and administrative function shared by a hybrid employer (as
settlor) and trustee relationship.\(^{16}\)

The ability to draft a trust deed so as to minimise the duties incumbent upon a
trustee and maximise the control of the employer exploits the benefits of flexibility
and undermines the essential features of the trust that promotes security.\(^{17}\) Given
the object of regulatory intervention has been identified as the prudential management
and control of superannuation activities for the purpose of ensuring the security of contributors'
finds,\(^{18}\) it could be argued that the flexibility of the trust is fatal to its
appropriateness for superannuation provision. However, to the contrary, statutory
intervention can be utilised to prevent unjustifiable exploitation of the structure by
promoting those principles at general law that promote security.\(^{19}\) The Goode
Committee in its review of occupational pension schemes likewise concluded that

---

\(^{14}\) In respect of the difficulties associated with the inclusion of wide exoneration clauses see Dal
Pont, "The Exclusion of Liability for Trustee Fraud" (1998) 6 APLJ 41.

\(^{15}\) See Hand, "A New Legal Basis for Occupational Pension Schemes" (1993) 3 ICCLR 101 at 104;
Hayton, "Trust Law and Occupational Pension Schemes" [1993] Conv 283 at 294; United
Kingdom, House of Commons Select Committee on Social Security, The Operation of Pension


\(^{18}\) See 4.2.1.

"some curbs need to be placed on the permissible content of scheme rules, especially in relation to certain of the powers that can be reserved to the employer and the trustees and the scope of exemptions given to trustees from liability of breach of duty."\(^{120}\)

Proponents of the contractual and company models may seize upon this weakness to argue that the requirement for legislative supplementation is therefore no bar to the adoption of either the contract or company model as a foundation for superannuation. If the trust model requires legislative supplementation in order to realise the advantages of the model, a priori the necessity of legislative assistance to achieve superannuation objectives is not a basis upon which utilisation of the contract and company model can be distinguished.

Yet whilst all models require legislative supplementation, the trust requires a much lesser degree of supplementation than the contract or company model. This flows from the fact that much of the legislative supplementation required in the trust model is positive supplementation; it simply reinforces the existing general law. The high threshold of standards and duties underpinning the general law is simply reinforced by the legislature. Also, the extensive body of case law interpreting and applying these general law principles applies to those principles enumerated in statutory form. In respect of the contract and company models, the existing law does not provide a suitable base level of protection. Consequently, new duties and restrictions would need to be created and ironically the protective attributes of the trust model would probably be borrowed for this purpose. That it is not simply a matter of legislating to reinforce existing general law duties is shown later in this chapter in the context of the regulation of Retirement Savings Accounts.\(^{121}\)

(iv) Imprecise Drafting and Difficulty of Enforcement

The application of the trust structure for superannuation provision is the subject of two further criticisms: that members' benefits are exposed to uncertainty due to imprecise drafting;\(^{122}\) and that the expense and time associated with litigation practically deters beneficiaries from seeking redress for grievances against a trustee's

---


\(^{121}\) See the heading “Supplementing the Contract Model – The RSA Scheme” in 4.2.2.2.

\(^{122}\) Hand, "A New Legal Basis for Occupational Pension Schemes" (1993) 3 ICCLR 101 at 102.
management and administration of the relevant trust. Though not without substance, these criticisms can be made of any other mechanism that is an alternative to the trust, and so they cannot be relied upon as a means to distinguish the suitability of trust from any other mechanism. Superannuation provision founded in contract and company can, to this end, also suffer the difficulty of imprecise drafting and the resultant struggle of interpretation. In respect of the enforcement of rights, whether arising from trust, contract, or company, the relevant individual is in each case subject to the vagaries of the court process.

4.2.2.2 CONTRACT

A contract is an agreement between parties recognised by the common law to be valid. Validity is premised upon an agreement that is certain in its terms and supported by consideration. Further formalities such as writing may also be required. The following two examples illustrate how the vehicle of contract can be utilised as a funding mechanism for the provision of superannuation and related benefits.

**CONTRACT - EXAMPLE NO 1**

The employer, by way of the employment contract, may promise to provide a benefit to the employee on his or her retirement at a specified age. Provision may also be made for the payment of a benefit: (i) to the employee if he or she becomes disabled; or (ii) to a person nominated by the employee upon the death of the employee. The employer may make provision for the funding of benefit in his or her accounts. More commonly, the employer would enter into a contract with a superannuation provider, such as a life office, whereby the insurer, in consideration for regular contributions, agrees to fund the benefits. The relationships between the parties can be diagrammatically represented as follows:

![Diagram of Contract of Insurance](image)

The employer, by way of an employment contract, may permit employees to join the company retirement scheme. Pursuant to the scheme the employee may enter into a contract for the provision of benefits with a participating superannuation provider, such as a life office or a financial institution. In this sense the employer simply facilitates the employees' entry into a contract with a superannuation provider. As with Example No 1 benefits may be payable: (i) to the employee upon his or her retirement or disability; and (ii) to a person nominated by the employee upon the death of the employee. The employer may either fund the contributions itself or withhold the contributions from the employee's salary or wages (or a combination of both).

See, for example, Lee, "Trustee Law and Superannuation Law: the Interface" (1997) 3 NZBLQ 116 at 116-117. The diagrammatical relationships between the parties are as follows:

**General Concerns**

The chief advantage of the contract funding structure is its simplicity. Given contractual arrangements are incidents of everyday life, the parties involved may more easily understand the structure and nature of the relationship. Notwithstanding the simplicity of this arrangement, three fundamental concerns arise in respect of the ability of the contract structure to promote a secure foundation for the provision of superannuation.

(i) **The Absence of a Segregated Fund**

The first concern is that there is no segregated fund of superannuation assets. Premiums paid to the superannuation provider ("provider") become the assets of the provider. The vehicle of contract creates only personal rights; employees become creditors of the provider, lacking any interest in the assets of the provider. As a consequence, upon insolvency employees must line up with the unsecured creditors.
and hope for a distribution. In comparison, beneficiaries of a trust have both personal and proprietary rights. The trust mechanism places an insolvency shield around the segregated fund preserving it for the purpose of the trust.\textsuperscript{124}

A further repercussion of the absence of a segregated fund is that there is no opportunity for representative monitoring. The trust relationship permits beneficiaries to monitor and control the activities of the trustee. There is no scope in the contract model for provision of this further layer of security. The provider is both the legal and equitable owner of the premiums paid and is therefore responsible only to itself for the management of those assets.

(iii) No Designated Protector

The second drawback of the contract vehicle is that there is no fiduciary relationship between the provider and the employee, and no general law duty on the provider to act in the “best interests of the employees”. The interest of the provider is essentially that of self-interest. The provider acts “in the best interests” of itself subject to any contractual or other legal restraints in so acting.

In the context of superannuation provision via the contract of insurance, some protection is provided as such contracts are recognised by the common law as contracts \textit{uberrimae fidie}, that is, of utmost good faith. As a consequence, an obligation to act with good faith is imported into every contract of insurance. This duty applies to both parties of the contract, the insurer and the insured. The term “utmost good faith” connotes that the obligation is essentially one of honesty\textsuperscript{125} and one that in breach requires some “dishonest, capricious or unreasonable conduct.”\textsuperscript{126}

In the High Court decision of \textit{Distillers Company Bio-Chemicals (Australia) Pty Ltd v AJAX Insurance Co Ltd}\textsuperscript{27} Stephen J went beyond the concept of honesty. Borrowing jurisprudence developed in the United States\textsuperscript{128} his Honour considered that the obligation of utmost good faith requires the insurer when exercising its rights and powers under the contract of insurance to have “regard for the interests of the

\textsuperscript{124} See 4.2.2.1.

\textsuperscript{125} \textit{Vermeulen v SIMU Mutual Insurance Association} (1997) 4 ANZ Ins Cas 60-812 at 74,987 per Hardie Boys J.

\textsuperscript{126} \textit{Kelly v New Zealand Insurance Company Ltd} (1996) 9 ANZ Ins Cas 61-317 at 76,520 per Owen J.

\textsuperscript{127} (1973) 130 CLR 1.

\textsuperscript{128} As to the American conceptualisation of the notion of “good faith” see generally Lücke, “Good Faith and Contractual Performance” in Finn (ed), \textit{Essays on Contract} (Law Book Co, 1987), p 155.
insured as well as its own interests". Although, this duty most commonly manifests itself in the duty of disclosure, it applies to all actions of the parties in respect of the contract. The duty of utmost good faith has been given statutory recognition in the Insurance Contracts Act 1984 (Cth), s 13, which imports into every contract of insurance, within the ambit of the Act, an implied term requiring "each party to it to act toward the other party, in respect of any matter arising under or in relation to it, with the utmost good faith".

Although the duty of utmost good faith provides some protection to the insured, it is not of a comparable nature to the protection accorded to beneficiaries under the trust structure. The issue is essentially one of focus, and can be elucidated in the context of the hierarchy of protective responsibility advocated by Professor Finn (now Justice Finn). The hierarchy of protective responsibility categorises the regulation of voluntary or consensual relationships in ascending order of intensity. At the lowest level is the "unconscionability standard", which is followed by the "good faith standard". At the highest level of intensity is the "fiduciary standard". Both the standard of unconscionability and standard of good faith proceed from the same footing, namely that individuals are entitled to act self-interestedly. The point of departure, and therefore the distinction between the two standards, is the extent to which the law permits self-interested acting. The unconscionability standard proscribes excessive self-interest or exploitative conduct. The standard of good faith, being of a higher level of intensity, requires further that the individual in his or her self-acting have regard to the legitimate interests of the other. Progress along the intensity spectrum to the fiduciary standard witnesses a complete change in focus. The fiduciary standard requires the individual to act not in a self-interested fashion.

130 See, for example, Banque Financiere de la Cite SA v Westgate Insurance Co Ltd [1991] 2 AC 249. See further Sutton, Insurance Law in Australia (3rd ed, LBC Information Services, 1999), pp 157-160.
131 Distillers Company Bio-Chemicals (Australia) Pty Ltd v AJAX Insurance Co Ltd (1973) 130 CLR 1 at 30-32 per Stephen J; Re Zurich Australian Insurance Ltd (1999) 10 ANZ Ins Cas ¶61-429 at 74,840-74,842 per Chesterman J.
Chapter 6: A Superannuation Relationship Framework

but in the interests of another;135 "to act selflessly and with undivided loyalty".136 The level of protective responsibility transforms from self-interest to self-less interest.137

This hierarchy of protective responsibility is directly relevant to choosing between the trust and contract structures. The highest level of protective responsibility applicable in the contractual model is that of good faith, a standard that is inward looking and founded upon self-interestedness. By comparison, the trust structure requires the legal owner of the assets to direct the activities of the trust entirely for the benefit of the beneficiaries. In doing so the trustee, subject to the terms of the trust instrument, cannot:138

- act in its own interest,
- act in the interests of a third party;
- profit from his or her position; or
- place himself or herself in a position of conflict vis-à-vis the trust and the beneficiaries.

The trustee must act in an entirely self-less manner. Given the object of this regulatory analysis is to select a structure based upon the ability of that structure to promote the security of contributors' funds and ultimately the security of benefits, the trust structure is the preferred vehicle for the delivery of this object. A greater level of prudential security is obtained by the assignment of the role of protector to the trustee. This role is not in any way replicated in the contract structure. Instead the structure permits a degree of self-interested acting, with the duty of good faith mediating between conflicting interests. The trust structure is directed entirely to the interests of the beneficiaries and demands that the trustee, as protector, direct his or her interests exclusively to that purpose. The structure is not concerned with mediating between conflicting interests but seeks to secure the paramountcy of a particular interest, that of the beneficiaries.139

138 As to duties of trustees see further 4.2.2.1.
The final disadvantage of the contract funding structure is that the doctrine of privity prevents a third party from enforcing the contract. The doctrine of privity holds that a contract confers rights and imposes liabilities only on the parties to it. A third party may be entitled to a benefit in the performance of a contract, but only the direct parties to the contract are recognised by the law as being able to enforce the receipt of such a benefit. In the superannuation context, the traditional application of the privity doctrine would prevent third parties, such as a death benefit nominee, from enforcing a contract between an employee and an employer pursuant to which the right to receive the death benefit was conferred upon a third party (usually a relative of the employee).

In the situation where the right to receive a death benefit flows from a contract of insurance, this inadequacy in the law has been remedied both at common law and by statute. At common law the High Court decision of Trident General Insurance Co Ltd v McNiece Bros Pty Ltd relieves the strictness of this doctrine in the context of contracts of liability insurance. A majority of the court allowed a third party to secure the benefit of a promise in a contract between the principal parties, Mason CJ and Wilson J on the ground that the intention of the contracting parties had been that a third party should benefit from performance of the contract, and that the common law rule as to privity operated unsatisfactorily and unjustly in the case. It could thus be argued that a third party to a contract of insurance for the provision of superannuation and associated benefits could likewise enforce the terms of the contract conferring the relevant benefits. The Insurance Contracts Act 1984 (Cth) reinforces the common law position in respect of contracts of general insurance and life insurance.

Although the inability of third parties to enforce a contract of insurance has been remedied, to the extent that a benefit (typically a death benefit) flows from another type of contract (for example, an employment contract) the doctrine of privity operates so as to prevent third parties from enforcing the terms of the contract.
Conversely, the structure of the trust, in particular a discretionary trust, permits so-called third parties not only to receive a benefit from the trust but to enforce the terms of the trust in the event that the benefit is not paid. Take, for example, the situation where a member of a superannuation trust has died. If the terms of the trust provide that upon death a benefit will be received by the spouse and/or children of the member (or indeed another person nominated by the member), those persons, although not "members" of the superannuation trust, are nevertheless beneficiaries of the trust. As such, the wife and/or children can, at law, enforce the terms of the trust. In comparison, if such a benefit were conferred via a contract of employment, the doctrine of privity would prevent them from enforcing the terms of the contract.

**Supplementing the Contract Model – The RSA Scheme**

The foregoing discussion considered the general nature of the contractual structure and its inadequacies. Such inadequacies can, however, be supplemented by statutory intervention. In Australia limited provision for superannuation may be effected through a Retirement Savings Account ("RSA"). An RSA is not founded upon the trust structure but is effected through a contract between the RSA institution and the RSA holder. But the nature of relationship is not left to the parties and notions of freedom of contract. Rather, the relationship between the parties is governed by statutory intervention principally in the form of the Retirement Savings Accounts Act 1997 (Cth) and the Retirement Savings Account Regulations 1997 (Cth) (collectively the “RSA Scheme”). The following assesses the suitability of the RSA Scheme, as representative of a supplemented contract structure, to fulfill the stated regulatory objectives.

The RSA Scheme was introduced in Australia in 1997. Its purpose was outlined in the Explanatory Memorandum to the Retirement Savings Accounts Bill 1999 (Cth) as being to provide:\textsuperscript{144}

a simple, low cost, low risk product especially suited to those with small amounts of superannuation, such as itinerant and casual workers. They will also be suited for those people who want to amalgamate several small superannuation holdings and those nearing retirement.

A key feature of the RSA Scheme is that superannuation provision is effected through a non-trust structure via an RSA. RSAs may be offered by approved RSA institutions, and

any constitutional corporation\textsuperscript{145} that is an authorised deposit-taking institution ("ADI"),\textsuperscript{146} life insurance company\textsuperscript{147} or prescribed financial institution\textsuperscript{148} may apply to APRA for approval as an RSA institution.\textsuperscript{149}

An RSA is in the nature of an account or policy that is opened with an RSA institution.\textsuperscript{150} If an RSA is opened with an ADI it is in the nature of a deposit account, whereas if a life insurance company supplies the RSA it will be a contracted policy similar in nature to a life insurance policy. The legal structure underlying RSAs, whether provided by an account or a policy, is that of a contract. However, as alluded to above, the RSA Act and RSA Regulations restrict the freedom of the parties and govern many aspects of the relationship and contract between the parties.

The RSA Scheme is modelled on the SIS Scheme. As such, RSAs must be maintained for the provision of retirement benefits and or death benefits.\textsuperscript{151} The RSA regulations detail operating standards that prescribe requirements for: (i) the disclosure of information;\textsuperscript{152} (ii) the preservation of and conditions for the payment benefits;\textsuperscript{153} (iii) the protection of benefits;\textsuperscript{154} and (iv) the circumstances in which contributions can be

\textsuperscript{145} A "constitutional corporation" is a body corporate that is a trading corporation or a financial corporation formed within the limits of the Commonwealth, within the meaning of the Constitution s 51(xix): Retirement Savings Accounts Act 1997 (Cth) s 16.

\textsuperscript{146} An "authorised deposit-taking institution" ("ADI") is a body corporate that is an ADI for the purposes of the Banking Act 1959 (Cth): Retirement Savings Accounts Act 1997 (Cth) s 16.

\textsuperscript{147} A "life insurance company" is a body corporate that is registered under the Life Insurance Act 1995 (Cth) or a public authority that is constituted by a law of a State or Territory and that carries on life insurance business within the meaning of section 11 of the foregoing Act: Retirement Savings Accounts Act 1997 (Cth) s 16.

\textsuperscript{148} A "prescribed financial institution" is a body prescribed for this purpose by the Retirement Savings Accounts Regulations 1997 (Cth): Retirement Savings Accounts Act 1997 (Cth) s 16.

\textsuperscript{149} If the application is in the approved form and accompanied by the prescribed fee, APRA must approve an applicant unless it is satisfied that the applicant cannot be relied upon to conduct RSAs in accordance with the Retirement Savings Accounts Act 1997 (Cth) and the Retirement Savings Accounts Regulations 1997 (Cth): Retirement Savings Accounts Act 1997 (Cth) s 16.

\textsuperscript{150} Retirement Savings Accounts Act 1997 (Cth) s 8.

\textsuperscript{151} Retirement Savings Accounts Act 1997 (Cth) ss 8(6), 15(i). This requirement is similar in nature to that in the SIS Scheme requiring trustees to ensure that a regulated superannuation fund be held solely for at least one core purpose and one or more ancillary purposes: SIS Act s 62 (see 2.2.2).

\textsuperscript{152} Retirement Savings Account Regulations 1997 (Cth) Pt 2. As to the SIS Scheme requirements in this respect see Table 2.1 in 2.1.1.

\textsuperscript{153} Retirement Savings Account Regulations 1997 (Cth) Pt 4. As to the SIS Scheme requirements in this respect see 2.2.4.4.

\textsuperscript{154} Retirement Savings Account Regulations 1997 (Cth) Pt 3. As to the SIS Scheme requirements in this respect see Table 2.1 in 2.1.1 and 2.2.5.
accepted. The Schemes also have similar penalties and dispute resolution regimes and share the same regulators (that is, APRA and ASIC).

Whilst the RSA and SIS Schemes share base commonalities, there are two significant distinguishing features.

- As RSAs are designed to appeal to those with small amounts of superannuation, so as to shelter those small balances from a high degree of risk, RSAs are required to be capital guaranteed. An RSA opened by account is capital guaranteed if the balance of the account cannot be reduced by the credit of any negative interest. An RSA based upon a policy is capital guaranteed if the contributions and accumulated earning cannot be reduced by negative investment returns or any reduction in the value of the assets in which the policy is held.

- The nature of the duties imposed upon RSA Providers differ significantly in terms of level and intensity as compared to a trustee under SIS Scheme. Common duties between the Schemes include the duty to: (i) establish arrangements for dealing with inquiries and complaints; (ii) keep and retain minutes of meetings, prescribed reports, and accounting records; (iii) lodge

---

155 Retirement Savings Account Regulations 1997 (Cth) Pt 5. As to the SIS Scheme requirements in this respect see 2.2.4.1.

156 The RSA Act has the same penalty structure as the SIS Act. Thus, certain provisions are labelled as civil penalty provisions and/or offences. See further Table 2.1 in 2.1.1.

157 Retirement Savings Accounts Act 1997 (Cth) s 47; Superannuation (Resolution of Complaints) Act 1993 (Cth) ss 15E-15K. As to the Superannuation Complaints Tribunal see 2.1.3.

158 Retirement Savings Accounts Act 1997 (Cth) s 16. As to the role of the Regulators in the context of the SIS Scheme see the heading “Regulators” in 2.1.1.


160 Retirement Savings Accounts Act 1997 (Cth) s 14(1).

161 Retirement Savings Accounts Act 1997 (Cth) s 14(2).

162 A person is an “RSA provider” at a particular time if, at that time, the person is the provider of one or more RSAs: Retirement Savings Accounts Act 1997 (Cth) s 12. A person who accepts, or has accepted, contributions to an account or policy is the “provider” of the account or policy: s 10. Most RSA providers will also be an RSA institution: s 12. Although every RSA provider must have been an RSA institution at one time, some may have ceased to be an RSA institution: s 12.

163 As to the duties imposed on trustees by the SIS Act see 2.2.3.4.

164 Retirement Savings Accounts Act 1997 (Cth) s 14(2).

165 Retirement Savings Accounts Act 1997 (Cth) ss 47-49, 64.
annual reports with APRA;\textsuperscript{166} and (iv) arrange for the auditing of accounts.\textsuperscript{167} However, significantly and unlike a trustee pursuant to the SIS Scheme, RSA Providers do not stand in a fiduciary position vis-à-vis RSA Holders, nor are they required to “act in the best interests” of RSA Holders.\textsuperscript{168}

The terms of the RSA scheme do not alleviate the inadequacies of the general contract model. RSA providers are not subject to the same strictness of duties as those imposed upon trustees. Nor do the provisions of the RSA Scheme place a security shield around RSA assets. Having stated this, an analysis of the RSA Scheme is not complete without recognition and examination of the features of the other schemes of regulation that are imported into the RSA Scheme by the nature of the RSA product. In that an RSA can be in the nature of an account or a policy, the systems of law (both common law and statute) that govern the banking and life insurance industries are germane to any analysis of the RSA Scheme. The following further reflects on the operation of the RSA scheme in the context of both these industries with a view to conducting an assessment of: (i) the extent to which statutory supplementation alleviates the inadequacies of the general contract model; and (ii) whether or not the features of a supplemented contract model promote a system of greater security of superannuation assets.

(i) Accounts with ADIs

An RSA founded upon an account will usually be offered by an authorised deposit-taking institution (“ADI”). In this form the account resembles a depositor account, that is, an account that is interest bearing. The RSA holder, or an employer on behalf of the RSA holder, will place contributions in the account and interest will be credited to the account by the ADI. Withdrawal is subject to the preservation and payment requirements detailed above. The contractual relationship between the parties is essentially that of debtor and creditor: the RSA holder is a creditor of the bank to the sum of the amount credited to the account.\textsuperscript{169} The contributions

\textsuperscript{166} Retirement Savings Accounts Act 1997 (Cth) s 44.
\textsuperscript{167} Retirement Savings Accounts Act 1997 (Cth) s 65.
\textsuperscript{168} As to a trustee’s duty to his or her beneficiaries see 2.2.3.4.
\textsuperscript{169} Foley v Hill (1848) 2 HL Cas 28 at 36; 9 ER 1002 at 1005 per Lord Cottenham; Croton v R (1967) 41 ALJR 289 at 291 per Barwick CJ; Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd [1986] 1 WLR 1072 at 1073 (PC).
deposited become an asset of the ADI. Chief Justice Barwick explained the significance of this relationship in Croton v R:170

Though in a popular sense it may be said that a depositor with a bank has "money in the bank", in law he has but a chose in action, a right to recover from the bank the balance standing to his credit in the account with the bank at the date of his demand or the commencement of action...But the money deposited becomes an asset of the bank which it may use as it pleases.

The scheme of regulation set out in the Banking Act 1959 (Cth) does not alter this position. As a result, both the legal and equitable interests in the contributions deposited in an RSA account pass to the ADI. The relationship between the parties is identical to that described in respect of the general contract model – it gives rise to mere personal rights and duties. There is no segregated fund in which the RSA holder retains a proprietary interest. As discussed above, the general consequence of this position in respect of the general contract model is that upon insolvency the relevant assets are not preserved for the purpose of the RSA Scheme.

The Banking Act seeks to strengthen the security of deposits through the implementation of a scheme of depositor protection. The scheme implements two key levels of protection. First, APRA as the prudential regulator of ADIs has the role of promoting the protection of the depositors. To this end, if either the ADI or APRA considers that an ADI is likely to become, or in fact becomes, unable to meet its obligations or suspends payment (or in fact becomes unable or suspends payment) APRA has the power to investigate or appoint a person to investigate the affairs of the ADI, or to take control of the ADI's business or appoint an administrator to take such control.171 Moreover, in its role as protector APRA is under a duty to exercise the powers and functions conferred pursuant to Division 2 of the Banking Act for the protection of depositors.172

Secondly, an ADI is required to hold assets of a value at least equal to the total amount of its deposit liabilities in Australia. Failure to do so constitutes an offence.173 In addition, if an ADI becomes unable to meet its obligations or suspends payment, the assets of the ADI in Australia are available to meet that ADI's deposit

170 (1967) 41 ALJR 289 at 291.
171 Banking Act 1959 (Cth) s 13A(1). To assist APRA in this role, an ADI is under an obligation to immediately inform APRA if the ADI considers that it is likely to become unable to meet its liabilities or that it is about to suspend payment.
172 Banking Act 1959 (Cth) s 12.
173 Banking Act 1959 (Cth) s 13A(4).
liability in priority to all other liabilities of the ADI.\textsuperscript{174} It is not presently clear whether or not this provision confers priority over secured as well as unsecured creditors. The use of the words "all other liabilities" conveys the impression that priority over all creditors, whether secured or unsecured, was intended. However, it is arguable that, as the \textit{Banking Act} does not confer a charge on depositors in respect of deposit liabilities (as it clearly could have), it was not Parliament's intention to grant priority over secured creditors.\textsuperscript{175} If this is correct, depositors would be the first unsecured creditors to be satisfied.

The upshot of the depositor protection provisions is that Parliament has attempted to supplement the general contract model by shielding depositors, and therefore RSA holders, from the limiting effects of being unsecured creditors. The extent to which this is successful is dependent upon the outcome of the scope of the priority in issue. If the intent of Parliament was to confer priority as against all other liabilities, this considerable deviation from the usual scheme of priority is an indication of the social and economic importance it placed upon depositors and the extent to which it wished to protect them.

Notwithstanding this conferral of priority, there remain two notable limitations. \textit{First}, the relationship between the parties remains personal in nature. The scheme does not, as does a trust, give rise to any proprietary rights in favour of the depositor/RSA holder. This serves to negate the availability of the process of tracing in respect any misappropriation of funds.

\textit{Secondly}, although APRA is designated as the "protector" of the depositor, its role is limited. The duty to exercise its powers and functions in the interests of the depositor does not take effect until it is likely that the relevant ADI will be unable to meet its liabilities. This is at a point too late. The trust in comparison designates the trustee, the entity with which the legal title and management of the assets is vested, as the \textit{continuing} protector of the beneficiaries. The trustee must act to promote the interests of the beneficiaries \textit{at all times}. Neither the RSA Scheme nor the \textit{Banking Act} designates a full-time protector of RSA Holders. Whilst the function of APRA is to promote the prudential security of the RSA Scheme and the banking industry, this

\begin{footnotesize}
\begin{itemize}
\item[\textsuperscript{174}] \textit{Banking Act} 1959 (Cth) s 13A(i).
\item[\textsuperscript{175}] Smith and Muldoon, "Commonwealth and State Legislative Controls over the Functions and Administration of Banks" (1990) 64 ALJ 13 at 21; Mallesons Stephen Jaques, \textit{Australian Finance Law} (4th ed, LBC Information Services, 1999), p 25.
\end{itemize}
\end{footnotesize}
does not equate to the protection conferred by the designation of an entity whose functions and powers must be exercised at all times for the benefit of one set of interests within that system. The further advantage of the trust in this context is that the protector role is conferred upon an entity (trustee) that interacts directly with the object of that protection (beneficiaries). In comparison, APRA as the protector of depositors is a third party to the central RSA relationship and seeks to regulate the actions of an entity whose economic survival is dependent upon promoting its own interests. Limited responsibility is placed upon ADIs to ensure the protection of superannuation savings deposited in RSAs. In any system founded upon self-interested acting, the issue with which the legislature must grapple is the inherent tension of balancing competing and conflicting interests. The supreme advantage of the trust model is that the interests of the beneficiaries are elevated above all interests, and relationship is not one of balance but one of unity in purpose.

(ii) Policies with Life Companies

An RSA in the form of a policy\(^{176}\) is in essence a life policy offered by a life company in accordance with the *Life Insurance Act 1995* (Cth) ("LIA"). An employer or the RSA holder pays a contribution to the life company in return for superannuation and associated benefits. Upon payment of a contribution, both the legal and equitable title in it passes to the life company. As distinct from the general contract model and an RSA based on an account, the LIA requires that the activities of life companies be conducted through statutory funds.\(^{177}\) A statutory fund is defined as being a fund that:\(^{178}\)

- is established in the records of a life company; and
- relates solely to the life insurance business of the company or a particular part of that business.

In that the assets of a statutory fund are to be kept separate and distinct from the assets of other statutory funds and all other assets of the company,\(^{179}\) the effect of creating a statutory fund is to segregate the assets and business related to that

---

176 The term "policy" is defined as having the same meaning as in the *Life Insurance Act 1995* (Cth); *Retirement Savings Accounts Act 1997* (Cth) s 16. The *Life Insurance Act 1995* (Cth) in turn defines "policy" as being a life policy, a sinking fund policy or a section 12A (insurance or annuity business) or section 12B (other financial business) policy: Dictionary Schedule.


179 *Life Insurance Act 1995* (Cth) s 34(3).
particular fund. The concept of segregation is further reinforced by requirements that:

- all assets, liabilities, investments and amounts received in connection with a particular fund be attributed to that fund;
- any policies issued in connection with a particular statutory fund specify the statutory fund to which it is referable;\(^{180}\)
- the assets of the fund be invested in a manner that is likely to further the business of the fund;\(^{181}\)
- the transfer of assets between funds is permitted only on a fair value basis and where the transfer is fair and reasonable in all the circumstances;\(^{182}\)
- each statutory fund comply with the prescribed requirements as to solvency;\(^{183}\)
- operating profits and losses be allocated as prescribed between the policyholders referable to a fund and the shareholders;\(^{184}\) and
- distribution of retained profits and shareholders’ capital be in accordance with the prescribed rules.\(^{185}\)

The LIA also seeks to limit the potential for the life company to act in a self-interested manner by requiring the life company, in its investment, administration and management of the assets of a statutory fund, to give priority to the interests of the relevant policy owners.\(^{186}\) This duty is reiterated in the context of directors, who are bound to take reasonable care and to use due diligence to ensure that the life company complies with its duty to the policy-holders.\(^{187}\) In addition, in the event of any conflict arising between the interests of the shareholders of the life company and the interests of the policy owners, directors must ensure that the company gives priority to the latter.\(^{188}\)

In respect of the winding up of a life company the assets of each statutory fund must be applied in accordance with the scheme of priorities set out in the \textit{Corporations Act}\(^{189}\)

\(^{180}\) \textit{Life Insurance Act} 1995 (Cth) s 35(1).
\(^{181}\) \textit{Life Insurance Act} 1995 (Cth) s 43(2).
\(^{182}\) \textit{Life Insurance Act} 1995 (Cth) s 45.
\(^{183}\) See \textit{Life Insurance Act} 1995 (Cth) Pt 5.
\(^{184}\) \textit{Life Insurance Act} 1995 (Cth) ss 57-60.
\(^{185}\) See \textit{Life Insurance Act} 1995 (Cth) ss 61-63.
\(^{186}\) \textit{Life Insurance Act} 1995 (Cth) s 32(1). This requirement will be satisfied upon evidence that at the time of the relevant act or decision it was reasonable to believe that the act or decision gave priority to interests of the policy owners: s 32(2).
\(^{187}\) \textit{Life Insurance Act} 1995 (Cth) s 48(2).
\(^{188}\) \textit{Life Insurance Act} 1995 (Cth) s 48(3).
Thereafter, the remaining assets are to be applied first in the discharge of policy liabilities of the company referable to the relevant statutory fund. The effect of this requirement is essentially to grant policy-holders priority over the unsecured creditors of the statutory fund once the liabilities of winding up and outstanding liabilities to employees have been satisfied (ie in accordance with the scheme set out in s 556(1)).

The requirement to operate a life insurance business through a statutory fund, and the associated segregation of assets, is clearly modelled upon the concept of a trust. Indeed, the separation of assets and direction to apply a fund for a specific purpose are often sufficient to substantiate an intention to create a trust at general law. However, s 34(5) of the LIA negates this conclusion; it states that nothing in the LIA is intended to constitute a life company or its directors as trustee(s) of the assets of the statutory funds of the company. Therefore, whilst borrowing the segregation approach from the trust model, the intention of Parliament was clearly to retain the basic contract model as the underlying relationship between the life company and the policy-holder. As a result, any contributions to the life company pursuant to the terms and conditions of the RSA become the assets of the life company, that is, both the legal and equitable interest to the contributions pass to the life company. The result is therefore the same as that in respect of the provision of RSAs by account: the RSA holders/policy-holders do not retain any interest in the statutory fund. The relationship gives rise to mere personal rights and obligations. As discussed in relation to RSAs created by account, the failure to permit policy-holders to retain a proprietary interest in the fund (and therefore have access to proprietary remedies) reveals again an inherent weakness of the contract model.

The LIA supplements the contract model and facilitates greater investor protection through, first, the prescription of positive duties requiring the life company and its directors to give priority to the interests of the shareholders, and secondly, elevating the interests of the policy-holders in the priority scheme applicable to a winding up. In respect of the former, the LIA goes further than either the RSA Scheme or the

---

189  Life Insurance Act 1995 (Cth) s 187(1).
190  Life Insurance Act 1995 (Cth) s 187(3).
191  Henry v Hammond [1913] 2 KB 515 at 521 per Channel J; Re Australian Home Finance Ltd [1956] VLR 1 at 8-9 per Herring CJ; Re Kayford (in liquidation) [1975] 1 WLR 279 at 282 per Megarry J; Paragon Finance plc v D B Thakerar & Co (a firm) [1999] 1 All ER 400 at 408-414 per Millett LJ.
192  Life Insurance Act 1995 (Cth) s 34(5).
Banking Act in the governance of self-interested acting. The elevation of the policy-holders' interests above that of the shareholders of the company is a clear indication of Parliament's intention to afford increased protection to policy-holders.

Notwithstanding this statutory intervention, the trust relationship grants a higher level of protection again. As discussed in respect of the general contract model, the duty of trustees to act entirely in the interests of the beneficiaries straddles the divide between regulated self-interested acting and selfless acting. The issue is essentially one of focus. Directors are required both at general law and pursuant to statute to act in the interests of the company. In so doing the focus is very much on the shareholders, the body to whom the directors are accountable. The provisions of the LIA do not oust this responsibility. Instead they attempt to govern the inherent conflict of interest through the elevation of one set of interests over another. The trust model (subject to the terms of the trust) does not permit self-interested acting to any degree. Although the life company is required to give priority to the interests of the policy-holders, its position of being also responsible to the shareholders may distort the considerations of the company as to what are the interests of those policy-holders. In other words, the interests of the policy-holders may be determined through "shareholder/company tinted glasses".

The elevation of the interests of the policy-holders in the priority scheme applicable to a winding up is similar to that prescribed for the Banking Act. However, as with the Banking Act, it is not clear from the terms of the LIA whether or not the priority is extended over secured creditors. The extent of protection provided is therefore dependent upon the conclusion of this issue.

4.2.2.3 COMPANY

A company is an incorporated association of persons who have chosen to associate for a common purpose. In Australia, the incorporation process begins with an application for incorporation to the regulator (the Australian Securities and Investments Commission: "ASIC"). Status as a body corporate is granted upon registration by ASIC. At both common law and pursuant to the Corporations Act 2001 (Cth), upon incorporation a

---

193 Corporations Act 2001 (Cth) s 117.
194 Corporations Act 2001 (Cth) s 117.
company is a separate legal entity distinct from its promoters and shareholders. Lord Sumner described the nature of a separate legal entity in *Gas Lighting Improvement Co Ltd v Inland Revenue Commissioners*:

Between the investor, who participates as a shareholder, and the undertaking carried on, the law interposes another person, real though artificial, the company itself, and the business carried on is the business of the company, and the capital employed is its capital and not in either case the business or the capital of the shareholders. Assuming, of course, that the company is duly formed and is not a sham...the idea that it is mere machinery for effecting the purposes of the shareholders is layman’s fallacy. It is a figure of speech, which cannot alter the legal aspects of the facts.

As a consequence of separate legal entity status, a corporation has the same powers, rights and responsibilities as a natural person. A corporation can, in its own name, acquire, hold and dispose of property, enter into contracts, sue and be sued. A further consequence of separate entity status is that shareholders do not have any direct interest in the company’s assets. Even if a shareholder owns all the shares of a company, this does not grant either a legal or equitable interest in the assets of the corporation.

Corporations can be categorised by liability and public status. In the context of superannuation the most relevant types of companies are proprietary or public companies limited by shares, and companies limited by guarantee.

A company limited by shares is formed with a share capital. The share capital is essentially the amount contributed by the shareholders. In return a shareholder is issued a “share” representing the fraction of capital contributed. A share is a contract between the company and the shareholder that confers upon the shareholder a bundle of rights against the company. A company may issue different classes of shares with differing rights attaching. A company is said to be limited by shares when the liability of shareholders is limited to any unpaid amount of the issue price of the share. Companies limited by shares can be either proprietary or public companies. A proprietary company is a private company that is designed for a group of persons who do not wish the company to be able to invite the public to subscribe for its share capital or to lend money to it. The number of shareholders is statutorily limited to 50 persons, although

---

195 *Salomon (Pauper) v A Salomon & Co Ltd* [1897] AC 22 at 51 per Lord Macnaghten; *Corporations Act 2001* (Cth) s 1.

196 [1923] AC 723 at 740-741. These remarks were relied upon in the High Court decision of *Hobart Bridge Co Ltd v Federal Commissioner of Taxation* (1951) 82 CLR 372 at 385 per Kitto J.

197 *Macaura v Northern Assurance Co Ltd* [1925] AC 619.

198 *Corporations Act 2001* (Cth) s 9.
this number does not include employee shareholders.\textsuperscript{199} A public company is company that is not registered as a proprietary company,\textsuperscript{200} and may be listed or unlisted.\textsuperscript{201}

By way of comparison, a company limited by guarantee does not have the power to issue shares and is prohibited from accepting contributions of capital whilst it is a going concern.\textsuperscript{202} The members of a company limited by guarantee are liable to contribute funds to the company if and only if the company is wound up without adequate funds to discharge its liabilities.\textsuperscript{203} Each member is then liable to pay up the amount that the member has undertaken to guarantee.\textsuperscript{204} The constitution of the company will prescribe the amount of the guarantee. Companies limited by guarantee are always public companies.

There are instances of the corporate form being used in conjunction with both contract and trust structures. For example, where an employer offers a superannuation scheme by way of contract to employees, the employer may be constituted as a company. Alternatively, the trustee of a superannuation fund may be constituted as a company. In each case the scheme itself is reliant upon either contract or trust. In the present discussion the emphasis is upon the funding of a superannuation scheme through the corporate form as opposed to the incorporation of the corporate fund through the contract and trust structures.\textsuperscript{205}

The following example illustrates how a company could be utilised as a funding mechanism for the provision of superannuation and related benefits.

\textsuperscript{199} Corporations Act 2001 (Cth) ss 45A(i), 113(i).

\textsuperscript{200} Corporations Act 2001 (Cth) s 9.

\textsuperscript{201} See Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed, Butterworths, 2003), Ch 5.

\textsuperscript{202} Corporations Act 2001 (Cth) s 124.

\textsuperscript{203} Corporations Act 2001 (Cth) ss 9, 517.

\textsuperscript{204} Ford, Austin and Ramsay, Ford's Principles of Corporations Law (11th ed, Butterworths, 2003), [5.090].

\textsuperscript{205} Whether or not the issues of concern in respect of a company arise in the context of a corporate trustee is discussed below in this section under the heading "A Corporate Trustee?".
Contributions made by or on behalf of a person could be exchanged for shares in a company limited by shares. If an employer were organising the scheme on behalf of employees, the scheme could be operated through an existing proprietary company, as the limit placed upon the number of shareholders for a proprietary company does not include employee shareholders (Corporations Act 2001 (Cth) s 45A(1)). At the time of retirement, the shares could be redeemed or bought back by the company for the value of the amount contributed. Any interest earned on the amounts contributed could be returned to the shareholder by way of a bonus share issue or as a deferred dividend. Importantly, redemption or the buy back of the shares would be conditional upon reaching the retirement age or some other condition associated with superannuation schemes, such as death or suffering a permanent disability. Pursuant to the current Corporations Act 2001 (Cth) such a scheme would be classified as an “employee share scheme” (as defined by s 9). See, for example, the collective investment schemes called “management companies” in the United States – ALRC, CSAC, A Review of Collective Investment Schemes in Overseas Jurisdictions, Collective Investments Research Paper No 2, 1993, pp 16-17.

Support for the company structure could be argued to arise from two reports in the United Kingdom. In 1980 the Committee to Review the Functioning of Financial Institutions (the “Wilson Committee”) was concerned that much of the framework for the regulation of pensions depended on a body of trust law developed for different purposes. Against this conclusion it recommended that future pension schemes be regulated by a new Pension Schemes Act in a form analogous to the Companies Act. It envisaged that such an Act would impose clear statutory obligations on scheme trustees to make regular disclosures of information to members. Following the demise of the pension trusts plundered by the late Mr Robert Maxwell, the Social Security Committee of the House of Commons undertook an inquiry into the “Operation of Pension Funds”. The latter Committee, likewise disillusioned with the medium of the trust, supported the Wilson Committee’s conclusion that a new legal basis for pension funds should be sought and that it should be analogous to the law that regulates companies.

While the foregoing reports suggested that the company was the preferred medium for delivery of superannuation benefits, a closer examination reveals that the suggestion related to the issue of disclosure: that a system of disclosure regulation, similar to that required of Companies, be incorporated into the regulatory framework for pensions. This

---

206 United Kingdom, Committee to Review the Functioning of Financial Institutions, Report, Cmdn 7937, 1980, at ¶1222.
207 United Kingdom, Committee to Review the Functioning of Financial Institutions, Report, Cmdn 7937, 1980, at ¶1225.
208 As to the Maxwell fraud see 5.2 note 169.
is quite a step removed from a suggestion that the company vehicle serve as a medium for the delivery of superannuation objectives. Indeed, neither report conducted an examination into what structure would best serve the interests of pension delivery. Instead the Social Security Committee recommended that an Inquiry be conducted to examine the issue. The Pension Law Review Committee was subsequently constituted for the purpose of reviewing the framework of law and regulation within which occupational pension schemes operated. In its 1993 report, that Committee rejected the conclusions and recommendations of its forebears and endorsed the view that trust law provides a satisfactory foundation for the interests, rights and duties arising in relation to pension schemes.

Although the argument of this thesis is similar in terms to that concluded by the Pension Law Review Committee, the Committee did not conduct an analysis of the company structure as an alternative to the trust structure. For this reason, the conclusions and recommendations of that Committee cannot be relied upon, for the purposes of the current regulatory analysis, as a rejection of the company structure for the delivery of superannuation related benefits.

Like the trust relationship, the company vehicle affords an opportunity for employee or member participation in the management of the company. A further advantage is that assets of the fund are held by a single entity. Unlike the trustee structure, where individual (as opposed to corporate) trustees hold the assets of fund, a change in the management of the company does not necessitate a transfer of title for the assets. Yet these advantages do not outweigh the significant concerns that can be raised in respect of the ability of the company structure to facilitate the security of pension funds in comparison to that offered by the trust.

Like the contract medium, the company structure suffers the deficiency of not shielding the assets supporting the superannuation scheme on insolvency. The company holds both the legal and equitable interests in the assets of the superannuation scheme. Shareholders have no interest in the capital assets of the fund. Consequently, and particularly in the scenario where an employer company makes provision through a separate class of shareholders for superannuation and superannuation related benefits,

---
upon insolvency of the company the assets of the superannuation scheme are available for distribution to company creditors.\textsuperscript{212}

Three further concerns arise.

\textbf{(i) No Designated Protector}

In the context of the shareholder and company relationship, there is no designated "protector" of the assets supporting the superannuation scheme. As outlined above,\textsuperscript{213} trustees are required to act exclusively in the best interests of the beneficiaries. In this respect, the beneficiaries of a trust are conferred the advantage of the highest level of protective responsibility known to the general law.\textsuperscript{214} In comparison, the company structure does not offer an equivalent level of protection in law or in equity. This stems principally from the conferral of separate entity status upon the incorporated form; there is imposed a separate legal entity between those that manage the company and its members/shareholders. The relationship between the various stakeholders in a company is defined by the company's constitution. Section 140(i) of the \textit{Corporations Act 2001} (Cth) describes the nature of a company's constitution as taking effect as a contract between:

- (i) the company and each member;
- (ii) the company and each director and company secretary; and
- (iii) a member and each other member.

In the present context the two relationships of primary significance are those subsisting between the parties described at (i) and (ii).

Upon acquiring shares the member enters into a contractual relationship, as defined by the company's constitution, with the company. In the context of this relationship there is no requirement, either at law or equity, that the company act in the best interests of its members. The company is required only to observe and perform its functions and duties in accordance with the constitution. The constitution could be framed so as to require the company to act in the best interests of the shareholders, but this would be contrary to the nature of the relationship created. In equity, a trustee's duty to act in the best interest of the beneficiaries flows from the fact that

\textsuperscript{212} As to the deficiencies of the contract structure see 4.2.2.2.

\textsuperscript{213} See the heading "Protective Features of the Trust" in 4.2.2.1.

\textsuperscript{214} See the heading "No Designated Protector" in 4.2.2.2.
he or she holds and manages property for the benefit of the beneficiaries. A company does not hold property for the benefit of the beneficiaries. Any property is held legally and beneficially for the benefit of the company.

The role of directors is typically to manage the property, affairs and business of the company. In the pursuance of this role the general law and statute imposes duties on directors. At general law, directors are "fiduciary agents" of the company. The fiduciary relationship is manifested in the dual prohibition against profiting from one's position as director and placing oneself in a position of conflict with the company. Other applicable general law duties include the duties to:

- act bona fide in the interests of the company as a whole.
- act with reasonable care and diligence.
- exercise powers for a proper purpose.
- not to fetter discretion.

The statutory duties imposed by the Corporations Act 2001 (Cth) overlap and apply concurrently with the general law so that directors are under a duty:

- To act with the prescribed degree of care and skill.
- To act in good faith in the best interests of the corporation.
- To act for proper purposes.
- Not to improperly use their position or information obtained in their

---

216 Bishopsgate Investment Management Ltd (in liq) v Maxwell (No 2) [1994] 1 All ER 261 at 265 per Hoffman J; Duke Group Ltd (in liq) v Filer (1998) 27 ACSR 1 at 297 per Mallighan J.
217 Furs Ltd v Tomkies (1936) 54 CLR 583 at 592 per Latham CJ; Regal (Hastings) Ltd v Gulliver [1942] 1 All ER 378 at 385-389 per Lord Russell; Boardman v Phipps [1967] 2 AC 46 at 123 per Lord Upjohn.
218 Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 CLR 199 at 206 per Knox CJ, at 219 per Issacs J.
219 Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 at 428-429 per Romer J; Daniels v Anderson (1995) 37 NSWLR 438 at 495-497 per Clarke and Sheller JJA; Gamble v Hoffman (1997) 24 ACSR 369 at 372-373 per Cnr J.
220 Australian Metropolitan Life Assurance Co Ltd v Ure (1923) 33 CLR 199 at 206 per Knox CJ, at 219 per Issacs J; Peters' American Delicacy Co Ltd v Health (1939) 61 CLR 457 at 482 per Latham CJ; Ascot Investments Pty Ltd v Harper (1981) 148 CLR 337 at 348-349 per Gibbs J; Permanent Building Society (in liq) v Wheeler (1994) 14 ACSR 109 at 137 per Ipp J.
221 Thorby v Goldberg (1964) 112 CLR 597 at 605 per Kitto J.
222 Corporations Act 2001 (Cth) s 180(t).
223 Corporations Act 2001 (Cth) s 181.
224 Corporations Act 2001 (Cth) s 181.
position to gain an advantage for themselves or someone else, or to cause detriment to the corporation.  

Notably, directors' duties are owed to the company. Prima facie, directors are not responsible for the interests of the members, only the interests of the company. As a consequence, there are ordinarily no direct fiduciary duties owed by directors to shareholders. The corporate entity dictates that the legal lines of responsibility to the member are lengthened and weakened. Having stated this, a level of protection is afforded to the members in that the substance of the duty imposed on directors to act *bona fide in the interests of the company as a whole* requires directors to give consideration to the interests of the members. The phrase “the company as a whole” is not taken to mean a commercial entity distinct from its corporators; it refers to the corporators as a general body. In this respect, directors act in a quasi-protective role vis-à-vis the members.

Notwithstanding the duty to consider the interests of the members, two factors appreciably detract from the level of protection provided to members. First, as a result of the imposition of the corporate entity between the directors and the members, the ability of members to enforce the directors' duties is more difficult as those duties are owed to the company. This factor is examined in greater detail below. Secondly, the requirement to *act bona fide in the interests of the members as a whole* requires directors to also have regard to the interests of the creditors in circumstances where the company is insolvent or nearing insolvency.

The duty to consider the interests of creditors had its genesis in the judgment delivered by Mason J in *Walker v Wimborne*, where his Honour observed:

In this respect it should be emphasised that the directors of a company in discharging their duty to the company must take account of the interests of its shareholders and its creditors. Any failure by the directors to take into account the interests of creditors will have adverse consequences for the company as well as for them.

---

225 *Corporations Act 2001* (Cth) ss 182, 183.
227 *Greenhalgh v Arderne Cinemas Ltd* [1951] Ch 286 at 291 per Evershed MR; *Ngurli Ltd v McCann* (1953) 90 CLR 425 at 438 per Williams ACJ, Fullagar and Kitto JJ.
228 See the heading below in this section “(iii) The Right of Shareholders to Challenge Decisions”.
229 (1976) 137 CLR 1 at 6-7.
The duty has even been expressed to apply when a proposed act will place the company at a risk of insolvency or jeopardise the company's solvency. Professor Keay expresses the rationale for the duty as being the protection of the interests of creditors in that without the duty "many creditors are left with little or no protection from companies that are in financial straits". The rationale for the conferral of protection to creditors, and the concomitant conferral of priority over and above shareholders, stems from the notion that shareholders enjoy limited liability and creditors are unable to look beyond the assets of the company. In this respect Keay states:

...when insolvency exists the notions of corporation ownership and creditors' rights converge. The creditors then are the real owners of the company, the ownership rights of the shareholders having been expunged as there is nothing over which they have a claim. Hence, if a company is insolvent, directors act improperly if they employ funds that are payable to creditors in order to continue the activities of the company.

In essence, in circumstances of insolvency creditors stand in the shoes of the shareholders and therefore their interests become those of company. Whilst the duty to consider the interests of the creditors is said to arise from a desire to protect creditors, no correlative right to enforce the duty is granted to creditors. Instead, the duty owed by directors in this respect remains one owed to the company. Nevertheless, the duty cannot be relaxed, or breach of the duty ratified, by the shareholders.

The operation of these principles in the context of the provision of superannuation benefits inhibits the provision of a secure and protective foundation. This is particularly concerning in the situation where a company has made provision for

---


231 Keay, "The Director's Duty to Take into Account the Interests of Company Creditors: When Is It 'Triggered'?" (2001) 25 MULR 315 at 323.


234 Spies v The Queen (2000) 201 CLR 603 at 636-637 per Gaudron, McHugh, Gummow and Hayne JJ.

235 Sycotex Pty Ltd v Baseler (1994) 122 ALR 531 at 550 per Gummow J; Yullong Lines Ltd of Korea v Rendsburg Investments Corporation [1998] BCC 870 at 884 per Toulson J.

236 Sycotex Pty Ltd v Baseler (1994) 122 ALR 531 at 550 per Gummow J.
superannuation through issuing shares (presumably of a separate class) that can be redeemed at a later date. The assets underlying the value of those shares are in no way protected upon the insolvency of the employer company. As discussed above, as trust assets are unavailable to the creditors of the employee or trustee, a shield of protection is placed around the superannuation assets. Moreover, trustees must direct their entire attention to the sole interests of the beneficiaries. Whilst the directors are required to consider the interests of the members in the performance of their duty to act in the best interests of the company, where the company nears insolvency their focus turns from the shareholders to the creditors. This requirement by and large abrogates any protection initially provided to shareholders. In the company context there are sound policy justifications for this shift in focus. However, where the company structure is used as a mechanism for the provision of superannuation and superannuation related benefits these policy justifications are entirely inconsistent with the objectives of the providing a secure environment for the accumulation and payment of benefits.

(ii) Duties of Directors not Analogous to those of Trustees

Historically directors were described as “trustees” and, upon becoming directors, were said to accept a trust. The following description is indicative of this nineteenth century conceptualisation of the director:

The directors are persons selected to manage the affairs of the company for the benefit of the shareholders. It is an office of trust, which if undertaken, it is their duty to perform fully and entirely. A resolution by the shareholders, therefore, that shares or any other species of property should be at the disposal of the directors is a resolution that it shall be at the disposal of the trustees. In other words, that persons entrusted with that property shall dispose of it within the scope of the function delegated to them in the manner best suited to benefit their cestui que trust.

The description of directors as trustees reflects the representative nature of the directorial office and the degree of control granted over corporate property. However, in the early twentieth century it was apparent that the trustee model was too stringent for the operation of corporate ventures, and the model was rejected in

---

236 Ferguson v Wilson (1866) LR 2 Ch App 77 at 90 per Cairns LJ; Joint Stock Discount Company v Brown (1869) LR 8 Eq 381 at 401 per James VC; Great Eastern Railway Company v Turner (1872) LR 8 Ch App 149 at 152 per Lord Selborne LC; Re Forest of Dean Coal Mining Company (1878) 10 Ch D 450 at 453 per Jessel MR.

237 York and North Midland Railways v Hudson (1892) 16 Beav 485 at 491; 51 LR 866 at 868 per Sir John Romilly MR. See also Great Eastern Railway Co v Turner (1872) LR 8 Ch 149 at 152 per Selborne LC; Re Forest of Dean Coal Mining Co (1878) 10 Ch D 450 at 453 per Jessel MR.
favour of the fiduciary notion.\textsuperscript{38} The recognition of the different functions of trustees and directors founded the necessity for the law in respect of directors' duties to develop unbounded by the strict notions of equity that governed (and continue to govern) trustees' duties to beneficiaries. In Daniels \textit{v} Anderson the development of the law was well described by Clarke and Sheller JJA as follows:\textsuperscript{39}

"For reasons well documented...it became apparent that the duty and function of a director did not correspond with those of a trustee. While the duty of a trustee is to exercise a degree of restraint and conservatism in investment judgments the duty of a director may be to display entrepreneurial flair and accept commercial risks to produce a sufficient return on the capital invested..."

Quoting from the judgment of Jacobs J in \textit{Re International Vending Machines Pty Ltd and the Companies Act}\textsuperscript{40} their Honours continued:\textsuperscript{41}

"It seems to me that it serves no useful purpose to debate whether or not a director is in the position of a trustee. However, that still leaves open the question whether his duties and obligations either wholly or in part are the same as those of a trustee. It seems to me that the duties of directors in many instances differ from the duties of trustees, particularly is this difference noticeable in regard to the type of careful conduct which may be expected of a director compared with a trustee. A trustee in the ordinary way is obliged primarily to keep the trust property safe. However, a director of a company is a commercial man and any duty of his in regard to dealings with the property of the company on its behalf must be liked at in the light of his position in commerce. Therefore, I think it is true that the tests of prudence which has been applied by the courts in the case of trustees are not the same test as must be applied in the case of directors of a company.

This progression of the law represents a judicial recognition that the utilisation of the company model carries with it an implicit assumption of a greater degree of risk. The operations of a corporate venture require a greater degree of latitude, particularly in the context of investment. This in turn sanctions the making of business judgments by directors in a "spirit of enterprise untrammelled by the concerns of a conservative investment trustee".\textsuperscript{42} The directorial function has clearly been conceptualised by the judiciary as one that carries with it a greater assumption of investment risk in the hope of commensurate rewards.\textsuperscript{43} As a result, in that the objective in selecting a mechanism for provision of superannuation benefits is

\textsuperscript{38} Percival \textit{v} Wright [1902] 2 Ch 421 at 425-426 per Swinfen Eady J; \textit{Re Kingston Cotton Mill Company (No 2)} [1896] 1 Ch 331 at 346-348 per Vaughan Williams J; \textit{Re City Equitable Fire Insurance Co Ltd} [1925] 1 Ch 407 at 426 per Romer J.

\textsuperscript{39} (1995) 37 NSWLR 438 at 494.

\textsuperscript{40} (1961) WN (NSW) 465 at 473.

\textsuperscript{41} Daniels \textit{v} Anderson [1999] 37 NSWLR 438 at 494.

\textsuperscript{42} Daniels \textit{v} Anderson [1999] 37 NSWLR 438 at 501.

facilitating the security of the scheme, the trust as a medium that seeks growth with a focus upon security stands as the preferred vehicle.

(iii) The Right of Shareholders to Challenge Decisions

Individual beneficiaries of a trust can, on behalf of all beneficiaries, institute an action to restrain breaches of trust, and trace and recover assets improperly disposed of. The right of shareholders to institute such proceedings is more limited. As a general principle, the company is considered the proper plaintiff in respect of any wrong. In the situation where a director of a company commits a wrong, at general law the rule in Foss v Harbottle directs that it is one committed against the company. As such, the company is the proper plaintiff unless an exception to the rule can be established. As companies act through their directors, a situation may arise where the directors who have breached their duties influence, either directly or indirectly, the decision as to whether or not to take proceedings. If a decision is taken not to pursue a breach of duty, the majority of shareholders may, unless prevented by the company constitution, institute proceedings and remove the directors. Alternatively, the majority may ratify the director’s alleged wrongdoing. In the latter scenario, a shareholder who stands in the minority will lack standing to enforce the breach or reclaim property on behalf of the company unless he or she can make out an exception to the rule in Foss v Harbottle.

The most relevant exception in this context is that a fraud on the minority has been committed. The fraud on the minority doctrine imposes limitations on the voting power of the majority. “Fraud”, for this purpose, does not mean dishonesty but rather that the action is beyond the scope of the power granted. The rationale for placing a limit on the power of a majority was explained by Dixon J in Peters’ American Delicacy Co Ltd v Heath in the following terms:

The chief reason for denying an unlimited effect to widely expressed powers such as that of altering a company’s articles is the fear or knowledge that an apparently regular exercise of the power may in trust be but a means of securing some personal or particular gain, whether pecuniary or otherwise, which does not fairly arise out of the subjects dealt with by the power and is outside and even inconsistent with the contemplated objects of the power.

244 (1843) 2 Hare 461; 67 ER 189.
246 Winthrop Investment Ltd v Winns Ltd [1975] 2 NSWLR 666 at 681 per Samuels JA.
247 (1938) 61 CLR 457 at 511.
The limitation on the voting power of the majority has been alternatively expressed as a prescriptive duty requiring the majority to exercise their voting power "bona fide for the benefit of the company as a whole." This represents "a very general expression negativing purposes foreign to the company's operations, affairs and organisations".

The unjustifiable refusal of the majority to allow an action to be maintained in the name of the company to redress a wrong done to it by one or more of the individuals constituting the majority has been described as an example of circumstances falling within the fraud on a minority exception. A refusal will be unjustifiable where the acts complained or are of a fraudulent character or beyond the powers of the company.

In Australia the general law derivative action has been considered unsatisfactory and ineffective to provide protection to minority shareholders. As a result, the action has been abolished by the Corporations Act 2001 (Cth) s 236(3) and replaced by a statutory derivative action. Pursuant to the latter, a person who is a member or officer (or former member or officer) may bring proceedings on behalf of a company if the court has granted the person leave to do so. An application will be granted if the court is satisfied that:

(a) it is probable that the company will not itself bring the proceedings, or properly take responsibility for them, or for the steps in them;
(b) the applicant is acting in good faith;
(c) it is in the best interests of the company that the applicant be granted leave;
(d) if the applicant is applying for leave to bring proceedings – there is a serious question to be tried; and

248 Allen v Gold Reefs of West Africa Ltd [1900] 1 Ch 656 at 671 per Lindley MR.
249 Peter's American Delicacy Co Ltd v Heath (1938) 61 CLR 457 at 512 per Dixon J.
250 Peter's American Delicacy Co Ltd v Heath (1938) 61 CLR 457 at 505 per Dixon J.
251 Burland v Earle [1902] AC 83 at 93 per Lord Davey.
253 Corporations Act 2001 (Cth) s 237(2).
254 A presumption that granting leave is not in the best interests of the company will arise where the prescribed circumstances in Corporations Act 2001 (Cth) s 237(3) are made out. As the presumption applies only to proceedings by the company against a third party (or vice versa), it is not relevant in the context of a company failing to take action against directors for a wrong committed against the company.
(e) either: (i) at least 14 days before making the application, the applicant gave written notice to the company of the intention to apply for leave and of the reasons for applying; or (ii) it is appropriate to grant leave even though subparagraph (i) is not satisfied.

A further option available to shareholders is to seek an order to remedy a company’s oppressive conduct of affairs. The Corporations Act 2001 (Cth) s 233 permits the court to make an order in relation to a company where the conduct of a company’s affairs is either contrary to the interests of the members as a whole, or oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members. The most relevant orders in the current context are that the company institute, prosecute, defend or discontinue specified proceedings, or confer authority on a member to do so on behalf of the company.

Though statutory remedies provided by the Corporations Act 2001 (Cth) arguably improve the protection of shareholders, particularly minority shareholders, the right to seek redress is not equivalent to that granted to beneficiaries. There is not an unqualified right for a shareholder to remedy a wrong to the company. Instead, a shareholder must either establish the grounds pursuant to the statutory derivative action or establish oppression. In respect of the statutory derivative action, Prince, drawing on the New Zealand experience with similar statutory derivative provisions, contends that the requirements to be made out by an applicant before a court will grant leave for the person to take proceedings are unnecessarily strict and will make it difficult for shareholders to access the remedy provided. Moreover, given the common law remedies under the Foss v Harbottle exceptions have been abolished, shareholders are potentially in a worse position than previously. Regardless of the success or otherwise of the statutory derivative action in providing a remedy for shareholders, at the very least it can be stated that the position remains that

255 Corporations Act 2001 (Cth) s 232.
256 Corporations Act 2001 (Cth) s 233(1)(f)-233(1)(g).
257 Prince, “Australia’s Statutory Derivative Action: Using the New Zealand Experience” (2000) 18 CSLJ 493 at 510-511. The difficulties identified by Prince are that:

* the requirement that there be a serious question to be tried necessitates the court giving consideration to the merits of the proposed litigation, which increases the time and expense of arguably a procedural hearing;
* the requirement that the proposed litigation be in the “best interests of the company” could be difficult to make out particularly if a cost/benefit analysis is adopted; and
* the requirement that the applicant is acting in good faith may be very difficult to make out if the applicant may potentially benefit financially from the proposed litigation.

shareholders do not have an unqualified right, as do beneficiaries, to pursue a wrong committed against the company.  

A Corporate Trustee?

Although the focus of this section is the assessment of the suitability of the company mechanism, as the corporate structure is often combined with that of the trust, comment is required as to whether the disadvantages of the corporate funding vehicle affect the suitability of the trust.

The trustee of a superannuation scheme may be either a natural person(s) or a company. Where a company is utilised, invariably the company will be constituted by a nominal shareholding held either by the employer-sponsor or its directors.

The disadvantages of employing the company as a mechanism for the delivery or funding of superannuation benefits do not flow through so as to effect the suitability of the trust structure. As the trust structure is the principal structure, all general trust principles apply. This in turn serves to negate the effect of the three principal objections to the company structure. As the trustee must act in the best interests of the beneficiaries, the trustee is designated as the protector of the beneficiaries. The superannuation scheme assets are protected by the general principles that operate to take trust assets outside the pool of assets available upon insolvency of either the employer-sponsor or the trustee. Finally, the beneficiaries retain their individual right to institute an action to restrain breaches of trust and trace and recover assets improperly disposed of.

---

259 It is worthy to note that this weakness is identified in the context of assessing the suitability of the corporate structure for the provision of superannuation benefits. No attempt is made to analyse the relative advantages and disadvantages of permitting majority decisions to bind the minority within the corporate context. Indeed, majoritarian control can be justified on the basis of: (i) promoting commercial and economic efficiency within a corporate structure; and (ii) given the majority shareholding represents the members with the greatest collective financial holding of the company, operating the company in a manner that is advantageous to the greatest number of shareholders (Ranero, *The Intimate Connection of Trust and Corporation (LLM Thesis, University of Tasmania, 1999)*, at 155). The identification of such policy justifications serves to further illustrate that the underlying functions of the company structure are inconsistent with the notion of facilitating the security of benefits of all beneficiaries.

260 As to the trust see 4.2.2.1.

261 See the heading "(ii) Existing Body of Law" in 4.2.2.1 and the heading "No Designated Protector" in 4.2.2.2.

262 See the heading “The Protective Features of the Trust” in 4.2.2.1.
The final issue that remains in respect of a corporate trustee is the position of the directors of the trustee. In this context two matters are raised. First, the foregoing recognised that there is a disparity between the duties owed by a trustee and those owed by a director to the disadvantage of the scheme member. However, in the context of a corporate trustee the disparity in duty is not of importance as the beneficiaries are protected by the duty owed to them by the corporate trustee. In other words, the company as trustee takes on the duties of trustee and so a greater level of protection is afforded to the scheme members (that is, the beneficiaries).

Secondly, whilst in the general company context directors' duties are owed only to the company, there is a line of judicial authority that suggests that directors of a corporate trustee are also responsible to beneficiaries as if they were individual trustees. Therefore, a breach by the directors of duty to the company would give rise to a related breach of duty by the directors to the trust beneficiaries. However, this line of argument is by no means a settled principle. Chief Justice King in Hurley v BGH Nominees Pty Ltd was in no doubt that the law had yet to extend this far when he commented that:

There is no authority which establishes that a director of a trustee company is under a fiduciary duty to the beneficiaries of the trust in respect of property he holds by the trustee company in its capacity as trustee. It may well be that when the issue arises the courts will hold that such a duty exists, but, for the time at least, it remains to be established.

Justice Finn of the Federal Court of Australia declined to express a concluded view on the matter when the issue arose in Australian Securities Commission v AS Nominees Ltd. Regardless of the conclusion on this issue, further protection for beneficiaries against directors for the misuse of their company’s trustees’ powers or trust property is afforded by the ability of beneficiaries to seek a remedy against directors under accessory and recipient liability principles. The accessory liability principles dictate that any person who dishonestly assists or induces a trustee will be liable as a constructive trustee for both the losses to the trust fund as well as any personal gains. Furthermore, where a person receives property already subject to a trust with the requisite knowledge that it is trust property and that the transfer is in breach of fiduciary duty, the recipient liability

265 Wilson v Lord Bury (1880) 5 QBD 518 at 535 per Baggallay LJ; Re French Protestant Hospital [1951] Ch 567 at 570-571 per Danckwerts J; Abbey Malvern Wells Ltd v Ministry of Local Government and Planning [1951] Ch 728 at 738-739 per Danckwerts J.

266 (1982) 1 ACLC 387 at 390-391. See also Bath v Standard Land Co Ltd [1911] 1 Ch 618 at 635 per Fletcher Moulton LJ; Inge v Inge (1990) 3 ACSR 63.


268 Barnes v Addy (1874) LR 9 Ch App 244 at 251 per Lord Selborne LC; Consul Development Pty Ltd v DPC Estates Pty Ltd (1975) 132 CLR 373; Royal Brunei Airlines Sdn Bhd v Tan [1995] 3 WLR 64.
principles dictate that he or she will be made a constructive trustee of that property for the benefit of the beneficiaries. It is the availability of these avenues of the relief that prompted Finn J to question “whether this heralded development in our law [that directors owe fiduciaries duties to beneficiaries] is desirable or necessary in the trust law context.” Rather than affirmatively deciding the issue of directorial responsibility to beneficiaries, his Honour, in respect of the facts before him, chose to utilise the “quite orthodox” and more extensive avenue of protection that is afforded by the accessory liability principles.

---

**4.3 Industry Preference**

In February 2001 the Australian Commonwealth Government requested the Productivity Commission (“Commission”) to undertake a National Competition Policy review of the SIS Act. As part of the review the Commission sought submissions from the public on the suitability of the trust structure for the purposes of superannuation. Specifically the public was asked to comment on the following questions:

- Is it appropriate that the SIS Act focuses on trusts as the principal legal structure of superannuation funds?
- Could other legal structures for superannuation funds be contemplated – for example, an incorporated financial institution – that are prudentially supervised under other legislation?

The submissions to, and conclusions of, the Commission strongly supported the retention of the trust as the foundation for the regulation of superannuation. In part, the Commission concluded that the “trust basis of the legislation is effective in facilitating

---

270 For a further assessment of this issue see Pollard, “Pension Schemes: Corporate Trustees” (2000) 14 TLI 2.
prudent management of superannuation entities.\textsuperscript{272} Selected extracts from various submissions are set out in Tables 4.3 and 4.4 (appearing at the conclusion of this section) as evidence of industry support for the trust mechanism. In particular, the following statement drawn for the submission of the Association of Superannuation Funds of Australia ("ASFA") is reflective of the general industry response:\textsuperscript{273}

The trustee system has long been the accepted mechanism for managing superannuation funds both in Australia and throughout the Anglo-American world. ASFA believes that maintaining the trustee structure is paramount for the sound prudential management of superannuation funds. The trust relationship, with its origins in English common law, provides a simple, strong and flexible structure within which superannuation funds can operate. The main principle of trusteeship, namely a trustee designated to administer funds in the best interests of the beneficiaries, is suited to superannuation with its long term objectives, large number of often financially unsophisticated members and rights enjoyed by non-member beneficiaries. The compulsory nature of superannuation reinforces the need to maintain a governance approach that is strong yet flexible.

ASFA believes that maintaining the trustee structure is paramount to the effective operation of the current principle based prudential regulatory regime. It is an effective, well-understood and appropriate governance structure that precludes the trust being operated in the interests of anyone except members and other beneficiaries. A trustee structure has the advantage over other management structures such as managed investment schemes, in that there is a body of common law that exists around which a principle based regulatory regime can be structured.

Significantly, not one submission suggested that the trust structure be replaced as the foundation for superannuation regulation. However, it must also be recognised that the Commission found limited instances where there may be scope for the provision of superannuation products without a trust structure.\textsuperscript{274} Linked to this finding was a recommendation that "APRA should review the need for life insurance companies which write superannuation business in their statutory funds to comply with the prudential requirements of the SIS legislation".\textsuperscript{275}


Principally this finding and recommendation flowed from the submissions of two participants in the review. Phillips Fox Actuaries and Consultants submitted in respect of public offer superannuation funds that where the "trustee is a wholly owned subsidiary of a financial institution and there is no representation by members little is achieved by the added expense of trusteeship." Prompted by a concern to reduce regulatory duplication, APRA suggested in its submission that superannuation in life office statutory funds be written by way of a direct contract between the member and life company rather than via an interposed trustee.

The effect of both submissions would be to rely on contract and company mechanisms for the provision of superannuation benefits in certain circumstances. Given the conclusions drawn in the last section in respect of these mechanisms generally, and also the more particular instance of supervision pursuant to the LIA and the Banking Act, such a result would likely appreciably detract from the protection provided by the trust mechanism. In particular, the greatest concern is that the designated protector of the superannuation assets, namely the trustee, would be removed. Moreover, the degree of security of scheme assets on insolvency is questionable in respect of the life insurance and banking regulatory schemes.

Concerns in respect of the limited removal of the trust structure were also expressed in the responses of three participants to the Commission's draft report. The Industry Funds Forum strongly endorsed the finding that the trust structure was effective in facilitating prudent management. Moreover it expressed, "grave reservations" on the possibility of extending the range of prudentially supervised corporations that could provide superannuation products without a trust structure. The Jacques Martin Industry Funds Administration Pty Ltd considered that to accept that a "lesser standard is permissible because the trustee is a related body corporate to a life office is not an acceptable position.


279 See the headings "(i) Accounts with ADIs" and "(ii) Policies with Life Companies" in 4.2.2.2.

Moreover, "if all superannuation business in life office statutory funds were to be written by way of contract then, to the extent that this would lessen the duty owed to the member [it] should not be allowed". The comments of Mr Ross Clare in his representation of ASFA at the Commission hearings also indicated a preference for the retention of the trust structure. Finally, and somewhat curiously, the Associate Commissioner of the Commission noted that, in following up the claims by Phillips Fox Consulting Actuaries that the trust structure added little to the management of superannuation schemes, some life companies indicated that they would keep the trust structure as "it does actually provide a structure for making decisions and handling issues".

The industry response to the Commission's review demonstrates strong support for the trust structure as the foundation for superannuation provision. In turn, this signifies that not only do the attributes of the trust make it the preferred vehicle for the delivery of superannuation but also that from an industry perspective the mechanism is effective in industry operation, and that the costs associated with the structure do not impede or preclude its efficient operation.


### Table 4.3 - Selected Extracts from Submissions to the Productivity Commission Review

<table>
<thead>
<tr>
<th>Industry Body</th>
<th>Extract</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>W M Mercer</strong> (Submission No 8)</td>
<td>The trust structure has generally worked well for many years. It is particularly appropriate for corporate funds.</td>
</tr>
<tr>
<td><strong>Industry Funds Forum</strong> (Submission No 10)</td>
<td>We strongly support the trustee system and in particular the equal representation nature of trustee boards...We recommend that the Productivity Commission's findings reflect the above and not propose any significant structural regulatory changes to the superannuation system.</td>
</tr>
<tr>
<td><strong>PricewaterhouseCoopers</strong> (Submission No 14)</td>
<td>Our view is that the Trustee system is the appropriate legal structure for superannuation funds. Trustees are responsible to the members of the fund and have a fiduciary responsibility to manage the fund as if it was their own money.</td>
</tr>
<tr>
<td><strong>Institute of Actuaries of Australia</strong> (Submission No 16)</td>
<td>We believe that a trustee structure provides a sound prudential base for the superannuation system. We note that this structure is one adopted by many countries.</td>
</tr>
<tr>
<td><strong>Australian Council of Trade Unions (&quot;ACTU&quot;)</strong> (Submission No 22)</td>
<td>The ACTU strongly supports the requirement that funds be required to have a trustee comprising equal employer-employee representation as the responsible entity. The record of these funds speaks for itself. There is no example of such trustee with employer and union appointed director presiding over a fund which has collapsed or otherwise failed to meet its responsibilities in a way which has put members' benefits at risk.</td>
</tr>
</tbody>
</table>


### Table 4.3 - Selected Industry Responses to the Productivity Commission's Draft Report

**Finding 6.1** in Commission's draft report stated:  
"THE TRUST BASIS OF THE LEGISLATION IS EFFECTIVE IN FACILITATING PRUDENT MANAGEMENT OF SUPERANNUATION ENTITIES..."  

The industry response to this draft finding is detailed below:

<table>
<thead>
<tr>
<th>Industry Body</th>
<th>Extract</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Australian Superannuation Funds Association (&quot;ASFA&quot;)</strong> (Submission No D836)</td>
<td>ASFA is pleased with many of the findings of the Productivity Commission Draft Report. In particular, ASFA supports Draft Findings 6.1 and 6.2 that endorses the continued use of the trust structure and the role for representative trustees.</td>
</tr>
</tbody>
</table>
The purpose of the SRF is to provide a framework of analysis that can be applied to resolve tension or conflict between the various bodies of law constituting “superannuation law”. The preference of the trust is at its core. Though the attributes of the trust engender a secure superannuation environment and justify its preference, its principles should not be slavishly applied. Nor should advancement of the law be denied. The trust is not flawless in its application. For example, flexibility has been exhorted as one of its greatest strengths, indeed this feature has ensured the durability of the trust in the modern era. Yet in the context of superannuation, it may also be a weakness.

While the SRF promotes priority of trust principles, it nevertheless permits relegation of such principles where:

(i) the use of trust principles denies the fulfilment of a main objective of superannuation; or

(ii) the rationale underlying the relevant trust principle is redundant in the context of superannuation.

Logic dictates that the second exception essentially goes with saying. The first requires further exploration. The legislative justification for intervention in the superannuation market has been identified as prudential security. Clearly, therefore, in the context of the interaction of trust principles and statutory regulation, prudential security – as the main objective of superannuation regulation – gives substance to the second exception. To this
end, the words "main objective of superannuation" could be simply substituted with the words, "prudential security". However, the SRF has a broader application: it applies as between trust and contract as well as between trust and legislation. It follows that the exception must have relevance in both contexts.

The essence of the trust concept permits application of the second exception in the broader context. The general principles of trust law revolve around the nature of the trustee's office. The trustee holds legal title, not for his or her own interests, but for the exclusive benefit of the beneficiaries. The very structure of the trust, the separation of legal and equitable interests, engrains the protective attributes of the trust. In other words, the trustee is the protector of the assets constituting the fund. As has been argued, to facilitate this function equity places its most stringent duties on trustees — "the highest principles of corporate morality". It, moreover, dictates that not even to the slightest degree can the trustee entertain any thought of advancing his or her own interests, or those of a third party, ahead of the beneficiaries' interests. It is these concepts that found the basis of the trust. It is not denied that the extent of protection can be varied by express provision in the trust instrument. Indeed, exploitation of this very feature is what has propelled its commercial application. Nevertheless, the trust as envisaged by equity is fundamentally protective in nature. In the specific context of superannuation, the object of the trust is to secure the trust fund for the purpose of providing benefits to the members and beneficiaries. Again this argument does not deny that other factors may influence an employer's decision to utilise a trust. Historically, the trust has been attractive for the degree of control it permits to the employer. Yet one cannot escape the conclusion that ultimately the stated purpose of superannuation and pension trusts, independently of statute, is to provide superannuation and related benefits to members and beneficiaries. Security and protection of the fund is essential to this purpose.

Viewed against this background, it is the concept of protection and security that gives substance to the SRF. It justifies the priority accorded to the trust. It may sanction the relegation of trust principles in favour of statutory initiatives or contract principle. Finally, where the rationale underlying trust principles is redundant in the superannuation context, it provides a criterion against which to judge any replacement principles.

---

For the purpose of the second limb of the SRF, what then is “prudential security”? As with many definitions, it is often easier to begin with what it is not. In neither legislative nor general law capacities, it is not a form of guarantee. General law principles do not guarantee the benefits flowing from a trust. Investment of the fund is left to the wisdom of trustees, and provided the trustees have acted prudently, complied with general law duties and the terms of the trust instrument, there is no sanction if the real value of the fund is not maintained. Equally, the Commonwealth Government did not seek to provide a system of absolute security. Instead, a system was sought that placed superannuation savings at the lower end of the risk scale. The performance of superannuation assets was intended to be dependent upon the wisdom of investment decisions, for it was considered that “to aim for riskless superannuation would be contrary to the very nature of the risk-return trade-off and would be likely to stifle product development and competition and to reduce retirement income levels generated from a given profile of contributions.” Although prudential supervision concerns safeguarding superannuation savings it is not designed to override commercial investment decisions and assessments of risk by trustees and managers.

It can therefore be seen that the essence of security is that of minimising risk. The risks apparent in the superannuation industry have been identified as the following:

- **Systemic Risk**: Systemic risk is the risk that the possible failure of financial...
institutions in the market or the economy generally will impact negatively upon superannuation funds.

- **Agency Risk**: Agency risk is the risk that the interests of those operating the fund are not completely aligned with those of the members. The complexity associated with the management of a superannuation fund and the informational asymmetries between those managing the fund and the members, combined with a general lack of member knowledge of the complexities involved, creates opportunities for, or the risk of, incompetence, inefficiencies and perhaps outright fraud and theft.

- **Investment/Portfolio Risk**: Investment risk is comprised of both diversifiable risk and market risk. Diversifiable risk is the risk that returns will be negatively impacted by the failure to properly diversify investments. Portfolio diversification tends to mitigate against this risk, leaving funds subject to market risk. Market risk is essentially the risk that market fluctuations will impact negatively upon fund returns. It is a type of systemic risk, but the long term nature of superannuation assets tends to mitigate against this type of risk.

Added to these is a fourth category: operational risk. Sometimes considered a type of agency risk, it refers to the risk of loss resulting from shortcomings in systems, people and internal controls. It can arise whether the management of a superannuation fund is outsourced to a third party, the employer or performed by the trustee.

Though pre-eminently defined in terms of risk, a factor that further defines the concept of prudential security is the ever present issue of cost. A framework of prudential security should seek to "strike a balance between the level of protection for superannuation savings and the additional costs imposed." Thus, to the extent that compliance costs affect the ability of stakeholders to comply with the regulatory regime or significantly reduce the ultimate benefits available to superannuation beneficiaries, such costs are relevant to assessing the suitability of existing or proposed systems of prudential control.

It is this conception of prudential security that is utilised in the following chapter to identify those situations in which the SRF permits or even necessitates adoption of

---


principles other than those of trust. For ease of reference, part (i) of the second limb will be referred to as either the “prudential security limb” or “protective limb”, whereas part (ii) of the second limb will be referred to as the “inapplicability limb”.

---

**Conclusion**

Justification for governmental intervention in the marketplace is premised upon an unregulated market failing to achieve, or provide circumstances that promote, what the government perceives as important policy objectives. In Australia, the government, in the face of a rapidly ageing population, slow population growth, increasing life expectancy and the added complexity of the Australian disinclination to save for the future, was concerned to introduce a means of increasing individual retirement savings, thereby reducing pressure on the national budget in years to come. The SG Scheme with its compulsory contribution design not only facilitated achievement of government's independent retirement savings objective but also cast a duty on the government to provide a system of regulation to protect the pool of assets created. Thus the objective of the SIS Scheme can be identified as the **prudential management and control of superannuation activities for the purpose of ensuring the security of contributors' funds.**

The success of a system of regulation is assessed by the suitability of the mechanism chosen as its foundation to advance the identified regulatory objective. In the regulation of the superannuation market, the process of regulatory analysis demonstrates that, of the legal structures available, the trust and its associated principles of law are most likely to facilitate the objectives of prudential control and the security of funds.

This conclusion is primarily premised upon the protective attributes ingrained in the trust relationship. The highest duties known to the general law are cast upon trustees in their investment and administrative function, such that they are required to act without regard to self but entirely in the interests of beneficiaries. Added to this, the trust mechanism by its segregated fund and split ownership not only places a shield of insolvency protection around fund assets upon insolvency, but also imposes a hybrid of personal and proprietary obligations such that upon breach an action can be maintained not only against the trustee personally but also against what remains identifiable as trust property.
In comparison, the nature of the contract and company structures is inconsistent with superannuation objectives. Both structures are directed towards the pursuance of profit and therefore the promotion of self-interest, with any protection provided being merely a limit on self-interested acting. Moreover, there is no designated protector or guardian of the persons to whom superannuation benefits are to be paid. Finally, a consequence of the absence of a segregated fund and split ownership in that fund is that the assets are not protected in the event of insolvency and the right to recover assets through the process of tracing is lost. Although, as demonstrated through the schemes of regulation applicable to the life insurance and banking industries, deficiencies in protection can be supplemented by statutory intervention, this has not entirely replicated the protection provided by the trust. In both schemes of regulation some insolvency protection is provided, but the level of protection is unclear and superannuation depositors are placed on the same level as all other depositors. Additional protection is not provided and again no designated protector of benefits is specified. The underlying rationale for this is simply that the structures and regulation are directed towards ends beyond that of providing a high level of protection for superannuation assets, investments and benefits.

The conclusion that the trust is the preferred mechanism for the delivery of superannuation objectives is supported not only by the legislature's initial choice of the trust as the foundation of the SIS scheme, but also by the industry submissions and evidence presented at the recent Productivity Commission review of the SIS Act.

If the trust mechanism is the preferred mechanism, then logically the principles that give substance to the mechanism should be used in priority to all others in the resolution of tension and conflict in the law. It is only where the application of those principles deny or detract from delivery of the policy objectives underlying superannuation, or where the rationale underlying the relevant principle is inapplicable in the context of superannuation, that regard can logically be had to other principles such as those arising from contract or company spheres. This represents the SRF put forth in this thesis. This framework provides a system against which current statutory provisions, new legislative initiatives and the reasoning of the judiciary can be analysed in areas where the interaction of various bodies of law produces tension or conflict. Moreover, in that the trust is argued to be the most suitable vehicle but not the "perfect" vehicle, attention can also be given to the suitability of various trust principles in their application to superannuation.
Chapter 5

The Interaction of Trust and Legislation

Introduction ................................................................. 193
5.1 Trustees: Capacity .................................................. 194
  5.1.1 Disqualified Persons ............................................. 196
  5.1.2 Approved Trustees ............................................... 198
  5.1.3 The Proposed Universal Licensing Regime ............... 202
    5.1.3.1 Competency .................................................. 205
    5.1.3.2 Risk Management Plans .................................. 207
    5.1.3.3 Resource Assessment – The Relevance of Capital .... 210
    5.1.3.4 Ongoing Supervision ....................................... 221
    5.1.3.5 Registration .................................................. 222
    5.1.3.6 Extension to Employer-Sponsored Funds? ............. 222
    5.1.3.7 Synthesis ...................................................... 229
5.1.3.7 Synthesis ...................................................... 229
5.2 Trustees: Constitution & Representative Trusteeship ....... 231
  5.2.1 Lack of Independence .......................................... 236
  5.2.2 Concerns regarding Competence ............................. 238
  5.2.3 Balance of Representation .................................... 240
5.3 Trustees: Duties & Covenants .................................... 242
  5.3.1 General Approach ............................................... 244
  5.3.2 Covenant (a) – Honesty ....................................... 245
  5.3.3 Covenant (b) – Standard of Care ......................... 247
    5.3.3.1 Ordinary Person versus Business Person .......... 250
    5.3.3.2 The Property of Another ................................ 259
    5.3.3.3 Care, Diligence and “Skill” ............................. 260
    5.3.3.4 Professional Trustees .................................. 261
    5.3.3.5 Synthesis .................................................. 265
  5.3.4 Covenant (f) – Investment .................................... 267
  5.3.5 Covenant (g) – Reserves ..................................... 270
Conclusion ................................................................. 270
Introduction

The SIS Act, in conjunction with the general principles of trust law, provides the regulatory blocks of the Australian superannuation system. Like other jurisdictions canvassed by this thesis the SIS Act chooses the trust as the vehicle for the delivery of its superannuation objectives. As discussed in Chapter 4, the protective features ingrained in the trust relationship predicated this choice. In light of the superannuation relationship framework ("SRF"), this chapter examines the essence of the interaction between general trust principles and the SIS Act. The principal focus is the trustee. As the central responsible entity of the trust framework the success of the regulatory regime turns very much upon the success of the trustee. To this end, various elements of trusteeship and associated duties are examined to determine if the SIS Act has departed from or modified general trust principles, and then if such departure or modification is justified on the basis of the SRF. In this respect the prudential security limb of the framework is of greatest relevance. Given risk minimisation is the essence of prudential security, the analysis conducted is directed at this issue.

A significant feature of this chapter is the application of the SRF to a major reform initiative. In 2001 the Superannuation Working Group ("SWG") was established to examine options for reform in two areas: the prudential and legislative framework, and fund governance. Comprised of representatives from APRA, ASIC and the Commonwealth Treasury, the SWG recommended the introduction of a universal trustee licensing system as a means of increasing the safety of superannuation. In accepting this recommendation, the Commonwealth Government recently released the Superannuation Safety Amendment Bill 2003 in exposure draft form. It is to the recommendations of the SWG and the details of draft bill that the SRF is applied.

The interaction of the trustee and employer, and the influence of the latter on the former, has historically been a cause of prudential concern. The SIS Act seeks to reinforce the position of the trustee by regulating the scope of the employer's control and influence. Although strictly this concerns the interaction of the SIS Act with general trust principle,

---

for contextual reasons examination of these issues is considered in Chapter 6. There the SIS Act provisions are considered in light of impact of the employment relationship upon general trust principle.

5.1 TRUSTEES: CAPACITY

At general law a person or entity capable at law of holding property in his or her own right has the capacity to hold the office of trustee. This principle is circumscribed by the SIS Act, which prohibits a “disqualified person” from acting as a trustee of a superannuation entity. The term “disqualified person” has both individual and corporate aspects. An individual is a “disqualified person” if he or she: (a) has been convicted of an offence involving dishonesty at any time; (b) is an undischarged bankrupt; or (c) has had a civil penalty order imposed pursuant to the Act. A company is a “disqualified person” if any of its directors or other managers are disqualified persons, or if it is in receivership, official management or liquidation. The disqualified person net extends beyond the bounds of the trustee, additionally prohibiting a person from being a responsible officer of a corporate trustee if he or she is, to his or her knowledge, a disqualified person. APRA may, on the application of an individual who is otherwise a disqualified person, waive that disqualification.

In the context of public offer funds, approved deposit funds and pooled superannuation trusts the legislature in conjunction with APRA has created additional barriers to trusteeship. The SIS Act requires that the trustees of such funds be approved and

---

2 _Halsbury's Laws of Australia_, vol 27, TRUSTS, [430-3000].
3 SIS Act ss 120(i), 121(i).
4 SIS Act ss 120(2), 121(i).
5 “Responsible officer”, in relation to a body corporate, means a director, secretary or executive officer of that body corporate: SIS Act s 10(i).
6 SIS Act s 121(2).
7 As to the form of this application, and the circumstances in which it can be made, see SIS Act s 126B.
8 For ease of reference the term “public offer funds” in this section is used to collectively refer to “public offer superannuation funds”, “approved deposit funds” and “pooled superannuation trusts”.

- 194 -
continually comply with any conditions that accompany approval. An application for approval will be granted provided APRA is satisfied that the applicant can be relied upon to perform its trustee duties, and either:

- has net assets, or is entitled to an approved guarantee in respect of its duties as trustee, to the value of $5 million dollars;
- the combined value of net assets and an approved guarantee (described above) is equal to $5 million dollars; or
- adheres to the prescribed custody requirements.

Guidelines on the information and undertakings that APRA takes into account in determining whether or not an applicant has the required capacity, and can be relied upon to perform its trustee duties are contained in the approved trustee application form issued by APRA. Significant factors that influence APRA in its decision are detailed in Table 5.1.

### TABLE 5.1 — FACTORS RELEVANT TO THE APPROVAL OF TRUSTEES

<table>
<thead>
<tr>
<th>Significant factors which influence APRA in its decision to grant approval to the trustee of a public offer fund include:</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Custody: The applicant must supply details of its arrangements for the physical custody and security of fund assets which ensure the fund assets will be kept separate and protected;</td>
</tr>
<tr>
<td>☐ SIS Responsibilities: The applicant must detail how particular responsibilities prescribed by SIS will be met, including the arrangements for:</td>
</tr>
<tr>
<td>- member inquiry and complaints;</td>
</tr>
<tr>
<td>- the selection and monitoring of investment managers;</td>
</tr>
<tr>
<td>- keeping records in respect of meetings and decisions, changes to the trusteeship or directorships and member reports;</td>
</tr>
<tr>
<td>- identifying, monitoring and informing APRA of significant adverse events;</td>
</tr>
<tr>
<td>- ensuring investments comply with the in-house asset rules and are made on an arm’s length basis; and</td>
</tr>
<tr>
<td>- unclaimed money.</td>
</tr>
<tr>
<td>☐ Employer-sponsored Public Offer Funds: For public offer funds with standard employer-sponsored members, the applicant must detail its arrangements for ensuring that policy committees are established and that employee representatives are appointed to those committees;</td>
</tr>
<tr>
<td>☐ Training: The applicant must detail the staff training that is proposed or has been conducted for educating the staff of the proposed trustee in relation to the duties and responsibilities imposed by the SIS Act and the general law;</td>
</tr>
<tr>
<td>☐ Service Providers, Delegates and Experts: The applicant must detail its procedures for ensuring that experts, service providers, delegates and subcontractors have the appropriate qualifications, capacity and experience;</td>
</tr>
</tbody>
</table>

---

9 SIS Act s 21(2).
10 SIS Act s 26(1).
11 SIS Regulations reg 3.03.
12 SIS Act ss 26(1)(b)(iia), 26(1A); SIS Regulations reg 3.03.
13 SIS Act s 26(1)(b)(iii).
Minimisation of Fraud: The applicant must detail its systems, controls and structures in place to ensure that the chances of fraud and non-compliance with the relevant legislation, trust deed and maladministration are minimised; and

Regulatory Compliance: The applicant must detail its procedures to ensure its ongoing compliance with APRA and regulatory obligations, including the prescribed disclosure of information.


Continued approval is contingent upon compliance with the conditions set out in the instrument of approval. APRA has released a draft pro forma instrument of approval for general guidance. Conditions of particular significance are detailed in Table 5.2.

### Table 5.2 – Selected Conditions of Approval

<table>
<thead>
<tr>
<th>Selected conditions from the draft instrument of approval issued by APRA include that:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• the trustee board be constituted by at least four directors, three of whom are Australian residents;</td>
</tr>
<tr>
<td>• the trustee inform APRA in writing (within 7 days of becoming aware) of any event that may affect the trustee's ability to perform, in a proper manner, the duties of a trustee;</td>
</tr>
<tr>
<td>• the trustee inform APRA in writing of any change to chairman, chief executive officer, company secretary, directors or other responsible officers;</td>
</tr>
<tr>
<td>• the trustee inform APRA, at least 14 days in advance, of any persons who have the power to exercise a controlling influence over the financial or operating policies of the trustee or any material increase in the controlling influence of any person over the trustee;</td>
</tr>
<tr>
<td>• the trustee is prohibited from engaging in any business or commercial activity that is not in its capacity as trustee of a superannuation entity, unless: (i) it is necessary or reasonably incidental to the trustee's activities as trustee of a regulated superannuation entity or entities; (ii) the trustee carried out that type of activity at the time of approval or variation thereto; or (iii) the activity is otherwise approved by APRA;</td>
</tr>
<tr>
<td>• the trustee maintain adequate levels of insurance against: (i) liabilities incurred as a result of a breach of its professional duty as trustee of an entity; and (ii) material damage and consequential loss in respect of its business or undertaking as trustee.</td>
</tr>
</tbody>
</table>

Source: APRA, "Instrument of Approval of Trustee", in CCH, APRA Superannuation Digest (CCH, Looseleaf), at §§35-355.

In summary, there are two entry level requirements. At the base level all trustees and directors are subject to the disqualified person provisions. As a second barrier to entry, trustees of public offer funds must be approved; this is premised upon both operational and financial capacity to undertake the duties of trusteeship. As this modifies the general trust law position, what follows is an assessment of whether these barriers to entry can be justified upon the basis of the SRF.

### 5.1.1 Disqualified Persons

That the trust has been selected as the vehicle for the provision of superannuation benefits means that the administration and management of the constituent fund automatically falls to the trustee. Ispo facto, responsibility for the security and viability of the fund is the responsibility of the trustee. On this basis, promotion of the main regulatory objective —
prudential security — essentially demands that eligibility for trusteeship (and directorships) be in some way limited. In the context of the superannuation industry, the “disqualified person” concept emanated from the recommendations of the Senate Select Committee on Superannuation and the Australian Law Reform Commission in their respective inquiries foreshadowing the introduction of the SIS Act.\(^\text{14}\) The importance of ensuring the safety of superannuation was argued to justify the introduction of the prohibitions.

In terms of the Rocha typology of risk assessment,\(^\text{15}\) the disqualified person provisions seek to mitigate a type of agency risk: the risk of fraud and mismanagement by an agency, in this case, the trustee. The risk of fraud and mismanagement is significantly decreased if persons who have shown themselves to be dishonest, incapable of managing their financial affairs, or who have previously breached the SIS Act, are barred from the management position of trustee. If persons who display characteristics contrary to the promotion of prudential security are barred from participation, the risk of what the legislature is seeking to prevent — fraud and mismanagement — is necessarily decreased. The further advantage of this approach is its consistency with the regulation of companies, where persons are likewise disqualified from managing corporations in circumstances of dishonesty, insolvency and mismanagement.\(^\text{16}\) It follows that disqualification of persons who would otherwise at general law be eligible for trusteeship is justified on the basis of the prudential security limb of the SRF.

The regulatory schemes in Hong Kong and the United Kingdom also bar participation at the trustee level for persons considered unfit for trusteeship.\(^\text{17}\) The Goode committee recommended to the UK Parliament that the most effective approach is “to disqualify those who have shown themselves unfit to be trustees of a pension fund or otherwise to be engaged in the management of a pension fund.”\(^\text{18}\) Similarly in Hong Kong, a company seeking approval for trusteeship must satisfy the regulator that its controllers are persons


\(^\text{15}\) See 4.4.


\(^\text{17}\) As to the disqualified person provisions in the United Kingdom and the Hong Kong see 3.1.2.2 and 3.4.2.2 respectively.

of good reputation and character and have not been found guilty in any jurisdiction for offences involving fraud or dishonesty.\textsuperscript{19}

\textbf{5.1.2 Approved Trustees}

Regarding the appointment of trustees, the SIS Act distinguishes between employer-sponsored funds and public offer funds; the latter must have an approved trustee.\textsuperscript{20} As outlined above, approval is premised upon the capacity, both operational and financial, of the entity to carry out the duties of a trustee. This is a significant step away from the freedom conferred by the general law in respect of appointment.

In Australia the approved trustee provisions emanated from the \textit{Companies Act 1958} (Vic), the provisions of which were adopted from equivalent English statutes.\textsuperscript{21} Unit trusts, the category in which modern public offer superannuation funds historically fell for definition, were originally regulated pursuant to the "other interests" provisions of the Victorian Act. In addition to an "approved" deed, trustee "approval" by the Attorney-General was required.\textsuperscript{22} The regulatory intent of these provisions, although alternatively termed "prescribed interests", was adopted by various State company Acts and then subsequently incorporated into the \textit{Companies Code}\textsuperscript{23} and later the \textit{Corporations Law}.\textsuperscript{24} In these Acts trustee approval was premised on trustee independence from the management company and on the National Companies Securities Commission (subsequently the Australian Securities Commission) being satisfied that the trustee and its officers had the necessary

\textsuperscript{19} \textit{Mandatory Provident Fund Schemes (General) Regulation 1998} (Cap 485A) (HK) reg 16(2)(a). See 3.4.2.2.

\textsuperscript{20} For ease of reference the term "public offer funds" is in this section used to collectively refer to "public offer superannuation funds", "approved deposit funds" and "pooled superannuation trusts".

\textsuperscript{21} Barriers of entry for trusteeship of unit trusts were considered by the Company Law Committee in its inquiry into the provisions of the \textit{Companies Act 1948} (UK) (United Kingdom, Company Law Committee (Chairman: Rt Hon Lord Jenkins), \textit{Report of the Company Law Committee}, Cmdn 1749, 1962). The Committee recommended that a trustee of a registered unit trust should be, in the opinion of the Board of Trade, a suitable person to operate such a trust. It also recommended that "[t]he Act might set out specific grounds upon which the Board of Trade might decide that managers or trustees were unsuitable, eg because their directors or other officers were persons who had been convicted of an offence involving fraud or dishonesty, but the Board should also have a general power so to decide on any other grounds": at §316. These recommendations were incorporated into the \textit{Companies Acts 1967, 1976 and 1980} (UK).

\textsuperscript{22} \textit{Companies Act 1958} (Vic) s 635(3)(a) (repealed).

\textsuperscript{23} \textit{Companies Code} ss 165, 167 (repealed).

\textsuperscript{24} \textit{Corporations Law} ss 1065, 1067 (repealed). Employer-sponsored funds were specifically excluded from these requirements: \textit{Corporations Regulations} regs 7.12.05, 7.12.06 (repealed).
experience, qualifications, knowledge, skills, and financial and staff resources to adequately discharge the functions of a trustee and to fulfil its obligations.25

Following the recommendation of the Australian Law Reform Commission,26 the regulation of public offer superannuation funds was transferred in 1993 from the Corporations Law to the SIS Act. The requirements for approved deeds and approved trustees were retained with the result that a higher threshold of entry was required for trusteeship of public offer funds as compared to non-public offer funds (otherwise termed, in the Australian context, employer-sponsored funds).

As with the disqualified person provisions, this restriction on the general law freedom of appointment is defensible upon the basis of the prudential security limb of the SRF.

As described in Table 5.1,27 the first step in the approval process requires the applicant to present evidence to satisfy APRA that it can be relied upon to perform its duties. Relevant to APRA’s consideration is information concerning arrangements for the custody of assets, the processes in place for control and compliance systems, the procedures for interaction with services providers and delegates, the processes for seeking expert assistance and ensuring ongoing compliance with regulatory obligations and responsibilities, and the qualifications and training of staff. These considerations are clearly directed at lessening operational risk. If an applicant can demonstrate that it has the necessary competence to undertake the duties of a trustee and adequate processes and systems for the security of assets, detection of fraud and regulatory non-compliance, the risk of operational failure is decreased. The advantages of this approach are soon lessened or even negated if there are no ongoing requirements. To this end, the approval conditions described in Table 5.228 are directed towards continued operational capacity. Approved trustees are obliged to inform APRA of various events, including any event that may affect the trustee’s ability to perform its duties, and any change to its responsible officers or persons who exert a controlling influence. This information assists APRA in its regulatory oversight function of assessing continuing as well as initial competence to carry out trustee duties. The further condition

27 See above at 5.1.
28 See above at 5.1.
of prohibiting trustees from engaging in activities inconsistent with the provision of superannuation services is a classic example of mitigating agency risk: the risk in this case is that the responsible entity's interests are not aligned with those of the superannuation fund members. Trustees must act in the interests of the superannuation beneficiaries rather than chasing the allure of increased profits from activities inconsistent with the superannuation function.29

The second step in the approval process necessitates the applicant demonstrating a financial capacity of $5 million in either net assets or an approved guarantee (or a combination thereof). Alternatively, the custody requirements prescribed by APRA will suffice.30 Although at the time the SIS Act was introduced in Bill form there was no official stated rationale for the imposition of these capital requirements, APRA subsequently stated that the rationale “appears to have been focussed totally on the theory of allowing only entities of substance to hold superannuation assets in the retail area”.31 This is reinforced by the comments of the current Commonwealth Government in an Issues Paper titled “Options for Improving the Safety of Superannuation” where it stated that:32

> The purpose of the approval process, particularly the financial requirements, is to assess whether Approved Trustees are committed, competent and viable players and that they have capital at their disposal to remedy funding, administrative and compliance problems if, and when, they arise.

These statements suggest a twofold purpose: to assess the bona fides of the applicant and its commitment to the superannuation purpose; and to provide a financial buffer against funding, administrative and compliance problems. The Background Issues paper released by the Superannuation Working Group added a third rationale: the risk of losing the capital outlaid provides an incentive to perform and manage the fund well.33

These entry requirements are again directed towards minimising agency risk. A significant financial commitment demonstrates a commitment to the provision of superannuation services to members. The risk of losing this financial commitment assists to align the

---

29 See 6.5.
30 SIS Act s 26(o)(b)(iii).
interests of the approved trustee with those of the superannuation fund members. It can be further argued that the requirements are directed towards operational viability. A significant capital amount can assist with future losses concerning administrative systems or compliance problems. Alternatively, the financial buffer may "decrease the risk of a disorderly or non-compliant winding up if the business fails".35

Prima facie the entry requirements for approved trustees facilitate prudential security through the legislative strategies to lessen both agency and operational risk. This conclusion is supported by that of the Productivity Commission in its review of superannuation legislation in 2001. Though remarking that the benefits of the entry requirements are not readily quantifiable, the Commission reported that:36

[0]verall, the current entry requirements for approved trustees are likely to have facilitated the prudent management and prudential supervision of superannuation funds. This benefit is assessed as exceeding the costs of restricting entry, which are likely to be quite small. The entry requirements need reduce the risks of less prudent management by only a small amount in order to generate a net benefit.

Despite these conclusions, in the face of high profile corporate collapses there have been industry rumblings regarding the approved trustee structure. In the opinion of Ross Clare,37 the approved trustee structure failed to prevent the losses arising from the management of the Employees Productivity Award Superannuation Fund38 and the collapse of Commercial Nominees of Australia Pty Ltd.39 The Association of

---

34 The most common example in this respect is losses arising from a computer system failure.


38 The Employees Productivity Award Superannuation fund (EPAS) is a public offer industry superannuation fund for employees in the hospitality industry in Queensland. In just one year the value of the fund was reduced from $27 million to $18 million dollars (1997-1998). It was estimated that members lost 51 per cent of their entitlements: Commonwealth of Australia, Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services: Some Case Studies, Second Report, 2001, at ¶1.1.

39 Commercial Nominees of Australia Pty Ltd was an approved trustee with assets of the fund totalling around $300 million. It was the trustee of "approximately 475 small APRA funds, a master trust known as the Confidens Investment Trust (Confidens), two trusts known as Enhanced Equity Fund (EEF) and the Enhanced Cash Management Trust (ECMT), and a number of corporate and public offer superannuation funds including the Australian Workforce Eligible Rollover Fund (AWERF), the Network Super Fund and the Midas Super Fund": Commonwealth of Australia, Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services: Some Case Studies, Second Report, 2001, at ¶4.1. The size of the loss caused by the company's collapse has been estimated to be $25 million, affecting some 25,000 investors: at ¶4.3.
Superannuation Funds of Australia ("ASFA"), although prefacing its observation with the comment that the vast majority of funds are safe, secure and well-managed, has likewise opined that "whichever way the figures are studied, the greatest incidence of fraud and losses have been in funds with Approved Trustees".40

In view of these concerns, an issue that demands consideration is whether or not the entry requirements could be improved so as to achieve a greater level of prudential security. A related issue is whether or not the prudential security of employer-sponsored funds could be further enhanced by implementation of a similar approval process for trusteeship.

The essence of these issues was recently examined by the Superannuation Working Group ("SWG"), which recommended that the approved trustee provisions be replaced with a universal licensing regime. The proposed licensing regime is described in detail below at 5.1.3. As a precursor it can be said that the proposed licensing regime is an extended version of the existing approved trustee entry requirements. The Commonwealth Government supports this recommendation, and to initiate its implementation has released the Superannuation Safety Amendment Bill 2003 in exposure draft form.

In light of the proposed reform an assessment of the issues raised in this section is discussed in the context of the proposed licensing regime.41 To this end, the following section assesses the general prudential viability of the proposed universal licensing system and of imposing an additional barrier of entry for employer-sponsored funds.

5.1.3 The Proposed Universal Licensing Regime

The Proposal

The cornerstone recommendation of the recent SWG inquiry is that the SIS Act be amended to require superannuation entities (other than self managed superannuation funds and exempt public sector superannuation schemes) to be licensed by APRA. Termed the "universal licensing regime", it represents an expanded version of the current system that

---


41 See 5.1.3.3.
applies in respect of approved trustees.\textsuperscript{42} It is proposed that, to obtain a licence, a trustee will be required to:\textsuperscript{43} 

- comply with the conditions of the licence, other legislative requirements and the covenants in the trust deed;
- meet minimum standards of competency;
- develop a risk management plan;
- have adequate resources in place (including financial, technological and human resources);
- have adequate levels of professional indemnity insurance and material damages/consequential loss insurance in place;
- have adequate outsourcing arrangements in place; and
- meet any other conditions as prescribed in regulations or as required by APRA.

An effect of the proposed regime is to bring employer-sponsored funds that are not also public offer funds into the net of licensing. Also, it would bring the regulation of superannuation funds into line with the regulation of other financial products such as managed investment schemes and insurance.

The Commonwealth Government initially signified support for this recommendation by pronouncing its intention to amend the SIS Act at the earliest opportunity to require all superannuation fund trustees to obtain a licence to operate a superannuation fund.\textsuperscript{44} Subsequently, in May 2003, the Superannuation Safety Amendment Bill 2003 ("SSAB(ED)"") was released in exposure draft form for industry comment. The exposure draft is in broadly the same terms as the SWG proposal. In order to obtain a licence trustees will be required to meet a "fitness and propriety" standard, develop a risk management strategy and, in the case of public offer funds, meet the prescribed capital requirements.\textsuperscript{45} Ongoing supervision is facilitated by the prescription of licence conditions, which in part require the trustee to continually meet the fitness and propriety standard, comply with its risk management strategy, develop and comply with a risk management plan, and register any funds upon commencement.\textsuperscript{46} The exact degree of correspondence between the SSAB(ED) and the SWG proposal is not yet apparent as much of the former will presumably be contained in

\textsuperscript{42} As to approved trustees see 5.1.2.
\textsuperscript{45} Superannuation Safety Amendment Bill (ED) 2003 ss 29C, 29D.
\textsuperscript{46} Superannuation Safety Amendment Bill (ED) 2003 s 29E.
regulations and approved forms. As such, the following assessment proceeds on the footing that the SSAB(ED) is generally coextensive with the SWG proposal, noting and assessing, where possible, any specific differences between the proposals. To this end, industry comment reflects chiefly on the SWG proposal.

**Preliminary Analysis**

Although the superannuation industry has indicated general support for a universal licensing regime, concerns have been raised regarding the application of the regime to not-for-profit funds, the increase in compliance costs to superannuation funds, and the inability of the regulator to effectively implement the system without adequate resources.

Notwithstanding these concerns, the proposed universal licensing regime, has the potential to facilitate a greater level of prudential security than the approved trustee provisions upon which it is based. The introduction of the proposed regime signifies an important change in supervisory approach. Not only would there be greater emphasis upon ex ante control; it also envisages a shift in emphasis to a more “risk centred” approach. In that the essence of prudential security is the minimisation of risk, the increased emphasis upon risk management prima facie makes the universal licensing regime more efficacious in facilitating prudential security. Pre-vetting is more effective if the ability of a trustee to operate a scheme is judged in terms of risk management. Industry participants in the SWG inquiry, in particular, favoured this approach. AMP commented that:

> All regulation of the superannuation industry should be risk based and risk should be defined, measured and monitored by APRA... All trustees of superannuation funds should be licensed by the regulator on the basis of a risk assessment with the licence if necessary setting out whatever requirement the regulator considers necessary to establish an acceptable level of risk.

Similarly WM Mercer stated that it considered the SWG “review of safety in superannuation is really about addressing the management of risk in the operation of superannuation funds.” AMP likewise agreed “that the safety of superannuation would be

---

47 The term “not-for-profit” fund is essentially a synonym for “employer-sponsored fund” or “corporate fund”, but does not include an employer-sponsored fund that is also a public offer fund. See further the heading “Extension to Employer-Sponsored Funds?” in 5.1.3.3.


increased if all trustees were to be licensed as part of a broad risk based assessment of all managed superannuation funds.50

Aside from these preliminary comments, the following explores four main features of the proposed licensing regime: competency, risk management, ongoing regulatory supervision, and registration. Consideration is also given to the viability of extending the licensing regime to employer-sponsored funds.

5.1.3.1 COMPETENCY

A proposed licence criterion is that the trustee demonstrate a minimum standard of competence, referred to in the SSAB(ED) as the “fitness and propriety standard”.51 Although the detail of this standard has not yet been released, the SWG envisaged that APRA would assess the trustee’s competence to operate a fund in a prudent manner.52 As with the current approved trustee structure, this would appear to involve assessing trustees’ operational capacity. As the entry requirements for approved trustees facilitate prudential security,53 logically the same can be said in the context of the fitness and propriety standard: the industry will be prudentially safer if only those persons or entities that demonstrate competence are permitted to act as trustees. However, use of the phrase “fitness and propriety” arguably indicates a broader assessment that extends to the knowledge, experience and suitability of the trustee. Greg Brunner, a manager at APRA, has foreshadowed the fitness criteria will focus on the “qualifications, competence and worthiness of an individual”, which in turn encompass consideration of the trustee’s “skills, knowledge, expertise, diligence and soundness of judgment to undertake responsibilities”.54 If so, this presents a further avenue enhancing prudential security. APRA will not only assess the capacity of the trustee to perform its duties, but also its suitability to that function.55

51 Superannuation Safety Amendment Bill 2003 (ED) s 29D(d).
53 See 5.1.2.
55 Although not referred to by the SWG, this feature closely resembles the trustee approval process in Hong Kong, where trustees are required to demonstrate suitability, skill, financial soundness and capability: see 3.4.2.2.
This feature would be further enhanced if the "fitness and propriety standard" carried a requirement whereby each director of a trustee and each individual trustee were required, in the absence of other appropriate qualifications, to undergo an accredited minimum level of training in respect of their duties and obligations. The present system permits persons to act as a trustee or director without any specific knowledge of either their duties or the operation of superannuation funds. Although not specifically canvassed by the SWG, many industry participants exhorted the virtues of mandated minimum levels of training. Moreover, the Senate Select Committee on Superannuation and Financial Services has recommended that trustees undergo a mandatory minimum level of training prior to service.\textsuperscript{56} This issue is also pertinent in respect of employer-sponsored funds where employee representatives, in particular, are amateur trustees, with possibly no experience in general business, let alone the intricacies of superannuation and the corresponding duties of trustees. This proposal should not be taken as suggesting that trustees should be "professional trustees" experienced in the business of superannuation. Nor should it be seen as an attempt to homogenise trusteeship. In this respect Pickering contends that it is essential that the office of trusteeship attract a wide range of participant:\textsuperscript{57}

Trusteeship is a team game and not an individual pursuit. Not every trustee requires the same level of knowledge or interest in each aspect of trusteeship.

While trustees may not need the same level of knowledge, a basic core minimum would facilitate the performance of their functions. Now, following a recommendation from the Myners Review that trustees should be required to undertake training, especially in finance and investment,\textsuperscript{58} the United Kingdom Government is presently investigating the most appropriate means of implementing this requirement.\textsuperscript{59}

Issues of trustee training are also relevant in the context of extending the proposed licensing regime to employer-sponsored funds, and in respect of competence of

\begin{footnotesize}
\begin{enumerate}
\item Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, \textit{Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services}, First Report, 2001, at \S\S3.51.
\item Myners, \textit{Institutional Investment in the United Kingdom: A Review} (commissioned by HM Treasury (UK)), 2001, at \S\S2.31, \S\S2.51-\S2.54.
\end{enumerate}
\end{footnotesize}
employee representatives under the equal representation rules, and so are discussed in more detail under each of these headings.60

5.1.3.2 **Risk Management Plans**

The second major feature of the SWG proposal is that trustees be required to prepare and maintain a risk management plan in respect of each fund they operate. In essence this would require a trustee to demonstrate how it intended deal with specific risk areas by articulating the risk management processes and practice that the trustee proposed to follow.61 In was further envisaged that an annual audit be used to monitor compliance, with significant breaches reportable to APRA and members.

The SWG risk management plan proposal is modelled in part upon the requirement for the responsible entities of Managed Investment Schemes to prepare a compliance plan setting out the measures they will apply to ensure that the operation of the scheme complies with all obligations pursuant to the *Corporations Act 2001* (Cth) and the scheme's constitution.62 However, this proposal is broader in nature, requiring trustees to address specific risk areas as well as compliance issues. Moreover, so as to allay industry concerns regarding the high costs of such plans, it is proposed that the plan address critical areas - for example, investment, outsourcing and governance - rather than all aspects of compliance.63

The SSAB(ED) has incorporated this proposal, albeit in modified form. It contemplates that trustees will submit a risk management strategy as part of their licence application.64 The risk management strategy relates to the operations of the trustee as trustee. To this end, it must identify, monitor and manage risks associated with governance, decision-making processes and outsourcing, as well as risks arising from fraud and expected changes in the law.65 Unlike the SWG proposal, trustees are also required to set out a business plan indicating how they intend to achieve their business

---

60 See 5.1.3.6 and 5.2.2 respectively.
62 *Corporations Act 2001* (Cth) s 601HA (see generally Pt 7C.4).
64 Superannuation Safety Amendment Bill 2003 (ED) s 29C(d).
65 Superannuation Safety Amendment Bill 2003 (ED) s 29H(2). The strategy must also set out the circumstances in which an audit of the relevant risks will be undertaken (s 29H(2)(f)).
In addition to developing a strategy, trustees will be required, as a condition imposed upon licences, to develop and comply with a risk management plan for each of its funds. It is proposed that the plan identify the risks arising in the operation of each particular fund, for example, the risks associated with the fund's investment strategy, financial position and outsourcing arrangements.

Consistent with the general industry consensus that the introduction of risk management plans would strengthen monitoring and assist to ensure risks are adequately identified, it can be said that the risk management proposal adds value to prudential security measures. This is for two reasons. First, under either the SWG or the SSAB(ED) formulations the proposed strategies and plans are completely consistent with the fundamental nature of prudential security: the minimisation of risk. The essence of the proposal is to require trustees to give detailed consideration to the operational risks apparent in superannuation funds and the entity itself. Trustees must then develop strategies to guard against those risks. The proposal also signals a change in regulatory approach. Currently, specific risks are addressed by specific legislative intervention. The proposed licensing regime adds a second layer of risk management, directed to the risks of individual fund operations.

Secondly, the proposal directs the attention of trustees to operational and entity risks. In August and September of 2002 research was conducted by the Institute of Chartered Accountants in conjunction with Deloitte Touche Tohmatsu whereby 69 of Australia's top superannuation funds and master trusts were surveyed regarding issues relating to fund administration and trustee processes. Although finding a high level of fund governance amongst Australia's largest funds, in respect of trustee processes it concluded that:

"The most significant area requiring improvement is the involvement of trustees in the assessment and monitoring of risks facing their funds. This includes the monitoring of internal controls designed to address those risks. Contrary to the understanding of many trustees,"
risk is not limited to investment risks but encompasses strategic and operational areas. For many Trustees, risk assessment and management is a new challenge. The identification of risk areas needs to be followed by a strategy to manage and control those risks...

Only some half of the funds surveyed had undertaken a formal assessment of the risks facing their funds. An equivalent percentage did not have formal processes in place to assess and monitor the effectiveness of internal controls operating within their fund. The conclusion that risk assessment is an area requiring improvement reveals not only that a large percentage of the industry is not conducting risk assessment but also that many trustees are unaware that the concept of the risk includes operational and governance risk. That trustees are not even aware of the incidence of this type of risk is a risk in itself. Given these findings, the proposal that trustees develop and maintain risk management strategies/plans is a compelling recommendation.

As to the SSAB(ED) proposal, the necessity of distinguishing between entity strategies and fund plans must be queried. ASFA has strongly contended that the division will create confusion over the relative roles of the strategy and plan, as well as create an artificial distinction between the trustee and the fund. This may well be true. ASFA suggests, rather, that the risk management strategy should articulate the trustee's overarching policies and approaches to risk, whereas the management plan detail the actual risk management procedures. The SWG proposal or alternatively that of ASFA is simpler in design with precisely the same outcome. To this end, the SSAB proposal is the less preferred option, albeit with the caveat that, as no commentary or explanatory material accompanied the exposure draft, the Department of Treasury's objectives in this respect are difficult to judge.

72 Institute of Chartered Accountants and Deloitte Touche Tohmatsu, Governance of Superannuation Funds, Research Report, 2002, at 12.
73 ASFA, General Comments and Recommendations on the Superannuation Safety Amendment Bill 2003 Exposure Draft (submitted to Department of Treasury in response to its call for comment on the SSAB(ED)) (available at www.superannuation.asn.au), July 2003, at 5.
5.1.3.3 Resource Assessment – The Relevance of Capital

The Proposal

As a further component of the licensing regime, the SWG proposed that APRA assess, in the context of the relevant risks, whether or not each fund has adequate resources, including capital, in place. It recommended that this criterion replace the current capital requirement for approved trustees. Though the Commonwealth Government indicated in-principle support for the proposed framework, it nevertheless considered that other requirements such as the requirement to develop risk management plans will address concerns regarding operational risk. As such, the Commonwealth Government supports the retention of the status quo. To facilitate this position, the SSAB(ED) permits trustees to apply for different categories of licence. Applicants for a public offer entity licence must satisfy APRA that the prescribed capital requirements have been met. These requirements are the same that currently exist for approved trustees.

Given the divergence between the SWG and SSAB(ED) proposals, the questions that arise are: (i) whether an assessment of resources with a flexible risk driven approach is to be preferred to the static prescription of a capital amount; and (ii) whether there is any prudential need to impose capital requirements upon employer-sponsored funds.

Maintaining the Status Quo – Assessment

Industry Concerns

Although theoretically the current capital requirements can, as part of the approved trustee requirements, be justified in terms of the SRF, there remain industry concerns regarding the present formulation of the requirements. Submissions by industry participants to both the Productivity Commission and the SWG cast doubt on the

---

75 As to approved trustees see 5.1.2.
77 Superannuation Safety Amendment Bill 2003 (ED) s 29B.
78 The Superannuation Safety Amendment Bill 2003 (ED) s 29B recognises classes of licence. One class covers trustees of public offer entities. Other classes will be defined by the regulations. See further note 150.
79 Superannuation Safety Amendment Bill 2003 (ED) ss 29D(h), 29DA.
80 As to the arguments in favour of this approach see 5.1.2.
81 In 2001 the SIS Act, the Superannuation (Resolution of Complaints) Act 1993 and various other pieces of superannuation legislation were referred to the Productivity Commission for inquiry and report by the Assistant Treasurer. The scope of the inquiry was limited to legislation governing the prudent management and supervision of superannuation, and specifically
ability of the minimum capital requirements to achieve their stated aims. In particular, industry submissions questioned whether capital in and of itself lessens or eliminates the risk of operational or governance breakdown, but is instead purely a pool of money that can be drawn upon once a problem has already occurred. Reservations were also expressed as to the ability of the minimum capital base to act as a sufficient financial buffer in the face of operational or governance breakdown. AMP and the Australian Retirement Income Streams Association Ltd ("ARISA") suggested that insurance would in many cases provide more complete protection. Moreover, premiums charged would reflect a market-based assessment of the risk apparent in the relevant entity. In a similar vein Towers Perrin argued that sufficient liquidity and working capital is more important than holding a minimum level of net tangible assets. The latter is merely indicative of the substance of an entity whereas the former provides resources to address operational failures.

That the capital requirements provide an incentive for approved trustees to act prudently and in the interests of members was also queried. Submissions addressing this whether such legislation was consistent with the principles enunciated in the Commonwealth Competition Principles Agreement. For the report of the inquiry see Commonwealth of Australia, Productivity Commission, Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation, 2001.

The objectives of the capital requirements are described at 5.1.2.


Commonwealth of Australia, Superannuation Working Group, Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002, submissions by ARISA at 4; AMP at 8. See also submissions by Law Council of Australia at 6; WM Mercer at 8; ACTU at 5; NSP Buck at 15 (NSP Buck proposed a concept of portfolio insurance to replace the existing capital requirements); ASFA at 30.


matter considered that sufficient incentive flowed from the general law duty of trustees (as replicated in the SIS Act s 52 covenants) to act in the best interests of beneficiaries.\textsuperscript{89}

The final concern was that the present capital requirements do not account for the diversity of the superannuation industry. Funds differ in size, type and administration—"one size does not fit all".\textsuperscript{90} The static prescription of an "across the board" capital requirement does not in any sense reflect the nature of a fund, the risks that the particular fund faces and any concomitant need for capital. For example, in respect of accumulation schemes ISFA argued that it is difficult to appreciate how further capital requirements could be justified given that "these funds are fully allocated to individual accounts, there are no vesting issues and investment arrangements are subject to disclosure and generally transparent".\textsuperscript{91} Similarly, many funds outsource investment and administration. If appropriate contractual arrangements are in place, there may be no need for larger amounts of capital or operational reserves.\textsuperscript{92} In respect of funds that self-administer PWC observed that regard must be had to the distinction between capital and operating reserves. Although some funds self-administer, it was argued that this does not mean that they need capital:\textsuperscript{93}

\[\text{the fund uses members' money to buy administrative systems, employ people and so on. The cost of this is no different to paying an outsourced provider. Such funds may need operating reserves to cover themselves for inadvertent administrative error and so on. In our experience, many self-administered funds have operating reserves to cover the potential for such operating risks.}\]


\textsuperscript{92} Commonwealth of Australia, Superannuation Working Group, Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002, submissions by Law Council of Australia at 5; Towers Perrin at 10; ACTU at 5.

Despite general dissatisfaction with the present static formulation of the capital requirements, the general undertone of industry submissions did not favour a removal of these requirements. This was for two principal reasons.

First, industry places an intrinsic value on a for-profit scheme demonstrating commitment to the industry. This commitment ideal is also valued in the managed investment funds sector. In a discussion paper released by the Companies and Securities Advisory Committee (“CSAC”) in 1992 it was suggested that a capital requirement for the then prescribed interest schemes (now managed investment schemes) did not serve the stated aims well enough to warrant its imposition. The subsequent Review reported that industry was critical of this position principally on the ground that scheme operators would then not be required to show commitment to the industry. Whilst there was wide acknowledgment that any chosen amount of capital would be arbitrary, and for some schemes inappropriate, it was nevertheless considered that an element of “comfort” is gained from the capital requirements. The importance of an

94 The aims of the capital requirement in the managed investment scheme industry are in essence the same as those in the superannuation industry. It is aimed at providing:
- some indication of the capacity of the operator to conduct funds management operations and to continue as a going concern (“skill money”);
- evidence of the commitment by the operator to its scheme management activities (“hurt money”); and
- a pool of funds for investors who succeed in litigation against an operator for breach of duty (“comfort money”).


97 The Review recommended that the Corporations Law impose a minimum capital requirement on scheme operators, calculated as five percent of the total assets of an operator’s schemes, subject to a minimum of $100,000 and a maximum of $5 million respectively: ALRC, CSAC, Collective Investments: Other People’s Money: Volume 1, Report No 65, 1993, at ¶10.31. This recommendation was subsequently incorporated with amendment in the Managed Investments Act 1998 (Cth). In order to operate a managed investment scheme the responsible entity must hold a dealer’s licence (Corporations Act 2001 (Cth) s 601FA). To obtain a licence the applicant must satisfy ASIC that, inter alia, its net tangible assets will be maintained at a minimum of $50,000 or, if the value of the scheme’s assets exceed $10 million, five percent of those assets up to a maximum of $5 million (Corporations Act 2001 (Cth) s 913A). In a recent review of the Managed Investments Act 1998 (Cth) Mr Malcolm Turnbull postponed consideration of the capital requirements preferring to await the considerations of the SWG. In this respect Turnbull noted:

While the regulatory objectives and principles applicable to the managed investment and superannuation industries may differ, there are sufficient parallels between these industries to justify reconsideration of NTA [net tangible asset] requirements in light of any findings that may flow from the Superannuation Working Group.
element of "comfort" is also reflected in the Productivity Commission's conclusion that the custody requirements are beneficial to member interests by reinforcing the trustee's commitment to the task and ensuring that the trustee has some capacity to conduct its affairs.\(^8\) This can also be seen to underlie the Commission's recommendation that the custodial concession is "not consistent with prudential objectives and that all approved trustees should be required to have a specified minimum level of substance in their own right."\(^9\)

Secondly, it was considered that there remains a role for access to a capital base in the event of operational or governmental failure provided that there is a risk related assessment of the need for the capital held. Rather than abolish the current capital requirements, many industry participants favoured a "risk related" approach that seeks to directly mitigate against specific risk rather than the simple prescription of an arbitrary amount representing a somewhat crude assessment of possible risk.\(^10\) This would involve the development of a framework that assesses capital adequacy requirements against the way a fund operates in conjunction with the presence of risk mitigation factors. For example, the availability of insurance, access to operating budgets and reserves, sufficient contractual protection in respect of outsourcing to service providers, as well as the availability of capital to service providers, are factors that mitigate the risk of operational failure and thus are directly relevant to assessing the amount of capital required.

From a regulatory point of view, APRA generally supported the application of minimum capital requirements. It argued that the current system provides protection by permitting an institution to continue operation in the face of losses. Nevertheless

---


\(^10\) Commonwealth of Australia, Superannuation Working Group, *Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation*, 2002, submissions by ABA at 3; ASFA at 30; CPA at 3; IFSA at 9-10 (note in particular the principles adopted by the International Investment Fund Association in respect of the degree to which investment schemes should be subject to capital adequacy requirements); IAA at 6, Law Council of Australia at 4; PWC at 5.
APRA saw a case for a more robust and risk-focused regime than the present flat $5 million amount.\textsuperscript{101}

In light of these industry concerns, the SWG recommended that APRA should determine the amount of resources, including capital, required by a trustee to address the operational risks relevant to that trustee. Rather than specify a maximum or minimum amount the legislation should list the factors that APRA should consider in its assessment.\textsuperscript{102}

\textbf{Analysis}

Whilst prescription of a minimum capital base can be argued to enhance prudential security, a better approach is one that is risk driven and assesses the need for capital requirements against relevant risk factors. It is the presence of risk that is deleterious to prudential management and security. As such, an approach that assesses the risks present in the operation of a particular superannuation scheme, and sets entry requirements in accord with that risk profile, is more likely to enhance prudential security. Moreover, a risk driven assessment of the need for resources is not only consistent with the concept of minimising risk, but also complements the risk driven approach underlying the universal licensing regime, in particular, by the associated introduction of a risk management plan.

There remains, however, one main impediment to the application of this approach. The "risk based" framework requires greater participation of the regulator at the ex-ante stage. Both the SWG proposal and the SSAB(ED) contemplate the assessment of some resource issues at the licensing stage.\textsuperscript{103} However, to incorporate a variable capital requirement dictates an even greater participative and assessment role for APRA. Rather than assessing whether a trustee has satisfied the minimum capital requirements, the approach becomes one of \textit{actively determining} those requirements. This has significant resource implications. Thus, while the risk based framework may be a

\begin{itemize}
\item \textsuperscript{102} As to the factors suggested as being relevant see Commonwealth of Australia, Productivity Commission, \textit{Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation}, 2001, at 49-50. The SWG further recommended that APRA provide guidance to industry on the weightings it intends to apply to the listed factors and that the new framework be developed in conjunction with industry stakeholders: at 43-51.
\end{itemize}
preferred approach it is recognised that, unless sufficient resources are available for its implementation, it may not in practice be viable. Moreover, if a significant risk management approach is effectively incorporated via a risk management plan, the benefits of a variable capital approach over and above a minimum prescribed amount may in practice be negligible. Therefore, if the prescribed minimum standards, although not perceived to be ideal, provide an acceptable level of prudential security, maintaining the status quo may be the sounder option.

**Extension to Employer Sponsored Funds?**

**Industry Concerns**

There are strong arguments that the prescription of static capital requirements in respect of employer-sponsored funds does not serve the ends of prudential security or minimise the risks apparent in such funds. The SWG and, to a more limited extent, the Productivity Commission addressed this issue in their recent reviews of superannuation. Industry participants resoundingly rejected the suggestion that capital adequacy requirements be imposed upon employer-sponsored (sometimes termed “not-for-profit”) funds. The four main objections follow.

**(i) Fails to Recognise Crucial Differences**

The first argument maintains that the proposal fails to recognise the crucial distinction between employer-sponsored (not-for-profit) funds and public offer (“for-profit”) funds. For-profit or “retail” funds are owned by shareholders and therefore must be operated with shareholder profit and growth in share value in mind. In pursuing profit for shareholders such funds engage in marketing to the public and hold themselves out as professional trustees. In short, they are commercial businesses that assume risk and capital is required as a buffer for

---


business loss. In contrast, employer-sponsored funds are established for the sole purpose of providing retirement benefits for members and are governed by both employer and employee representatives. Membership is restricted and there is no concept of earning a profit for the relevant employer. The upshot of this distinction is that for-profit funds raise the potential for a significant conflict of interest – the pursuance of profit for shareholders versus acting solely in the interests of members.

Although there is a clear distinction between the two types of fund the industry participants perhaps over emphasise the significance of this distinction. The regulatory context in which all regulated superannuation funds operate, both for-profit and not-for-profit funds, is governed by trust principles. Although there may be a profit motive, trustees of for-profit funds are required at general law to act in the best interests of the beneficiaries/members of the fund. This is reinforced in the SIS Act by a specific trustee covenant to this effect. To act in the best interests of beneficiaries not only dictates that consideration of other interests are excluded but also requires the trustee to act in the best financial interests of the beneficiaries. To this end, the interests of the trustee are singularly aligned with the interests of the members. In this context is better to view the industry concern as one of agency risk; the existence of a profit motive, notwithstanding general law and statutory principle, increases the risk that members' interests will be disregarded.

(ii) Inapplicability of the Stated Rationale

The second argument focuses upon the inapplicability of the stated rationales for the imposition of capital adequacy requirements on not-for-profit funds. It will be recalled that these rationales are three-fold:

- to demonstrate financial substance and long-term commitment by the trustee;
- to have money at risk to provide an incentive to the trustee to manage the fund well; and
- to provide a financial buffer against funding, administrative and compliance problems.

---

108 SIS Act s 52(2)(c).
109 See 6.5.
110 See 5.1.2.
Industry submissions rejected the applicability of the first two stated rationales. It was said that there is long history of commitment of employers and unions to superannuation. Specific commitment is evidenced by the very act of employers or an industry sector establishing a scheme. Moreover, the holding of capital by a trustee does not of itself demonstrate a long-term commitment as the continued operation of such funds is usually at the discretion of employers, employer organisations and member organisations. In terms of financial substance, where a fund is not being conducted for a profit motive, its financial substance is argued to be the "pool of members' money contributed to the fund and preserved by law until the member retires" as opposed to the holding of capital.

Specifically in respect of the second rationale it was contended that an incentive to manage the fund well and to act prudently is not provided by the holding of capital, but that motivation derives from the general law requirement to act in the best interests of the beneficiaries as well as the statutory imposition of prudential standards.

As to the third rationale, the essence of industry submissions was similar to that presented in respect of approved trustees. Funds within the industry are diverse both in terms of size and management. In the context of not-for-profit funds it was considered of greater importance to implement measures mitigating operational risk, including the adequacy of outsourcing, capital adequacy of administrators, custody arrangements, the adequacy of insurance arrangements and the existence of operating or administration reserves.


114 Commonwealth of Australia, Superannuation Working Group, Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002, submission by AIST at 5; IAA at 6; Law Council of Australia at 5; Meat Industry Employees Superannuation Fund at 4; ACTU at 5.

115 Commonwealth of Australia, Superannuation Working Group, Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002, submissions by the AIST at 4-5; IAA at 6; Law Council of Australia at 5-6; Meat Industry Employees Superannuation Fund at 4; Towers Perrin at 10; WM Mercer at 8; ACTU at 5; ASFA at 29-30.
(iii) Difficulty in Raising the Prescribed Amounts

Industry submissions asserted that practically it would be very difficult for trustees of not-for-profit funds to raise the necessary capital; the only options being to raise the necessary amount from the employers in question or from the members' retirement savings.\footnote{Commonwealth of Australia, Superannuation Working Group, \textit{Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation}, 2002, submissions by AIST at 4; Law Council of Australia at 5-6; WM Mercer at 8; ASFA at 29; Meat Industry Employees Superannuation Fund at 4.} As it is unlikely that employers would be willing to tie up scarce capital, the capital requirements would most likely be sourced from the fund itself. This could impact negatively upon members' benefits.\footnote{Commonwealth of Australia, Superannuation Working Group, \textit{Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation}, 2002, submissions by AIST at 4; Law Council of Australia at 5-6; WM Mercer at 8; ASFA at 29; Meat Industry Employees Superannuation Fund at 4.} Moreover, in the context of mitigating operational risk, capital provisions would be inefficient as a loss buffer as each fund would only have access to its own capital.\footnote{Commonwealth of Australia, Superannuation Working Group, \textit{Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation}, 2002, submissions by AIST at 4; Law Council of Australia at 5-6; WM Mercer at 8; ASFA at 29; Meat Industry Employees Superannuation Fund at 4.} Support for this assertion was drawn by ASFA from a World Bank Social Protection Discussion Paper where it was stated that:\footnote{Rocha, Hinz and Gutierrez, \textit{Bank, Improving Regulations and Supervision of Pension Funds: Are there Lessons from the Banking Sector?}, Social Protection Discussion Paper, No 9929, 1999, at 25.}

The notion of capital does not have any meaning in funds constituted as trusts, foundations and mutuels, as these entities do not have shareholders, although the liability assigned to the sponsors of these arrangements often serves as a proxy. In pure DC (defined contribution/accumulation) schemes providing no minimum return there is no rationale to constitute capital, except in the form of voluntary reserves, agreed by the members and designed to smooth fluctuation six yearly returns.

(iv) Loss of Employer-Sponsored Funds

As a final argument, industry participants were particularly concerned that the imposition of a capital requirement would result in many employer-sponsored funds leaving the industry. This in turn risks “destroying part of the superannuation sector that has the lowest cost, a close link with members and is desired and supported by a large part of the population”.\footnote{Commonwealth of Australia, Superannuation Working Group, \textit{Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation}, 2002, submissions by AIST at 4; CPA at 3. See also submissions by Meat Industry Employees Superannuation Fund at 4; ACTU at 4-5. The ACTU was concerned that the introduction of capital requirements may be "an attempt to drive such funds out the industry" and also "an
become members of public offer funds. Increased consolidation of funds combined with the consolidation that the industry has witnessed in this sector over the past five years concentrates retirement savings within a relatively small number of large funds. Ultimately, it increases the systemic risk of an even greater loss of retirement savings in the event of a single collapse.

**SWG Response & Comment**

In light of these compelling concerns the SWG did not favour the prescription of minimum capital requirements for non-profit, employer-sponsored funds. Instead, it considered that its approved trustee recommendations should apply: that APRA determine the amount of resources, including capital, required by a trustee to address the operational risks relevant to that trustee. Arguably this “risk driven” approach accounts for industry concerns. However, this approach to capital has not been adopted by the SSAB(ED). Given therefore the strong arguments presented by industry as to the impractically of applying capital standards in this context, the status quo is the most appropriate. Employer-sponsored funds will not, it seems, be served by the introduction of capital requirements.

attempt to force a commercial managed investment model onto superannuation whether or not this in the interests of members”.


Industry submissions presented compelling arguments as to impracticality of applying capital standards to employer-sponsored funds. Moreover, due to the nature and administrative structure of such funds the holding of capital is generally regarded as an inappropriate mitigator of operational risk. The risk driven approach recommended the SWG accounts for these concerns. Rather than the static prescription of a capital amount, the investigation that would be conducted by APRA would need to identify the operational and governance risks faced by the particular superannuation fund and then assess the risk mitigation strategies in place. In the context of an employer-sponsored fund, factors such as adequate service provider contracts, the existence of adequate operating budgets and reserves, functional member representation and the ability to draw on the resources of the employer sponsor, may indicate that a minimum capital requirement is not required. Various industry submissions, although objecting to the prescription of minimum capital adequacy requirements on employer-sponsored funds, nevertheless considered a risk driven approach as being appropriate (Commonwealth of Australia, Superannuation Working Group, *Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002* submissions by IAA at 6; Trustee Corporations Association of Australia at 14; CPA at 3; ABA at 3; ASFA at 29-30). To this end, the Institute of Actuaries of Australia opined that (submission by IAA at 6):

The IAAust believes it is appropriate that a capital adequacy framework reflects the particular risk to which the entity providing a product or service is exposed. This may naturally lead to different capital adequacy requirements for different superannuation providers if the capital adequacy framework appropriately takes account of different risk exposures.
5.1.3.4 **ONGOING SUPERVISION**

The introduction of the proposed universal licensing regime may provide an avenue for ongoing risk based supervision. Not only is the proposal aimed at pre-vetting those who enter the market; successful licensees must also meet the licence criteria on an on-going basis. Moreover, it is envisaged by both the SWG and SSAB(ED) that APRA be given appropriate powers to enforce compliance with the licence regime, including powers to issue directions, disqualify or suspend trustees, vary conditions, and suspend or revoke licences. As a consequence, the risk driven approach will be carried through from the ex ante stage to the ongoing stage. Ongoing supervision is important to the success of the universal licensing regime. Various industry participants to the SWG warned against the ineffectiveness of introducing a licensing regime limited to licensing alone, which could become a mere administrative formality.

The introduction of a universal licensing regime represents a significant shift in regulatory and supervisory approach. The current regime is primarily an ex-post regulatory and supervisory approach that is reactive in nature and focuses on remedial and punitive problem resolution. The proposed licensing regime in its ongoing supervisory approach is more pro-active in nature and requires the regulator to take a more direct and interventionist approach.

The prudential need for a more pro-active approach was highlighted by the Senate Select Committee's investigation into the failure of Commercial Nominees of Australia Pty Ltd. The Committee considered “that APRA needs to be more vigorous in its approach to its oversight of trustees”. In an earlier report it also recommended that APRA review its approach to risk management to ensure that it has transparent procedures in place to detect early warning signals of impending institutional or fund

---


failure or loss. The introduction of a greater risk driven approach is likely to assist APRA to identify such concerns initially and subsequently monitor those concerns on an ongoing basis. The earlier areas of operational and governance risk can be identified the greater the likelihood that processes will be implemented to avert the occurrence of a detrimental event.

5.1.3.5 REGISTRATION

In conjunction with the universal licensing regime, a system of fund registration is also proposed whereby licensed trustees register all funds with APRA prior to commencement. Incorporated as a licence condition, registration will involve lodging the trust deed, risk management plan and a certification that both comply with the relevant requirements. Presently, APRA is unaware of the commencement of a fund until an election is lodged under SIS Act s 19 declaring the fund to be a regulated superannuation fund. The registration requirement is directed at affording APRA an opportunity to assess the viability of the fund prior to the acceptance of contributions, thereby enabling the identification of operational risk concerns at a formative stage. It has the further advantage of bringing Australia into line with its international counterparts. Each jurisdiction canvassed by this thesis has some requirement as to registration. Even New Zealand, the least regulated industry, mandates registration of superannuation schemes.

5.1.3.6 EXTENSION TO EMPLOYER-SPONSORED FUNDS?

Given the merit in the universal licensing regime reform, an issue that demands consideration is whether such a regime is likely to enhance the prudential security of employer-sponsored funds. Currently, the barrier to entry to trusteeship for an employer-sponsored fund is the "disqualified person" provisions described earlier. The SSAB(ED) increases the barrier by drawing employer-sponsored funds in the net of

---


128 Superannuation Safety Amendment Bill 2003 (ED) s 29E(1)(b).

129 Superannuation Safety Amendment Bill 2003 (ED) ss 29L, 29M.

130 In the United Kingdom a system of scheme approval is incorporated via the taxing authorities: see 3.1.2.1. In Ontario all schemes (and amendments thereto) must be registered with the regulator (the Superintendent of Financial Services): see 3.2.2.1. In Hong Kong, in addition to an approval process for trustees, all schemes must be registered with the regulator as either an employer sponsored scheme, master trust scheme or industry scheme: see 3.4.2.1.

131 See 5.1.1.
trustee licensing. Traditionally, the imposition of further barriers to entry for employer-sponsored funds has been resisted on two bases: the unique nature of employer-sponsored funds, and the prudential advantages of the system of representative trusteeship.\textsuperscript{132}

In 1992 the Australian Law Reform Commission gave consideration to this issue in its discussion paper on superannuation. It concluded against the implementation of further controls on employer-sponsored funds, reasoning that:\textsuperscript{133}

The trustees of employer-sponsored or industry superannuation schemes are currently not required to be approved by the ASC. This exemption should also continue. This is because the responsible entities of these schemes are clearly different from the responsible entities of publicly marketed personal superannuation schemes. Because they include representatives of members and the employer, they are intrinsically linked to a particular scheme. The resources which would be required to pre-vet or approve the responsible entities of these superannuation schemes with more than 5 members would be significant. The only ground on which the approval could be refused would be the suitability of individual board members. There may be political difficulties if a government authority were to attempt to deny approval for a responsible entity which included elected member representatives.

While it is true that non-public offer funds do not offer products to the public and do not have representative trusteeship, neither factor substantiates that a trustee, or the system instituted by the trustee, is competent and viable in the management of a superannuation fund. In particular, a system of representative trusteeship is directed towards different ends. As discussed below,\textsuperscript{134} representative trusteeship is a tool utilised to minimise a specific agency risk: the risk that employer representatives at the trustee level will not act in the best interests of the members of the fund. Representative trusteeship cannot in any sense guarantee competency in operating a fund. Intimate involvement does not determine whether or not trustees are able in terms of knowledge, experience and skill to carry out their duties. Employee representatives can identify and raise matters that are contrary to the members' best interests but this does not translate into an inherent ability to determine if the trustee is carrying out its duties to the prescribed level of care. An equivalent concern arises in respect of employer representatives.

\textsuperscript{132} As to the system of employer and member representation see 5.2.


\textsuperscript{134} See 5.2.
For these reasons, the rationale put forward by the Australian Law Reform Commission is flawed. The last sentence of the quote extracted above perhaps reveals the overriding concern at the time, namely that in 1992, prior to the introduction of the SIS Act, the introduction of further controls on employer-sponsor funds was politically difficult if not inexpedient.

In the current political and regulatory environment, it cannot be said that all industry participants favoured the extension of the licensing regime to employer-sponsored funds. The main concern was the increased cost to the smaller funds as well as the possibility of an adverse impact upon the member representation system. WM Mercer, in its objection to the licensing of non-public offer funds, argued that it:

...would adversely affect the current equal representation approach as volunteer member representatives would be reluctant to get involved and/or the trustees of many not-for-profit funds would decide that the costs and time involved in obtaining a licence would not justify the fund remaining in existence.

The Corporate Super Association, representing more than 75 per cent of the not-for-profit sector of superannuation funds, strenuously opposed any extension of licensing. Arguing that the track record of the not-for-profit sector has been extremely good, with no significant breaches reported, it did not perceive any need for the licensing regime.

Though the SWG recognised the inherent distinction between non-profit fund and for-profit funds, it nevertheless concluded that a different regulatory approach in respect of non-profit funds was not justified or appropriate. The foundation for the conclusion was that:

Regardless of whether a fund is run for profit or not members need to have the same confidence in the soundness of the trustees to manage their retirement savings. A

---


136 Commonwealth of Australia, Superannuation Working Group, Report of the Superannuation Working Group on Options for Improving the Safety of Superannuation, 2002, submission by CSA at 12-13. The CSA raised three further points. First, the track record of the "Not For Profit sector has been eminently superior to that of the For Profit sector", where the approved trustee structure already applies. Second, although APRA had reported problems in the not-for-profit sector, this related only to the management of smaller funds, notably those with assets less than $5 million. As the problems occurred in a small minority of the small corporate funds, the CSA argued that this could not justify application of the same solution across the whole range of funds in that sector. Thirdly, it suggested that the problems reported by APRA, including problems with investment decisions and related party transactions were better remedied by solutions more specific than the imposition of a licensing regime.

representative trustee structure, while giving employees a voice in running the fund, does not guarantee the competence of those trustees to operate the fund.

In line with this conclusion, extension of the universal licensing regime can be seen as prudentially sound and serves to minimise the risks apparent in employer-sponsored, non-profit, schemes. Two factors justify this conclusion: competence and flexibility.

(i) Competence

Currently there is no assessment of the competence of trustees to operate a superannuation fund. The universal licensing regime introduces a system whereby the competence and viability of funds is examined before contributions are accepted into the fund, and the risk inherent to a particular fund is identified and monitored during the life of the fund.

This should not be taken to suggest that employer-sponsored funds are currently at grave risk. Indeed, the SWG concluded that the majority of trustees are professional in their conduct. Yet at the same inquiry evidence indicated, particularly in funds without an approved trustee (ie employer sponsored funds), that there is a low standard of stewardship.

The issues paper preceding the SWG report stated that most APRA enforcement action is concentrated on 60 per cent of employer-sponsored funds, that is, “corporate funds whose trustees are subject to equal employer/employee representation rules, and who possess varying degrees of financial expertise”. The problems identified were in respect of “inadequate fund governance, insufficient competence of trustees and managers, and inappropriate or poor investment and risk management strategies”.

Echoing these concerns were the comments of Mr Pat Hannan, a former State Director APRA, and Mr Rassi of the Australian Institute of Chartered Accountants. Mr Hannan considered that in his experience the most significant concern in annual ISCI/APRA audits of superannuation funds was poor trusteeship, stating that “ignorance, whether innocent or mischievous remains the greatest problem and

---


threat to member’s superannuation benefits. Mr Rassi, drawing on evidence collated from a report prepared in his capacity as an approved auditor for some 600 funds, presented a similar view. The report concluded that in 1999 the main audit issues that arose were primarily the result of the following three factors:

- a lack of experience and knowledge of the legislation governing superannuation funds;
- a lack of monitoring by trustees of the superannuation fund’s operation; and
- a lack of appropriate internal controls to ensure that the fund is being managed in accordance with SIS legislation and the fund’s governing rules.

Findings presented by the Institute of Criminology similarly reveal that the real risk is not fraud, but ignorance and incompetence among superannuation trustees.

The introduction of the universal licensing regime is likely to make trustees more aware of their responsibilities and highlight the risks apparent in the operation of their fund. The main vehicle through which this will be achieved is the requirement that trustees prepare a risk management plan. Yet the regime would arguably be more efficacious in terms of prudential security if a minimum level of compulsory accredited training for each trustee (and directors thereof) were incorporated as part of the licence criteria. Each trustee is personally responsible for his or her duties to members. It follows that he or she should possess basic knowledge of what those duties are, and a basal level of competence to fulfil those duties. Even where many trustee functions are outsourced, the trustee retains a duty to oversee and supervise the actions of the delegate or agent. Consequently, a minimum level of knowledge is required individually, as well as well competence collectively. This, in conjunction with the universal licensing regime, would assist to address the paucity of knowledge apparent in superannuation trustees.

---

140 Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services, First Report, 2001, at 23 (see submission no 57 at 3).


142 Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services, First Report, 2001, at §3.21. See also Commonwealth of Australia, Official Committee Hansard, Senate Select Committee on Superannuation and Financial Services, 1 September 2000, at 703-704.
Chapter 5: Trust and Legislation

The Senate Select Committee of Superannuation and Financial Services supports accredited trustee training. In its first report on prudential security and consumer protection, it recommended that APRA work more closely with superannuation funds, the Australian Institute of Superannuation Trustees and others to ensure that an appropriate level of education and training is provided to trustees, including a mandatory minimum level of training prior to service.  

Although not canvassed by the SWG, many industry submissions highlighted the advantages of introducing a system of training. For example, NSP Buck suggested that a person should satisfy a capability test in order to be an individual trustee or a director of a corporate trustee, a mandatory continuing education program being an integral part of this process. Similarly, IFSA pointed out that the training and education of trustees is as important as their licensing, and WM Mercer submitted that compulsory trustee training would help ensure that trustees are aware of their obligations and of the potential sources of risk for their fund.

A concern with this approach is that its potential to limit the persons available to serve on trustee boards and to dissuade potential employee representatives. NSP Buck detailed this concern as follows:

In relation to the issue of equal representation, we note that in our experience, even without accreditation requirements, it is often difficult to obtain sufficient nominations for member-elected directorships available. In many superannuation funds, some member-elected directors are effectively co-opted as insufficient numbers of members respond to calls for nominations.

Given the compulsory training initiative flows from a foundation of prudential security, this concern does not in and of itself provide a ground upon which to reject

---

143 Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services, First Report, 2001, at §3-51.
the initiative. However, the concern is directly relevant to the formulation of a training regime. Such a regime must be designed to support the operation of the equal representation rules. To introduce a scheme that denies the effect of those rules is to also deny the prudential advantage wrought by those rules. Such a result would be counterproductive. In effect the management of one risk, lack of knowledge, would be traded against another, the potential for an employer trustee to act in its own interests. Any compulsory training regime must provide an incentive for employees to become employee representatives as well as permit flexibility in working arrangements for training and trustee duties. To this end, the position in the United Kingdom is instructive and provides fodder for reform. There employers must not only permit employees who are trustees (or directors) of a pensions scheme to take time off for the purpose of undertaking trustee duties or training in respect thereof, but must also remunerate such time.

(ii) Flexibility

The second reason relates to the degree of flexibility that can be built in to the proposed licensing regime. Specific details regarding the various classes of licence and the differing conditions attaching to those classes have yet to be released. However, with the adoption of at least a two class system, the licence criteria and conditions could be, and should be, fashioned to account for the different nature of employer-sponsored funds as compared to public offer retail funds. This would permit the licence criteria and conditions to reflect the risk inherent in funds of the same type. Ideally the size of funds could also be factored into the various classes created. The Australian Institute of Superannuation Trustees illustrates this point by arguing that “a single employer fund, offering benefits only to its 200 employers should not have to meet the same criteria as a multi-employer fund with over one

---

148 As to the equal representation rules see 5.2.
150 Pursuant to Superannuation Safety Amendment Bill 2003 (ED) s 29B there will be classes of licence. One class covers trustees of public offer entities. The other classes will be defined by the regulations. As the regulations have not yet been released, the number of classes is not yet clear. However, APRA has indicated that current intent is to offer three licence tiers with the cost and degree of supervision associated with each tier varying with the nature of the funds within those tiers: Brunner, “Safety in Superannuation Proposals”, presented at Superannuation 2003: A Waterfall of Reform, Coffs Harbour, February 2003, Law Council of Australia, at 8.5.
million members, offering benefits to the general public as well as employees of the participating employers”. 152

The advantage of regime flexibility is that the distinct nature of different funds and the specific issues that arise in respect of such funds can be managed by way of specific licence criteria and conditions. The licensing arrangements should match the operations of the funds, with the result that ultimately funds will not bear unnecessary cost in complying with criteria that are not directly fashioned to militate against the risks associated with funds of that type and size.

5.1.3.7 SYNTHESIS

While the current provisions of the SIS Act are aimed at minimising specific risks across all funds, the universal trustee licensing proposal differs in that it can be considered a “whole of management” approach. Particular aspects that facilitate this risk driven approach are an increased focus on competency, the development of risk management plans/strategies, a greater emphasis on ex ante and ongoing regulatory supervision as well as increased access to information for APRA. As such, the proposal is consistent with the prudential security limb of the SRF.

The general law is not concerned in any way with the capability, competence or suitability of trustees to their functions. This is left entirely at the discretion of the settlor or appointor. Yet it almost goes without saying that operational risk will be lessened if the ability of trustees to perform their functions is assessed. Although the approved trustee requirements in the SIS Act go some way in this direction in the context of public offer funds, the universal licensing regime presents a superior model. It assesses competency and suitability, is more risk focused, and retains a degree of flexibility sufficient to permit its application across the industry. Moreover, it is proactive approach aimed at prevention rather than cure. Yet prudential security of the regime would, it has been argued, benefit from the introduction of compulsory specialist training for trustees and directors.

As all details of the proposed regime have yet to be released, its exact parameters are as yet unclear. As the adage goes, “the devil is in the detail”. Consequently, the conclusions drawn are largely premised on the general principles of the regime, taking account

where possible the detail encompassed in the SSAB(ED). Although theoretically the regime is promoted as the superior model, there is a significant impediment to its potential success — the success of APRA in its regulatory role. APRA has been criticised for its failure to act in the wake of relatively recent high profile collapses. Moreover, there is concern regarding APRA’s level of expertise and ability to implement a risk based supervision model. Highlighting this latter concern are the results of a recent performance audit of APRA’s regulation. The Australian National Audit Office found that APRA had not consistently and comprehensively applied its own risk based framework in relation to regulated superannuation funds. Added to this is the perpetual issue of resources. The degree of action required by the regulator will have a direct bearing upon the resources required to effectively fulfil that function. The proposed regime contemplates a proactive and ongoing regulatory approach that will in turn require a greater level of resources for its initial implementation and ongoing regulation. This simply adds to the concern that APRA is already inadequately resourced.

Thus, whilst theoretically it is contended that the universal licensing regime is theoretically likely to be a superior model to the present system its success in practice will depend upon its detail, the complexity and duplication between differing regulatory regimes and, most importantly, the ability and success of its regulator.

153 See 5.1.3.4.
154 Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services, First Report, 2001, at 12-13. In this context the Senate Select Committee of Superannuation and Financial Services recently reported that it had received evidence of a lack of practical expertise at APRA. The Institute of Chartered Accountants commented to the Committee that:

At the moment there is a real resource issue in APRA. On the positive side, a lot of the people who were in APRA have moved out into industry. So, with a lot of the knowledge, skills and experience that they have built up, they are now in industry working on compliance monitoring and things like that...on the negative side, there are not a lot of resources left in APRA from the view point of the industry.

Commonwealth of Australia, Official Committee Hansard, Senate Select Committee on Superannuation and Financial Services, 15 June 2000, at 380. See also in this context at 377 (Mr Mark Cerche, Corporate Super Association). Commonwealth of Australia, Senate Select Committee on Superannuation and Financial Services, Prudential Supervision and Consumer Protection for Superannuation, Banking and Financial Services, First Report, 2001, Submission No 31. Despite APRA disputing that it lacked practical expertise, the Committee recommended that APRA establish an industry secondment scheme for its employees to gain practical experience in the financial services industry: at 16.

5.2 TRUSTEES: CONSTITUTION & REPRESENTATIVE TRUSTEESHIP

At general law there is a wide-ranging freedom for the settlor to constitute the trustee as he or she sees fit. In the absence of legislative proscription, it is open to the sponsoring employer to constitute itself as trustee or alternatively vest in itself a power of appointment or removal. Either freedom permits the employer to control the affairs of the fund. Although once appointed trustees are required to act in the interests of beneficiaries, "the difficulties of obtaining information about the reasons for trustees' actions, and the risks of starting hostile action...severely undermine[s] the members' ability to enforce this duty".156

In Australia, and to a more limited extent in the United Kingdom157 and Ontario,158 Parliament has intervened to vary this balance of control by requiring member representation at the trustee level. Specifically, the SIS Act requires standard employer-sponsored funds that have more than 4 members, but are not public offer funds, to comply with the equal representation rules.159 However, if such a fund has more than 4 but less than 50 members, alternative arrangements, approved by APRA, may be agreed between the employers and a majority of the members,160 or the fund can choose to comply with the alternative agreed representation rule set out in the SIS Act.161 Standard employer-sponsored funds with more than 4 members that are also public offer funds must either have an independent trustee or comply with the equal representation rules. In addition, the

---

157 In the United Kingdom, in the absence of alternative arrangements, members must nominate at least one-third of total trustees (or directors thereof): Pensions Act 1995 (UK) ss 16-21. See 3.1.2.2.
158 In Ontario, although the employer will frequently act as administrator of the pension plan, in the case of a multi-employer pension plan established pursuant to a collective agreement or trust agreement, a board of trustees that is constituted by at least 50% member representatives must act as the administrator. In respect of other plans, a pension committee is permitted to act as the administrator provided that the committee is constituted by at least one member representative: Pension Benefits Act RSO 1990, P8, s 8. See 3.2.2.2.
159 SIS Act ss 92(4), 93(4).
160 SIS Act s 92(4)(c).
161 SIS Act s 92(4)(b). The "alternative agreed representation rule" is complied with if there is a single corporate trustee that is appointed following nomination by agreement between the employers and a majority of employees, provided also that the trustee is not an associate of a standard employer-sponsor and is an "approved trustee" that is specifically approved for this purpose: s 92(g).
trustee may be required to establish policy committees to provide advice to the trustee as well as providing an avenue of communication between the members and the trustee.\(^{162}\)

The equal representation rules require that a group of two or more trustees, or the board of a corporate trustee, be constituted by equal numbers of employer and member representatives.\(^{163}\) Where the governing rules permit the appointment of an independent trustee or director, the fund will be taken to have complied with the equal representation rules provided that the independent trustee/director does not have a casting vote.\(^{164}\)

A "member representative" is any person who is nominated by either the members of the fund or a trade union or other organisation that represents the interests of those members.\(^{165}\) The SIS Act places the trustee under a duty to establish a system of rules for appointing and for ensuring that member representatives can only be removed in prescribed circumstances.\(^{166}\) There is no statutory requirement that the representative also be a member of the fund, although the governing rules of the fund may limit persons eligible to stand for representation. A trustee who fails in this duty is guilty of a strict liability offence.\(^{167}\)

The equal representation rules were introduced with the advent of the *Occupational Superannuation Standards Act 1987* (Cth). The primary motivation for their introduction stemmed from an underlying ideology that superannuation contributions are deferred pay and as such members should have input into the management of what is perceived as "their" money. Additionally, the rules promote member control and the accountability of responsible entities to scheme members.\(^{168}\) In this context, the equal representation rules foster prudential security through the minimisation of agency risk. The rules provide a

\(^{162}\) SIS Act ss 92(3), 93(3); SIS Regulations regs 3.05-3.09.

\(^{163}\) SIS Act s 89(1).

\(^{164}\) SIS Act s 89(2).

\(^{165}\) SIS Act s 107(1).

\(^{166}\) SIS Act s 107(2). The prescribed circumstances in which a member representative can be removed are in the event of: death, mental or physical incapacity, retirement, termination of employment, the member representative becoming a disqualified person, the suspension or removal of the trustee by APRA, or other circumstances prescribed: s 107(2)(a).

\(^{167}\) SIS Act s 107(4).

\(^{168}\) See Commonwealth of Australia, *Parliamentary Debates*, House of Representatives, 14 May 1987 at 3246 (Mr Barry Jones, Minister for Science), and 2 June 1987 at 3812 (Mr Robert Brown).
direct control upon the actions of the employer and its representatives, and alleviate the risk that the interests of the employer will be preferred to those of the members.\footnote{169}

In a perfect world trustees will act in the best interests of the beneficiaries. A trustee is not the representative of his or her appointors and must exercise the discretion granted personally without being subordinated to their views. Nor should trustees be influenced by the ideology and views of the appointor. However, parliaments in Australia and overseas have recognised that this does not always accord with practical reality.\footnote{170} As was expressed by the Goode Committee in the United Kingdom:\footnote{171}

...however scrupulous the employer may be, there is no substitute for the discipline of another voice in the decision-making process, who can ensure that the employer-appointed trustees do not allow themselves, consciously or unconsciously, to be unduly influenced by the wishes and concerns of the employer.

\footnote{169} That employer control and dominance is a potential risk is graphically illustrated by the Maxwell scandal in the United Kingdom. Following the death of Robert Maxwell in 1991, it was discovered that an amount of over £400 million had been misappropriated from the pension funds of two of his public companies, Maxwell Communications Corporation ("MCC") and Mirror Group Newspapers ("MGN"). The theft was perpetuated by a practice known as "stock lending". Essentially, stocks owned by the pension funds were lent to Maxwell's private companies. The practice of stock lending was not illegal, but the loans were never repaid. The collateral given to support the loans was other Maxwell interests. By the time the fraud was discovered these interests had been sold but the proceeds had not been directed back to the pension funds. Crucial to the perpetration of this fraud was Robert Maxwell's control—he was "chairman of the board of trustees of the pension funds, and the assets were managed by a company which was ultimately owned by his family. He was, effectively, employer, trustee and investment manager": Freiberg, "Bang Bang Maxwell's Silver Hammer: Superannuation Crime in the 1990s" (1996) 24 ABLR 217 at 219. That it was only this degree of control that maintained the structure is evidenced by the fact that shortly after his death it all came tumbling down. Freiberg aptly concludes in this respect (at 220):

The Maxwell fiasco exposed a range of weaknesses in the system of regulating pension funds in the United Kingdom. All the lines of defence failed. Although the trustees of the funds are there to protect the assets of the fund, Maxwell was both the employer and trustee and was inevitably faced with a hopeless conflict of interest. In his capacity as trustee, he took control of the pension funds and dealt with them in fundamental breach of his duties. The investment of so much the funds was imprudent, but not, at that time, illegal. By all accounts, he was a ruthless and dominating person who overbore the other trustees and his employees.

See also Hand, "Lessons to be Learned from the Mirror Group Newspapers Pension Funds" (1992) 3 ICCLR 5; Ellison, "Aspects of 'Maxwell' and Implications for Australian Superannuation Funds", presented at Superannuation 1993: Members' Rights and Trustee Accountability, Melbourne, February 1993, Law Council of Australia. The fallout could be described as calamitous, affecting some 32,000 past and present members. It was estimated at the time that 18,000 members would lose their pension entitlements completely. Moreover, in July 1992 approximately 8,000 Maxwell pensioners received their last pensions (Klumpes, "Maxwell and the Accountability of Superannuation Schemes in Australia: A Critical Review of Law Reform" (1993) 21 ABLR 194 at 195). The fraud spurned two inquiries (United Kingdom, House of Commons Select Committee on Social Security, The Operation of Pension Funds, Second Report, HC 61-II Session 1991-1992, 1992; United Kingdom, Pension Law Review Committee, Pension Law Reform: The Report of the Pension Law Review Committee, Cm 2341-1, 1993) and resulted ultimately in the enactment of the Pensions Act 1995 (UK).

\footnote{170} Arthur, Pensions and Trusteeship (Sweet & Maxwell, 1998), at §2.2.2.

To this end, the Senate Select Committee on Superannuation has concluded that the equal representation rules provide a good protective safeguard against fraud and malpractice, and are a potent form of prudential supervision. In requiring member representation Parliament sought to further align the interests of the employer with those of the members. Though the equal representation rules impinge upon the freedom otherwise available at general law, this restriction is justified not only on the ground that it promotes prudential security but also because it further reinforces the duty that trustees must act solely in the best interests of members. Therefore, the restriction upon a settlor's right or "freedom of trust" to determine the constitution of the trustee (or trustee company board) strengthens one of the main protective features of the trust – the duty to act solely in the best interests of the beneficiaries.

The considerable industry support for an equal representation model is a measure of its success in Australia. The Australian Institute of Trustees has asserted that "the representative trustee system is the key to the success of the current prudential regulation regime". Similarly, Finlaysons considers that the equal representation requirements have provided "unquantifiable benefits", adding significantly to the overall confidence of members in the operation and management of superannuation funds. The ACTU also strongly supports equal representation, arguing that the system provides very significant protection for fund members. Moreover, with no major collapses in this sector of the industry, the record of such funds is argued to speak for itself.

---

172 Commonwealth of Australia, Senate Select Committee on Superannuation, Safeguarding Super: The Regulation of Superannuation, First Report of the Senate Select Committee on Superannuation, 1992, at §5.5.


174 Finlaysons is a commercial law partnership based in Adelaide.


177 Commonwealth of Australia, Productivity Commission, Review of the Superannuation Industry (Supervision) Act 1993 and Certain Other Superannuation Legislation, 2001, submission no 22 at 2. See also submission no 41 at 2 (Government Superannuation Office, Queensland Department of Treasury).
Research completed in the United Kingdom lends further credence to the viability of the member representation system. Schuller and Hyman undertook research to clarify the extent and nature of member participation in pension schemes, and to assess and explain its impact. Importantly, at the time of the research, although employee representation in pension schemes was not legislatively mandated, over half of the funds examined had voluntarily introduced some form of member representation; typically one-third to one-half representation.\(^{178}\) A major advantage identified was the ability of such representation to safeguard the members' interests, it being considered that it was only natural for an employer trustee to be inclined to neglect the members' interests. Of equal importance was a concomitant increase in members' perception and confidence that their pension fund was being operated in their interests. The introduction of member representatives was further seen to impact positively upon the amount of information available (and its wider dissemination) to members.\(^{179}\) Finally, member representatives had a greater input into the exercise of discretionary powers in respect of members as "they are often best placed to know the particular circumstances of the case, and the general feeling was that they take the responsibility very seriously."\(^{180}\) It was considered that employee and employer representatives operated in a highly consensual manner having a mutual interest in pursuing the best interests of members. Interestingly, when differences of opinion were apparent, the differences did not necessarily coincide with the employer and employee divide.\(^{181}\)

Despite the apparent success of member representation systems, it is not correct to say that introduction of a representative system of trusteeship has passed without any expression of concern. To this end, there are three main impediments to the successful operation of an employee representative system: lack of independence, concerns regarding competence, and the balance of representation. Each is discussed in turn below.

---


5.2.1 LACK OF INDEPENDENCE

The advantages of employee representation at the trustee level can be compromised if the employee representatives are insufficiently independent from the control and influence of the employer.182 This may be so, for example, if member representatives sense that their employment is at risk if trustee decisions are not those favoured by the sponsoring employer.183 Statutory measures have been introduced to counter this risk. It is a criminal offence for any person, including employers, to intentionally or recklessly commit an act of victimisation against either a trustee or a responsible officer of a corporate trustee.184 “Victimisation” is defined to include subjecting or threatening to subject the trustee (or responsible officer) to detriment on the grounds that the trustee or officer has fulfilled or is proposing to fulfil an obligation imposed on the trustee or officer, or has exercised or is proposing to exercise the trustee's powers in a particular way.185

An employee who is a trustee (or a responsible officer of a trustee) will be taken to have been subject to detriment if the employer dismisses the employee, injures the employee in his or her employment, or alters the position of the employee to the employee's prejudice.186 Not only do criminal sanctions apply but the trustee or officer may recover any loss or damage against the person who committed the act of victimisation.187 As a further protection, in the recovery of such loss or damage the onus or proof is reversed; the plaintiff is not required to make out the reason for the defendant's alleged action, instead the onus is upon the defendant to demonstrate that the act of victimisation was not motivated by the alleged reason.188

183 Commonwealth of Australia, Senate Select Committee on Superannuation, Safeguarding Super: The Regulation of Superannuation, First Report of the Senate Select Committee on Superannuation, 1992, at ¶5.10.
184 SIS Act s 68(1).
185 SIS Act s 68(2), 68(3).
186 SIS Act s 68(4). This will not be the case if the employer (i) permanently ceases to be an employer-sponsor of the relevant superannuation fund; (ii) temporarily ceases to contribute to a superannuation fund in respect of a class of members in which the employee is included; or (iii) reduces the level of contributions to a superannuation fund in respect of a class of members in which the employee is included: s 68(4).
187 SIS Act s 68(8).
188 SIS Act s 68(5). See Argent, “Obligations of Employers and Advisers under SIS” (1994) 6 ASLB 33 at 35.
The position of employee representatives is similarly protected in the United Kingdom. Employees who are trustees (or directors of a trustee) have the right not to be subjected to any detriment in employment or be unfairly dismissed.189

The upshot of these protections is that the interests of the trustees are more truly aligned with those of the beneficiaries. As such, the agency risk that the trustee will act other than in the best interests of the beneficiaries is reduced, and in turn the reduction of risk facilitates prudential security.

The position is somewhat different in Ontario. Member participation is relevant in two circumstances, both of which relate to the type of entities permitted to administer a plan. In the first scenario, as an alternative to an employer, a pension committee may administer a pension plan. Although the committee must be constituted by member representation, as the percentage of such representation is not prescribed, there may only be one member representative.190 Member participation in the second scenario is much stronger – in the case of a multi-employer pension plan191 established pursuant to a collective agreement or trust agreement, a board of trustees constituted by a least 50% member representatives is statutorily required to administer the pension plan.192 Despite encouraging member representation, there exists a significant protection gap in Ontario. Unlike Australia and the United Kingdom, member representatives are not protected from any controlling or undue employer influence. There is thus a potential danger that member representatives may feel compromised in their ability to act in the best interests of members. An effective member representation system must be founded upon an underlying system of member protection. This permits member representatives to freely act in the interests of beneficiaries and minimises the risk of undue pressure, or fear of direct or indirect retribution.

189 Employment Rights Act 1996 (UK) ss 46, 47, 102, 103.
190 Pension Benefits Act RSO 1990, P8, s 8. Zigler has observed that the introduction of this provision did not increase the number of plans governed by pensions committees; if anything it served to ensure that employers abolished pensions committees declaring themselves to be the administrator: Zigler, "Unions and Pension Plans - The Impact of Collective Bargaining on Pension Plan Administration", presented at Pension Fund Governance, Toronto, April 1993, Insight Information Inc, at 5, 10.
191 A "multi-employer pension plan" means a pension plan established and maintained for employees or two or more employers who contribute (or on whose behalf contributions are made) to a pension fund by reason of agreements, statute or municipal by-law, to provide a pension benefit that is determined by service with one or more of the employers, but does not include a pension plan where all employers are affiliated within the meaning of the Business Corporations Act RSO 1990, c B16; Pension Benefits Act RSO 1990, P8, s 1.
5.2.2 Concerns Regarding Competence

Attendant to the introduction of employee representation is the risk that such representatives will not have sufficient knowledge or expertise to effectively fulfil the role of trustee (or director thereof). If the role of member representatives is in part that of watchdog, a base level understanding of the duties and obligations of trustees and the operation of superannuation schemes is essential to successfully fulfil this role. Moreover, where employer representatives are financially astute and knowledgeable regarding superannuation, lack of experience on the part of member representatives permits de facto control of the trustee to rest with the employer representatives, thereby negating the very purpose of the statutory initiative.193

An argument often raised in this context is the lack of experience can be "cured" by delegating functions, the employment of agents, or simply seeking advice. Yet the trustee remains the responsible entity and must understand this role; it must select and supervise agents and delegates and critically assess advice. This too requires knowledge.

Regarding competence, Ambachtsheer and Ezra have observed that "pension fund fiduciaries are often chosen for myriad reasons that have nothing to do with their capability".194 In their view:

The most common reason many pension funds continue to be "organizationally challenged" is that their governing boards either don't know what their job is, or if they do, are not doing it well. The reverse is also true. Behind every well-run pension fund stands a governing board that knows its job and does it well.

A means of reducing the risk that trustees, and member representatives in particular, do not understand their position or lack the knowledge to successfully fulfil their role, is to require trustees who lack appropriate qualifications to undergo mandatory specialist trustee training. This is not to suggest that trustees and directors become experts in every

---


194 Ambachtsheer and Ezra, Pension Fund Management Excellence (John Wiley & Sons, 1998), as quoted in Oliver, "Alternative Governance Models", presented at Pension Regulation Summit Conference, Toronto, April 1999, Federated Press, at 7. This concern was also raised at first inquiry of the Senate Select Committee on Superannuation. W A Lee objected to the proposed equal representation requirements on the grounds that neither employer or employee representatives were selected for their expertise, and that decisions may be guided by political rather than purely financial policies: Commonwealth of Australia, Senate Select Committee on Superannuation, Safeguarding Super: The Regulation of Superannuation, First Report of the Senate Select Committee on Superannuation, 1992, at ¶5.7.

field of knowledge required in the management and administration of a superannuation fund, nor that the level of education and training catapult representatives into the professional sphere. Instead, the training and education should develop an understanding of trustees’ duties and responsibilities and the workings of superannuation schemes.196

Evidence from industry indicates that many superannuation funds take responsibility for the training of trustees. Research conducted by the Institute of Chartered Accountants in conjunction with Deloitte Touche Tohmatsu indicates that 83% of the Australian superannuation funds surveyed provided or funded some level of training for trustees. However, the extent and type of training is of concern. It was reported that 17% of trustees spent no time on training at all whilst only 60% of trustees spent more than ten hours on training.197 The type of training conducted was mainly attendance at an annual conference or short courses. Only 50% of the superannuation funds surveyed provided training in the form of specialist trustee courses such as the ASFA Certificate of Trusteeship.198

The results of research in the United Kingdom are even more telling. A study by Schuller and Hyman in the 1980s exposed a widespread need, expressed by trustees themselves, for further training, particularly in finance and investment.199 Most recently, following a survey of 226 trustees, Myners reported that in the first 12 months of trusteeship 26 per cent of trustees received less than one day’s training and 43% received one or two days training.200 The type of training was predominantly seminars and conferences, with only 16% of participants attending an experienced trustee course. Beyond the initial 12 month period, 46% of trustees reported that no further training was received.201

In Australia, the issue addressed was raised prior to the enactment of the SIS Act. The Companies and Securities Advisory Committee, although not favouring obligatory training, concluded that it was reasonable, given the complexity of the role of trustees, that trustees

(and directors of trustees) complete some form of trustee training.202 Also, many industry submissions to the first inquiry of the Senate Select Committee on Superannuation argued strongly for compulsory specialist trustee education.203 However, notwithstanding these submissions, and the Committee's own conclusion that "trustee education is essential for the long term viability of the industry",204 in recognition that the superannuation industry was in a state of evolution, it did not recommend compulsory trustee training.

A decade has now passed since the introduction of the SIS Act and the foundations of regulation are well set. The time is now ripe for the introduction of such compulsory education and training. The proposed universal licensing regime could be utilised for this purpose. As was argued earlier,205 prudential security would be further enhanced if the "fitness and propriety standard" introduced a compulsory education requirement.

5.2.3 Balance of Representation

The Level of Member Representation — 50% or below?

Another factor that may impact upon the level of employer independence is the balance of representation — is equal representation the ideal or is a lesser representation appropriate? It is at this point that the member representation systems of Australia and the United Kingdom diverge. Equal representation is mandated in Australia, whereas one-third member representation is sufficient in the United Kingdom. Ontario has a bet each way — multi-employer pension plans require equal representation, whereas member representation on pension committees may be as low as one member. Although there is to date no empirical data upon which to found a conclusion, from a theoretical point of view equal representation is arguably a superior model. In short, there is strength in numbers. It may be argued that whatever the balance, all trustees are required to act in the best interests of members. However, the aim of prudential security is to minimise the risk that this will not occur. Though member representation has proven an effective safeguard in this respect, the safeguard loses strength with a minority member representation. This is simply


204 Commonwealth of Australia, Senate Select Committee on Superannuation, Safeguarding Super: The Regulation of Superannuation, First Report of the Senate Select Committee on Superannuation, 1992, recommendation 5.4 at 43.

205 See 5.1.3.1.
because the employer (or its representatives) maintains control of the trustee board. The attendant danger is that minority member representatives may practically lack the ability at the trustee level to in any way impact upon the employer view. Moreover, collectively the member representatives could not at a voting level even prevent a breach of trust. Equal representation minimises the danger of undue control and influence and further aligns the interests of the trustee with the interests of the beneficiaries.

The Level of Employer Representation — 50% or below?

It has been contended that there is no justification for mandating a 50 per cent employer representation at the trustee level, particularly in respect of defined contribution plans where the members, as opposed to the employers, bear the investment risk. In this context, although not taken up by the legislature, the Goode Committee in the United Kingdom recommended that the trusteeship of defined contribution schemes be constituted by two-thirds member representation and one-third employer representation, whereas the opposite should apply for defined benefit schemes.

There is no empirical evidence indicative that a 50 per cent employer representation inhibits the prudential security of superannuation funds. Anecdotally, equality of representation in Australia appears to have been success. To prescribe the balance of trusteeship based upon the representative group that bears the greatest investment risk does not necessarily facilitate prudential security of funds. In many funds an employer's experience in business can add much to the administration of a superannuation scheme and, in the case of high staff turnover, can also give stability to the trusteeship. At a macro level, to further decrease employer representation without compelling empirical evidence risks employers choosing to close employer-sponsored funds and transferring employees to the public offer fund sector. This would have the effect of further consolidating the superannuation industry, with the possible result that a majority of superannuation fund members would be located in a few very large public offer funds. In short, insufficient diversification of fund types and size within the industry risks widespread losses in the event of fund failure. It follows that there is not at present any compelling prudential justification in Australia for reducing the percentage of employer representation.

5.3 TRUSTEES: DUTIES & COVENANTS

In the development of the present superannuation regime, the Commonwealth Government statutorily entrenched the trustee as the central responsible entity in the management and administration of superannuation funds. In doing so, it sought also to clearly delineate the obligations of trustees. The spectrum of duties cast upon trustees by the SIS Act is outlined in Chapter 2. For the purposes of this chapter the SRF will be applied to those duties that define the fundamental nature of the trustee office: the "trustee covenants".

Section 52(2) of the SIS Act sets out eight trustee covenants that are implied into the governing rules of all superannuation entities, and which cannot be excluded or modified by the constituent trust documents. These covenants are detailed in the following table.

Table 5.3 - Trustee Covenants

<table>
<thead>
<tr>
<th>SIS ACT s 52(2)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) to act honestly in all matters concerning the entity;</td>
<td></td>
</tr>
<tr>
<td>(b) to exercise, in relation to all matters affecting the entity, the same degree of care, skill and diligence as an ordinary prudent person would exercise in dealing with property of another for whom the person felt morally bound to provide;</td>
<td></td>
</tr>
<tr>
<td>(c) to ensure that the trustee's duties and power are performed and exercised in the best interests of the beneficiaries;</td>
<td></td>
</tr>
<tr>
<td>(d) to keep the money and other assets of the entity separate from any money and assets, respectively: (i) that are held by the trustee personally; or (ii) that are money or assets, as the case may be, of a standard employer-sponsor or an associate of a standard employer-sponsor, of the entity;</td>
<td></td>
</tr>
<tr>
<td>(e) not to enter into any contract, or do anything else, that would prevent the trustee from, or hinder the trustee in, properly performing or exercising the trustee's functions and powers;</td>
<td></td>
</tr>
<tr>
<td>(f) to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity including, but not limited to, the following: (i) the risk involved in making, holding and realising, and the likely return from, the entity's investments having regard to its objectives and its</td>
<td></td>
</tr>
</tbody>
</table>

---

209 Commonwealth of Australia, Parliamentary Debates, House of Representatives, 27 May 1993 at 1101 (Mr Gary Johns, Parliamentary Secretary to the Treasurer).

210 See 2.2.3.4.
expected cash flow requirements; (ii) the composition of the entity’s investments as a whole including the extent to which the investments are diverse or involve the entity in being exposed to risks from inadequate diversification; (iii) the liquidity of the entity’s investments having regard to its expected cash flow requirements; (iv) the ability of the entity to discharge its existing and prospective liabilities;

(g) if there are any reserves of the entity – to formulate and to give effect to a strategy for their prudential management, consistent with the entity’s investment strategy and its capacity to discharge its liabilities (whether actual or contingent) as and when they fall due; and

(h) to allow a beneficiary access to any prescribed information or any prescribed documents.

In the formative stages of the SIS Act it was stated by the then Treasurer that the foregoing covenants are “essentially a clarification of the obligations already imposed by trust law...[and are] essential trustee duties which represent fundamental obligations to beneficiaries”. Similarly, in the second reading debate of the SIS Bill the Parliamentary Secretary to the Treasurer stated that “what we have done is simply to transcribe trust law – already existing trust law that will govern the behaviour of the these people [trustees] – codify it and write it down.” If these statements are correct, it must be possible to identify the relevant general law trustee duties from which the covenants flow. In respect of covenants (c), (d), (e), and (h), this would appear to be the case. First, the duty to act in the best interests of the beneficiaries is a fundamental and long established trust law duty, and is a reflection of fiduciary duties owed by trustees to beneficiaries. Secondly, the requirement expressed in (d) to keep the trustees’ personal assets and those of the employer-sponsor separate from trust assets is a reflection of the duty not to mix trust moneys with the trustee’s own, which itself extends from trustees’ fiduciary duty not to place themselves in a position of conflict between duty and personal interest. Thirdly,

---


212 Commonwealth of Australia, Parliamentary Debates, House of Representatives, 27 September 1993 at 1103 (Mr Gary Johns, Parliamentary Secretary to the Treasurer).

213 Cowan v Scargill [1985] 1 Ch 270 at 286 per Megarry VC. See 6.5.

214 As to a trustee’s fiduciary position vis-à-vis beneficiaries and the resulting no-conflict prohibition see Kech v Sandford (1726) Sel Cas T King; 25 ER 223; Breen v Williams (1996) 186 CLR 71 at 113 per Gaudron and McHugh JJ.
covenant (e) is a specific application of the general law duty imposed on trustees not to fetter their powers and discretions.\textsuperscript{215}

\textit{Fourthly}, access to prescribed documents and prescribed information expressed in covenant (h) reflects trustees' general law duty to account.\textsuperscript{216} Though the expressions "prescribed documents" and "prescribed information" are defined broadly to include a large range documents and information in respect of the trust,\textsuperscript{217} the principles expressed in \textit{Re Londonderry's Settlement}\textsuperscript{218} and \textit{Hartigan Nominees Pty Ltd v Rydge}\textsuperscript{219} as to disclosure of trust information have been preserved by the \textit{Corporations Act}. Under this Act a trustee is not required to disclose:\textsuperscript{220}

- internal working documents of the entity;
- information or documents that would disclose, or tend disclose: (i) personal information of another person if, in the circumstances, the disclosure would be unreasonable; or (ii) trade secrets or other information having a commercial value that would be reduced or destroyed by the disclosure; or
- information or documents in relation to which the trustee of the entity owes to another person a duty of non-disclosure.

To the extent these covenants are representative of general trust law duties their inclusion in the SIS Act is justified upon the basis of the SRF. This is especially so given that the duties from which the covenants flow are essential to the concept of the trust and fundamentally define the nature of the trustee beneficiary relationship.

There is some doubt as to the extent to which the remaining covenants reiterate general law principles. What follows is an assessment of these covenants in the context of the SRF, preceded by a comment on the general approach of implying the covenants into the governing rules of a superannuation entity.

\subsection*{5.3.1 General Approach}

Section 52 of the SIS Act is formulated so that the covenants specified are implied into the governing rules of each superannuation entity. This has a twofold effect. \textit{First}, to the extent that the obligations specified in the covenants are distinguished from general law duties the

\begin{itemize}
\item \textsuperscript{215} As to this duty see 2.2.3.4.
\item \textsuperscript{216} As to this duty see 2.2.3.4 and 6.5.
\item \textsuperscript{217} SIS Regulations reg 4.01; \textit{Corporations Act 2001} (Cth) s 1017C.
\item \textsuperscript{218} [1965] Ch 918.
\item \textsuperscript{219} (1992) 29 NSWLR 405.
\item \textsuperscript{220} \textit{Corporations Act 2001} (Cth) s 1017C(4).\end{itemize}
application of the general law is excluded or modified (whichever is relevant) by the express terms of the trust deed. The essence of this consequence is what underlies the discussion of the remaining individual covenants below.

Secondly, it prevents the framers of the trust instrument from abrogating or modifying the obligations contained in the covenants by alternative expression in the trust instrument. As discussed in Chapter 4,\(^2\) the flexibility of the trust flows from the ability of the settlor to frame its terms so as to modify the principles of equity and general trust law that govern the trust relationship. Except for the “irreducible core” of obligations fundamental to the concept of a trust,\(^2\) fiduciary and general law duties of a trustee can be excluded, diluted or supplemented. Although this flexibility is a much commended feature of the modern commercial trust,\(^2\) in the context of superannuation funds the ability to draft a trust deed so as to minimise the duties incumbent upon a trustee can undermine the essential features that promote security.\(^2\) On this basis, restricting the flexibility permitted at general law is entirely justified, if not necessitated, by the prudential security limb of the SRF. The process of implying covenants reinforces the protective nature of the trust and negates the risk that its fundamental protective attributes will be minimised or excluded.

5.3.2 Covenant (a) – Honesty

It is difficult to assess whether or not this covenant is consistent with general law principles in that there is no express corresponding general trust law duty, and in any case its scope has yet to be judicially determined. Although at general law there is no duty on trustees to act honestly per se, such a duty may be seen as flowing from the requirement that trustees act bona fide. In a sense honesty can be considered so fundamental that it goes without saying. Yet at general law the duty to act bona fide is usually limited to acting bona fide in the best interests of the beneficiaries. Megarry VC in Cowan v Scargill\(^2\) stated that “the duty of trustees towards their beneficiaries is paramount. They must, of course, obey the law; but subject to that they must put the interest of their beneficiaries first”. This duty, Megarry VC observed, may even require a trustee to act dishonourably (though not

\(^2\) See 4.2.2.1.

\(^2\) Armitage v Nurse [1997] 3 WLR 1046 at 1056 per Millett LJ. In this case Millett LJ considered that the “irreducible core” obligation of the trust was the “duty of the trustees to perform the trust honestly and in good faith for the benefit of the beneficiaries”: at 1056.


\(^2\) [1985] 1 Ch 270 at 287.
illegally) if the best interests of the beneficiaries require it.\textsuperscript{226} Therefore, although the duty to act bona fide may encompass a duty to act honestly, that duty is limited in scope to the best interests of the beneficiaries of the trust. It does not extend to third parties. Prima facie, a requirement to act honestly in all things concerning the entity requires a trustee to act honestly in all dealings including those with third parties. In requiring a trustee to act dishonourably but not illegally, \textit{Cowan v Scargill} essentially permits dishonesty in the form of a type of moral turpitude. The question that arises is whether this type of conduct is a breach of covenant (a).

The facts of \textit{Buttle v Saunders}\textsuperscript{227} provide a useful example for analysis. Here the trustees struck a bargain for the sale of trust property but did not bind themselves by a legally enforceable contract. Contracts had been prepared, but a further trustee signature was required, when the trustees received a higher offer. In response to an action for breach of trust, the trustees sought directions from the court. The trustees were held to be under a duty to consider and explore the better offer despite feeling honour-bound to carry through with the initial offer. In this regard Wynn-Parry J commented that:\textsuperscript{228}

\begin{quote}
It redounds to the credit of a man who acts like that in such circumstances. Trustees, however, are not vested with such complete freedom. They have an overriding duty to obtain the best price which they can for their beneficiaries. It would, however, be an unfortunate simplification of the problem if one were to take the view that the mere production of an increased offer...should throw on the trustees a duty to accept the higher offer...trustee have such a discretion in the matter as will allow them to act with proper prudence...I can imagine cases were trustees could properly refuse a higher offer and proceed with a lower offer. Each case must, of necessity, depend on its own facts. In regard to the case no before me, my view is that the trustees and their solicitors acted on an incorrect principle. The only consideration which was present to their minds was that they had gone so far in the negotiations...that they could not properly, from the point of view of commercial morality, resist from those negotiations.
\end{quote}

It could be said that the trustee had acted dishonestly in that his word was given and a bargain struck. However, there being no legal impediment to their actions, the trustees were required to act in the best interests of the beneficiaries and in so doing "gazump" the initial offerees.

Honesty in this context could be defined as acting in accordance with the law, but beyond that a trustee's duty is defined completely by the best interests of the beneficiaries. If this scenario is applied to the covenants, on a strict view, the trustee in accepting the higher offer would have been in breach of covenant (a). However, to reject the second offer and

\begin{flushright}
\textsuperscript{226} \textit{Cowan v Scargill} [1985] 1 Ch 270 at 288.
\textsuperscript{227} [1950] 2 All ER 193.
\textsuperscript{228} \textit{Buttle v Saunders} [1950] 2 All ER 193 at 195.
\end{flushright}
continue through with the initial bargain would be a breach covenant (c): the duty to act in the best interests of the beneficiaries. In light of this conflict, two options may arise as to the possible scope of term "honesty":

(i) The term honesty includes a type of moral turpitude which applies regardless of whether the trustee was attempting to act in the best interests of beneficiaries; and

(ii) The term honesty includes a type of moral turpitude but is confined by the duty to act in the best interests of the beneficiaries – in other words, covenant (a) is read is down in light of covenant (c).

The first option must be dismissed on the ground of inconsistency. As is highlighted by the Buttle v Saunders scenario, it could place a trustee in an impossible situation – "damned if you do and damned if you don’t”. It was unlikely to have been the intention of parliament to potentially place the trustee in such a situation. In the absence of direct authority, it is contended that the second option is the most appropriate.

This option reflects the general law position. On the basis that the covenants have been assumed to reflect the general law, this conclusion may logically be drawn. This argument is strengthened by the judicial interpretation of the statutory duty formerly imposed on directors to “act honestly in the exercise of their powers and the discharge of the duties of their office”. In this context the phrase “act honestly” has been interpreted to mean acting bona fide in the interests of the company. Therefore, although honesty is required, the overriding concern is the interests of the company.

5.3.3 COVENANT (b) – STANDARD OF CARE

Covenant (b) sets the standard of care that a trustee must obtain in the performance of its duties and powers: that degree of care, diligence and skill as an ordinary prudent person would exercise in dealing with the property of another for whom the person felt morally bound to provide. At the outset it must be noted that although referred to in this context as a standard of care, the phrase duty of care is often used as a synonym both at a judicial and commentary level. As in both contexts the phrase refers to the benchmark against which a trustee’s performance of all of its duties and powers is measured, the phrase standard of care will be used and references citing a duty of care should be read as synonymous.

229 Corporations Law s 232 (now repealed).
The General Law Duty

The standard of care required by the general law is that of an ordinary prudent business person. The classic statement is that of Jessel MR in Re Speight:\[33\]

A trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way. If it were otherwise, no one would be a trustee at all.

In that trustees' actions are measured against those of an ordinary prudent business person the standard is objective. There is no investigation of what standard the trustee itself would ordinarily use in its own business operations.

It has not always been clear that the requisite standard is positioned in the business sphere. Various early English and Canadian cases alternatively referred to the ordinary prudent man as opposed to the ordinary prudent man of business.\[33\] However, the High Court of Australia, relying upon the English authority of Speight v Gaunt\[33\] and Re Whiteley\[34\] has explicitly correlated the standard with the man of business; “it is a duty of reasonable care—the care which an ordinary prudent man of business would take”.\[35\]

At general law, professional trustees, such as trustee companies, are arguably subject to a higher standard of care. In Bartlett v Barclays Trust Co (No 1) Brightman J was prepared to impose a higher standard of care on a trust corporation, reasoning as follows:\[36\]

A trust corporation holds itself out in its advertising literature as being above ordinary mortals. With specialist staff of trained trust officers and managers, with ready access to financial information and professional advice, dealing with and solving trust problems day after day, the trust corporation holds itself out, and rightly, as capable of providing an expertise which it would be unrealistic to expect and unjust to demand from the ordinary

---

[33] (1883) 22 Ch D 727 at 739-740 per Jessel MR (affd Speight v Gaunt (1883) 9 App Cas 1 at 19 per Lord Blackburn, at 30 per Lord Fitzgerald).

[34] Fales v Canada Permanent Trust Co (1976) 70 DLR (3d) 257 at 267 per Dickson J (giving the judgment of the Supreme Court).

[35] (1883) 9 App Cas 1.

[36] (1886) 33 Ch D 347.

[1980] 1 Ch 515 at 534. See also the obiter comments of Harman J in Re Waterman's Will Trusts [1952] 2 All ER 1054 at 1055.
Chapter 5: Trust and Legislation

A prudent man or woman who accepts, probably unpaid and sometimes reluctantly from a sense of family duty, the burden of trusteeship.

The occasion has not arisen in Australia for the application of this principle, but there have been obiter comments in support of the above, most notably those of Finn J in *Australian Securities Commission v AS Nominees*. His Honour noted that although the standard of care is of general application, it was settled a century ago during a period when trust corporations were not used for trading and investments. As such activity is now commonplace his Honour considered that:

There is, now in my view, a substantial question now to be answered as to whether a higher standard is not to be exacted from at least corporate or professional trustees (i) which hold themselves out as having a special or particular knowledge, skill and experience and (ii) which, directly or indirectly, invite reliance upon themselves by members of the public in virtue of the knowledge etc they appear so to have.

If it were necessary, his Honour indicated that he would have applied, to the trustee companies in question, a standard of care higher than that of the ordinary prudent business person. However, it was unnecessary to do so in the circumstances as the trustees' actions had fallen short of even the prudent business person measure.

In the context of the duty of investment a higher standard of care is statutorily recognised to apply to professional trustees in all Australian States and New Zealand. The typical standard of care required is that which a prudent person engaged in that profession would exercise in managing the affairs of others.

---

242 *Trustee Act 1925* (ACT) s 14A(a); *Trustee Act 1925* (NSW) s 14A(a); *Trustee Act 1893* (NT) s 61(a); *Trusts Act 1973* (Qld) s 22(i)(a); *Trustee Act 1936* (SA) s 70(a); *Trustee Act 1898* (Tas) s 71(a); *Trustee Act 1958* (Vic) s 60(i); *Trustee Act 1962* (WA) s 18(i)(a); *Trustee Act 1956* (NZ) s 13C. The United Kingdom has gone a step further requiring that trustees exercise such care and skill as is reasonable in the circumstances having regard in particular:

* to any special knowledge or experience that he has or holds himself out as having, and
* if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

However, this standard does not apply generally nor in relation to the trustees of occupational pension funds. Instead it applies only in relation to the circumstances set out in the relevant schedule: *Trustee Act 2000* (UK) s 1(i), sch 1.
Comparison of general law to Covenant (b)

The standard adopted by the SIS Act in covenant (b) is apparently a lower standard than that applicable to trustees at general law. Specifically the covenant can be distinguished from the general law on four bases. First, and most obviously, the covenant sets the measure as the ordinary prudent person, not the ordinary prudent business person. Secondly, the measure is not that of the fictitious person dealing with his or her own property but with the “property of another for whom the person felt morally bound to provide”. Thirdly, the covenant refers not only to care and diligence but adds the component of “skill”. Finally, the covenant does not distinguish between professional and other trustees; the ordinary prudent person standard is applied to all trustees. The significance of these distinctions is heightened when it is considered that, as outlined earlier, the SIS covenants do not stand alongside the general law but rather replace it.

The following defines and assesses each distinguishing feature in the context of the SRF.

5.3.3.1 ORDINARY PERSON VERSUS BUSINESS PERSON

The standard specified in the SIS Bill originally replicated the general law. However, the covenant was replaced with the lower ordinary prudence standard following industry concerns that it would be difficult to obtain representative trustees if the standard was set too high, and employee representatives would be dissuaded from accepting nomination if they were not persons of business. The case authorities reveal attributes of the ordinary prudent business person. Three cases present relevant illustrations for this purpose.

(i) Speight v Gaunt

That a different level of knowledge and experience is required of an ordinary prudent business person, as opposed to an ordinary prudent person, is evident from the seminal authority in this area, Speight v Gaunt.444 It concerned a trustee who employed a broker for the purpose of purchasing securities on the London Stock Exchange. The broker forwarded a fraudulent bought-note to the trustee and obtained money from the trustee on the pretence that payment was due the next day. The broker misappropriated the money for his own use, never purchased the securities and subsequently became bankrupt. The loss to the estate was some £15,000.

443 See 5.3.1.
444 (1883) 9 App Cas 1.
In the course of outlining the relevant principles Lord Blackburn noted that:

Where there is a usual course of business the trustee is justified in following it, though it may be such that there is some risk that the property may be lost by the dishonesty or insolvency of an agent employed. The transactions of life could not be carried on without some confidence being bestowed...Men of business practically ascertain how much confidence may be safely bestowed, or rather whether the inconvenience and hampering of trade which is avoided by this confidence is too heavy a premium for insurance against the risk thus incurred.

Applying this approach, the trustee's actions were held to be entirely appropriate; it was the normal course of business for a trustee to obtain the services of a broker for the procurement of shares, and to pass payment for the securities through the broker as agent. Moreover, there was nothing to draw suspicion so as to doubt the honesty or veracity of the broker and thus expose the trust to the risk of loss.

Two attributes of the ordinary prudent business person can be drawn from this case. First, a measure of protection is granted to a trustee if he or she follows what is regarded as the usual course of business. The trustee must therefore know what the usual course of business is or know where to obtain guidance as to the accepted course of business (a "knowledge" element). So it can be postulated that the ordinary prudent business person is credited with a different level of knowledge and experience than the ordinary prudent person. Secondly, the trustee must make an assessment about the level of confidence to place in the person with whom the trustee is dealing. In other words an assessment of risk must be made. This attribute is subtler than the first, and could be termed a "business like approach". It could similarly be described as requiring a degree of business acumen.

(ii) **Australian Securities Commission v AS Nominees**

The proceedings in *Australian Securities Commission v AS Nominees Ltd* concerned, inter alia, an application by the Australian Securities Commission ("ASC") for the winding up of three of corporate respondents: AS Nominees Ltd (ASN), Ample Funds Ltd (Ample) and AS Securities Pty Ltd (Securities). All were members of a group of companies, the AS Group, that were founded by the fourth respondent, Mr Windsor. ASN and Ample...

---

245 *Speight v Gaunt* (1883) 9 App Cas 1 at 19-20 (emphasis supplied).
246 *Speight v Gaunt* (1883) 9 App Cas 1 at 9-13 per Earl of Selborne LC, at 20-27 per Lord Blackburn, at 29-32 per Lord Fitzgerald.
were corporate trustees of superannuation and unit trusts and had for all intents and purposes common boards. Securities acted as a manager of the trusts.\textsuperscript{248}

In support of its claim the ASC detailed a series of 12 transactions it alleged displayed a pattern of conduct demonstrating unfitness for the corporate respondents to have control of trusts. The ASC’s concern was in part premised upon the need for investor protection and the need for the public to maintain confidence in the proper management of superannuation trusts.\textsuperscript{249}

Prior to detailing each transaction Finn J commented upon the applicable standard of care expected of a business person. Whilst identifying the standard as that of the ordinary prudent business person conducting a business as if it were his or her own, Finn J emphasised what he described as a “requirement of caution”. Drawing on jurisprudence from the United States, Finn J quoted the following extract from \textit{King v Talbot:}\textsuperscript{250}

\begin{quote}
It...does not follow, that, because prudent men may, and often do, conduct their own affairs with the hope of growing rich, and therein take the hazard of adventures which they deem hopeful, trustees may do the same; the preservation of the fund, and the procurement of a just income therefrom, are primary objects of the creation of the trust itself, and are to be primarily regarded.
\end{quote}

It is this requirement of caution that serves also to distinguish the expectations of trustees and directors, and likewise separates the purposes of trusts and companies. A trustee is to exercise a degree of restraint and conservatism in investment judgments whereas the duty of a director may be to “display commercial flair and accept commercial risks to produce a sufficient return on the capital invested”.\textsuperscript{251} Finn J also considered that the requirement of care and caution is indicative of the “different risks that persons who invest their assets in companies on the one hand and in trusts on the other are considered likely to have assumed”.\textsuperscript{252}

\textsuperscript{248} As an indication of the complexity of the matter, Finn J described the AS Group as being “made up, apparently, of 10 companies bound together in a predictable bewildering way by interlocking shareholdings held in some instances by individual companies of the group, in others by directors, and in either case sometimes as trustee or nominee for yet another group company or director”: \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 5.

\textsuperscript{249} \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 6.

\textsuperscript{250} \textit{NY 76} (1869), cited in \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 12.

\textsuperscript{251} \textit{Daniels v Anderson} (1995) 37 NSWLR 438 at 494 per Clarke and Sheller JJA.

\textsuperscript{252} \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 13.
The requirement of care and caution is exemplified in the twelve transactions that are the subject of the case. For the purpose of this chapter regard is had to four of these.

- **Transaction No 1:** This transaction concerned the fact that ASN held a defaulting loan for a period of three years and had not attempted to foreclose or call up the guarantees. Finn J held that the conduct amounted to a breach of ASN's standard of care because as a matter of prudent management it was required to safeguard the investment. For all "practical purposes the only certain source of repayment was the security it held". Thus it should have closely monitored the security giving careful consideration to the appropriate time for its realisation.

- **Transaction No 2:** ASN paid an amount of $279,000 by way of a commitment fee to secure an investment of US$10 million from a company in the United States. The amount was to be returned by way of a surety bond once the first instalment of investment money was made. Two directors from ASN were sent to the United States to check the investment and the bona fides of the company. One such director paid the commitment fee whilst in America despite written advice warning that the transaction could be fraudulent, specifically noting that "there have been increased reports of fraudulent attempts to seek payment of advance loan commitments fees for loans which are never made". The particular director did not take any personal steps to check the bona fides of the American company or the surety bond. The commitment fee was lost as the surety bond was never honoured. Finn J held that there was a strong arguable case that entering into the arrangement with its ancillary requirement of a commitment fee was so imprudent as to amount in all probability to a breach of trust. The risk that ASN was taking was not one which was appropriate for a prudent trustee to take - restraint and conservatism was required, not "the hazard of adventure".

- **Transaction No 3:** This transaction concerned the sale of units in a trust that was settled for the purpose of purchasing a large office building in Melbourne. The day immediately before subscriptions were to be returned to investors if the trust was not fully subscribed, Ample decided to invest in 7 million units. To fund the purchase it entered into a secured loan agreement for $6.3 million. Contrary to the board's decision, the lender's recourse was not limited to the units purchased but extended to the assets of the trust. Ample did not have the income to service the loan and so ASN subsequently invested $5 million through pooled superannuation trusts to underwrite the investment. Two years after making the investment the value of the property fell by $10.7 million, some 23%. Finn J found that the decision to invest was taken by the trustee board in less than three hours without independent advice or an up-to-date valuation, relying only upon the valuation in the prospectus. There was a mere cursory examination of the financial implications of the investment and there was no clear view of either the strategy the board was putting into effect in making the investment, or the term of the investment. Moreover, there was no evidence that any member of the board was experienced in valuing the Melbourne commercial property market. In respect of ASN's investment in Ample, there was no minuted instance of the board making such a decision. The investment was characterised by Finn J as hazardous and a recklessness of some magnitude, such that the breach of trust was grave. The question was not one of "good or bad company conduct" but rather whether there

---

had been the proper discharge of the duties of trusteeship. His Honour concluded with the remark that "[i]f cannot be assumed that persons who invest in superannuation funds intend their investment to be hazarded in high risk activities... The person making investment provision for his or her future may be expected to be somewhat more risk averse than the corporate entrepreneur".\textsuperscript{357}

\textit{Transaction No 4:} ASN and Ample invested $2.4 million in a company that managed a dairy venture. The investment was in the form of three separate loans. Security for the loans was by way of various charges. There was a considerable delay, in one instance almost a period of a year, in lodging the charges with the ASC. Pursuant to the then \textit{Corporations Law} the charges would have been void against a liquidator had the company invested in gone into liquidation during the period of delay.\textsuperscript{358} Finn J held that the trustee had failed to take appropriate steps to protect its investment and had not acted in a prudent manner, with the result that the trust was exposed to potential losses if the loans were not repaid. The delay in lodging securities extended over a period of three years and at the time of judgment various securities were still not lodged. It was not simply a matter of failing to properly supervise an agent. The trustee, who was cognisant of the pattern of delay, had a duty to intervene in the face of demonstrated dilatoriness.\textsuperscript{359}

The first attribute of the fictional man that can be drawn from the judgment of Finn J is that of prudence. The standard is not that of an ordinary business person but that of an ordinary \textit{prudent} business person. Thus the fictional business person is careful and cautious and not one who is prone to the hazard of adventure or is required to demonstrate entrepreneurial skill. The second attribute, which is a corollary of the first, is that the ordinary prudent business person seeks to safeguard the assets of the trust. This is in essence the business-like approach typified in \textit{Speight v Gaunt}. If there is a significant enough risk that the capital or income of an asset will not be returned to the trust, an ordinary prudent business person would realise that asset so as safeguard the assets of the trust. At the very least, an ordinary prudent business person would seek to preserve the capital assets of the trust.

The third attribute typical of the ordinary prudent business person is that he or she investigates proposed transactions and investments. Advice will be sought where required, current valuations obtained, consideration given to nature of the asset, an asset management strategy developed, investments will be properly secured and appropriate documentation completed. Again this evidences a business-like approach, in this case, to the investment of assets. This attribute is partly explicable on the basis of knowledge. Presumably the ordinary prudent business person will have a greater level of

\textsuperscript{357} \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 29.

\textsuperscript{358} \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 30.

\textsuperscript{359} \textit{Australian Securities Commission v AS Nominees} (1995) 133 ALR 1 at 32.
knowledge than the ordinary prudent person on matters of business. However, a better way of explaining the actions of the ordinary prudent business person is that he or she adopts a prudent business like approach. This is not entirely dependent upon knowledge; if a person acting as trustee has no experience in business, this experience can be sought upon advice. Therefore, it is not a prerequisite that a trustee have the same knowledge as a person experienced in business but that he or she adopts a business-like approach.

(iii) Fouche v Superannuation Fund Board

_Fouche v Superannuation Fund Board_\(^{260}\) concerned a trustee investment in the development of a proposed tourist hotel. The Superannuation Fund Board was the trustee of a superannuation fund providing benefits to employees of the Tasmanian public service. The President (of the Board) was a qualified solicitor whereas the remaining members were public servants. Generally decisions of the Board were made on the recommendation of the President. Upon such recommendation, the Board agreed to lend an initial amount of £3,500, secured by a first mortgage, to Fouche for the purchase of a country property. Subsequently, it was further agreed that an additional amount of £41,500 be advanced for redevelopment of the property into a tourist hotel. The conditions of the loan, the terms of advancement and type and adequacy of the security were left at the discretion of the President. In the month preceding this decision £21,900 was advanced to Fouche on the authority on the President.

Concerns regarding the investment were later raised in Parliament at the initiation of the Auditor-General. This combined with mounting negative publicity led all the members of the Board to resign. The newly constituted Board demanded immediate repayment of the moneys advanced and further advised that the investment was in breach of trust and that it proposed to institute appropriate proceedings in the Supreme Court. Fouche in turn commenced an action against the Board claiming that the remaining advances had not yet been received. The Board delivered a defence and counterclaim (adding the members of the Board as defendants) seeking declaration that the Board had acted in breach of trust and that Fouche received the advances with notice of the breach.

\(^{260}\) (1952) 88 CLR 609.
At Supreme Court level it was held that the investment was in breach of trust, and Fouche was ordered to repay all monies to the superannuation fund with interest. Despite this finding, the action against the Board members failed. On appeal, the High Court affirmed the breach of trust but found against the Board members. The investment was held to be of a hazardous and speculative nature and one that should have never been made. In particular: (i) the security was of a dubious nature; (ii) no serious inquiries were made about Fouche's financial means or his prospects of being able to make the repayments; (iii) no serious inquiries were made regarding the details of the development; and (iv) no real valuation of the property upon completion was obtained. The President was "content with the vaguest assurances about what Fouche could or might do, and the rest of the board, if they thought about the matter at all, were content with whatever Rule [the President] told them". In addition, no consideration had been given to the risky nature of the subject matter of the investment and the ability of the development to turn a profit. The High Court expressed a degree of sympathy for the members of the Board, other than the President, "[f]irstly, because they had no qualifications for the task of investing trust funds, and secondly because, in consequence they relied very largely on [the President's] judgment." Notwithstanding this degree of empathy and the assumption they all acted honestly, it held that:

...the standard to be applied is the standard of the reasonably prudent man of business, and it is nothing to the point that they were not men of business at all. Having regard to all the facts and circumstances...we can see no escape from the view that all four defendants were guilty of gross negligence in assenting to the investment which is attacked, and that all are liable to make good any loss resulting therefrom.

Like AS Nominees, Fouche reflects the business-like approach expected of the ordinary prudent business person. Investment opportunities must be investigated, valuations obtained, assets secured and a risk-versus-return analysis conducted. It is not sufficient to act honestly and rely upon others for the exercise of judgment. Advice can be sought but ultimately each trustee must exercise an individual judgment. Regardless of experience, or lack thereof, trustees will be held at general law to the business standard.

---

261 Fouche v Superannuation Fund Board (1952) 88 CLR 609 at 634 per curiam.
263 Fouche v Superannuation Fund Board (1952) 88 CLR 609 at 633-635 per curiam.
263 Fouche v Superannuation Fund Board (1952) 88 CLR 609 at 641 per curiam.
264 Fouche v Superannuation Fund Board (1952) 88 CLR 609 at 641 per curiam.
Analysis – Superannuation Relationship Framework

By a process of deduction the ordinary prudent person is one that will take care and caution in its duty as trustee, but is not required to adopt a business-like approach. Thus an ordinary prudent person could arguably not be expected to adopt a risk-versus-return approach or undertake the type of investigation required of ordinary prudent business person.

The SRF accords priority to trust principles unless a second limb exception applies: prudential security or inapplicability. In this context neither exception applies with the result that lowering the general standard of care in untenable. To lessen a standard fundamental to the protective nature of the trust is to likewise lessen the protection available to beneficiaries. Five arguments support this view.

First, the rationale for departing from general principle is not premised upon prudential security considerations but rather to pacify industry concerns that it would otherwise be difficult to obtain representative trustees.\(^{265}\) It is acknowledged that the representative trustee system (otherwise termed the equal representation system) is itself a reform aimed at facilitating the prudential security of contributors’ funds. Arguably if the representative trustee system were to fail then the security of funds would be compromised. However, reducing the standard expected of trustees is not the only means of encouraging representative participation. Government sponsored training of employee trustees would assist to give trustees the confidence to undertake their representative duties.\(^{266}\) Financial incentives could also be investigated.\(^{267}\) In addition,


\(^{266}\) As to the issue of education and training see 5.1.3.1, 5.1.3.6 and 5.2.2.

\(^{267}\) In a report commissioned by the HM Treasury (UK) Myners recommended that trustees, including representative trustees, be paid for their services. In this context it was stated that:

Furthermore, the review believes that, in general, paying trustees for the performance of their duties is good practice. Their task is a serious and complex one, the effective completion of which requires considerable time and energy, and should be rewarded.

Myners, Institutional Investment in the United Kingdom: A Review (commissioned by HM Treasury (UK), 2001, at ¶2.30. This recommendation was criticised on the basis that it would impose a greater burden upon employers. Moreover, the duties of employer representatives are fulfilled as a part of the employment function and employee representatives are, in the United Kingdom, permitted to carry out their duties during work hours (see Richards, “The Evolving Role of the Pension Fund Trustee”, presented at APL Annual Conference 2001, Brighton (United Kingdom), Nov 2001 (see www.apl.org.uk), at 8. Rather than appealing to direct payment as an
employee representation at the trustee level is not statutorily confined to employees of
the relevant employer-sponsor; it can be sourced outside of the workplace. In light of
these other options it is an unacceptable compromise to lower the standard of care
required of all trustees in the sector in order to encourage representative trustees.

Secondly, the investment of funds is itself a facet of business. Beneficiaries are therefore
entitled to expect that their funds will be managed in line with a business-like approach.
The compulsory collection of superannuation contributions only adds to the
significance of this matter.

Thirdly, covenant (b) directly represents to the community the standard expected of
superannuation trustees. Lowering the generally applicable standard carries with it a
negative connotation regarding the importance of superannuation. The standard of care
applicable in the comparative sector of managed investment schemes further highlights
this issue. The responsible entities of such schemes “must exercise that degree of care
and diligence that a reasonable person would exercise if they were in the responsible
entity's position”. The responsible entities of managed investment schemes are in the
business of investing funds. Therefore, a reasonable person in shoes of a responsible
entity would be held to business-like standard. It is curious that a higher standard
should apply to an investment vehicle in which persons can choose to invest, whereas a
lower standard applies to an investment vehicle funded significantly by compulsory
contribution. The duty to provide a system of regulation that facilitates a higher
standard of prudential security surely lies with the latter.

Fourthly, in any event the trustee legislation empowers the court to relieve a trustee,
either partly or wholly, for breaches of trust where the trustee has acted honestly,
reasonably and ought fairly to be excused. This statutory avenue of relief can assist
representatives, both employer and employee, in appropriate circumstances. An
example in the superannuation context is the New Zealand case of Jones v AMP

incentive for representatives, especially member representatives, consideration could be given
to the provision of taxation incentives such as rebates.

See 2.2.4.1.

Corporations Act 2001 (Cth) s 601FC(i)(b).

Trustee Act 1925 (ACT) s 85; Trustee Act 1925 (NSW) s 85; Trustee Act 1893 (NT) s 49A; Trusts Act
1973 (Qld) s 76; Trustee Act 1936 (SA) s 56; Trustee Act 1988 (Tas) s 50; Trustee Act 1958 (Vic) s 67;
Trusteers Act 1962 (WA) s 75. See Halsbury’s Laws of Australia, vol 27, TRUSTS, [430-5520]-[430-
5545].
Perpetual Trustee Co NZ Ltd.\textsuperscript{271} Here it was alleged that the defendant, as the trustee of an employee superannuation fund, had not acted prudently in exercising its powers of investment in the period immediately preceding the 1987 sharemarket crash. Although Thomas J found no breach of trust had been made out, he added that in any event the defendant would have been relieved from any liability on the basis that:\textsuperscript{272}

In this case, I do not doubt that Perpetual acted honestly and reasonably; it made proper inquiries and took advice, it directed its mind to the critical question of what was in the best interests of the trust, it kept the investment under review, it invested the trust fund with a reputable life insurance company which had performed, and continued to perform, relatively well as a fund manager, the A unit was a particularly suitable form of investment for a fund the size of that in issue, Perpetual did no more or less than what any number of other superannuation funds were doing in investing in a life policy with AMP and specifying the A unit as the vehicle for the funds management, and the A unit performed well. The performance of the A Unit only declined with the sharemarket crash of October 1987, an event which most commercial and professional persons and institutions failed to predict. In all this there is no evidence of any lack of good faith or aberrant or unreasonable behaviour.

Finally, there is an apparent inconsistency between the standard of care specified in covenant (b) and the duty to prepare an investment strategy in covenant (f). As is discussed below, in the exercise of the duty to invest trustees are required to prepare an investment strategy the foundation of which is managed portfolio theory. Trustees are required to give consideration to risk and the projected return of investments as well as the balance of the investment portfolio. In essence, the approach adopted is the business of investment. This gives rise to a fundamental inconsistency: on the one hand the standard of care is that of the ordinary person, whereas on the other “investment” hand the ordinary person is required to adopt a business-like approach.

5.3.3.2 The Property of Another

Covenant (b) refers to the fictitious person exercising the same degree of care, diligence and skill that would be used if dealing with the property of another for whom the person felt morally bound to provide. This is distinguished from the general law duty of care that refers to the fictitious person dealing only with his or her own affairs.\textsuperscript{273}

\textsuperscript{271} [1994] 1 NZLR 690.

\textsuperscript{272} Jones v AMP Perpetual Trustee Co NZ Ltd [1994] 1 NZLR 690 at 712-713.

\textsuperscript{273} Fouche v Superannuation Fund Board (1952) 38 CLR 609 at 641 per curiam; Australian Securities Commission v AS Nominees (1995) 133 ALR 1 at 12 per Finn J. It is noted that some early English formulations of the standard of care are more closely aligned to the covenant (b) formulation in that they relate to a person for whom the trustee felt morally bound to provide. See, for example, Re Whiteley (1886) 31 Ch D 347 at 355 per Lindley LJ (affd Learoyd v Whiteley (1887) 12 App Cas 727, but their Lordships did not appear to take up this formulation of the standard of care: see at 733 per Lord Watson). This is not the accepted general principle in Australia.
Presumably a person of ordinary prudence would exercise greater care and caution with the property of a third party. The same risks that may be taken with personal property would perhaps not be taken with the property of another, particularly where the person felt morally bound to provide for that other. Covenant (b) can be likened in this respect to the standard of care applicable to administrators of pension plans in Ontario. Section 22 of the Pension Benefits Act RSO 1990, P8 directs an administrator to take the same care, diligence and skill that a person of ordinary prudence would exercise in dealing with the property of another. Commentators in Ontario are clearly of the view that this is a more stringent standard than that at general law.

Though covenant (b) can be argued to depart from general principle, paradoxically it directly reflects the trustee function: that of managing the trust fund on behalf of another. Measuring trustees' conduct against this standard is more consistent with the trust relationship than the general law formulation. To this end, it is to be preferred.

5.3.3.3 CARE, DILIGENCE AND "SKILL"

Covenant (b) adds the word "skill" to the standard general law formulation. An argument could be mounted that the inclusion of the word "skill" is a statutory attempt to expand the standard of care. However, in that the standard is that of an ordinary prudent person, it is difficult to conceive how the addition of the word "skill" is of especial import as the ordinary prudent person would not have any specialised skill in the area. This position is maintained even if the word "skill" were added to general law formulation, such that a trustee was required to exercise that care, diligence and skill of an ordinary prudent business person. Presumably a function of acting with due care and prudence (whether of business or otherwise) includes utilising the skill associated with that standard. The three cases discussed in detail earlier are testament to this point.

---

275 See 3.2.2.2.
277 See 5.3.3.1.
It would be anomalous to find that a person had exercised the required care and prudence but not the required skill.

5.3.3.4 PROFESSIONAL TRUSTEES

At general law a higher standard of care arguably applies to professional trustees. This is premised upon such trustees having, and holding themselves out as having, specialist knowledge, training and skill, and inviting reliance thereon in return for remuneration. In such circumstances the standard of care expected is that of a reasonable trustee in the same position – the ordinary prudent professional trustee.

Prima facie it would appear that covenant (b) reduces the standard care applicable to professional trustees. However, this is in part remedied by statutory recognition in each Australian jurisdiction requiring professional trustees in the exercise of the duty of investment to be held to a higher duty – that which a prudent person engaged in that profession would exercise in managing the affairs of others. Given the SIS Act covenants are implied into the governing rules of each superannuation fund (as opposed to a statutory prescription of a standard), the trustee statutes of each State remain operative. Consequently, in the limited context of the duty to invest professional trustees are subject to the higher standard.

As with the distinction between the ordinary prudent person and the ordinary prudent business person, departure from general principle cannot be justified in the context of the SRF. Without regard to the effect of the standard prescribed by the trustee legislation and its relationship to covenant (b), the standard applying to professional trustees is lowered by two levels. The three possible standards in descending order are:

(i) Ordinary prudent professional trustee
(ii) Ordinary prudent business person
(iii) Ordinary prudent person

Covenant (b) relegates the standard of care from (i) to (iii). Neither the prudential security limb nor the inapplicability limb of the SRF validates this departure from the general law. Professor Waters, commenting on the decision of *Fales v Canada Permanent*...
Chapter 5: Trust and Legislation

Trust Co,\textsuperscript{281} where the performance of a professional trustee was compared to that of its co-trustee, the widow of the deceased, remarked that:\textsuperscript{282}

It is readily apparent that there is a genuine difficulty here. That a corporate professional trustee, with its range of technical services and its widely disseminated advertisements, should be required to demonstrate only the level of skill and attentiveness that is asked of the testator’s widow or a friend of the family performing a kindness, is \textit{prima facie} absurd.

In similarly strong terms, Nelson, commenting on the position in Texas, argues that it is insufficient that a company that manages trusts and advertises its skills as a professional trustee is held to the same standard as an unpaid layperson. Instead, he opined:\textsuperscript{283}

As Bogert stated “A banker should not, any more than a lawyer or a doctor, gain business as a specialist and defend mistakes as a layman.”\textsuperscript{284} The fact that corporate trustees are held only to the standard of the ordinary prudent person is far behind legal thought, legal trends, and plain common sense. Almost any layperson can intuitively grasp that the corporate trustee should be held by law to a higher standard. In fact, almost any layperson expects that.

Whilst it may be argued that the effect of covenant (b) in the professional trustee context is of no consequence, due to provision in the general trustee legislation enforcing the higher standard, this argument is of limited application. Most significantly, the higher standard applies only to the duty of investment. Other trustee duties include selection and supervision of agents, accounting to beneficiaries, exercising discretion and the conduct of inquiries relevant to that exercise of discretion as well as ensuring a proper internal organisation and proper function of the fund so as to perform these duties.\textsuperscript{285} It is contradictory to require a professional trustee to operate at the higher standard in the performance of the duty to invest, but at the lowest standard in respect of all other functions. Professional trustees represent that they have experience in the whole gamut of trustee services, not merely in investment. Consequently, if the main rationale for the imposition of a higher duty is the representation of skill, knowledge and experience and the consequential reliance by the consumer, logically the higher standard should apply in respect of \textit{all} functions. It may be argued that the investment function is the most important and the one most likely to

\textsuperscript{281} (1976) 70 DLR (3d) 257.
generate loss if the standard of performance is not met. Therefore, practically, it matters little if a lower standard applies to other functions. However, inaccuracies in accounting, and poor selection and supervision of agents may, for instance, equally give rise to substantial losses. Moreover, it is not simply a matter of quantum of loss. For many individuals, with the exception of the family home, their superannuation benefit may well be their largest asset. Therefore, it is equally as important that superannuation regulation be directed towards prudential security at a micro level as well as at a macro level. Discretionary decisions regarding disability and death benefits, accounting to beneficiaries, the selection and supervision of agents must also be performed at an appropriate standard.

The Law Commission of England and Wales has suggested that the standard of care is of decreasing relevance, commenting that:286

[the common law duty of care in investment matters is no longer of particular significance in relation to such trustees. This is because pension trustees may delegate their discretion to make any decision about investments to an appropriately qualified fund manager and, in practice, are effectively obliged to do so. Provided they take certain steps to the appointment and supervision of their fund manager they have no liability for its act or defaults.]

The Pensions Act 1995 (UK) s 34(2) expressly permits delegation of the investment function to an investment manager. Trustees must take all steps to satisfy themselves that the fund manager has the appropriate knowledge and experience for managing the investments of the scheme, and that the manager is carrying out its work competently, having regard to the need for diversification and of investments and the suitability of the scheme of investments.287 Where this is so trustees are afforded statutory exoneration in respect of the fund manager’s actions.288

But contrary to the Law Commission’s view, it is only partly true to state that trustees are not involved in the investment function; whilst trustees are permitted to delegate, they must choose the delegate and subsequently, as contemplated by the Act, supervise the delegation. In respect of both of these functions the standard of care is relevant. Should trustees exercise ordinary prudence in choice, or is a business-like approach


more appropriate? Equally, in supervision, should trustees assess competence and compliance with ordinary prudence, or should a business-like approach apply? The general law is similar in effect. Care must be taken in selecting suitable agents that possess the requisite expertise and competence for the task, and in supervising the agent in the work undertaken. Provided the requisite care is taken the trustee does not guarantee the agent's performance. Significantly, however, the standard against which selection and supervision is judged is the general law standard – that of the ordinary prudent business person.

Moffat and Chesterman suggest that a disadvantage of raising the standard of care for professional trustees is that often the trust instrument will exclude liability or limit it to circumstances involving wilful default. This, it is argued, has the practical effect of reversing the hierarchy of standard of skill and care so that the professional trustee may in fact be held to a lower standard of care than that of the ordinary prudent person. However, this is not of concern in the Australian context, as the SIS Act declares any provision in a superannuation trust deed void in so far as it attempts to exempt or indemnify the trustee for liability for breach of trust if the trustee has either failed to act honesty or failed to exercise the degree of care and diligence that was required. Similar statutory protection is now provided in the United Kingdom, albeit only in respect of the investment function.

---

289 Fry v Tapson (1884) 28 Ch D 268 at 280 per Kay J; Robinson v Harkin (1896) 2 Ch 415 at 423-424 per Stirling J; McMahon v Cooper (1904) 4 SR(NSW) 433.

290 Graham v Gibson (1882) 8 VLR (Eq) 43; Guazzini v Paterson (1918) 18 SR (NSW) 275; Re Lucking's Will Trusts (1968) 1 WLR 866 at 876-877 per Cross J.

291 Re Speight (1883) 22 Ch D 727 at 741-744 per Jessel MR, at 759-762 per Lindley LJ (affd Speight v Gaunt (1883) 9 App Cas 1). As to delegation and the appointment of agents see Halsbury's Laws of Australia, vol 27, TRUSTS, [430-4385], [430-4475].


293 SIS Act s 56.

294 Pensions Act 1995 (UK) s 33.
5.3.3.5 SYNTHESIS

Covenant (b) lowers the general law standard care in all but one respect. At general law trustees are assessed against the fictitious ordinary prudent business person— not the lower ordinary prudent person standard. Moreover, professional trustees are subject to an even higher standard. This too is not reflected in covenant (b), although the higher standard applies to the duty of investment by virtue of the general trustee legislation. The only aspect in which covenant (b) is more stringent than the general law is in requiring the ordinary prudent person to act as if morally obliged to provide for another. Even so, this aspect is not sufficient to draw the standard to a level equivalent to the ordinary prudent business person. It is by no means implicit that an ordinary prudent person morally obligated to act for another will adopt a business-like approach to its functions. The standard remains that of ordinary prudence.

As is argued above, neither limb of the SRF justifies this departure from the general law. Instead, the very nature of the superannuation function, that of investing funds for return, intrinsically requires a business-like approach. The compulsory nature of the superannuation in Australia further heightens the need to apply this approach. The ordinary prudence standard effectively provides a shield for the trustee.295

The concern underlying the argument that the general law standard detracts from the representative trustee system simply highlights the need for educating and training representatives.296 It does not supply a prudential justification for lowering the standard of care.

The issue is also under the spotlight in the United Kingdom. In a review commissioned by Treasury, Myners recommended that the investment standard be raised. Already at the higher “business” standard, Myners proposed that trustees be required to exercise their duties and powers “with the skill are care of someone familiar with the issues concerned”.297 The United Kingdom government has indicated its intention to implement this recommendation not only in respect of the investment function but all

296 See 5.1.3.1, 5.1.3.6 and 5.2.2.
trustee functions. Similar to this proposed standard are the standards of care applicable in New Zealand and Hong Kong. In both countries the standard is implemented via terms statutorily implied into the trust instrument. In Hong Kong, the trustee is required to exercise the care, skill, diligence and prudence to be reasonably expected of a person administering a provident fund scheme, and who is familiar with the operation of such schemes. Moreover, professional trustees are held to a higher standard: namely, the knowledge and skill that the trustee has or ought reasonably to be expected to have, because of its profession or business. The standard applied in New Zealand is essentially the same, although it applies only in respect of the investment function.

To this end, it is recommended that Australia adopt the standard applicable in Hong Kong, for four reasons. First, it implements a higher standard and is specifically directed towards persons familiar with superannuation schemes. Secondly, the standard is intrinsically linked to the training and education recommendations made in this Chapter. Thirdly, it directly applies a higher standard to professional trustees. Finally, it achieves consistency across regimes. The standard applicable to superannuation trustees would be equivalent to that applied to responsible entities of managed investment schemes.


299 Mandatory Provident Fund Schemes Ordinance 1995 (Cap 485) (HK) s 24. See 3.4.2.2.

300 See 3.3.2.2.
5.3.4 COVENANT (f) – INVESTMENT\textsuperscript{301}

In that the very purpose of a superannuation trust is to confer financial benefits on beneficiaries on the happening of prescribed events, "[t]he investment power and duties of trustees lie at the very heart of this purpose, because they are concerned with the management of the trust property in the trustee's hands."\textsuperscript{302} Consequently, trustees are under a duty to invest in the manner authorised by the trust instrument, statute or court order.

In the performance of this duty covenant (f) requires trustees to develop an investment strategy for the investment of fund assets, having regard to risk, the composition of the entity's investments as a whole, the liquidity of the entity's investments and the ability to discharge existing and prospective liabilities. This approach effectively requires trustees to take a portfolio management approach to investment.\textsuperscript{303} The general law has not

\textsuperscript{301} Given the current investment climate, there has been much focus on the investment of superannuation and pensions trust funds. Many issues arise in this context, including the appropriateness or otherwise of prescribing minimum investment for certain categories of investment (for the approach adopted in Hong Kong see 4.4.2.2), the exclusion of certain types of investments, and the adoption of ethical investment policies. In that these issues are beyond the scope of the covenants prescribed by the SIS Act s 52(2), they are likewise beyond the scope of this Chapter. It is nonetheless worthy to draw attention to the reforms proposed in the United Kingdom by the Myners Review as a blueprint for more effective institutional investment decision-making. The outcome of the Myners Review was the development of a set of best practice principles. It recommended that pension funds in their Statement of Investment Principles detail what they are doing to implement each principle, and that an explanation be given if they choose not to meet a given principle: Myners, \textit{Institutional Investment in the United Kingdom: A Review} (commissioned by HM Treasury (UK)), 2001, Ch 11.

In response, the UK Government issued a revised set of principles and expected that pension funds would publicly disclose their compliance with these on a voluntary basis: United Kingdom, HM Treasury and the Department for Work and Pensions, \textit{Myners Review: Institutional Investment in the UK - The Government's Response}, 2001, at 59. An assessment of the success of this voluntary system will commence in 2003. The results of this assessment will provide valuable information on the success or otherwise of market-driven regulation as opposed to statutory intervention.

\textsuperscript{302} Lord Nicholls of Birkenhead, "Trustees and their Broader Community: Where Duty, Morality and Ethics Converge" (1996) 70 ALJ 205 at 207.

\textsuperscript{303} ALRC, CSAC, \textit{Collective Investments: Superannuation}, Report No 59, 1992, at 109. The salient features of "modern portfolio theory" have been described as follows:

First, the measure of a person's wealth is the value of her portfolio looked at as a whole. Second, the security of the investor's fund can be enhanced by diversifying it across a range of counter-reacting ('negatively correlated') investment vehicles. Third, decisions as to which investment vehicles ought to be included in a portfolio cannot be made in isolation; they may be made in light of the nature of the other elements of the portfolio. Thus investment vehicles which might be thought speculative when considered in isolation may not be speculative when considered in the context of a portfolio's overall holdings. Fourth, the return on a portfolio reflects both income and capital returns and to separate the two is an artificial exercise.

traditionally mandated that trustees adhere to the portfolio approach to investment, or that trustees develop an investment strategy, although in recent times this appears to have changed.

In *Cowan v Scargill* [304] Megarry VC observed that “[t]he large size of pension funds emphasises the need for diversification”. The New Zealand High Court decision in *Re Mulligan (decd)* [305] also lends support to the use of modern portfolio investment theory. In that case the residuary beneficiaries sought to challenge the performance of trustees over a 40-year period. A testator left his widow a substantial legacy and a life interest in a farm. The residue fell for division between the testator’s nieces and nephews. The trustees of the estate were a trustee company and the widow. The plaintiffs alleged that the trustees had failed to protect the capital of the trust against inflation. As such, the real value of the fund eroded. Essentially, Panckhurst J held that the trustees had committed a breach of trust by failing to invest in a portfolio of equities so to counter the negative effects of inflation. [306]

In *Nestle v National Westminster Bank plc* [307] like *Re Mulligan*, a testator left his widow a legacy and a life interest in property. The residuary beneficiary challenged the trustees’ management of the fund upon the basis that the real value of the estate had not been maintained over the course of several decades. Unlike *Re Mulligan*, the English Court of Appeal held in favour of the defendant trustees. Although several breaches of trust were identified, the plaintiff could prove no quantifiable loss. The plaintiff unsuccessfully argued that the trustees should have followed a course of diversification during the period 1922-1960. The court’s failure to uphold the diversification argument stemmed not from a disregard of modern portfolio theory, but from its inability to accept “that failure to diversify in that decade was a course which no prudent trustee would have followed”. [308] Hence, the decision cannot be viewed as authority for a singular line-by-line approach to the review of investments. Rather, between 1920-1960 modern portfolio theory was not an accepted investment method and therefore not a method that the ordinary prudent

---

304 [1985] 1 Ch 270 at 290.
305 [1998] 1 NZLR 481.
308 *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260 at 1281 per Staughton LJ.
business person would have utilised. The following observation by Dillon LJ is instructive: "What the prudent man should do at any time depends on the economic and financial condition of that time – not on what judges of the past, however, eminent have held to be the prudent course in the conditions of 50 to 100 years before".

The portfolio management approach is also promoted by general trustee legislation. It requires trustees, in exercising their general power of investment, to have regard to matters essentially relating to modern portfolio theory. It adds that in proceedings against a trustee for breach of trust in respect of a duty relating to the trustee's power of investment, the court may, when considering the question of the trustee's liability, take into account, inter alia, whether the trust investments have been made pursuant to an investment strategy. Hence, the trustee legislation encourages trustees to adopt modern portfolio theory in investing trust funds.

As in the current commercial environment modern portfolio theory is an accepted investment theory, diversification of risk in the context of a trust's investments can be characterised as the prevailing standard of the ordinary prudent business person, particularly so in the context of large commercial trusts such as many superannuation funds. On this basis, covenant (f) simply reflects the general law. If this is not the case, any departure from general trust law principles is clearly justified on the basis of the prudential security limb of the SRF. The entire objective of the strategy is to lessen the risk of poor investment choice – it is a pure risk management approach. The importance of such strategies is underscored by the fact every jurisdiction canvassed by this thesis has introduced similar requirements.

309 Staughton LJ did, however, remark that he was inclined to the view that there should have been diversification in the 1950s: Nestle v National Westminster Bank plc [1993] 1 WLR 1260 at 1281.


311 Trustee Act 1925 (ACT) s 14C(1); Trustee Act 1925 (NSW) s 14C(1); Trustee Act 1893 (NT) s 8(1); Trusts Act 1973 (Qld) s 24(1); Trustee Act 1936 (SA) s 9(1); Trustee Act 1898 (Tas) s 8(1); Trustee Act 1958 (Vic) s 8(1); Trustee Act 1962 (WA) s 20(1).

312 Trustee Act 1925 (ACT) s 89(1); Trustee Act 1925 (NSW) s 90(c); Trustee Act 1893 (NT) s 10E(c); Trusts Act 1973 (Qld) s 30B(1); Trustee Act 1936 (SA) s 13C(c); Trustee Act 1898 (Tas) s 12D(c); Trustee Act 1958 (Vic) s 13C(c); Trustee Act 1962 (WA) s 26B(c).


314 As to the United Kingdom, Ontario, New Zealand and Hong Kong, see the headings "Investment" at 3.1.3.2, 3.2.3.3, 3.3.2.3 and 3.4.2.3 respectively.
5.3.5 Covenant (g) – Reserves

There is no express requirement at general law that trustees adopt a strategy for the maintenance of reserves. However, it can be seen to reflect the requirement of prudence in the management of the trust fund.

Conclusion

A strength of the SIS Scheme is not only its choice of the trust, but its attempt to strengthen the underlying trust relationship by reinforcing the position of the trustee as the central responsible entity. To this end the implementation of the SIS s 52 covenants are critical and necessitated by the SRF. With the noted exception of the standard of care, the covenants reinforce the duty of trustees and curb the general flexibility of trust principles that could otherwise risk lowering trustee standards. The standard of care is the weakness in this stronghold. The very importance of superannuation savings indicates that the standard should be greater than that of ordinary prudence. Moreover, neither the prudential security or inapplicability limbs of the SRF justify departure from the general law “business” standard. On this same basis, professional trustees should be held to the standard that they represent. It is therefore recommended that a standard similar to that under review in the United Kingdom, and already implemented in Hong Kong, be adopted.

The proposed universal licensing regime has the potential to facilitate greater prudential security. Again the focus is on the trustee. The interests of prudential security, and thus the SRF, dictate that trustees be assessed for capacity, capability and suitability. These features are just as relevant for employer-sponsored funds as public offer funds. However, as with all reform, success in implementation and regulatory supervision will present the greatest challenge.

The move to the proposed universal licensing regime represents a significant shift in regulatory approach. Traditionally a reactive system, that proposed is pro-active and interventionist. In the spectrum of international regulation, it will place Australia at the high end of regulatory intervention. In terms of the jurisdictions canvassed in this thesis, the proposal is similar in nature to the MPF system in Hong Kong. Interestingly, in the development of its regime, Hong Kong looked to the attributes of other systems that it regarded as best practice. This led to the adoption of covenants that are very similar in nature to those in the SIS Act s 52(2). Moreover, the approval regime for MPF trustees
resembles the approved trustee provisions in Australia, although with a greater focus on the suitability of the approved trustee. The proposed universal regime not only "catches" Australia up to the requirements of the Hong Kong regime, but arguably the risk dominated framework surpasses, theoretically at least, the latter's prudential strength. That proactive risk-focused frameworks are the way of the future is perhaps signified by the proposal in the United Kingdom for the introduction of a new regulator that is risk-focused and flexible in nature.315

More so than any other jurisdiction discussed in this thesis, Australia has embraced the concept of representative trusteeship. Equal representation is a particular strength of the framework - "a potent force of prudential supervision".316 However, a consistent theme of this Chapter is the need for training and education. This is not to say that the present system is at grave risk. However, like the United Kingdom, the regime can nevertheless improve. In this context, it is recommended that the introduction of compulsory specialist trustee training would add to the prudential strength of the universal licensing regime and representative trusteeship.

In conclusion, the interaction between trust law and the SIS Act provides a strong regulatory foundation. Limiting the inherent flexibility of general trust law is justified and necessitated by the prudential security limb of the SRF. Moreover, the proposed universal licensing regime and the recommendations concerning the standard of care and training would only add to the regime's prudential strength.

---
